ANNUAL REPORT & ACCOUNTS

2012

the
COVENTRY
TLC not PLC

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Ian Pickering

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Bridget Blow

Chief Executive
David Stewart

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PERFORMANCE HIGHLIGHTS 2012

£88.5m	**Strong financial performance** Profit before tax increased by 49% over 2011.
£5.1bn	**Increased mortgage lending** Gross mortgage lending exceeded £5 billion, representing 3.6% of all UK mortgage advances and over four times the Society's market share of gross lending at the start of the credit crisis in 2007.
£2.3bn	**Helping homeowners** Net mortgage lending of £2.3 billion was equivalent to 31% of the growth of all UK mortgage balances.
0.05%	**Very low impairments** Certain to be amongst the lowest impairments of any major mortgage lender. (Impairment losses on loans and advances to customers/Average loans and advances to customers)
£20.1bn	**Member savings balances** Savings balances grew by over £1 billion to a new record of £20.1 billion.
Best buy	**Leading the way on savings** Coventry ISAs were in the national press 'best buy' tables for over 40 weeks of the year.
2.83%	**The highest reported average savings rate[1]** In 2011 Coventry reported the highest average savings rate of any top 10 building society or mutual lender and increased this figure in 2012 to 2.83%.
0.38%	**The most cost-efficient building society** Spending just 38p per £100 of assets, Coventry remains the UK's most cost-efficient building society. (Based on reported administrative expenses, depreciation and amortisation/Average total assets)
23.2%	**Strong and secure** Member reserves increased by £67.5 million, supporting the highest reported core tier 1 ratio of any top 10 building society or mutual lender at 23.2%.
Zero	**Sales incentives** No individual Coventry member of staff is incentivised to sell products - and hasn't been since 2010.
Just 6	**FOS outcomes adjusted** During 2012, the Financial Ombudsman asked for the outcome on a complaint referred to it for review to be changed on just six occasions.
275+	**Supporting local communities** Over 275 organisations supported by Society staff volunteers and fundraising in 2012, with total community investment rising to £2.3 million.

[1] Average rate estimate based upon interest payable on shares divided by average of opening and closing shares balances, as disclosed in 2011 Annual Report & Accounts.

CHAIRMAN'S STATEMENT

My predecessor as Chairman, David Harding, retired at the end of 2012. David joined the Board in 1996 as a non-executive director and was appointed Chairman in 2005. David steered the Society through the most difficult economic period that most of us can remember throughout which it has performed extremely strongly.

David was committed to keeping the Coventry as an independent mutual building society as he knew that this was in the best interest of members - a belief that I wholeheartedly endorse. I hope that members will join me in thanking David for all that he has done for the Society, and wishing him well for the future.

The economic environment during David's last year as Chairman was no less challenging than those that had gone before. There is a saying that seems to sum up much of what happened in 2012 –'the more it changes, the more it stays the same'.

It is often held to be of a slightly pessimistic nature and with regard to the recovery of the UK economy I think this interpretation is reasonably accurate.

In 2012 the UK economy reported a 'double-dip' recession for the first time since 1975. Inflation fell back from its recent peak but remained stubbornly above the Bank of England's target of 2.0%, and the Base Rate stayed at its historical low of 0.50% for another 12 months. Further releases of Quantitative Easing were made to stimulate, or at least protect, the economy but hopes for an export-led recovery were dampened by continued instability in the eurozone and a weak global economy.

The Government continued with its programme to reduce public spending in pursuit of a balanced budget, but the recession has extended timescales for this to be achieved.

Somewhat at odds in this bleak environment, UK employment remained relatively strong during the year. However commentators have observed that many of the jobs created in the private sector, which have offset public sector losses, are part-time and potentially temporary in nature. There is clearly no room for complacency with respect to the job market.

The impact on the housing market of this static but uncertain economic environment was predictable. Volumes remained subdued at levels witnessed over recent years but significantly down on those experienced pre-credit crisis. House prices were broadly flat, with the reduced availability of mortgage finance affecting demand, and supply being reduced by an unwillingness or inability to price to sell.

As was said in the Chairman's Statement last year, the UK appears to face further years of low growth, low interest rates and austerity measures. These challenges are reflected in Moody's recent downgrade of the UK. Whilst not unexpected the action nevertheless highlighted the lack of progress in returning the UK economy to growth. However, although it may be right to paint the wider economic picture in fairly bleak tones, I am more positive in reviewing the Society's progress throughout this period.

The Society is a dynamic organisation which changes in relation to the demands of its members, its competitors, the regulator and the wider economic environment.

It is also firmly rooted. As one of the UK's most traditional large building societies we understand that our role is to protect our members' interests, whether borrowing members or savers. What is clear, following six years of turmoil and rapid change in the financial services industry, is that this focus underpins a robust and successful business model.

In 2012, the Society grew its lending and savings balances. It retained control of costs and margin which enabled a prudent approach to lending which in turn protects both individuals and the overall membership.

We have remained strongly profitable, adding £67.5 million to our reserves and this, combined with the high quality of our lending and mortgage assets, means that once again we have the highest reported core tier 1 capital ratio of any top 10 building society or mutual lender.

Our responsible lending, low level of arrears and impairments, strong capital position, low costs and control of margin have helped us to retain our 'A' ratings from both Fitch Ratings (A) and Moody's Investor

Services (A3). In fact we are the only major high street bank or building society not to have been downgraded in the last three years.

The Chief Executive's Review explains this exceptionally strong performance in appropriate detail. However, I would like to emphasise that it is particularly notable because it continues a track record which precedes the onset of the credit crisis and has been maintained uninterrupted by the economic downturn.

In this, 'the more it changes the more it stays the same' becomes an extremely positive endorsement of the Society, its consistency of objective and the skill and insight of the team which has led and implemented this strategy.

It is my belief that the Society's performance is evidence not only of the strength of the business model but the integrity of the decision-making.

During the years of unrestrained housing market growth, the Society's strategy was viewed by some as overly cautious. Since 2007, the same actions are seen to be prudent and admirable.

This prudence has protected members, and as we enter a new era of financial services regulation in 2013, it is important that the increasing level of oversight and regulatory control does not risk the competitiveness and diversity of financial services in the UK. I believe that organisations with the right leadership and values can deliver the right outcomes for customers.

At our Annual General Meeting in April we will be proposing that members accept a special resolution which reflects this dynamic environment. Amongst a number of 'housekeeping' rule changes which follow updates to the Building Society Association's Model Rules, a positive vote will also permit the issue of new forms of capital instrument (including Core Capital Deferred Shares). This will enable us to strengthen further the Society's capital base and so protect the interests of members. Details of the changes will be sent to all qualifying members of the Society with their Notice of AGM and voting forms.

I am honoured to be the new Chairman of Coventry Building Society. My seven years experience on the Board means I understand the Society very well and, most of all, I understand our responsibilities to our members.

That is why I am confident in saying that the Board and I remain unanimous in believing that Coventry should remain an independent mutual building society. The Society will continue to develop, adapt and grow. What it will not do is change the values that have enabled such outstanding performances to be achieved throughout such troubled times.

These challenges are likely to continue. However, as David said last year, at such times the need for a robust and secure financial organisation, providing fair long-term value to savers and borrowers alike, has never been greater. I am confident that the Society remains well positioned to protect the interests of members in the coming years.

Finally I would like to thank every member of staff for their commitment and contribution to what has been another extremely successful year for the Society and its members.

Ian Pickering
Chairman

CHIEF EXECUTIVE'S REVIEW

I am pleased that 2012 proved to be another successful year for Coventry Building Society. The Society once again achieved a strong all round performance maintaining its track record since the onset of the financial crisis and subsequent economic downturn.

As I reflect on the year, it is clear that the economic challenges we face will continue to define the housing market and the experience of savers for some time to come. A low interest rate environment, concerns about inflation, slow recovery from recession and a very uncertain international situation provided a challenging context in which to operate.

In addition to the economic challenges, there continues to be a deterioration in public perception of the financial services industry. During 2012 there have been many examples of poor practice uncovered within the industry, the impact of which cannot be underestimated. In addition to the new regulatory authorities, all of those who work in the industry have a responsibility to build trust and confidence in the UK's financial services. This will not be a quick process.

In this context the overall performance of the Society, of which financial results are just a part, is even more important. Coventry Building Society has a simple model – we attract and retain savings from individuals, and use this money to enable people to buy homes.

As a mutual organisation, these savers and borrowers own the Society. Whilst some may not understand this fact, it creates a different relationship from that of a customer, and is one we do not forget. We have a responsibility to put the interests of all our members first in everything we do. This determines how the Society is managed as we aim to provide fairness, security and long-term value to members.

The long-term nature of this relationship is key. As a mutual building society we must achieve sustainable profits. Our appetite for risk is therefore aligned to the need to provide security to both savers and borrowers. This model continues to prove resilient and sustainable.

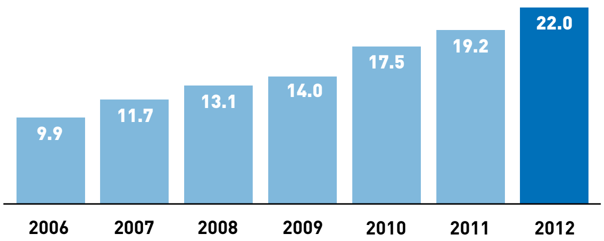
However, the business model is not enough. Success is achieved through excellence in execution and the values that govern the decisions we take. The Society's focus on managing costs, risks and margin underpin its financial strength and ability to compete. Collectively these attributes have enabled consistently robust performance throughout this challenging period, and allowed us to improve the products and services we offer.

Mortgages

In 2012 the Society advanced £5.1 billion (2011: £4.0 billion). This was a record performance in terms of both the value of advances made and the market share achieved. Our share of gross lending was over four times greater than our market share at the onset of the credit crisis, whilst in net lending terms the Society provided over 31% of the total UK market.

The Society's financial strength also enabled it to purchase a £500 million loan book of high quality UK buy-to-let mortgages originated by Bank of Ireland. I believe this transaction will deliver genuine value to members.

Mortgages (£bn)



Key Performance Indicator:

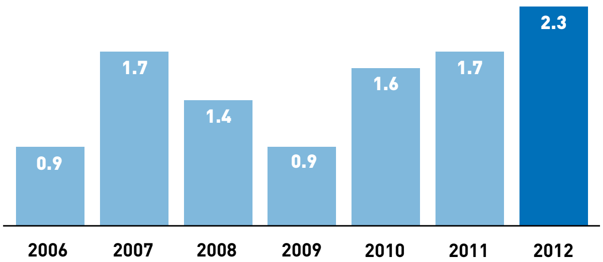
The lending performance of the Society, and most importantly, the consistency of this performance, is shown by the growth in overall loan balances held at the Society on an annual basis. The Society's ability to maintain its growth highlights the sustained support it has provided to members and the wider housing market during a period when new mortgage lending as a whole was severely restricted.

We expect this performance to maintain the Society's position as one of the UK's top 10 for new lending for the fifth consecutive year, a position we had never previously achieved. Mortgages offered by the Society have been in the national press 'best buy' tables for 48 weeks of the year.

This has been achieved throughout a period in which lending volumes across the market as a whole have been significantly reduced, partly as a result of a reduction in mortgage availability and partly due to lower demand. The Society's ability to maintain consistent levels of lending in challenging periods as well as under more favourable conditions demonstrates the sustainability of its business model.

In 2012, Coventry was responsible for almost one-third of the net growth in UK mortgage balances, meaning that the Society has now accounted for 23% of all UK mortgage growth over the last three years. This continues a track record which has seen the Society achieve positive net lending in every year since the onset of the credit crisis.

Net mortgage lending (£bn)



Key Performance Indicator:
Net lending represents the organic growth in mortgage balances at the Society – the difference between new mortgage lending and the amount repaid to the Society by existing borrowers and excludes the purchase of loan books from other lenders, and any balances acquired in a merger. Coventry's net lending is equivalent to 23% of that undertaken in the UK over the last three years.

Most importantly we have achieved this mortgage growth without recourse to high risk lending. The Society protects its membership through the quality of its mortgage book and, as in previous years, it has not undertaken commercial or second charge lending. Exposure to unsecured lending is insignificant, with no new lending in 2012.

The results of this responsible lending approach can be seen in arrears which are significantly better than that of the industry as a whole and impairment figures which have consistently been amongst the lowest reported by any large mortgage lender.

As at 31 December 2012, only 0.72% of mortgage balances were 2.5% or more in arrears, at the time of the latest available published data, arrears were 48% of the industry average (FSA: 30 September 2012).

Impairment charges were just £9.6 million from a loan book totalling in excess of £22.0 billion.

We do not forget those members that might be struggling, for whatever reason, to meet their mortgage payments. The extensive measures we have in place to support these members mean that just 71 properties were in possession at the end of 2012 (2011: 94) from a total population in excess of 200,000 accounts.

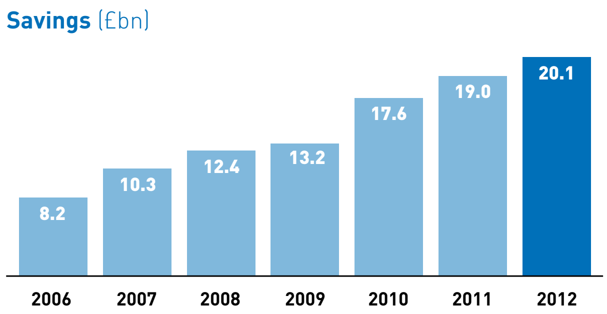
Retail savings

Too often, building societies are described simply as mortgage lenders. Whilst our lending performance is strong, we are also a savings provider.

We seek to attract and retain savings balances not simply to fund mortgages, but because it is a core objective to provide our members with an attractive rate of interest and a safe home for their savings.

In recent years, I have talked about the Society's ability to compete for retail savings balances and the strength of our funding position.

Since the onset of the credit crisis the Society has grown retail savings balances by £11.9 billion and in 2012, we achieved another new record figure for overall savings held at the Society of over £20.1 billion, an increase of £1.1 billion.



Key Performance Indicator:
The growth in savings balances held at the Society demonstrates its ability to offer new and existing members competitive savings rates. The increase in saving balances has underpinned the Society's capability to grow its mortgage lending throughout the period, whilst also demonstrating a clear and sustained focus on the needs of saving members.

This year in particular I want to reflect on the devastating impact that the crisis has had on savers.

Whilst the Society's funding position has been strong throughout the crisis, this has not necessarily been true across the market as a whole. In 2012 the Government recognised the issues facing many in the industry with the launch of the Funding for Lending Scheme (FLS).

In many ways this initiative, which is designed to stimulate economic growth through encouraging the provision of loans to businesses and households, is very welcome. However, and whilst it is too early to see the impact on lending, its first few months of operation has coincided with a significant reduction in overall savings rates.

This reduction has taken place at a time in which savings rates were already at historic lows and in many cases below the level of inflation. This is a huge challenge for the nation as a whole as well as for the industry. Protecting member interests, particularly saving members, is extremely challenging in this environment. The Society's financial strength means we have been able to offer market-leading savings accounts, but more importantly to take positive action where we can to support our saving members.

Whilst figures for 2012 will not be available until all societies have reported, it is a fact that Coventry Building Society reported the highest average savings rate[1] of any top 10 building society or mutual lender in 2011 as well as both the highest average reported rate over the preceding three and five year periods.

This performance can be seen in the number of weeks that Coventry savings accounts were in, or headed, independently produced national press 'best buy' tables. In the key cash ISA market, often the mainstay of an individual's long-term savings planning, our 60 Day Notice ISA topped the tables for 41 weeks in 2012 and our Junior ISA has been a market-leading[2] account since the day it was launched in April.

In fact the average ISA rate paid by the Society increased in 2012, and is now approaching five times Bank of England Base Rate. This will improve further in 2013, following the decision, which we believe is unique amongst major high street banks and building societies, to raise variable rates on existing easy access cash ISAs to 2.50% AER[3] from the new tax year. This will mean that none of the Society's quarter of a million ISA savers will earn less than 2.50% AER - equivalent to the 'best-buy'[4] easy access cash ISA rate at the time of the decision. Whilst no guarantee can be made of long-term rates, as a mutual organisation, owned by its savers and borrowers, we believe this is the right thing to do and we are pleased to be able to take a lead in supporting savers in this difficult environment.

This has also been achieved whilst maintaining the lowest standard variable rate of any of our peer group[5] of larger building societies, in each of the years 2010 to 2012.

No organisation, particularly one of the size of Coventry Building Society, can ignore market pricing completely. We are, however, committed to continuing to do all we can to balance the interests of savers and borrowers and to provide a fair deal, as well as long-term security, to our savings members.

[1] Average rate estimate based upon interest payable on shares divided by average of opening and closing shares balances, as disclosed in 2011 Annual Report & Accounts.
[2] Compared to high street banks and building societies (Junior ISA: based on a balance of £3,600 or less, 60 Day Notice ISA based on a balance of £1,000 or less) excluding those with restricted availability (e.g. existing customers only or reliant on maintaining or opening another product with the same provider).
[3] Annual Equivalent Rate.
[4] Source: Moneyfacts.
[5] Peer group of larger building societies defined as building societies with reported assets of between £5 billion and £50 billion.

Wholesale funding

Wholesale funding, funds attracted from the money markets, does have a role to play in serving members' interests.

It provides stable, longer term finance which helps us to manage our liquidity effectively and by using such funds judiciously we can improve the overall rates we offer to both savers and borrowers.

Whilst our ability to compete and fund mortgage growth through retail deposits is proven, this is complemented by continuing and cost-effective access to the wholesale markets.

In May 2012, we successfully issued our first public residential mortgage backed securitisation (RMBS), which raised £800 million of stable, term funding at attractive pricing. We also took the opportunity later in the year to return to the unsecured market, successfully raising €500 million. Both issues were oversubscribed.

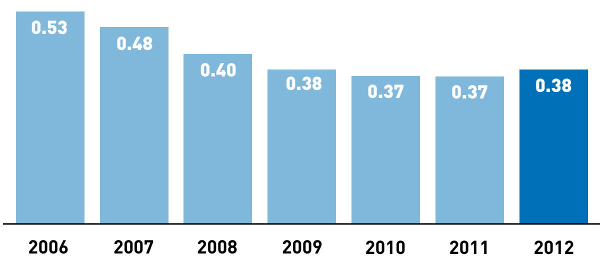
Costs

Coventry has a reputation for rigorous cost control.

In recent years we have achieved the lowest reported cost to mean assets ratio of all UK building societies, and in 2012 I am pleased to report that we maintained this position whilst continuing to invest in member services.

At 0.38% the Society's cost to mean assets ratio is significantly lower than reported by other UK building societies and this is central to our ability to provide the best value mortgage and savings products to our members.

Cost to mean assets ratio (%)*



* Administrative expenses, depreciation and amortisation / Average total assets.

Key Performance Indicator:

The Society has a responsibility to its members to manage costs efficiently. The measure of cost to mean assets shows how much it costs to manage each £100 of average assets. The lower the ratio the more efficiently an organisation is being managed. Coventry has the lowest cost to mean assets ratio reported by the UK building society sector by a significant margin.

Financial performance

In 2012, the Society attracted more members, grew mortgages and savings balances and maintained control of costs and margin. This strong all round performance resulted in further growth in profitability.

As I mentioned earlier, a building society's priority should be to protect members' interests rather than maximise profits. However, retained profits are also the primary source of capital strength and it is essential that we continue to add to our reserves in order to protect members' interests and grow the Society.

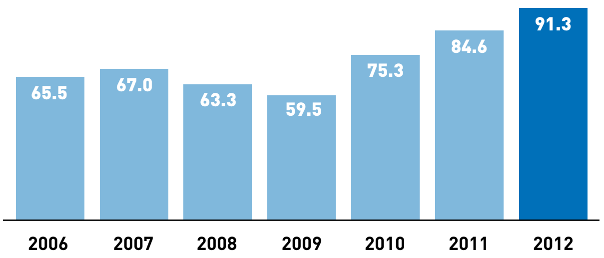
This has been achieved each year since the onset of the credit crisis. The ability of the Society to deliver strong levels of profit throughout this challenging period is a key measure of success and evidence of the resilience of the Society's business model. Coventry is the only top 10 building society or mutual lender that has grown its assets and reported a profit in each year since the financial crisis took hold in 2008.

This strong focus on cost and efficiency helps us keep the Society's net interest margin low at 0.73%, so benefiting both our mortgage and savings members.

After making further provision to fund the Financial Services Compensation Scheme, for which funding in the last 5 years has totalled £42.6 million, the charitable donation to the Poppy Appeal, and recognising the one off benefit resulting from the closure to future accrual of the final salary pension scheme, profit before tax rose 49% to £88.5 million.

CHIEF EXECUTIVE'S REVIEW
(continued)

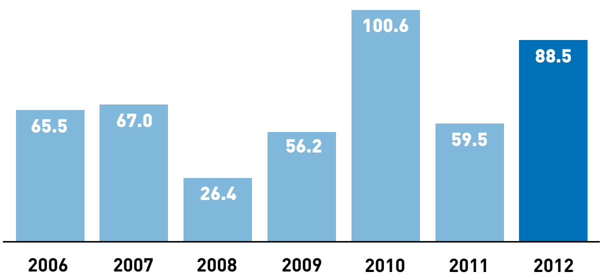
Operating profit before exceptional items (£m)



Key Performance Indicator:
The Society's operating profit before exceptional items indicates the repeatable profitability of the organisation based on its trading performance. It discounts items of profit recorded as exceptional, for example the change to the pension arrangements in 2012, as well as costs that are beyond the Society's direct control, such as funding the Financial Services Compensation Scheme.

It should be stressed that the decision to close the final salary pension scheme to future accrual was taken to manage risks at the Society rather than to deliver a benefit to profitability. The pension environment has changed beyond recognition in recent years and the open-ended guarantee to fund pensions based on final salaries of staff presents risk beyond the Society's control. A new Group Personal Pension Plan is being launched to all staff in 2013.

Profit before tax (£m)



Key Performance Indicator:
Profit before tax is stated once exceptional items have been taken into account. The Society's resilient performance throughout this period enabled it to increase its reserves in every year of the financial crisis. Recent examples of exceptional items include accounting adjustments following the merger with Stroud & Swindon (2010), which increased profit in that year, and contributions to the Financial Services Compensation Scheme to support customers of failed institutions (2008-2012) which have reduced profit before tax.

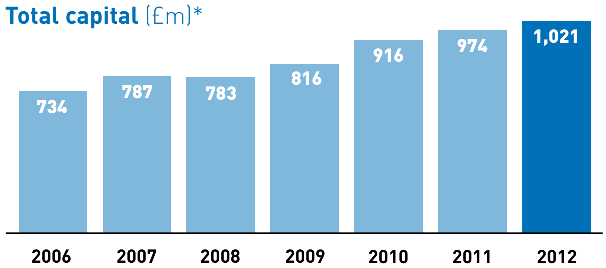
After taxation, the total transferred to the Society's reserves in 2012 was £67.5 million.

Capital strength
With a number of organisations still rebuilding their capital position, it is another salient indicator of the Society's financial strength that it has comfortably the highest reported core tier 1 ratio of any top 10 building society or mutual lender at 23.2%.

This is underpinned by the quality of the Society's lending and consequent assessment of the risk presented by our mortgage assets. As I have mentioned previously, the ability to generate sustainable profits, evidenced over many years, is vital too.

In the six years since the onset of the credit crisis, the Society has added over £300 million to its reserves.

Total capital (£m)*



* Total capital is comprised of equity, subscribed capital and subordinated liabilities

Key Performance Indicator:
Total capital represents the resources held to protect saving members against the risk of possible losses. Building societies predominantly add to capital by making and retaining profit. The Society's ability to add consistently to its total capital reserves during a period of unprecedented market turmoil is evidence of its resilient and sustainable business model.

The overall performance continues to be independently recognised by the two credit agencies that review the building society sector.

In 2012 Fitch Ratings (A) and Moody's Investor Services (A3) maintained Coventry's 'A' class rating. This is particularly significant in an environment which caused the ratings of a number of financial services organisations to be negatively reviewed. It is worth repeating that Coventry Building Society is the only major high street bank or building society not to have been downgraded by any credit rating agency in the last three years.

Putting Members First

In presenting our Accounts, it is natural to describe in detail the financial performance of the Society and the secure, stable and sustainable position that it has maintained throughout the economic downturn. However, I also believe that the decisions which drive this performance are entirely consistent with the responsibility we have to protect the interests of our members – a responsibility that extends to all aspects of our activities.

Appropriate products

It is this member-focus that has protected the Society from the Payment Protection Insurance (PPI) scandal, which has perhaps characterised the loss of trust and confidence in financial services more than any other issue. Since the judicial ruling in 2011, huge sums have been put aside by high street banks and millions of individuals have been compensated for products that should not have been sold to them. That the industry will continue to be dogged by this scandal in 2013 demonstrates the scale and almost ubiquitous nature of this problem.

Coventry Building Society, however, has had a different experience. Decisions regarding the design of the PPI sold by the Society and the sales process used, have protected individual members and the Society itself. I believe the fact that PPI has not been a material issue for the Society is evidence that member interests are considered at the outset and that the provision of compensation is no substitute for this approach.

The 'success' of claims management companies has generated speculation about business areas that could form the basis of future compensation claims, with attention focusing most recently on packaged bank accounts. Although the Society has had the capability to launch such accounts we have not done so, preferring to provide simple and straightforward products for our members.

Excellent service

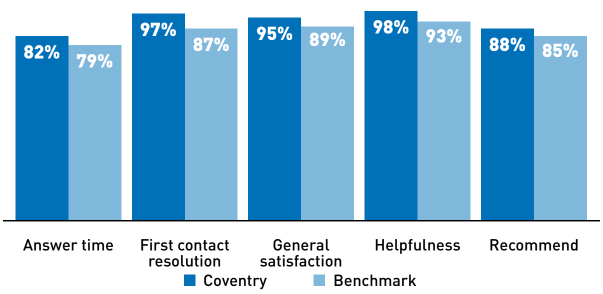
Equally during 2012, concern was raised in the media and by consumer protection groups about the pressure put on banking staff to sell financial products to customers, a concern that extended to banks and building societies alike.

That is why Coventry Building Society does not use sales incentives of any kind and in 2013, our branch staff will not have any sales targets at all. We believe that this provides absolute clarity to our staff to meet the needs of the members they serve.

Listening to members

To help maintain this focus we have extended the use of surveys, focusing on specific events as well as more general service expectations. For example, the customer service centre consistently achieves above benchmark scores in the independently-assessed Bright Index, and in 2012 we introduced a similar approach to improve feedback in the branch network. We regularly survey our intermediary mortgage partners and perform ad-hoc surveys on key matters of interest.

Telephone service



Key Performance Indicator:

The Bright Index assesses 50 key performance indicators for a large number of contact centres. These figures allow the Society to understand better the service it delivers in comparison with a group of financial services organisations, and is one of the means by which improvements are identified.

In this regard I also want to draw attention to the work of our Members' Council and to thank the volunteers who take part. The Council is now entering its fifth year and during this time a rotating committee of members has met quarterly to discuss the performance of the Society, explain what matters to them and provide valuable insight to our ongoing developments.

In addition we continue to invite members to 'roadshows', events held around the country which enable members to meet and discuss Society matters with staff at all levels of experience from the local branch to members of the Board.

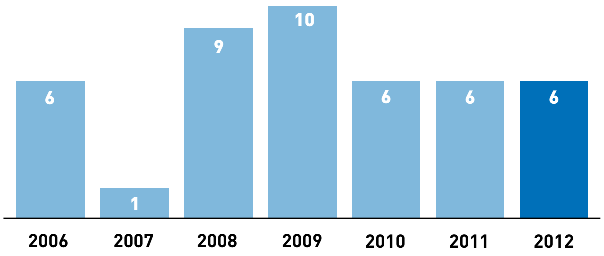
Resolving problems

These activities demonstrate the importance that the Society places on listening to members. Further real evidence of this commitment to service is demonstrated by our record of receiving and resolving complaints.

In 2012, the regulations regarding complaint handling were simplified, giving organisations one opportunity to address any concerns before a customer could seek redress through the Financial Ombudsman Service (FOS).

Of the complaints that were referred to and reviewed by FOS in 2012, just six were changed in favour of the complainant. This is further evidence that the Society, whilst not getting everything right first time, does work extremely hard to take appropriate action when things go wrong.

Complaints -
No. of adjusted outcomes requested by FOS

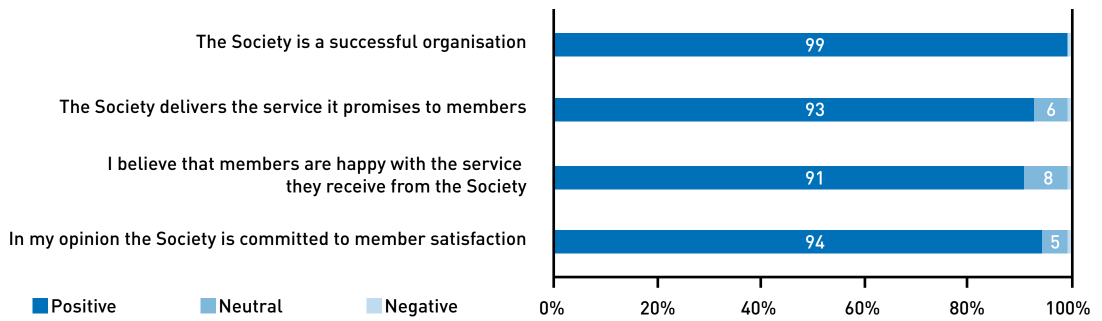


Key Performance Indicator:
This shows the number of times the Financial Ombudsman Service has asked the Society to change the way it has acted over a complaint. A consistently low number of 'changed outcomes' was maintained during a period in which the Society achieved record share of the mortgage and savings markets and which coincided with the introduction of new complaint rules, and industry-wide mis-selling scandals.

Engaged staff

Our ability to provide the service our members expect demands knowledgeable and motivated members of staff.

In 2012, in addition to asking the views of many members and intermediaries, we also surveyed all members of staff to understand, amongst other things, their perception of the Society and the service we offer. The results were extremely encouraging, highlighting not only a thorough understanding of the Society's values and aims, but also an ambition to do the best possible job for our members. I was particularly pleased to have confirmation that our staff believe that the Society is genuinely committed to doing the right things for our members.



These findings are supported by independent assessment.

In 2012, the Society had its triennial assessment by Investors in People. The assessment concluded that, 'The vision and values that accompany the core principles of 'Members First' are firmly embedded within the culture of the organisation. Without exception, people believe they are central to the way that decisions are made and services delivered' (IIP report 2012).

As a result, the Society was awarded 'Gold' status, being one of the first large banks or building societies to have received this recognition.

The importance that we place on skilled and knowledgeable staff was reinforced by a strong performance in the 2012 National Training Awards, in which the Society won the regional award for large employers and was highly commended at the national level, being placed in the top three of all UK employers.

Support for communities

This report should review the all round contribution made by the Society. I mentioned corporate social responsibility earlier and I believe that we must also play our part in supporting the communities we serve. Part of this is through our continued physical presence and we remain committed to our network of branches, continuing to invest in the services they provide.

However, it is a harsh reality of the economic environment that charities and local community groups are suffering a downturn in income as demand for their services rise.

I am pleased to report that we continue to expand the support we offer to these groups, both through staff fundraising and the work of staff volunteers, with the total community investment supported by these activities increasing to a new record total of £2.3 million.

These figures include the significant donations made to The Royal British Legion's Poppy Appeal as a result of our portfolio of Poppy affinity accounts. The success of this portfolio, which was launched towards the end of 2008, has already resulted in total donations from the Society to the Poppy Appeal of over £7.5 million, of which £1.9 million was donated in 2012.

We have now adopted The Royal British Legion as our corporate charity for the next three years, and since this decision was made the Society has supported The Legion in many additional ways, including the provision of premises during the Poppy Appeal campaign and increased volunteer activities, for example supporting events at remembrance gardens, and Poppy Appeal collections.

This has followed the completion during 2012 of our very successful three year partnership with Age UK. Through the actions of staff and the support of members we not only raised in excess of £180,000 but supported a number of campaigns designed to improve the experience of elderly people in the UK. The relationships formed, particularly at a branch level, continue to be extremely helpful in supporting some of our members and providing an insight to our staff of the issues they face.

Making an impact at a local level has been a theme throughout the year with many successful community partnerships now established between branches, head office teams and community groups. Further support continues to be provided through the Coventry Building Society Charitable Foundation which has donated £830,000 since it was launched.

The commitment and enthusiasm of members of staff in supporting our community activities is exceptional. It is seen across the board in support of national fundraising events like the 2012 Children in Need appeal, when almost all staff contributed to raising over £40,000, beating last year's record as they went.

It is also seen in long-standing commitments to local schools and debt agencies to improve financial awareness amongst those who need it most. If the lessons of the financial crisis are to be learned then this type of support is becoming ever more important.

CHIEF EXECUTIVE'S REVIEW
(continued)

Summary

I noted at the outset that in 2012 the Society has achieved another strong performance. I say this not only because of the strength of the financial performance in the face of a sustained downturn in the economic environment, but the progress made in other aspects of the Society's activities.

At its heart, however, is a single-minded proposition. The Society, which in its product set is possibly the most traditional of all large building societies, exists to protect and serve the interests of its members. This simple philosophy is not as simple to execute as it might appear, particularly when considering the competitiveness and, at times, poor practices of the UK's financial services industry. However, the Society's performance has demonstrated that this focus can provide a robust and sustainable business model.

I said last year that the age of austerity might be a long-lasting phenomenon. Building societies have been in existence for over 150 years. The values of prudence, responsibility and fairness which were present at the start of the building society movement have proved as relevant today as in the 19th century. Our aim is to retain these values, whilst ensuring that the Society remains relevant to members today.

If we do this successfully, the Society will continue to deliver security, stability and value to new and existing members.

David Stewart
Chief Executive

DIRECTORS' REPORT

Business objectives and activities

The Society's principal objective is the provision of a range of personal financial services including mortgage finance for house purchase and improvements, savings and insurance.

The directors consider that all activities carried out during the year were within the powers set out in the Memorandum of the Society.

Business review

The Society recorded a strong performance in 2012, maintaining its track record of sustainable growth during a period of ongoing economic uncertainty and instability.

The resilience of the Society is shown by achieving consistently strong performances over the six years of economic crisis since 2007. It is based on strong fundamentals of prudent management of risk, efficiency, a focused business model and lending quality, which have enabled it to continue to attract and retain savings balances and consistently maintain support to the mortgage market. The Society remains strongly and sustainably profitable, adding capital to its reserves in 2012 as in each of its preceding 128 years.

The ability of the Society to deliver a consistent performance in a difficult environment as well as under more benign conditions stands out in the financial services sector.

The Society is the only major high street bank or building society that has not been downgraded in the last three years. It retains it's 'A' rating (Fitch 'A', Moody's 'A3'), and has done so throughout the credit crisis. This recognition as one of the strongest UK mortgage lenders continues to generate confidence amongst individual members and institutional investors alike, and the Society has again grown both retail and wholesale investments in 2012.

In providing value and security, the Society remains true to its original remit to support savings and borrowing members. In delivering constant and sustained support to the mortgage market, it continues to play a role in the recovery of the wider UK economy.

The Society's business performance is reviewed by the Chairman and Chief Executive, which form part of the Directors' Report (see pages 2 to 12).

External environment

The UK economy remained weak in 2012 and forecasts for growth in 2013 are subdued. A 'double-dip' recession was reported in the first half of 2012 with a recovery in the third quarter the result of one-off factors including the Olympics. Although inflation did reduce in the year, it remained above the Bank of England Monetary Policy Committee target as a result of rising energy, food and education costs.

Government hopes for an export-led recovery are being affected by ongoing international uncertainty in Europe and the US and a downturn in China's growth rate. Although UK unemployment rates stabilised at approximately 8%, it is feared that excess capacity is being maintained and new jobs are predominantly low-quality or part-time.

The increasing political imperative to stimulate the economy whilst maintaining plans to reduce the budget deficit resulted in further Quantitative Easing and the maintenance of the Bank of England Base Rate at its record low of 0.50%. Although a further reduction in Base Rate is possible, current forecasts predict that it will remain at 0.50% throughout 2013 and 2014.

The desire to stimulate growth also led to funding initiatives to encourage greater mortgage lending and business loans. The Funding for Lending Scheme, an £80 billion initiative, was instigated in the latter half of the year with organisations representing a significant number of the largest UK lenders taking part. Whilst this will support mortgage affordability, volumes are likely to remain low with the housing market continuing to operate at levels significantly below those preceding the credit crisis. Valuations are being protected by an ongoing shortfall of supply.

The framework of regulation for financial services continued to be developed. The results of the Mortgage Market Review were announced and the Retail Distribution Review was widely discussed prior to its implementation in January 2013. Trust in financial services organisations remains at a premium, however, with Payment Protection Insurance mis-selling continuing to prove extremely damaging to the industry in both cost and reputation. A number of additional examples of mismanagement, incompetence and even criminality further damaged public and political confidence in the industry.

Overall expectations for 2013 remain depressed with levels of demand, and consumer and market confidence, damaged by the ongoing uncertainty in the UK, Europe and US, and budget deficit reduction measures.

Impact on Coventry Building Society

Coventry Building Society is not insulated from the challenges of the current economic conditions. The low interest rate environment costs the Society investment income whilst developments in regulations and reporting requirements add additional costs. The static housing market and competition to attract and retain retail balances have presented challenges to an organisation dedicated to the provision of mortgages and savings products.

However, it is in this environment that the Society has once again proven its core strength, recording another year of extremely strong performance.

The resilience of the Society and its ability to deliver sustained outperformance through good times and bad shows the strength of its underlying business model and its expertise in implementation.

Coventry remains a traditional building society, specialising in the provision of savings and mortgages. It must attract and retain savings in order to fund responsible lending, and in doing so ensure that sustainable levels of profitability are achieved in order to add capital to its reserves and provide financial security to its membership.

The Society continues to achieve each of these objectives. Most importantly it does so whilst providing excellent value to its members.

This is made possible by a number of key attributes. Coventry is comfortably the most cost-efficient building society reported in the UK. This position has been held by the Society for a number of years and the solid platform this provides enables a strongly competitive approach to the pricing of its mortgage and savings products. The Society also manages its resources extremely flexibly, and enabled by quick decision-making, this supports a speed of action that enhances its competitive position.

Most importantly the Society has maintained its balance of savings and lending without taking on higher levels of risk. This has ensured a very high quality mortgage book which continues to perform extremely strongly. The benefit of low levels of arrears and impairments has reinforced this positive cycle and helps the Society to maintain its focus on low risk, prudent and profitable lending.

The strength of the Society is also independently recognised by its continued success in accessing wholesale funds. The Society has successfully issued a variety of medium and long-term notes in the UK and Europe over the last few years. In 2012 this record was maintained with its first public residential mortgage backed securitisation (RMBS), which raised £800 million and a further €500 million unsecured issuance in November. In both cases the issues were significantly over-subscribed.

Future developments

Looking ahead to 2013 it seems clear that the economic environment will not improve significantly. The prospects for growth in the UK economy remain uncertain with the need to reduce the UK budget deficit and the ongoing international instability continuing to dampen demand.

The outlook for the housing market remains subdued. The low interest rate environment and resilience of the employment market will protect householders to a certain extent, and repossessions are expected to remain low for the economic conditions.

However, confidence remains fragile and there is a genuine risk of a return to recession. The Society's ability to grow its share of low risk lending is dependent on its ability to attract funding, both institutional and individual investments, and this will continue to be an area of focus, whilst seeking to maintain the benefit of its low cost and efficient operations. Whilst economic conditions develop and new solutions are proposed, the underlying reality is the same for the Society in 2013 as it has been every year since the credit crisis began.

With a track record of success, Coventry Building Society remains well placed. It has a proven ability to compete in the retail markets and this strength has been backed by its continued ability to attract institutional investors.

The Society's control of costs and margin has ensured a sustainable level of profitability, which continues to enhance an exceptionally strong core tier 1 ratio of 23.2%, that is supported by the excellent asset quality of its mortgage book and low levels of impairments.

Coventry Building Society has core strength in the fundamentals of operating a successful savings and mortgage model. More importantly it has a track record of decision-making that puts members' interests first. This combination of strong foundations and a prudent member-focused strategy has been shown to be extremely successful. The Board continues to believe that the Society is well positioned to report further progress in 2013 and beyond.

Group accounts

The Accounts show the consolidated Group results of the Society and its subsidiaries, and the Society as a single entity.

Profit

Discounting the exceptional items recorded in 2011 and 2012 including integration and merger related costs, the contribution made to the Financial Services Compensation Scheme, the charitable donation to the Poppy Appeal, and the one off benefit resulting from the closure to future accrual of the final salary pension scheme, the underlying profits of the Society rose from £84.6 million to £91.3 million. As a result, the Group's profit after tax amounted to £67.5 million (2011: £46.6 million), which was added to reserves.

Capital

Capital Resources

The Group holds capital to protect its depositors, by ensuring that there will be sufficient assets to cover liabilities even in the face of unexpected losses. In assessing the adequacy of its capital, the Group considers the material inherent risks to which it is exposed and the need for capital to be available to support the development of the business. Capital adequacy and capital resources are monitored on the basis of the framework developed by the Basel Committee on Banking Supervision and subsequently implemented in the UK via European Union (EU) regulations and directives applied by the UK regulator, the Financial Services Authority (FSA).

The EU Capital Requirements Directive (Basel II) took effect from 1 January 2007. From 1 January 2008 the FSA granted the Group permission to use the Basel II Internal Ratings Based (IRB) approach to retail credit risk and capital management. This allows the Group to calculate capital requirements for prime owner occupied and buy-to-let mortgage exposures (excluding those transferred from the merger with Stroud & Swindon in 2010, and the mortgage book acquired from Bank of Ireland) using internally developed models that reflect the credit quality of the Group's mortgage book. This permission reflects the Group's detailed understanding of its customer base and control of its credit risk profile, and the Group has applied to the FSA for permission to extend the IRB approach to include the Stroud & Swindon mortgages. For other exposures and risk areas the Group follows the standardised approach which uses capital risk weighting percentages set by the FSA.

The table overleaf summarises the composition of regulatory capital for the Group as at 31 December 2012 and 31 December 2011. The Group repurchased £10 million of tier 2 subordinated debt in June 2012 in line with the scheduled call date. In addition £67.5 million was added to general reserves. The Group regularly reviews the appropriateness of its capital structure.

At 31 December 2012, and throughout the year, the Group complied in full with the capital requirements that were in force. Further information on how the Group manages capital, and evaluates its capital requirement can be found on pages 34 and 35.

	Notes	2012 £m	2011 £m
Tier 1			
General reserve		**811.4**	747.9
Pension fund surplus adjustment	1	**(10.1)**	(3.9)
Intangible assets	2	**(9.2)**	(9.5)
Deductions from tier 1 capital	3	**(9.6)**	(9.2)
Core tier 1 capital		**782.5**	725.3
Permanent Interest Bearing Shares	4	**160.0**	160.0
Total tier 1 capital		**942.5**	885.3
Tier 2			
Collective provisions for impairment	5	**0.4**	0.4
Subordinated debt	6	**55.5**	67.0
Deductions from tier 2 capital	3	**(9.6)**	(9.2)
Total tier 2 capital		**46.3**	58.2
Total capital		**988.8**	943.5
IRB approach			
Credit risk – Retail exposures		**2,034.0**	1,920.7
Standardised approach			
Credit risk – Retail exposures		**857.6**	776.7
Credit risk – Liquidity book		**201.2**	199.0
Credit risk – Other		**43.8**	83.9
Operational risk		**230.6**	202.4
Risk-weighted assets		**3,367.2**	3,182.7
Core tier 1 ratio (%)		**23.2**	22.8

1. Pension fund surplus - note 12 to the Accounts.
2. Intangible assets - note 21 to the Accounts.
3. Under Basel II, a deduction is made for the excess of expected losses on loans and advances to customers, calculated on an IRB basis, over accounting provisions, and are allocated 50% to tier 1 and 50% to tier 2 capital.
4. Permanent Interest Bearing Shares - principal amount outstanding only, note 34 to the Accounts.
5. Under Basel II, collective provisions for impairment relating to loans and advances to customers, calculated on a standardised basis, are included as tier 2 capital.
6. Subordinated debt - principal amount outstanding only, and if in the last five years to maturity, the subordinated debt is amortised on a straight line basis, note 33 to the Accounts.

Core tier 1 ratio

The Society retains a strong capital position with a core tier 1 ratio of 23.2% (2011: 22.8%).

Impact of Basel III

In July 2011, the European Commission published proposals to implement the Basel III capital and liquidity standards within Europe. The proposals consist of a new Regulation and a new Directive, collectively known as Capital Requirements Directive IV (CRD IV). The proposals are being debated in a 'triologue' by the EU Parliament, the EU Commission and the Council of Ministers. Some significant points remain at issue and the final text is expected to be published in the first half of 2013. The key elements of the Basel III Accord that CRD IV is expected to incorporate are as follows:

Quality of capital

The proposals bring more stringent requirements for the eligibility of capital instruments with a focus on common equity (which includes reserves) as the principal component of regulatory tier 1 capital, and changes to the regulatory deductions from common equity. The proposals set a minimum of tier 1 capital at 6% of risk weighted assets (RWAs), of which common equity tier 1 (CET1) is required to be a minimum of 4.5% of RWAs. The total of tier 1 and tier 2 capital is to be a minimum of 8% of RWAs.

Basel III applies the principle that tier 1 capital is available to absorb losses of the business on a 'going concern' basis. The Society's Permanent Interest Bearing Shares (PIBS) are not able to do this, and therefore will not be eligible as tier 1 capital. These PIBS will be 'grandfathered' and recognised as additional tier 1 capital on an amortising basis over 10 years from 1 January 2013, or to the call date if earlier. Of the Society's PIBS, £120 million will no longer be eligible as tier 1 capital from their call date in June 2016.

Basel III requires tier 2 capital to absorb losses on a 'gone concern' basis when a business reaches a 'point of non viability'. The Society's subordinated debt has no mechanism for recognising that point and so will be grandfathered as tier 2 capital in the same way as the Society's PIBS. The Society is monitoring market developments and may consider issuing Basel III compliant capital instruments should the market present favourable opportunities to do so. A number of rule changes are proposed as part of the AGM process that would support the issuance of Basel III compliant instruments.

Capital buffers

To promote the conservation of capital and the build up of adequate buffers that can be drawn down in periods of stress, CRD IV proposes the use of common equity capital buffers, namely a capital conservation buffer of 2.5% of RWAs to be built up during times of positive growth; and a countercyclical capital buffer of up to an additional 2.5% of RWAs to be built up when credit growth exceeds GDP growth, allowing firms to use this additional buffer in times of stress. These are expected to come into force from 1 January 2016 to 2019. The extent to which these will overlap with current capital planning buffers is not yet determined.

Counterparty credit risk

An additional capital charge for credit valuation adjustment risk will be required. The charge arises from the use of derivative instruments to manage interest rate and foreign exchange risk. The impact for the Group is expected to be immaterial.

Leverage

The CRD IV proposals introduce a non-risk based leverage ratio that is calibrated to act as a supplementary measure to the risk based capital requirements and is intended as a backstop measure. The calculation determines a ratio based on the relationship between tier 1 capital and total assets. The leverage ratio does not distinguish between unsecured and secured loans or recognise the ratio of loan to collateral value of secured lending. Consequently the leverage ratio has the potential to act as a primary constraint on low risk mortgage lenders even, as is the case for the Society, where strong underlying collateral exists. The CRD IV proposal is for the minimum level of this ratio to be 3%. This proposed measure does not come into effect until 2018. As at 1 January 2013 the leverage ratio of the Society was 3.4%.

Harmonisation of national regulations

Where Basel III is implemented in the EU via a regulation, the provisions will apply directly to firms in the EU without further national discretion. Furthermore, CRD IV attempts to harmonise national regulation across the European Union via implementation of a common rule book.

Basel III had no effect in 2012, and the Society has considered the impact of the introduction of these rules on future levels of capitalisation, including under stress testing within its capital plan. The directors consider that the Society will continue to remain well capitalised. A draft proforma presentation of the Society's capital on a Basel III basis reflecting the first year of transitional provision is presented below.

	Notes	Basel II 31.12.2012 £m	Basel III Adjustments £m	Basel III 1.1.2013 £m
Common equity tier 1 capital				
General reserve		811.4	-	811.4
Regulatory deductions				
Pension fund surplus adjustment	1	(10.1)	2.3	(7.8)
Intangible assets		(9.2)	-	(9.2)
Deferred tax assets	2	-	(0.3)	(0.3)
Deductions from tier 1 capital	3	(9.6)	(2.9)	(12.5)
Total common equity tier 1 capital		782.5	(0.9)	781.6
Additional tier 1 capital				
Permanent Interest Bearing Shares	4	160.0	(16.0)	144.0
Total additional tier 1 capital		160.0	(16.0)	144.0
Total tier 1 capital		942.5	(16.9)	925.6
Tier 2				
Collective provisions for impairment		0.4	-	0.4
Subordinated debt	4	55.5	(5.5)	50.0
Deductions from tier 2 capital	3	(9.6)	(2.9)	(12.5)
Total tier 2 capital		46.3	(8.4)	37.9
Total capital		988.8	(25.3)	963.5
IRB approach				
Credit risk – Retail exposures		2,034.0	-	2,034.0
Standardised approach				
Credit risk – Retail exposures		857.6	-	857.6
Credit risk – Liquidity book		201.2	-	201.2
Credit risk – Other	5	43.8	11.8	55.6
Credit valuation adjustment risk	6	-	125.0	125.0
Operational risk		230.6	-	230.6
Risk-weighted assets		3,367.2	136.8	3,504.0
Common equity tier 1 (as a percentage of risk exposure amount)		23.2%		22.3%
Tier 1 (as a percentage of risk exposure amount)		28.0%		26.4%
Total capital (as a percentage of risk exposure amount)		29.4%		27.5%
Leverage ratio				3.4%

1. Under Basel III, an adjustment for the associated deferred tax liability is required.
2. Under Basel III, a transitional adjustment of 10% of deferred tax assets that rely on future profitability is required.
3. Under Basel III, an adjustment for the tax effect is no longer applicable.
4. Under Basel III, a transitional deduction of 10% of the Society's Permanent Interests Bearing Shares and subordinated debt is made.
5. Under Basel III, where deferred tax assets arising from temporary differences are below the minimum level to be treated as a deduction from capital, they receive a risk weighting of 250%.
6. Basel III requires the inclusion of a capital charge relating to credit valuation adjustment risk, which equates to a risk-weighted assets figure of £125 million.

Liquidity and funding

Liquidity resources

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

Liquidity risk is managed through four different categories of resources in order of increasing realisation time. Separate limits are applied to each category. All liquidity is held for the principal purpose of meeting expected and unexpected cash flow requirements subject to the Society's defined tolerance (see pages 31 to 33). The amount of liquidity held in each category is managed with regard to the requirements derived from internal risk based measures, regulatory requirements, wholesale credit risk assessment, any encumbrance associated with the liquidity and the cost of holding such liquidity.

The Society's liquidity resources split into four categories, are set out below:

	Notes to the Accounts	**2012 £m**	2011 £m
Cash in hand and balances with the Bank of England[1]	16	**1,714.7**	1,585.8
UK Government Securities and multi-lateral development banks			
Securities - On-balance sheet[1]	18	**1,814.9**	1,970.1
Securities - Other	41	**100.0**	-
Other Securities and bank deposits			
Securities - On-balance sheet[1]	18	**498.3**	876.2
Bank deposits	17	**15.0**	175.6
Self issued covered bonds, RMBS and Bank of England approved mortgage portfolios	41	**3,947.5**	1,450.0
Total		**8,090.4**	6,057.7

[1] Market value

- The first category consists of cash held at the Bank of England in sterling and in accounts with UK clearing banks in sterling and euros.

- The second category consists of securities that are accepted by the FSA in the definition of the 'Liquid Assets Buffer' (LAB). The total LAB assets are the sum of the first and second categories and represent the most liquid assets held by the Society. Securities comprise highly-rated debt issued by either the UK government or certain FSA-approved multi-lateral development banks.

- The third category consists of other liquid assets where we can be reasonably certain that they could be realised in a liquidity stress. This includes highly rated covered bonds, mortgage backed securities, bank debt (floating and medium term notes) and deposits. Prudent assumptions are made regarding the cash that could be generated from such assets in a liquidity stress and the time that this would take, having particular regard to the eligibility of the assets in Bank of England liquidity facilities. All covered bonds and mortgage backed securities are in sterling and euros, issued by UK entities and were rated Aaa on issue. Bank debt and deposits are mostly in sterling with some denominated in euros to match the currency of a euro denominated wholesale debt issuance.

- The fourth category consists of mortgage collateral that could be used to access Bank of England liquidity facilities or could be sold to and repurchased from third parties under sale and repurchase agreements (repos). Included in this category are self-issued covered bonds, self-issued RMBS notes and two portfolios of mortgage loans which have been approved by the Bank of England.

The amounts held in each category vary depending on the projected cashflow requirements largely determined by business volumes and maturities of retail and wholesale funding. The Society will hold additional liquidity if higher than average outflows are anticipated. The current ratings and geographical distribution of the liquidity assets are set out in note 40 to the Accounts.

Cash, securities and other deposits held in the Society's covered bonds and RMBS programmes and balances deposited with counterparties under interest rate swap collateralisation agreements, are included in notes 16,17 and 18 to the Accounts. These balances are not included within liquidity resources as they cannot be realised on demand.

The amount of liquidity resources held is also subject to regulatory minimums set by the FSA. At 31 December 2012, and throughout the year, the Group complied in full with the liquidity requirements that were in force. Further information on how the Group manages liquidity, and evaluates its liquidity requirements can be found on pages 31 to 33.

Funding

The Society is predominantly funded through retail deposits. Retail funding consists of a mix of fixed rate bonds, variable products and ISAs. The Society has a strong record of attracting and retaining savings balances and has organically grown its retail savings book each year of the crisis. Wholesale funding is used to provide diversification and value to members through lowering the overall cost of funding. The Society retains access to short-term wholesale funding markets and made public issuances from all three of its long-term funding programmes in 2012:

- £500 million issued from the covered bonds programme in February 2012
- Inaugural 'Leofric' RMBS programme in May 2012, issuing £800 million externally
- €500 million issued from the senior unsecured Medium Term Note programme in December 2012

In addition, the Society drew £100 million from the Bank of England's Funding for Lending Scheme in December 2012.

Sale and repurchase arrangements (repos) are used to manage liquidity by converting liquid assets into cash as and when required (note 41 to the Accounts). A repo is an agreement to sell an asset to a counterparty combined with an agreement that the same asset will be repurchased at a later date.

In order to secure funding through covered bond and securitisations the Society is required to pledge assets as collateral. Details of assets pledged or encumbered to support funding are set out in note 41 to the Accounts. Encumbrance levels are monitored monthly against internal board-approved limits. Limits set are based on the Society's overall funding profile and peer group analysis.

An analysis of the Society's wholesale funding is set out in the table below (see notes 26, 27, 28 and 29 to the Accounts):

	2012 £m	**2012 %**	2011 £m	2011 %
Deposits from banks, including sale and repurchase agreements	**715.9**	**14**	510.9	13
Other deposits and amounts owed to other customers	**459.5**	**9**	572.3	15
Debt securities in issue				
Certificates of Deposit	**73.8**	**1**	192.4	5
Medium Term Notes	**1,260.4**	**25**	1,352.8	34
Covered Bonds	**1,805.3**	**36**	1,318.6	33
Residential Mortgage Backed Securities	**735.2**	**15**	–	–
Total	**5,050.1**	**100**	3,947.0	100

The Society does not have any significant maturities of long-term wholesale funding within the next 12 months. An expected maturity analysis for funding is shown below. This is based upon the earliest call date, where appropriate.

	2012 %	2011 %
Less than one year	**25**	45
One to two years	**11**	–
Two to five years	**34**	16
More than five years	**30**	39
Total	**100**	100

Impact of Basel III
In December 2010 the Basel Committee on Banking Supervision issued its proposals for liquidity risk management. This included two new measures

- Liquidity Coverage Ratio (LCR) – a 30 day short-term liquidity stress measure
- Net Stable Funding Ratio (NSFR) – a one year term stable funding metric

These proposals are yet to be finalised; however the Society monitors compliance against these metrics. As at 31 December 2012, the LCR and the NSFR were both above the 100% requirement, required by 2018.

Assets

Advances during the year amounted to £5.1 billion, contributing to total loan balances of £22.0 billion.

The total assets of the Group increased by £2.4 billion to £26.9 billion at 31 December 2012, representing growth of 10%. Changes in intangible assets and property, plant and equipment are detailed in notes 21 and 22 to the Accounts.

At 31 December 2012, there were 306 mortgage accounts 12 months or more in arrears (2011: 268). The balances on these accounts totalled £37.2 million (2011: £31.0 million) and the value of these arrears was £4.5 million (2011: £5.0 million).

Creditor payment policy

The Society's policy is to agree the terms of payment at the start of trading with the supplier and to pay in accordance with its contractual and other legal obligations.

Charitable and political donations

The Society provided for donations of £2.0 million (2011: £1.0 million) to charitable organisations during the year. This included a provision for £1.9 million (2011: £1.0 million) to The Royal British Legion's Poppy Appeal and £60,000 (2011: £50,000) to the Coventry Building Society Charitable Foundation.

The amount donated to The Royal British Legion illustrates the strength of the ongoing relationship with the Legion for which the Society has developed a portfolio of products.

The success of this relationship emphasises the high regard felt by many members for the work of The Royal British Legion on behalf of former and current members of the UK's Armed Forces. The ongoing popularity of the Poppy portfolio meant that by 31 December 2012, the total support given to the Poppy Appeal since the first Poppy Bond in October 2008 had reached £7.5 million. The number of members holding accounts which support the Legion now exceeds 125,000.

No contributions were made for political purposes. However, as a result of the Political Parties, Elections and Referendums Act 2000, time allowed for employees to carry out civic duties and political activity can amount to a donation. The Society supports a very small number of employees in this way.

Going concern

In preparing the financial statements the directors must satisfy themselves that it is reasonable for them to conclude it is appropriate to adopt the going concern basis.

The Society meets its day-to-day liquidity requirements, through managing both its retail and wholesale funding sources and is required to maintain sufficient liquid assets to comply with regulatory requirements, in order to continue to be authorised to carry on its business.

The Society's business activities, together with the factors likely to affect its future development, performance, position, liquidity and capital structure are set out in the Chairman's Statement, Chief Executive's Review and this Directors' Report. In addition, the Risk Management Report and notes 38 to 41 to the Accounts includes further information on the Society's objectives, policies and processes for managing its exposure to liquidity, credit, market, operational and business risk, along with details of its financial instruments and hedging activities.

The directors believe that the Society is well placed to manage its business risks, despite the current uncertain economic outlook. After considering factors including default rates on loans, house price movements and the Society's capital and liquidity position including the use of stress testing, the directors are confident that the Society has adequate resources for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the Annual Report & Accounts.

DIRECTORS' REPORT

(continued)

Principle risks and uncertainties

The principal risks and uncertainties faced by the Society are set out in the Risk Management Report on pages 26 to 34.

Corporate governance

The Directors' Report on Corporate Governance can be found on pages 38 to 45.

Directors' statement pursuant to the disclosure and transparency rules

The directors confirm that, to the best of each person's knowledge and belief:

- The financial statements, prepared in accordance with IFRS as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group and Society; and
- The management report contained in this Directors' Report and the Risk Management Report includes a fair review of the development and performance of the business and the position of the Group and Society, together with a description of the principal risks and uncertainties that they face.

Auditors

Following a review by the Board Audit Committee, the Board has agreed that a resolution proposing the re-appointment of Ernst & Young LLP as auditors of the Society will be submitted at the Society's 2013 AGM.

On behalf of the Board

Ian Pickering
Chairman
28 February 2013

CORPORATE RESPONSIBILITY REPORT

Corporate responsibility, environmental and employee factors

Staff

The Society's strong performance in 2012 was underpinned by the continued commitment and professionalism of its staff.

The strength of this commitment was demonstrated in the first quarter of the year when Investors in People undertook its triennial assessment of the Society. Following interviews with an independent selection of approximately 10% of staff, the Society was awarded 'Gold' status. Amongst the conclusions of the assessment, the directors were pleased to note the following:

'The vision and values that accompany the core principles of 'Putting Members First' are firmly embedded within the culture of the organisation. Without exception, people believe they are central to the way that decisions are made and services delivered. Those who are new to the organisation are swiftly immersed within the culture and fully engaged in maintaining the core principles and values.'

The requirement to understand and deliver the Society's goal to 'put members first' rests with all staff. This is of even greater importance at a time when economic conditions are placing members under increasing pressure and the reputation of the financial services sector is at a low ebb. The Investors in People assessment recognised both the importance of reputation to the Society and the emphasis placed upon it by all members of staff.

This does not happen by chance. The Society works extremely hard to ensure that staff are equipped and motivated to meet the needs of the membership. An example of this is shown by another award, the National Training Award for Large Companies. The Society was awarded the regional award for the West Midlands out of a total entry of 1,500 organisations and was judged third in the UK.

Motivation stems from the culture of the organisation. The demands placed on staff to be flexible and respond positively to changes in work volumes or the introduction of new technology or policies, are greater than ever. It reflects great credit on staff that these demands continue to be met.

It is said that success breeds success. Certainly the Society's achievements over the last six years have helped create a culture of high performance. The growth of the Society means an ongoing requirement to attract and retain high quality members of staff. It also means that the Society can provide increasing opportunities for career development.

The directors remain committed to investing in the staff of the Society to ensure that the right environment and opportunities exist for staff to achieve their potential and meet the expectations of the Society's membership.

Community

The Society continues to extend its community programmes, providing a range of support to organisations as diverse as national charities, schools, local advice agencies and small community groups.

The directors continue to believe that the Society's links between its core business activities and supporting vulnerable people demonstrates the best of corporate responsibility in action.

To achieve this a number of distinct programmes have been developed which utilise the skills, knowledge and enthusiasm of Society staff.

The clearest examples of this are initiatives to promote greater financial literacy amongst schoolchildren. In 2012 more than 75 volunteers worked in primary and secondary schools supporting numeracy and literacy activities, leading personal finance programmes or providing specialist support. The Society also provides mentoring, interview skills and placement opportunities to students at specialist finance academies across the Midlands. The provision of specialist support extends to tackling debt issues amongst adults via a four year relationship with Coventry Citizens Advice Bureau and the Coventry Law Centre.

Members of staff from across the organisation are also encouraged to support local community groups. Often small organisations, these make a big difference to the communities they are based in without significant recognition or funding. The awareness and public commitment that staff provide is as valuable as the funds that are raised. In 2012, funds raised at a corporate level were channelled to these local community partners for the first time, providing a further source of much needed support.

The Society also increased the funding available to its Charitable Foundation in 2012 from £50,000 to £60,000. These funds were again directed at supporting small, local charities and community groups with over £830,000 donated since the Foundation was established in 1999.

CORPORATE RESPONSIBILITY REPORT

(continued)

In 2012, the Society also completed its three year programme of support for Age UK, its corporate charity since 2009. In this time the Society raised £180,000 for the charity but of equal importance has been the opportunity to increase awareness amongst staff and members of the issues faced by the UK's elderly. The relationships formed over these three years continue to be of real benefit, with many branches maintaining contact with local offices of Age UK.

The Society has now adopted The Royal British Legion as its corporate charity. This is another clear example of the Society using its core competencies to deliver tangible benefits. In October 2008, it launched the first in its range of Poppy savings accounts which collectively have generated donations of over £7.5 million by 31 December 2012. It is apparent from the success of the Poppy portfolio and the many expressions of support received from members, that the work of The Royal British Legion continues to be held in extremely high regard.

At the heart of the Society's community programme is the enthusiasm, ideas and dedication of its staff. Community activities are encouraged by the Society for the tangible results that are achieved but also in recognition of the personal commitment made by members of staff outside of work. The Society supports individual members of staff by matching funds raised, providing community grants, and providing time for voluntary activities. This support is recognised by the loyalty and engagement of staff.

Supporting the communities we serve is one of the values of the Society and it will continue to be an intrinsic part of the service provided.

Environment

The Society is committed to reducing the environmental impact of its activities, in particular seeking to source energy responsibly and to reduce energy consumption where possible. Further aims are to limit the amount of paper used and ensure recycling opportunities are maximised.

The directors understand the close link between these aims and the objective of the business to maintain an efficient and cost-effective organisation.

Significant progress has been made in recent years to reduce the amount of paper used by the Society. This has been achieved by investing in the technology and processes at the Society's print fulfilment centre which enables a 'just in time' approach to printing statutory and marketing materials. The reduction in quantities allowed by this investment is significant, reducing waste and cost in equal measure.

The Society has also reduced the amount of paper used in marketing literature, and encouraged a greater use of email communication.

The installation of smart meters across all Society offices has made it possible to identify energy usage patterns and potential efficiency savings as a result.

Awards

The strong performance of the Society has once again been recognised in a number of independently assessed awards.

'Your Mortgage' magazine awarded Coventry Building Society the title of 'Best Building Society' for 2012 – the second year running that the Society has won this award. It is based on information provided by mortgage intermediaries and their clients with the citation acknowledging the 'long term, good value of its mortgages and savings products, coupled with its superlative service'.

It is particularly important to the Society in this period of historically low interest rates that it does as much as it can to support savers. A number of awards reflect this emphasis including the Moneynet award for 'Overall Best Savings Provider 2012'.

This was matched by a number of other savings related awards including: What Investment Awards, 'Best Savings Account Provider', Lovemoney 'Best Interest Rate (Savings)', Moneywise 'Savings - Best for consistency of rates' and Moneynet 'Best Overall Current Account'.

RISK MANAGEMENT REPORT

Overview

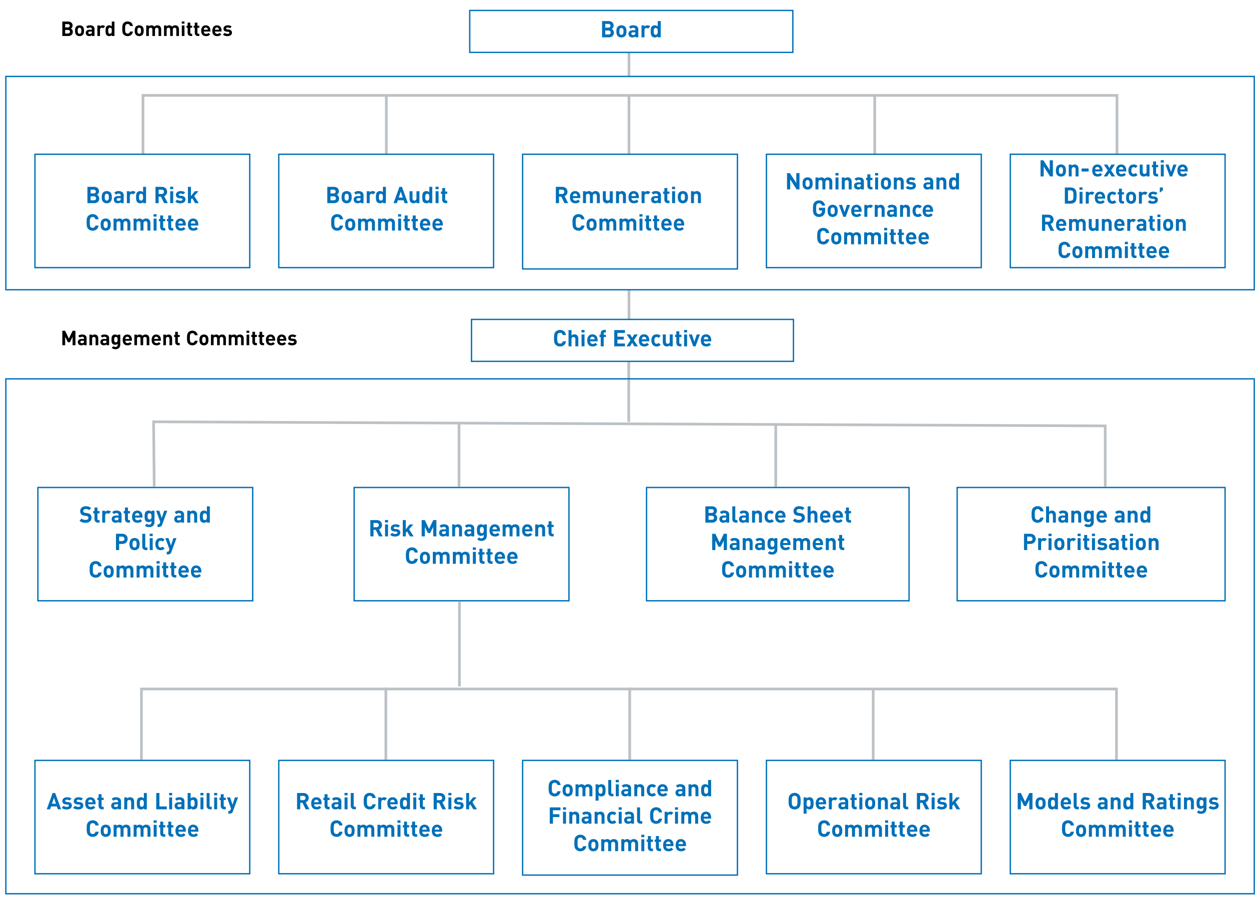
The Society is a mutual organisation run for the long-term benefit of its members. This objective is known throughout the Society as 'Putting Members First'. In keeping with this mutual status, the Board adopts a prudent approach to managing risk geared towards long-term value creation for the benefit of members. This low risk appetite is monitored and enforced through the Society's risk management framework described below.

Risk management structure

The Society's risk management structure is based on a three lines of defence model:

- First line of defence – risk management is primarily the responsibility of all managers and staff of the Society. Management have a responsibility to understand how risk impacts their area of the business and for putting in place controls or mitigating activities.
- Second line of defence – oversight is required to challenge managers and staff effectively in their performance of risk management activities and to provide risk management expertise. This is provided through risk support functions and risk committees. The Chief Risk Officer reports to the Chief Executive and has an independent reporting line directly to the Chairman of the Board Risk Committee.
- Third line of defence – the Society's internal audit function is responsible for independently reviewing the effectiveness of the Society's risk management structure and adherence to processes. The Head of Internal Audit reports to the Chief Executive and has an independent reporting line directly to the Chairman of the Board Audit Committee. The Board Audit Committee approves the work programme of internal audit and receives reports of the results on the work performed.

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



RISK MANAGEMENT REPORT

(continued)

Governance and oversight

Board committees

Details of the Board Committees can be found in the Directors' Report on Corporate Governance on pages 38 to 45.

Senior management committees

Strategy and Policy Committee
Chaired by the Chief Executive and comprised of the executive directors and senior management. This committee meets when required and deals with matters that fall outside the mandates of other committees or where matters are escalated for review by other executive committees or business areas.

Risk Management Committee (RMC)
Chaired by the Chief Risk Officer and comprised of the executive directors and senior management. This Committee ensures that risk is being identified and managed efficiently across the Society and that the Society's Risk Management Framework remains effective. The minutes of the Committee are presented to the Board Risk Committee along with a report prepared by the Chief Risk Officer.

The Society also has a number of sub-committees that are detailed below:

- **Asset and Liability Committee (ALCO)**
  Chaired by the Finance Director and comprised of executive directors and senior management. The Committee oversees the asset and liability risks faced by the Society, specifically market risk, wholesale credit risk and liquidity risk. Further it recommends to the Board, through RMC and the Board Risk Committee, key treasury policy changes and risk frameworks for approval. The minutes of the Committee are presented to the Board Risk Committee.
- **Retail Credit Risk Committee**
  Chaired by the Chief Risk Officer and comprised of the executive directors and senior management. This Committee monitors the management of retail credit risk across the Society and its subsidiaries, and the performance of the mortgage books to ensure compliance with limits approved by the Board. Further it recommends to the Board, through RMC and the Board Risk Committee, key lending policy changes and frameworks such as the retail credit risk appetite statement.
- **Compliance and Financial Crime Committee**
  Chaired by the Secretary & General Counsel and comprised of senior management. This Committee oversees regulatory conduct risk, compliance and financial crime policy and risk.
- **Operational Risk Committee**
  Chaired by the Head of Marketing and comprised of senior management. This Committee monitors operational risk, business continuity, safety and security in the Society. Further it recommends to the Board, through RMC and the Board Risk Committee, the operational risk appetite statement.
- **Models and Ratings Committee**
  Chaired by a non-executive director (Glyn Smith) and comprised of executive directors and senior management. This Committee monitors the performance of the Society's Basel II credit risk rating system and its use across the Society.

Balance Sheet Management Committee
Chaired by the Finance Director and comprised of executive directors and senior management. This Committee oversees the financial performance and balance sheet strategy of the Society, including product management, pricing and margin management of the retail savings and lending portfolios.

Change and Prioritisation Committee
Chaired by the Chief Executive and comprised of the executive directors and senior management. This Committee is responsible for prioritisation and approval of all projects, including project expenditure, in line with the Society's corporate plan.

Principal risks and uncertainties

The external environment is discussed in the Directors' Report and details the extent to which the Society has reported strong financial performance despite challenging macroeconomic conditions. One of the reasons for this is the Society's approach to risk management, and the monitoring of the impact that particular events may have on it. Within the 2012 interim financial statements, a number of themes were highlighted that continue to be key features of the environment:

- Depressed economic conditions
- Eurozone sovereign debt crisis
- Banking sector operational events
- Regulatory reforms

Depressed economic conditions
In 2012 the UK was reported once again to have entered recession, the so called 'double dip'. Whilst the reported GDP figures may yet be subject to revision it is clear that conditions are subdued and likely to remain so. The principal risks this creates for the Society are credit risk and house price risk. At the heart of its approach to lending, the Society will only enter into mortgage agreements with those customers who it believes can afford repayments even at higher rates, and adopts a supportive approach to those few that do experience difficulties, having entered into such agreements.

The Society regularly stress tests the projected performance of the mortgage book in more severely adverse conditions and a key feature of its approach to provisioning is that no reliance is placed on any future recovery of house prices, and realistic valuations are made for the likely proceeds received from forced sales in difficult conditions. The Board is confident that the Society's strong performance, relative to its peers, would be maintained whatever the outturn.

Eurozone sovereign debt crisis
This particular risk appears less likely at present but has been characterised by periods of concern around the points at which bailout funds are due and austerity measures required to be passed or met. In keeping with its low risk tolerance for wholesale credit losses, the Society has no exposure to peripheral EU countries and only 11% of its liquidity book is represented by assets where the counterparty is non UK based.

Should the eurozone break up and individual countries revert to original sovereign currencies (often referred to as redenomination risk) the Society's exposure would be to those with stronger underlying economies. As part of its stress testing programme the Society has modelled some of the possible second order impacts of a particular eurozone member default. Whilst this is difficult to predict with any certainty, the Board is confident the Society's position is mitigated to a level consistent with its risk appetite.

Banking sector operational events
It is clear from 2012 that in periods of stress the media attention and reputational impact of operational events is heightened. The Society recognises this and invests significant resources in ensuring the robustness of its systems and controls and ongoing monitoring. Key to establishing a low risk environment is the maintenance of a single core system, and following the acquisition of a mortgage book from Bank of Ireland the Society immediately and successfully transferred the assets onto its system. This follows a similar approach to the merger with Stroud & Swindon.

The Society is alert to emerging risks and assesses the likely impact. In addition detailed business continuity plans are maintained and regularly tested.

Regulatory reform
The agenda of regulatory reform continues to be full and congested. The responsibilities of the Financial Services Authority will be split in April 2013 between the Prudential Regulation Authority, which will supervise capital and liquidity, and the Financial Conduct Authority (FCA), which will regulate market conduct and customer treatment. The FCA will oversee regulatory reforms including those relating to the mortgage market (Mortgage Market Review – 'MMR'), and also the distribution of retail financial products (Retail Distribution Review – 'RDR'). Both have the potential to significantly alter the manner in which lenders and intermediaries interact with their customers and uncertainties remain concerning the impact they will have on the market.

The new global rules on liquidity and capital (Basel III) will be implemented in Europe by the Capital Requirements Directive and Regulation (CRD IV). It was originally expected that CRD IV would be released in its final form in June 2012 for implementation from 1 January 2013. The final regulation has been delayed and will now be considered by the European Parliament in March 2013. Certain key details are still unclear and implementation may be delayed until 2014. Nonetheless, the Society's programme of work, based on the draft rules, remains on track to deliver ahead of the regulatory requirements. Contentious elements of the CRD IV draft package still to be determined include the level of leverage ratio, and the details and powers for bank bail-ins.

The leverage ratio was originally intended to be a backstop measure. In assuming that the risk on a balance sheet is proportionate to the size of a balance sheet it ignores, and therefore penalises, the inherent strength within the balance sheets of many low risk building societies. This has been partially recognised by the European Parliament's Economic and Monetary Affairs Committee which has looked to amend the text on the leverage ratio, requiring different ratios for different business models, with a starting calibration of 1.5% for low-risk banking models (as would be anticipated for the Society). By contrast, the UK's Independent Commission on Banking (ICB) in September 2011 proposed a minimum leverage ratio of 4.06%. The UK government rejected this specific proposal. However, in December 2012 the Parliamentary Commission on Banking Standards agreed with the ICB and recommended that the level should be set by the Financial Policy Committee (FPC) and should be 'substantially higher' than 3%, albeit with longer transition period for building societies.

If the ratio were set at 3% or higher it has the potential to act as a primary constraint on low risk mortgage lenders even, as is the case with the Society, where strong underlying collateral exists. This proposed measure does not come into effect until 2018, and the Society is confident that compliant capital instruments will be available by this time. Should this not be the case, the Society retains significant scope to remain within the proposed requirements.

The CRD IV package still has a number of unanswered questions around the level of investor bail-in likely to be required by banks and building societies issuing debt. This includes some of the fundamental considerations such as the point of entry, eligibility, and the hierarchy of claims. These considerations are also included within the UK consultation on the 'Future of Building Societies' which proposes aligning ring-fenced banks with the Building Societies Act and which will extend to bail-in requirements.

Detailed rules on capital and liquidity will be developed by the European Banking Authority, which is developing a 'single rule book' including prudential requirements, supervisory standards and reporting requirements. These will make certain sections of the FSA's Handbook, including parts of BIPRU 12, redundant. This European dimension will play an increasing importance in the regulatory framework.

A new 'macro-prudential' regulator – the FPC – has been established in the UK to direct industry-wide application of rules in response to systemic weaknesses it has identified, including the setting of countercyclical capital buffers and sectoral capital buffers. This body has already had a significant impact in recommending changes to liquidity and capital rules and we expect this impact to increase. The equivalent European-level body, the European Systemic Risk Board may also start to have a similar impact.

Whilst this evolving external environment plays a fundamental part in determining the likelihood and impact of particular risks crystallising, the principal risks will always be inherent in the building society model. These principal risks are conventionally defined as:

- Credit risk
- Market risk
- Liquidity risk
- Operational risk
- Business risk

Each of these is described on the succeeding pages.

Credit risk

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

Retail credit risk

Lending

For a building society, this risk is most likely to present itself in the potential inability of borrowers to repay their mortgage. The Society's exposure to this risk is monitored and managed by a specialist department that reports to the Chief Risk Officer, and overseen by the Society's Retail Credit Risk Committee. The activities of and decisions made in the Retail Credit Risk Committee are overseen by the RMC and the Board Risk Committee.

The Retail Credit Risk Committee meets monthly, and is tasked with ensuring that the quality and mix of new lending and overall portfolio exposures are within the prudent limits and risk appetite set by the Board, and ensuring that adequate controls are in place to maintain the quality of lending. This includes setting, reviewing and monitoring lending policy, comprehensive credit risk management information and trend analysis on both new lending and the loan portfolio, including monitoring against available comparative data.

Retail credit risk is managed through a combination of an automated decision system and statistical modelling (including the use of credit scoring) that seeks to identify those customers who pose a greater risk of not repaying their mortgage, and the Society's underwriting process which seeks to ensure that customers only assume a debt that they can afford to repay, thereby safeguarding both themselves and the Society. This system assesses both the application and external credit bureau information against the Society's scorecard and lending policy rules, providing consistent lending decisions and ensuring that, where risk is higher, there is appropriate manual skilled underwriter intervention. There is a comprehensive quality assurance programme to monitor the quality of lending decisions and adherence to lending policy. Retail credit risk is further mitigated by the application of loan to value (LTV) policy rules, which form a key element of mortgage product design. This ensures the Society has prudent collateral levels, even in the event of a fall in property values.

The Society has a quantitative and qualitative retail credit risk appetite statement which is approved by the Board. Regular stress testing is undertaken which seeks to establish the extent to which losses may emerge under a range of macro-economic and specific stress scenarios and to ensure that the Society continues to remain within its retail credit risk appetite. These stress tests primarily consider the frequency and severity of default and house price movements as may be affected by economic events.

Arrears

The Retail Credit Risk Committee monitors arrears and the policy and strategy for recoveries. A specialist team works with borrowers in financial hardship or difficulty to resolve matters and each case is reviewed on its own merit. The overarching aim is to collect arrears and to regularise payments, using possession as a last resort or where it is the only credible option. Reasonable and realistic arrangements will be accepted, based on what the customer can afford, provided in the longer term there is a high degree of confidence the debt will reduce. Repossession of a property is only sought where all reasonable efforts to regularise matters have failed or the mortgage is unsustainable in the longer term. Regular reviews of the Society's arrears management function and processes are independently undertaken to ensure that borrowers are being treated fairly, appropriately and sympathetically and in line with established policies and procedures and regulatory guidance.

All loans one or more months in arrears are considered as past due or impaired and the Society has an established methodology for calculating impairment and providing for potential losses on these cases. This includes an assessment of the likelihood of default and possession and an estimate of the collateral value that will be realised at a future possession date. The Society makes prudent assumptions for those values and does not assume any future recovery in house prices. All assumptions are regularly reviewed.

Forbearance and Impairment

Forbearance occurs when, for reasons relating to the actual or apparent financial stress of a borrower the Society grants a concession, whether temporarily or permanently, to that borrower provided it is satisfied that the mortgage can revert back to sustainable terms within a reasonable period.

Forbearance is most commonly associated with the treatment of arrears cases, which are looked at on an individual case by case basis. Should borrowers find themselves in financial difficulty resulting in arrears, the Society will seek to help and work with them to resolve matters subject to the mortgage being put back on to a sustainable footing in the longer term.

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

- Arrangements, where monthly payments are maintained and the arrears are repaid over a period of time.
- Concessions, where it is agreed to accept the normal monthly payment, reduced payments, or in exceptional circumstances no repayments for a short period.
- Mortgage term extensions to reduce the amount of the monthly payment may be considered as part of a longer term solution, provided that payments will be sustainable over the life of the mortgage.

In rare cases, the Society may also capitalise arrears and schedule repayment of the balance over the remaining term of the loan when the period of financial difficulty has ended, provided that the customer has made at least six consecutive monthly payments and payments will be sustainable over the remaining life of the mortgage. Capitalisation will only be allowed once on each loan. In 2012, the Society capitalised arrears on 12 accounts, totalling £36,000.

As at 31 December 2012, £402.5 million of the Society's mortgage book (representing 1.8%) was in arrears and had been subject to some form of forbearance measure in the previous 12 months. The Society holds £9.4 million provision for such cases.

In relation to accounts not past due, recognising that arrears is not the only impairment indicator, the Society has put in place additional processes for dealing with requests involving a change in payment to ensure it is both reasonable and appropriate and to identify whether financial hardship is an issue. Where the change is at the request of the customer, there is no evidence of financial difficulty and the change is appropriate and within policy, the change is not considered as forbearance. A specialist team deals with any requests where it is considered there may be potential impairment and will assess requests individually.

During 2012, analysis has been undertaken, where forbearance has been granted or where there has been other potential impairment indicators or events, on accounts not past due. This analysis involved reviewing subsequent performance of up to date cases which had previously experienced an event that potentially indicated financial hardship. These events included accounts where payment holidays were granted on up to date accounts, where the customer was in temporary financial difficulty, accounts where direct debits had been cancelled or returned, and where payments were being made by the Department for Work and Pensions.

It was possible to conclude from this analysis that accounts which have experienced the above mentioned events have a higher propensity to become future arrears cases, but not so high that the assets are considered impaired. The balances on up to date accounts as at 31 December 2012 that had experienced forbearance totalled £148.2 million, 0.7% of the mortgage book. A collective provision of £0.2 million is held on the balance sheet for these cases reflecting the very low probability of default, the fact that over 95% of such assets remain up to date 12 months after the particular event, and also the high value of collateral held.

In addition, collective provisions have been raised for accounts not yet past due based on expected arrears and subsequent loss emergence, with appropriate management overlays. Collective provisions have also been raised where particular product types may be considered impaired due to market factors e.g. geographical location. These collective provisions amounted to £5.7 million (see note 13 to the Accounts).

Details of the Society's exposure to retail credit risk are contained in note 39 to the Accounts.

Wholesale credit risk

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

Treasury exposures and limits are focused in the main on strong UK institutions, with additional limits extended to a small number of highly rated banks in Europe and other developed economies such as Australia and Canada. Limits are set in line with a Board approved wholesale credit policy, which sets maximum limits taking into account internal analysis, external credit ratings, country of domicile and any other relevant factors. All credit limits require Board approval, and are subject to an initial assessment of the creditworthiness of the counterparty, with the approved limit then subject to at least an annual review. Exposures are reviewed on a daily basis to ensure that they remain within the approved limits.

Ongoing developments for Treasury counterparties are closely monitored by a specialist credit team, and are reported to, and reviewed by, a dedicated Treasury Credit Committee. This Committee meets weekly and is chaired by the Chief Risk Officer. The Committee is empowered to take immediate action to reduce or suspend limits where this is warranted by adverse changes in the creditworthiness of counterparties or market or local developments. The Committee reports through ALCO to the RMC and the Board Risk Committee.

Details of the Society's exposure to wholesale credit risk are contained in note 40 to the Accounts.

Market risk

Market risk is the risk that the value of income derived from the Society's assets and liabilities may change adversely as a result of changes in interest rates, foreign exchange rates or house prices. The Society's policy is to manage these risks prudently, which is ensured through the setting of limits by the Board. The Society ensures compliance with these limits through a combination of matching assets and liabilities with off-setting interest rate or currency characteristics, by the use of derivative financial instruments such as interest rate swaps and caps, foreign exchange swaps and foreign exchange forward purchase contracts, and through restrictions on the amount of lending undertaken at higher loan to value. Control of market risk exposure is overseen by ALCO, which reports to the RMC and the Board Risk Committee. The Society has strengthened its second line of defence for oversight and independent assessment of these market risks during 2012 through the establishment of a Balance Sheet Risk team reporting to the Chief Risk Officer. The most significant elements of market risk for the Society are interest rate risk, foreign currency risk and house price risk, each of which are described below.

Interest rate risk

Interest rate risk arises from the different interest rate characteristics of the Society's mortgages and savings products and from other financial instruments. Fixed and capped rate mortgages and fixed rate savings products expose an organisation, that principally operates within a variable rate environment (such as the Society) to the risk that interest rate fluctuations could cause either a reduction in interest income or an increase in interest expense relative to other interest flows.

Where the Society has issued fixed rate mortgages, the risk is that a general increase in interest rates would leave the Society facing higher interest expense, but without a compensating increase in interest income. In these circumstances, the Society would typically take out an interest rate swap with a counterparty bank under which the Society's fixed rate income is exchanged for one based on a variable rate which would be expected to follow the general pattern of interest rate movements and thereby reduce the Society's exposure. Similarly, in cases of issuing fixed rate savings products, the Society would typically take out an interest rate swap under which it receives a fixed rate of interest and pays a variable rate. With capped rate mortgages, the risk is that if the rates increase above a pre-determined level, the Society will be unable to increase its mortgage rate on these products to compensate. In these circumstances, the Society would typically purchase a rate cap that will pay a variable rate if an agreed index rate (for example, LIBOR) exceeds a certain level. The Society has a series of Board approved limits that ensure the impact of a change in general interest rates has limited effects on the net interest income generated. In addition, the Society regularly forecasts the impact of movements in the Bank of England Base Rate on the Society's balance sheet to ensure any potential adverse impact can be anticipated. This information is reported to ALCO. RMC and the Board Risk Committee every month.

Variable rate instruments may also cause interest rate risk where the underlying basis of the rate differs from the prevailing variable rate of the balance sheet. The risk is driven from market influences on the different basis which may not operate in an equal manner, creating uneven changes in the rates (e.g. Bank Base Rate and LIBOR). This risk is characterised as basis risk and is subject to limits, regularly monitored, stress tested, and reported monthly to ALCO, RMC and the Board Risk Committee.

The Society does not trade or take speculative positions on derivatives.

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

The Society has a very low risk appetite for foreign currency risk and manages this through the use of currency swaps and foreign currency forward contracts and also, where appropriate, by the matching of foreign currency liabilities with assets denominated in the same currency.

Redenomination risk is risk that in the event that the euro ceases to be traded or a particular country leaves the euro, previously matched foreign exchange positions, designated in euros, become unmatched when these are exchanged for an alternative currency (valued against a local currency equivalent). The Society has very little redenomination risk with all euro denominated exposure held in highly rated UK, Dutch or German counterparties, the predominance being UK entities.

Details of the Society's exposure to interest rate and foreign currency risk are contained in note 38 to the Accounts.

House price risk
Most significantly this risk arises from the value of the property forming the security for a mortgage being insufficient to repay the loan in the event of default and subsequent repossession. The Society manages this risk through a combination of prudent loan to value limits at inception and ongoing monitoring to ensure that bad debt provisions are sufficient to cover the potential losses that may arise in repossession situations.

With respect to 'lifetime mortgages', house price risk also arises from the 'no negative equity' guarantee, whereby the borrower is guaranteed that the amount recoverable by the Society at the end of the mortgage will not exceed the value of the property.

Under these loans, the borrower receives an advance but makes no payments of interest or principal until the loan is redeemed. The interest is added to the loan and recovered by the Society when the loan is redeemed. The 'no negative equity' guarantee therefore exposes the Society to the risk that the value of the property at the time of redemption is lower than the loan plus accumulated interest. The Society has managed this risk by granting loans only at relatively low loan to value ratios, subject to the age of the borrower, and through the use of statistical modelling to stress potential exposures within acceptable prudent limits. Only 1.5% of the Society's outstanding mortgage balances have been advanced on this type of product. The Society does not currently offer these products to new applicants.

The risks presented by house price movements are evaluated through stress testing and monitored by the Retail Credit Risk Committee and ALCO and, through these Committees, by the RMC and the Board Risk Committee.

Liquidity and funding risk
The essence of the Society's business is 'maturity transformation', whereby the Society borrows for relatively short terms, and lends on mortgages for much longer periods. This mismatch generates liquidity risk, the risk that the Society has insufficient funds to meet its immediate obligations and maintain day-to-day operations. This could manifest itself in an inability to raise new wholesale funding and replace existing funding as it matures, due to a severe liquidity crisis in the money markets, or in a loss of member confidence that causes a 'run' on retail funds. The Society maintains at all times liquidity resources which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due.

Funding risk is the risk that the Society is unable to obtain funds which are sufficiently long dated and diverse such that liquidity risks rise to unacceptable levels impeding its ability to operate economically. Funding risk is managed by ensuring that reliance on any single funding provider is minimised. This is principally achieved by limiting wholesale funding to a level lower than that imposed by both the building society nature limits and by the regulator. Concentration to retail customers is managed through having a broad customer base spread throughout the UK. The Society is predominantly funded through retail deposits, reflecting our long-term preference and nature as a building society. Wholesale funding is used to provide diversification and value to members. Funding is managed centrally enabling it to be used to fund assets throughout the business. In the event of a stress event the Society has a detailed Contingency Funding Plan which is approved by the Board annually and subject to regular testing.

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

The Society's appetite for liquidity risk is set out in the Liquidity Risk Tolerance Statement which has been adopted by the Board following a recommendation from the Board Risk Committee. The Tolerance Statement is kept under regular review and revised in line with changes to the risk environment and regulatory context. The Tolerance Statement was last revised in September 2012 and is set with reference to the ability to meet all cash requirements throughout a prolonged combination stress as defined below.

The Board determines the level of liquidity resources required to support the Society's business objectives through undertaking an annual Individual Liquidity Adequacy Assessment (ILAA) as part of the development of the Corporate Plan. In this process the Society reviews its liquidity risk management framework, together with the financial projections developed for the Corporate Plan, in order to assess the significant risks to which it is exposed and the adequacy of its risk assessment, management and liquid resources. The Society's internal audit function reviews the accuracy and consistency of the financial information included within the ILAA.

The ILAA considers a range of time horizons, in particular intra-day, one day, two weeks, three months and five years. The ILAA is compliant with the BIPRU 12 regime that was introduced by the FSA in 2010. The main 'combination stress' assessed in the ILAA estimates the impact from a two week Society-specific stress combined with a three month market-wide stress.

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

Liquidity is held for each of the principal drivers of liquidity risks:

- Withdrawal of on-demand and maturing retail deposits
- Inability to issue or roll-over maturing wholesale funding
- Funding concentration in particular markets or counterparties
- Requirement to honour extant mortgage applications and maintain a lending franchise
- Requirement to fund intra-day cashflows
- Trapping of liquidity within covered bonds and RMBS programmes
- Trapping of liquidity in particular currencies
- Downgrade requirements associated with the covered bonds and RMBS programmes
- Limits on the cash that can be generated from liquid assets in a liquidity event
- Ability to use contingent liquidity (self-generated assets) to generate cash in a liquidity event

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

- The Society's credit ratings are downgraded by two long-term notches, from A3/P-2 to Baa2/P-3 for Moody's and from A/F1 to BBB+/F2 for Fitch.
- Long-term wholesale funding matures on its earliest call date and no additional issuance occurs.
- Severe retail outflows occur having regard to the mix of deposits, in particular those that are considered to be most sensitive to a stress event. Assumptions are informed by an analysis of the experience of, among others, Northern Rock, Icesave (an Icelandic bank that experienced a period of stress in 2008) and Bankia (a Spanish bank that experienced a period of stress in 2012).
- Mortgage applications that have been received by the date of the stress are honoured through to completion at the normal completion rate.

The ILAA is reviewed by the FSA through their Supervisory Liquidity Review Process (SLRP), an in-depth periodic review and assessment of a firm's quantitative and qualitative liquidity risk management processes and operations. Following the SLRP, the FSA provides 'Individual Liquidity Guidance' (ILG), which sets out the amount and composition of liquidity that the FSA requires the Society to hold. This measure uses the same time period of three months and assesses similar liquidity requirements. The Society is required to meet a set percentage of the calculated Liquidity Requirement through LAB assets (the first and second categories of liquidity set out on page 19). During 2012 this was revised by the FSA to allow up to 10% of the requirement to be satisfied through mortgage collateral pre-positioned at the Bank of England including approved mortgage portfolios and self-issued covered bonds (the fourth category set out on page 19). The original intention was that the requirement would increase to 100% over time. However, this has now been suspended pending the replacement of the ILG regime with the Basel III equivalent, the Liquidity Coverage Ratio, which is based on a one month time period.

The requirement to meet this guidance primarily through a tightly defined Liquid Assets Buffer has resulted in a greater proportion of the liquidity book being represented by UK Government securities or invested with the Bank of England via a reserve account. Whilst these assets realise a relatively low yield, this reflects the very low credit risk represented by a highly rated sovereign entity, such as the UK Government, and ensures the assets can readily be converted into cash to meet liabilities, as they fall due.

Day-to-day management of the Society's liquidity position is the responsibility of the Liquidity Planning department working closely with the Treasury Front Office and overseen by the Society's Balance Sheet Risk department. Adequacy is assessed against a variety of limits and measures to ensure compliance with Board approved policy. The frequency of the assessments varies from daily to monthly dependent on the measure. Liquidity positions and the results of the combination stress and ILG are monitored regularly by ALCO and, through this committee, by the RMC, Board Risk Committee and the Board. All limits were in surplus as at the year end and throughout the year.

Operational risk

Operational risk is the risk of loss arising from inadequate internal processes, people and systems or from external events. These risks are managed as an integral part of the operation of each of the Society's business units. Management has a responsibility to understand how operational risk impacts the area of the business for which it is responsible, and for putting in place controls or mitigating activities, overseen and challenged by the Operational Risk team which acts as the second line of defence. This team also ensures co-ordination of the Society's operational risk assessment, risk event management process, operational risk stress testing, and other associated activities and is overseen by the Operational Risk Committee, RMC and the Board Risk Committee.

Key operational risks are regularly reviewed and considered more broadly in the context of potential linkages to reputational risk, regulatory and compliance risk, change risk, legal risks, information technology and systems risk, and business risk. Further resource has been dedicated to this area and it now includes specialist expertise in information technology.

The Society regularly stress tests such risks better to understand and manage the impact of their occurrence and quantification to support regulatory capital allocation. Over the last 18 months the Society has developed increasingly sophisticated scenario based stress testing to understand how an operational event may evolve and what degree of severity would be necessary to cause material loss or even 'break' the Society. For these more severe scenarios the Society has developed a Recovery and Resolution Plan that details options available to the Society and any obstacles to resolution.

Conduct Risk

Conduct risk, within financial services, refers to the way in which firms treat their customers, their behaviour towards each other and the way they operate in the market. The Society has articulated its commitment to its customers and its high business standards through its 'Putting Members First' principles. The principles have helped ensure the fair treatment of members. They provide a clear understanding and expression of the Society's purpose, which informs strategy, day-to-day decision-making and operations, by all members of staff across the organisation. The Society has developed a Conduct Risk Framework through which it has identified potential conduct risks facing the Society and the measures of control to manage and monitor such risks.

The Society is committed to meeting its legal and regulatory responsibilities and has a team dedicated to developing business standards and policy, overseeing regulatory change and monitoring compliance. In particular the Society is focused on delivering fair customer outcomes in the development and distribution of its products and services.

Conduct Risk is overseen by the Compliance and Financial Crime Committee which is chaired by the Society Secretary and General Counsel and reports to RMC and the Board Risk Committee.

Financial crime
Financial crime is managed by the Society's experienced Financial Crime team which is part of the risk management function, reporting directly to the Chief Risk Officer and overseen by the Society's Compliance and Financial Crime Committee.

This reflects the Society's focus on Financial Crime as a separate discipline with dedicated expertise to respond professionally to the evolving and substantial threat to the security and the safe operation of all financial institutions. Given the rapidly growing developments in technology, cyber-crime and communication and social media, the Society pays close attention to the source, likelihood and impact of financial crime generally and the various ways in which this could manifest itself. As such, the Society continues to increase investment in resourcing its Financial Crime team and its monitoring and control systems to prevent increasingly sophisticated criminal attacks.

Security and safety
The Society has a duty of care to its staff, members and visitors whilst present on Society premises. The Society has in place comprehensive health and safety polices and a compliance regime which includes internal and external inspection. This work is overseen by the Security and Safety Committee which is chaired by an executive director and reports to the Operational Risk Committee, RMC and Board each month.

Business continuity
The Society has developed Business Continuity Plans to manage situations in which buildings, systems or significant staff are unavailable, for example in the event of a flu pandemic or the loss of utilities. The Society's Business Continuity Plan is overseen by the Business Continuity Committee which reports into the Operational Risk Committee and is subject to regular testing.

Business risk
Business risk encompasses those aspects of the external environment that have the potential to affect the Society's business model. This is particularly relevant in the context of the multiple major regulatory initiatives currently being proposed or implemented, including those covering the FSA's move towards its twin peaks regime, the Basel III driven capital and liquidity requirements which will form the basis of the capital requirements regulation and capital requirements directive, banking reforms following a turbulent year of operational events for the major UK banks, and proposed alignment of Building Society legislation with the outcomes from the Vickers report. The Society has invested in additional expertise in its compliance and business change areas to manage the implementation of any new initiatives.

Capital

The primary purpose of capital is to absorb any losses that might arise from credit losses on lending, trading losses due to pressure on net interest income or expenses and losses from other adverse events such as operational incidents. The Board determines the level of capital required to support the Society's business objectives through undertaking an annual Internal Capital Adequacy Assessment Process (ICAAP) as part of the development of the Corporate Plan. In this process the Society reviews its risk management framework, together with the financial projections developed for the Corporate Plan, in order to assess the significant risks to which it is exposed, the adequacy of its risk management, and the capital resources it needs to support the risk exposures over the planning horizon.

An allocation of capital is made for each of the following risks facing the Society:

- Credit risk from mortgages and other retail lending
- Credit risk from liquidity and derivatives
- Operational risk
- Concentration risk
- Interest rate risk
- Pension obligation risk.

This allocation is based on regulatory requirements for credit risk and operational risk (Pillar 1) with additional allocations to reflect the degree of residual risk that remains after allowing for the effect of the risk controls operated by the Society (Pillar 2A).

This initial level of capital allocation is based on a 'point in time' assessment from the ICAAP date (30 September). A further capital allocation is made (Pillar 2B) which is a 'capital planning buffer' giving assurance that the Society can meet capital requirements under stressed conditions. The calculation of the capital planning buffer is a forward looking process and examines the Society's business plans in detail, and subjects them to economic and operational stress tests over a five year planning horizon. The severity and duration of the stress scenarios used is determined by the Society with reference to the 'anchor stress scenarios' published by the FSA. In particular the Society will incorporate second order effects of the stress scenarios including the likelihood of the spread between mortgage rates and Base Rate being compressed if interest rates rise significantly from their current level. This stress testing enables the Society to estimate the magnitude of losses that may be incurred, determine the impact of these losses on the stock of capital available to the Society, and compare this with the additional capital requirements that may be needed in a stressed environment.

The impact of the stress testing described above is compared with the ability of the Society to react to stressed conditions by modifying its business plans. The Society retains the ability to control the rate of asset growth and therefore has the flexibility necessary to react to stressed conditions by reducing the overall capital requirement, and so maintain adequate capitalisation. Furthermore, the Society maintains a significant proportion of the mortgages and retail savings on the balance sheet at administered interest rates. This provides the Society with the option of rebasing the interest margin if necessary in order to maintain an adequate level of capital generation. The capital planning buffer is set having regard to both the impact of the stress tests and the ability of the Society to undertake a credible scale of management action in response to the stress scenarios.

The ICAAP is used by the FSA in its Supervisory Review and Evaluation Process (SREP) through which it sets the Group's capital requirements, expressed as Individual Capital Guidance (ICG). The ICG directly incorporates the Basel II transitional floor being either the higher of the floor or the scaled Pillar 1 requirement. The FSA adds a capital planning buffer to the ICG to ensure that the requirements may be met throughout the planning horizon.

The ICAAP is reviewed by the Board Risk Committee before submission to the Board for formal approval as part of the corporate planning process. The Society's internal audit function reviews the accuracy and consistency of the financial information included within the ICAAP document.

Capital levels for the Group are reported to and monitored by the Board on a monthly basis. The Group continues to be strongly capitalised and maintains its capital substantially above its regulatory requirements. The Group's core tier 1 capital ratio is the highest reported by any top 10 building society or mutual lender and the Board believes this reflects the low risk profile of the Society's assets.

Further information on capital is available within the Directors' Report (see pages 15 to 18).

Further details of risk exposures are available in our Pillar 3 Disclosures on the Society's website: thecoventry.co.uk/pillar3

THE DIRECTORS AND SECRETARY

Bridget Blow, Deputy Chairman and Senior Independent Director (63)

Bridget Blow has been a non-executive director since 2007. As an experienced company director, Bridget has a strong information technology background, having been Chief Executive of ITNET plc. She is a past president of the Birmingham Chamber of Commerce and Industry and a non-executive director of Birmingham Hippodrome.

Bridget was a non-executive director of the Bank of England between 2000 and 2005.

Bridget is chairman of Trustmarque Group.

Bridget was the Society's Deputy Chairman in 2009 until May 2012 and subsequently reappointed into this role on 1 January 2013. She is also Senior Independent Director, Chairman of the Society's Remuneration Committee and a member of the Board Audit Committee and the Nominations and Governance Committee.

Roger Burnell (62)

Roger Burnell joined the Board as a non-executive director in 2008 and is a Chartered Accountant with over 25 years' senior executive experience. He worked as Finance Director and Managing Director of several businesses within the Thomson Travel Group before becoming Group Chief Operating Officer in 1998.

Since retiring from his executive roles Roger has continued to work at Board level through a number of non-executive directorships, including previously as Chairman of International Life Leisure Group, Chairman of The First Resort and Chairman of HomeForm Group. Roger is currently Senior Independent Director of Thomas Cook Group plc.

Roger is Chairman of the Society's Board Risk Committee and a member of the Board Audit Committee.

Gill Davidson, Secretary and General Counsel (47)

Gill Davidson is a qualified solicitor and joined the Society in 2011 following over 10 years working in financial services. She started her career at Pinsent & Co in Birmingham in 1987 and has subsequently undertaken a number of different roles, including Secretary to another building society, before joining the Society.

Gill is the principal legal advisor to the Board and is also responsible for compliance oversight of regulatory conduct risk and governance. In addition to her role as a member of the senior executive team she serves as Secretary to the Board and all its Committees and is also Secretary to the Trustees of the Society's pension scheme.

Colin Franklin (57)

Colin joined the Society over 33 years ago and has held line management responsibility for a number of areas including the branch network, operations and sales.

Joining the Society's executive team in 2005, Colin was appointed to the Board as Director of Sales and Marketing in 2009, with responsibility for sales operations, distribution, product development and marketing. He is also Managing Director of Godiva Mortgages Limited, the Society's intermediary lending subsidiary.

Peter Frost, Chief Operating Officer (47)

Peter Frost joined the Board in November 2012 as the Society's Chief Operating Officer.

A graduate of Liverpool University, Peter has over 20 years' experience in financial services, most recently with Barclays where he was Operations Director for the UK Retail Bank.

Peter has also held a number of non-executive directorships including Vaultex and iPSL.

Peter is a member of the Board Risk Committee.

Ian Geden (59)

Ian Geden has been a non-executive director since 2008. He has a first class honours degree in Horticulture from the University of Worcester and is a member of the Board Audit Committee and the Remuneration Committee.

Most of his 30 years' financial services experience has been in the mutual sector, including NFU Mutual where he was Chief Executive before retiring at the end of 2008. Ian was also Vice Chairman of the Association of British Insurers (ABI) and was Chairman of the Association of Mutual Insurers. Ian is a non-executive director of The Police Mutual, Faraday Reinsurance Limited and Faraday Underwriting Limited Syndicate 435.

John Lowe (40)

John Lowe joined the Society in 2007, initially to manage the Corporate Planning and Product Development functions, before assuming the role of Deputy Finance Director in 2009. He has been a member of the Society's Board since 2010 when he was appointed to the role of Finance Director.

A graduate of Oxford University and a Chartered Accountant, having qualified with Deloitte, John has over 15 years' experience of financial services gained across a broad range of businesses. He is a member of the Board Risk Committee and Non-Executive Directors' Remuneration Committee.

Ian Pickering, Chairman (57)

Ian Pickering joined the Society's Board as a non-executive director in 2005 and was appointed Chairman of the Board on 1 January 2013. He is also Chairman of the Nominations & Governance Committee and a member of the Remuneration Committee and Non-Executive Directors' Remuneration Committee.

A graduate of Cambridge University, Ian is a qualified Chartered Accountant and has worked in senior positions in the engineering industry for much of the last 25 years and was formerly a Chief Executive of Manganese Bronze Holdings plc. Prior to this he was a director of the Dennis Group plc.

Ian is a non-executive director of Latchways plc whose Audit Committee he chairs.

Fiona Smith (54)

Fiona Smith joined the Board as a non-executive director in 2002. Fiona is a Solicitor and was General Counsel and Company Secretary of Severn Trent plc from 2006 until 2011. Prior to this she was General Counsel and Company Secretary at National Grid plc, where she worked for 15 years, and then at Transport for London.

In December 2012 Fiona was appointed General Counsel for National Employment Savings Trust (NEST).

Fiona is a member of the Board Risk Committee and the Remuneration Committee.

Glyn Smith (60)

Glyn Smith joined the Board in 2010, following the merger with Stroud & Swindon Building Society, where he was also a non-executive director. He has over 30 years' experience in the financial services sector, most notably as a senior executive at Barclays Bank PLC and as Finance Director of Portman Building Society.

Glyn is a graduate of Cambridge University, a Chartered Accountant and member of the examinations team for the Institute of Chartered Accountants in England and Wales.

Since 2003, he has worked at board level through a number of non-executive directorships, including Domestic & General Group PLC, Covent Garden Market Authority and two Primary Care Trusts.

Glyn is Chairman of the Board Audit Committee and the Models & Ratings Committee. He is also a member of the Board Risk Committee.

David Stewart, Chief Executive (47)

David Stewart is a graduate of Warwick University and qualified as a Chartered Accountant with KPMG. In 2002 he joined the Board as Finance Director, before assuming Board responsibility for the Sales and Marketing functions in 2004. He was appointed Chief Executive in 2006.

Prior to joining the Society, David gained financial services experience at DBS Management plc where he was Group Finance Director and then Group Chief Executive.

David serves on the Council of the Building Societies Association and is a member of both the Chairman's and Executive Committees of the Council of Mortgage Lenders.

David is Chairman of the Non-Executive Directors' Remuneration Committee and a member of the Board Risk Committee and the Nominations and Governance Committee.

DIRECTORS' REPORT ON CORPORATE GOVERNANCE

The Board is accountable to the Society's members for the operation of the Society and places the highest priority on good corporate governance.

This report explains how the Board applies the principles of the UK Corporate Governance Code, (the Code), formerly the Combined Code which was updated in 2010, issued by the Financial Reporting Council, and the BSA Guidance for Building Societies on the Code. The Board has considered the requirements of the Code and will continue to comply in a manner which is proportionate to the Society's size and scale. Where the provisions of the Code and any revisions to it have not been adopted an explanation is provided below.

A further updated version of the Code will apply for financial years commencing on or after 1 October 2012 and this has been taken into account, to the extent that it has been considered appropriate to do so, in this report.

The Code requires disclosure of the Society's business model and strategies for delivering the objectives set by the Board and these are addressed in the Business Review (see Chairman's Statement (pages 2 and 3), Chief Executive's Review (pages 4 to 12) and Directors' Report (pages 13 to 22)).

The Board of Directors

The Society's Rules detail the appointment process for directors and require that the Board comprises not less than six, nor more than 12 directors. The Board has determined that its current composition is appropriate. The Board currently comprises a Chairman, five independent non-executive directors and four executive directors.

The following persons served as directors of the Society during the year: Bridget Blow, Roger Burnell, Colin Franklin, Peter Frost (since 1 November 2012), Ian Geden, David Harding, John Lowe, Ian Pickering, Fiona Smith, Glyn Smith and David Stewart. David Harding retired as a director on 31 December 2012.

No director has any interest in the shares or debentures of any associated body of the Society.

The Board has a formal schedule of matters that are reserved to it, and it has also delegated authority in other matters to a number of Board Committees, as described below. The Board has set clear terms of reference for these committees and has clearly documented delegated authority to the executive directors and senior management together with reporting systems for financial results, risk exposure and control assessment.

The Board applies principles of good governance by adopting the following procedures:

- the Board's role is to set the Society's culture and values, business strategy, risk appetite, review performance, and ensure that the necessary resources are in place for it to meet its objectives. The Board also has a general duty to ensure that the Society operates within its Rules, relevant laws, rules and guidance issued by relevant regulatory authorities and that proper accounting records and effective systems of internal control are established, maintained, documented and audited. In particular the Board's role is to provide overall direction to the Society and to safeguard the interests of its members. Other powers are devolved to the executive directors and senior management;

- the Board meets monthly (except August), and also holds an annual strategy review meeting. The non-executive directors also meet, without executive directors present, at least once a year;

- the size and composition of the Board and the senior management team is kept under review to ensure that there is adequate succession planning for executive and non-executive directors and that the Board has the appropriate skills and experience for the direction of the Society's activities;

- directors receive accurate, timely and clear information and it is the responsibility of the Chairman to ensure that this information is considered by the Board;

- the Chairman also ensures that, on appointment, non-executive directors receive a comprehensive tailored induction programme that covers the Society's business and regulatory environment. Non-executive directors update their skills, knowledge and familiarity with the Society through presentations by senior managers and by attending relevant bespoke internal and external courses; and

- all directors have access to the advice and services of the Secretary, whose appointment is a matter for the Board. The Secretary is responsible for ensuring compliance with Board procedures and advising the Board, through the Chairman, on governance related matters.

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

Set out in the table below are details of the directors during 2012 and their attendance record at Board meetings and relevant Board committee meetings during the year.

Name	Title	Number of Board Meetings – 11	Number of Board Audit Committee Meetings – 5	Number of Board Risk Committee Meetings – 11	Number of Nominations and Governance Committee Meetings – 5	Number of Remuneration Committee Meetings – 4
Ian Pickering	Chairman (appointed 1 January 2013)	11	5	11	4[3]	
David Harding	Chairman (resigned 31 December 2012)	11			5	4
Bridget Blow	Deputy Chairman	11	5		5	4
Roger Burnell	Non-executive director	11		11		4
Colin Franklin	Sales and Marketing Director	10				
Peter Frost	Chief Operating Officer (appointed 1 November 2012)	2[1]				
Ian Geden	Non-executive director	10	5			4
John Lowe	Finance Director	11		11		
Fiona Smith	Non-executive director	11		10[2]		4
Glyn Smith	Non-executive director	11	5	11		
David Stewart	Chief Executive	11		10	5	

1. Appointed to the Board on 1 November 2012 – maximum number of Board Meetings is 2.
2. Appointed to the Board Risk Committee on 22 February 2012 – maximum number of Meetings is 10.
3. Appointed to the Nominations and Governance Committee on 23 May 2012 – maximum number of Meetings is 4.

During 2012 the Board established a Non-Executive Directors' Remuneration Committee which met, for the first time, in January 2013.

Non-executive Directors

In the opinion of the Board, Bridget Blow, Roger Burnell, Ian Geden, Ian Pickering, Fiona Smith and Glyn Smith are independent in character and judgement based on guidance in the Code. The Board considered Mr Pickering satisfied the test of independence at the time of his appointment as Chairman on 1 January 2013.

Bridget Blow undertakes the duties of Senior Independent Director insofar as they are relevant to a mutual organisation. The role of the Senior Independent Director is to provide support to the Chairman in his role of leading and managing the Board, ensuring the views of members and other key stakeholders are conveyed and in conjunction with the other non-executive directors, evaluating the performance of the Chairman and leading succession planning for the Chairman.

Chairman and Chief Executive

The roles of the Chairman and Chief Executive are held by different people and are distinct in their purpose.

The Chairman is responsible for leading the Board and ensuring that it acts effectively. The Chief Executive has overall responsibility for managing the Society and for implementing the strategies and policies agreed by the Board.

David Harding was re-elected Chairman on 23 May 2012, and Ian Pickering was elected Deputy Chairman. Ian Pickering and Bridget Blow were elected by the Board, at its meeting on 19 December 2012, to be Chairman and Deputy Chairman respectively with effect from 1 January 2013.

Performance evaluation

The performance of the directors is appraised by the Chairman. The Chairman's performance is reviewed by the rest of the Board, in the absence of the Chairman.

The Board also periodically reviews its own performance. Towards the end of 2011 the Chairman commissioned Praesta Partners LLP to undertake an externally facilitated Board Effectiveness Review to look at the way the Board was working, particularly given the FSA's increasing requirements of building society directors. The Review confirmed that the Board operated effectively and made certain recommendations as to how the Board Committee structure might be improved. These recommendations have been substantially introduced during 2012. A further review of the Board's performance both collectively and as individuals, will be undertaken during 2013.

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

Appointments to the Board

The appointment of new directors is considered by the Nominations and Governance Committee which makes recommendations to the Board. In accordance with Rule 25 of the Society's Rules, all directors are subject to election by members at the AGM following their appointment or, where applicable, at the next following AGM. In addition, all directors must receive approval from the FSA as an approved person in order to fulfil their controlled function as a director.

In considering appointments to the Board the directors recognise and value the contribution that may be made from individuals with a broad range of skills and professional and business experience. During 2012 the Board have considered the issue of diversity and inclusion, from a Board and a Society wide perspective. The Board has taken note of the public debate on the subject of board diversity, notably on gender and the representation of women on the boards of companies. The Board has concluded that it is not in the interests of the Society to establish quotas or targets for the composition of the Board, as the overriding selection criteria is to appoint the best candidate. The Board is, however, committed to achieving a composition of the Board as diverse as possible, as appropriate.

Under Rule 26, directors have to submit themselves for re-election at least once every three years.

The directors retiring by rotation are Bridget Blow, Colin Franklin, Ian Pickering and Fiona Smith.

In February 2012, the Board, excluding for this purpose the Chairman, conducted a review to assess David Harding's performance as Chairman. They confirmed that he has led the Board effectively through a period of transition and difficult market conditions during which time the Society has performed extremely well.

Following the announcement by David Harding of his intention to retire on 31 December 2012, the Board's Nominations and Governance Committee undertook a comprehensive search, through using the services of an external firm, The Zygos Partnership, to identify suitable candidates for the role of Chairman. A number of external candidates and an internal candidate were shortlisted and interviewed by members of the Board.
At the conclusion of the search, on 23 May 2012, the Board, excluding for this purpose, Ian Pickering, unanimously confirmed the appointment of Ian Pickering as Deputy Chairman with immediate effect and his selection as Board Chairman following the planned retirement of David Harding on 31 December 2012.

The Board has decided unanimously to recommend Peter Frost, who joined the Board on 1 November 2012 as Chief Operating Officer, for election as director and the following directors for re-election by the members at this year's AGM:

Bridget Blow
Colin Franklin
Ian Pickering

Fiona Smith will not be standing for re-election at this year's AGM and will retire from the Board immediately following the AGM.

The Board has considered the provisions of the Code relating to re-election of directors, and does not feel that it would be appropriate, at present, to submit the entire Board for annual re-election by the members. The Board will continue to keep under review the appropriateness of the Code's provisions on the annual election of directors.

In addition to attendance at Board and committee meetings, as detailed below, and meetings with senior management and branch visits, non-executive directors are required to complete a detailed induction programme (on appointment) and to participate in director training in order to keep abreast with new regulatory requirements and some of the more technical aspects of the role. Non-executive directors are also encouraged to engage with the Society's members through the AGM process, the Members' Council Meetings and the Society's programme of member roadshows.

Board Committees

The Board has established a number of committees that have their own terms of reference. Details of the principal Board Committees, including their membership, are set out below.

Board Risk Committee

The Board Risk Committee assists the Board in fulfilling its oversight responsibilities for risk management across the Society. In particular the Committee undertakes the following:

- oversees and advises the Board in relation to current and potential future risk exposures to the Society, including determination of risk appetite, risk limits and tolerances across the full range of risks to which the Society may be exposed;
- satisfies itself on the design and completeness of the Society's internal control and assurance framework relative to the risks that it faces including culture, policy, processes, structure and systems;
- reviews major initiatives, such as acquisitions or change projects, and seeks assurance that appropriate due diligence has been carried out and that any associated movement in risks to which the Society may be exposed remains within risk appetite.

The Committee meets monthly and the members of the Committee are:

Roger Burnell (non-executive director, appointed as Committee Chairman on 1 January 2013)
Ian Pickering (Retired as Committee Chairman upon appointment as Board Chairman on 1 January 2013)
Peter Frost (Chief Operating Officer, appointed on 23 January 2013)
John Lowe (Finance Director)
David Harding (Board Chairman, retired as a member of the Committee on 1 January 2012)
Glyn Smith (non-executive director)
Fiona Smith (non-executive director, appointed as a member of the Committee on 22 February 2012)
David Stewart (Chief Executive)
Chief Risk Officer (Interim contract completed on 31 December 2012, new Chief Risk Officer is expected to join the Society on 1 April 2013).

In addition, the Society's Secretary attends Board Risk Committee meetings.

Board Audit Committee

The responsibilities of the Committee are in line with the provisions of the Financial Reporting Council Guidance on Audit Committees. The main function of the Committee is to assist the Board in fulfilling its oversight responsibilities with specific regard to:

- monitoring the integrity of the half-year and annual financial statements and any formal announcements relating to financial performance, focusing particularly on significant financial reporting judgements contained in them;
- reviewing the adequacy of systems of internal control and risk management processes;
- approving the annual internal audit plan;
- monitoring the effectiveness of the external audit process and making recommendations to the Board on the appointment, re-appointment and remuneration of the external auditors;
- ensuring that an appropriate relationship between the Society and the external auditors is maintained, including reviewing non-audit services which can be provided and fees; and
- reviewing the effectiveness of the internal audit function. The Committee is responsible for approving the appointment and removal of the Head of Internal Audit.

In 2012, the Committee met five times in the execution of its responsibilities and, in particular, considered reports on the following matters:

The Society's risk management framework and systems of internal control
In addition to reports from the Society's internal and external auditors, the Committee received a report from the Chief Risk Officer on the overall effectiveness of the Society's Risk Management Framework and a review from the Secretary on the Society's compliance with the Corporate Governance Code and the effectiveness of executive governance. The Committee received an annual report on the Society's whistle-blowing process and approved a revised whistle-blowing policy.

Preparation of financial statements and key areas of judgement
The Committee received a detailed paper from the Finance Director regarding going concern when assessing both the interim and full year 2012 accounts to support their basis of preparation (see Directors' Report for further details). Regular updates on financial reporting developments were also presented to enable the Committee to provide effective oversight on the reporting and disclosures within the Society's Annual Report & Accounts. The Interim and Annual Report & Accounts are scrutinised by the members of the Committee, of which a number are Chartered Accountants.

The Committee has reviewed relevant guidance on forbearance and impairment to assess the adequacy of the disclosures in the Society's Accounts and to satisfy itself that appropriate policies and processes are in place. In addition, detailed management reports, which had been subject to scrutiny by the external auditors, were reviewed to support the accounting assumptions approved by the Committee in the development of the Society's accounts, including the approach to loan fair value adjustments following the merger with Stroud & Swindon Building Society in 2010, pension assumptions, accounting for the acquisition of the Bank of Ireland mortgage book, effective interest rate methodologies and provisioning. These disclosures were subject to external audit.

The activities of internal auditors, including the effectiveness of the Internal Audit function

The Committee received reports at each meeting from the Internal Audit function detailing progress against the annual Audit Plan and monitoring the management response and completion of actions arising from that function's reviews. An annual review of the effectiveness of the Internal Audit function was undertaken through an assessment against the International Standards for the Professional Practice of Internal Auditing and against the Internal Audit function's terms of reference. As part of this review the Committee was provided with details of the quality assurance programme introduced into the function, the outcome of external and internal review processes and the qualifications and experience of the Internal Audit team. The review concluded that the function operated effectively.

The activities of the external auditors, including their performance

The Committee received regular reports from the external auditors, including matters highlighted from their audit work at the Society and other matters of general interest impacting the sector. At its meeting in February 2013 the Committee considered feedback on the performance of the external auditors during 2012. The feedback was facilitated by the Internal Audit function and involved key stakeholders across the Board, Committee members and Society management. The Committee was satisfied with the feedback and has recommended to the Board and members that Ernst & Young are reappointed at the 2013 AGM. The Committee has decided, in accordance with good practice, to put the audit work for 2014 out to tender during 2013. This was last tendered in 2007.

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

The Committee regularly reviews and monitors the Society's relationship with the external auditors to ensure that auditor independence and objectivity is maintained at all times, taking into consideration relevant UK professional and regulatory requirements. The Committee has developed a policy and framework which defines unacceptable non-audit assignments, pre-approval of acceptable non-audit assignments and procedures for approval of other non-audit assignments. This framework ensures that at no time will the external auditors audit their own work, make management decisions for the Society, create a conflict of interest or find themselves in the role of advocate for the Society. Further, the Society's policy and framework requires that the external auditors should not be appointed if the threat to their objectivity is other than clearly insignificant, unless appropriate safeguards can be applied to eliminate or reduce such threat to an acceptable level.

The effectiveness of the Committee

The Committee undertook a self-assessment exercise during 2012, co-ordinated by the Head of Internal Audit, to monitor the Committee's effectiveness. The review involved Committee members, the external auditors, senior management and other key stakeholders across the Society. The review concluded that the Committee had operated effectively during the year, and had performed its duties with appropriate levels of care and expertise.

During 2012, reports were provided to the Committee by the finance, internal audit, operational risk and compliance functions and by the external auditors.

During 2012 the Society engaged the external audit firm to provide non-audit services. These engagements included regulatory, accounting and taxation advice. Prior to the approval of proposals to appoint the external audit firm for non-audit work, the Committee, within the terms of the Society's policy and framework, satisfied itself on the following:

- the skills and experience of the audit firm,
- the safeguards in place to eliminate or reduce any threat to objectivity and independence,
- the nature of the non-audit services,
- the fees to be incurred for non-audit services, and
- the criteria which govern the compensation of the individuals performing the audit.

The Committee keeps non-audit engagements under review and receives regular reports from the external audit partner confirming that adequate safeguards remain in place. The Society also assigned services to a number of other major accountancy firms during the year.

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

The Committee consists of non-executive directors only, as follows:

Glyn Smith (Committee Chairman)
Bridget Blow
Roger Burnell (Appointed as a member of the Committee on 1 January 2013)
Ian Geden
Ian Pickering (Retired on 31 December 2012)

The Chairman of the Committee, Glyn Smith, has recent and relevant financial experience and is a Chartered Accountant.

The Society's external auditors, the Chief Executive, Finance Director, Chief Risk Officer, Secretary, Head of Internal Audit and other senior managers attend meetings as required by the Committee. In addition, the external auditors meet members of the Committee in a private session at least annually.

Following each Committee meeting, the minutes of the meeting were distributed to the Board and the Chairman of the Audit Committee provided a verbal update to the Society's Board on key matters discussed by the Committee.

Nominations and Governance Committee

The Committee consists of:

Ian Pickering (Board Chairman, appointed as a member of the Committee on 23 May 2012, appointed as Committee Chairman on 1 January 2013)
David Harding (Retired as Committee Chairman on 31 December 2012)
Bridget Blow (Deputy Chairman and Senior Independent Director)
David Stewart (Chief Executive)

The Committee is responsible for making recommendations to the Board on matters relating to the composition of the Board (including Board succession planning, the appointment of new directors, the re-appointment of retiring directors, the appointment of non-executive and executive directors to Committees of the Board) and senior management appointments.

In 2012 the Committee met and considered, amongst other things, its terms of reference, Board Committee membership and the appointment of the Chairman, non-executive directors and executive directors and other senior executive appointments.

Through the 2012 AGM process the Society issued a standing invitation to members to apply for the position of non-executive director. In addition, during 2012 national and local press advertisements invited candidates to submit applications for the appointment as a non-executive director to the Board. Through this process a number of candidates were interviewed by members of the Committee during 2012. A substantial number of applications were received and following interviews a candidate has been selected and an appointment will be announced upon approval from the FSA. External consultants and recruitment specialists are also employed by the Society in considering executive director and senior management succession planning.

Remuneration Committee

The Committee consists of non-executive directors only, as follows:

Bridget Blow (Committee Chairman)
Roger Burnell (Retired upon appointment as Chairman of the Board Risk Committee on 1 January 2013)

Ian Geden
David Harding (Retired on 31 December 2012)
Ian Pickering (Appointed as a member of the Committee on 1 January 2013)
Fiona Smith

The Committee is responsible for considering and approving the remuneration of executive directors and senior management and also sets targets for the Society's performance related bonus scheme in which all staff members participate. During 2012 the Committee has reviewed the implications of the FSA's Remuneration Code and approved the Society's Remuneration Policy Statement on behalf of the Board. In 2012 the Committee met four times. Further details of the Committee, the remuneration policy and directors' service contracts can be found in the Directors' Remuneration Report on pages 46 to 52.

In 2012 the Board, as in prior years, undertook the same process for the remuneration of the Chairman as it did to set the remuneration of the other non-executive directors. It was determined by the Board, acting upon a recommendation from the executive directors and excluding, for this purpose, the Chairman (David Harding).

From 2013, in accordance with the Code, the remuneration of the Chairman will be reviewed by the Remuneration Committee for recommendation to and approval by the Board. No director takes part in the discussion of his or her own remuneration.

Non-executive Directors' Remuneration Committee

This Committee was established in 2012 and consists of:

David Stewart, (Chief Executive and Committee Chairman)
John Lowe (Finance Director)
Ian Pickering (Board Chairman)

The Committee is responsible for considering and approving the remuneration of the non-executive directors, other than the Chairman, in accordance with the Society's Remuneration Policy Statement, and taking into account the roles undertaken by each director. Non-executive directors do not participate in the Society's performance related bonus scheme.

The terms of reference of the Board Risk Committee, Board Audit Committee, the Nominations and Governance Committee, the Remuneration Committee and the Non-Executive Directors' Remuneration Committee and the letters of appointment for non-executive directors, are available on request from the Secretary and General Counsel.

Internal controls and risk management

The principal categories of risk inherent in the Society's business are described in greater detail in the Risk Management Report.

Responsibility for implementing sound and effective systems of risk management and internal control has been delegated by the Board to senior management. The internal audit function provides independent assurance to the Board on the effectiveness of the systems of internal control and risk management through the Board Audit Committee.

The information received and considered by the Board Audit Committee provided assurance that, during 2012, there were no material breaches of control or regulatory requirements and that, overall, the Society maintained adequate systems of internal control.

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

- Regular reports to the Board, through the Board Audit Committee, from the internal audit function in respect of its independent audits of risk management processes and the effectiveness of internal controls across the Society. The Head of Internal Audit has direct access to the Chairman of the Board Audit Committee;
- Regular reports to the Board, through the Board Risk Committee, from the Risk function on the principal operational, credit, market and regulatory risks facing the Society and the strength of the controls in place to mitigate such risks. The Chief Risk Officer has direct access to the Chairman of the Board Risk Committee;
- Regular reports to the Board, through the Board Risk Committee, from the Compliance function on the strength of the controls in place to mitigate against conduct risk;
- Regular reports and presentations to the Board by the Chairmen of the various Board Committees – see above; and reports presented by the Chief Risk Officer at each Board meeting; and
- Stress testing various aspects of the Society's models and approval of the ILAA and ICAAP.

The Board is committed to effective internal control and risk management in the operation of the Society and to dealing with areas for improvement, which come to the attention of executive management and the Board promptly. The Society has a comprehensive system for reporting business, operational and financial performance to the Board.

The Society has a number of functions including Finance, Risk and Compliance, that establish and monitor the implementation of policies and processes across the Society. Each of these functions is subject to review by the internal audit function.

The internal audit function is responsible for independently reviewing and reporting on the adequacy and effectiveness of internal controls operated by management across the Society, thereby helping to evaluate and improve the effectiveness of risk management, regulatory compliance, control and governance processes. Through its programme of work, agreed by the Board Audit Committee, the internal audit function is able to provide assurance on control effectiveness.

The Board is satisfied that during 2012 the Society maintained an adequate system of internal control that met the requirements of the Code.

Relations with members

The Society's members comprise its shareholding investors and borrowers. The majority of its customers are therefore members and the Society encourages feedback from them on all aspects of the Society's activities.

All members, who are eligible, are encouraged to exercise their vote at the AGM either by attending in person or by voting by proxy, for which purpose they are sent a proxy voting form and reply-paid envelope, or they can vote in any branch or online. All proxy votes are counted. All resolutions are taken on a poll and the Chairman indicates the level of proxies lodged on each resolution by announcing the numbers for and against the resolution and the number withheld. A separate resolution is proposed on each item including a resolution on the Annual Report & Accounts. The Society employs Electoral Reform Services Limited to act as independent scrutineers and ensure the votes are properly received and recorded.

This report informs members of the policy for the remuneration of both executive and non-executive directors who are equally responsible in law for directing the Society's affairs.

Remuneration disclosure requirements

In order to comply with the disclosure requirements of the Capital Requirements Directive (CRD III), in respect of 'Code Staff', this report also outlines the responsibilities and decision-making process for determining remuneration policy, the link between pay and performance and the design and structure of remuneration, including the performance pay plans.

The Society is compliant with the FSA's Remuneration Code, and meets the additional requirements of the FSA's rules regarding remuneration disclosure, in compliance with the CRD III.

These additional disclosures focus on the remuneration policies and practices for staff who have a material impact on the Society's risk profile ('Code Staff'). Code staff consist of executive directors, non-executive directors and certain senior managers in control functions (for example, human resources, audit, risk and compliance).

Responsibility for the approval and periodic review of the Society's remuneration policy, whilst having due regard to the FSA's Remuneration Code, rests with the Remuneration Committee. This includes ensuring that the Society complies with the FSA remuneration disclosure requirements.

Society remuneration policy - principles

The Society's remuneration policy is based on the following key principles:

- the remuneration of directors and other Code Staff, including staff in control functions, is in line with the FSA's Remuneration Code;
- recruiting and retaining quality staff at all levels and to ensure that remuneration packages reflect their responsibilities, performance and experience;
- total rewards, subject to satisfactory performance, should be competitive and positioned around the market median for the comparator group;
- incentive plans, performance measures and targets are stretching and aligned with members' interests;
- no member of staff is incentivised on the basis of an individual or team sales target;
- remuneration promotes sound and effective risk management and does not encourage excessive risk taking;
- remuneration strategy is in line with the business strategy, objectives, values and long-term interests of the Society;
- remuneration strategy does not result in conflicts of interests;
- remuneration is consistent with the overall financial stability of the Society and does not present material risk to this stability;
- bonus payments will be limited or withdrawn where individual or business performance does not merit payment of a bonus;
- where staff do not perform to the required standard, under-performance will not be rewarded;
- remuneration of staff in control functions does not affect their independence in any way;
- the performance of all staff is reviewed each year against agreed individual and business objectives. The outcome of this review is taken into account when considering pay decisions; and
- no director, senior manager or member of staff is involved in the setting of his or her own remuneration.

Remuneration Committee

The Board has overall responsibility for the Society's remuneration, which is delegated to the Remuneration Committee. The Committee consists exclusively of non-executive directors and is chaired by Bridget Blow, Senior Independent Director.

The Remuneration Committee is responsible for setting and reviewing the elements that comprise the remuneration package for executive directors and senior management. These currently comprise a base salary, performance related bonuses, pension arrangements and other benefits. The Committee sets the targets of the Long Term Incentive Plan (LTIP) for executive directors and senior management and for the Society's annual performance related bonus scheme in which all staff members participate on the same basis.

In fulfilling this responsibility, the Remuneration Committee has taken full account of industry best practice as advised by the FSA and reviewed the remuneration policies of the Society's peer group and other businesses of a similar size and complexity.

Independent consultants have been commissioned to review the Society's remuneration for senior managers, and for executive and non-executive directors, including the Chairman. The Remuneration Committee is also able to access independent third party pay data from consultants Towers Watson, and KPMG LLP and Deloitte LLP have provided advice on matters relating to the remuneration of both executive and non-executive directors and other senior management. In 2012 the Remuneration Committee met four times.

Policy for executive directors

Executive directors are employed by the Society and are required to devote substantially the whole of their time to its affairs. The policy of the Board is to recruit and retain high calibre executive directors and to ensure that their remuneration reflects their responsibilities, experience and performance.

As would be expected, the Remuneration Committee has taken full account of best practice in executive reward and in corporate governance. The UK Corporate Governance Code states that 'a significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance'. It continues that performance related elements should be 'stretching and designed to promote the long-term success of the company'. Therefore some bonus arrangements are necessary if the Society is to meet the requirements of the Code.

The Remuneration Committee aims to comply with best practice recommendations and recognises that the use of carefully controlled performance related bonuses, which enable a flexible approach to remuneration, are in the best interests of the Society and its members. It enables payments to be aligned accurately to results and ensures that the Society's costs are reduced if for any reason financial performance deteriorates. The Committee believes that a combination of short and long-term plans supports this objective.

However, the Committee is equally clear that it is essential that these payments are not excessive, and added together are currently limited to a maximum of 60% of fixed pay. In addition, as described further below, all payments are approved by the Remuneration Committee which takes account of a number of factors to ensure that remuneration is consistent with and promotes effective risk management and fair treatment of members.

Whilst the Remuneration Committee accepts that best practice requires that a significant proportion of remuneration should be paid by way of variable, performance related pay, it is alert to the risk of excessive bonus payments and therefore it continues to set the potential for bonuses at levels below those typically available for similar performance amongst both our peer group of major building societies as well as other similar institutions.

The Remuneration Committee has considered the results of the Society's annual benchmarking exercise, which compares the total remuneration of the Society's executive directors and senior management with that paid at the eight largest building societies and mutual lenders in the UK.

As in previous years, this found that notwithstanding the fact that the Society is one of the larger institutions within the comparator group, and has consistently performed very strongly in comparison to peers, the total remuneration paid is below the median.

In addition, an independent review was conducted by Deloitte LLP who provided advice and benchmarking data on the remuneration of the executive directors. Deloitte's review encompassed the Society's comparator group and businesses of a similar size and complexity in the FTSE 250. It was based on publicly available data and therefore makes comparison to 2011 remuneration practice. It confirmed that the potential total remuneration for Society executive directors, incorporating variable pay, is below market median in comparison with major building societies and considerably below that of FTSE 250 companies. Most importantly, despite strong performance compared to the sector, the amount actually paid in 2011 was below median.

The FSA Remuneration Code requires that for awards granted after June 2012 at least 50% of any variable remuneration for staff where variable pay could exceed 33% of total remuneration is deferred over a further retention period, typically one to two years. A deferral instrument has been agreed with the FSA to meet this requirement. No deferral instrument was issued in 2012. Variable remuneration, including any deferred element, can also be withdrawn or reduced at the discretion of the Remuneration Committee if it emerges that the original assessment of performance was misleading or in the event of poor individual performance or due to a failure of risk management.

The maximum variable remuneration that can be paid to any employee, as determined by the Remuneration Committee, is limited to less than 40% of total remuneration for the year.

The Society's remuneration in 2012 is compliant with the FSA remuneration code, and the principal elements of the Society's remuneration packages are described in the following sections:

a) Base salary

For all employed staff, including executive directors, the Society aims to pay fair and competitive salaries, linked to individual performance. To ensure this, salaries are compared to market rates, including comparative data from the building society sector for executive and non-executive directors, with the aim of paying market median rates for experienced staff who have minimal training needs and who are performing to a good standard or above.

The latest review of market practice confirmed that executives and senior management were paid below the median of comparable institutions.

For each role there is a salary range, which allows for salaries to increase as individuals become more experienced in their role. Some areas of the business have accreditation or salary progression schemes which apply a minimum salary level when certain performance criteria have been demonstrated consistently.

Base salaries are subject to an annual cost of living increase approved by the Remuneration Committee and any changes are normally effective from 1 April each year.

b) Annual performance related bonus

All eligible staff participate in a discretionary annual performance related bonus scheme. Eligibility is dependent upon satisfactory individual performance, although the amount paid is determined by the performance of the Society as a whole. It applies to all staff on the same terms, including executive directors and senior management, Code Staff and staff in control functions. It does not apply to non-executive directors. No member of staff is incentivised on the basis of individual or team targets.

The scheme is reviewed each year in the light of business plans. The target requires that a certain level of profit before tax and certain exceptional items is achieved, with the Board retaining the discretion to change the threshold target in the light of unforeseen events and the determination of exceptional items. The Remuneration Committee also takes into account the Society's non-financial performance before an annual performance related bonus is calculated. These measures cover:

- competitiveness of rates paid to members;
- member satisfaction, including number and resolution of complaints;
- market share;
- operational performance;
- member engagement;
- staff engagement;
- community activity; and
- risk and compliance.

The maximum award for substantial over-performance is 20%. The annual performance related bonus is calculated as a percentage of base annual salary as at 31 December each year, the last day of the scheme year. There is no guarantee that a payment will result.

In line with the FSA's Remuneration Code, the Remuneration Committee will adjust the annual performance related bonus in respect of executive directors and senior managers if it deems this to be appropriate, taking into account a range of factors including satisfactory individual performance, risk management and customer service.

c) Long Term Incentive Plan

The Remuneration Committee established the Long Term Incentive Plan (LTIP) to ensure a strong link between the remuneration package of executive directors and senior managers and the interests of members through an assessment of the long-term performance of the Society. The LTIP also helps the Society to recruit and retain high calibre individuals and to ensure that their remuneration packages reflect their responsibilities, performance and experience.

The LTIP rewards sustained performance and the achievement of challenging financial targets over a three year performance cycle. In 2012, an LTIP grant was made, whereby participants are eligible to receive an award based on the performance of the Society over the three year period from 2012-2014. An on-target performance would provide a 10% of salary payment for executive director and a 5% of salary payment for other senior management, with a current maximum of 40% (executive director) or 20% (senior management) for substantial over-performance over the period. This is below the 50% of salary maximum currently permitted under the Society's LTIP Rules.

There are currently three executive directors and four senior managers that have been awarded grants under one or more of the Society's LTIP schemes.

To protect the interests of members, the Committee may amend any payment if it considers it appropriate in light of either the Society's overall performance or economic conditions. In making its assessment the Remuneration Committee may take into account any one or more of the following factors:

- member satisfaction;
- member engagement;
- regulatory record;
- market share;
- risk management factors;
- overall financial performance of the Society relative to the performance of other building societies and in light of the market conditions prevailing during the performance period;
- individual performance and conduct; and
- any other factors the Remuneration Committee feels are relevant.

Any LTIP awarded is calculated as a percentage of base annual salary at the time the LTIP was granted.

All payments under the LTIP are subject to approval by the Remuneration Committee and are not pensionable.

d) Pension arrangements

Coventry Building Society closed its final salary pension scheme to all new entrants, including senior managers, in December 2001, replacing it with a defined contribution pension scheme.

No special arrangements have been put in place for the executive directors or senior management and consequently the Finance Director and Chief Operating Officer, who joined subsequent to January 2002, are active members of the Society's funded defined contribution pension scheme.

David Stewart left the final salary scheme immediately before being appointed Chief Executive in July 2006, and joined the defined contribution scheme.

The Sales and Marketing Director, whose long service at the Society pre-dates January 2002 by a number of years, continues to be a member of the Society's contributory final salary pension scheme.

Full details of executive directors' pension benefits can be found in note 11 to the Accounts.

During 2012, following extensive consultation with staff, Trustees and the trade union, Unite, a decision was made to close the final salary scheme to future service accrual. For most staff this will take effect from 1 April 2013. At the same time the Society's funded defined contribution pension scheme

(Stakeholder Scheme) will also be closed. These will be replaced by a new Group Personal Pension (GPP) scheme which will be offered to all staff and will also be compliant with the pensions auto enrolment requirements being introduced in 2013. Executive directors, executives and senior management have been transferred to the GPP on the same terms as other members affected by the closure of the scheme.

e) Other benefits

Each executive director is provided with a fully expensed car or a cash alternative, and personal membership of a private medical insurance scheme.

Directors' emoluments are disclosed in note 11 to the Accounts.

Non-executive directors

Non-executive directors are independent of the Society's management and are not required to devote the whole of their time to its affairs.

A Committee consisting of the Chairman, Chief Executive, Finance Director and Head of Human Resources has been established, to set and review the elements that comprise the remuneration of non-executive directors (with the exception of the Chairman) from 2013. No director takes part in the discussion of his or her own remuneration and recommendations for the remuneration of the Chairman are made by executive directors.

Fees of non-executive directors, are reviewed annually in light of their responsibilities and comparative information from other building societies, and financial institutions. Consistent with the Society's approach to the remuneration of executive directors, the Society has reviewed fees paid by its peer group of building societies and FTSE 250 companies of a similar size to Coventry, finding that those paid at Coventry are broadly market competitive with the exception of those of the Chairman, which are lower than market.

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

Directors emoluments are disclosed in note 11 to the Accounts.

Directors' service contracts

In 2006 the Society appointed David Stewart as Chief Executive. A service contract was entered into which is terminable by David Stewart on six months' notice and by the Society on one year's notice.

In 2009 the Society appointed Colin Franklin (Sales and Marketing Director) to the Board. A service contract was entered into which is terminable by Colin Franklin on six months' notice and by the Society on one year's notice.

In 2010 the Society appointed John Lowe (Finance Director) to the Board. A service contract was entered into, which is terminable by John Lowe on six months' notice and by the Society on one year's notice.

In 2012 the Society appointed Peter Frost (Chief Operating Officer) to the Board. A service contract was entered into, which is terminable by Peter Frost on six months' notice and by the Society on one year's notice.

Aggregate remuneration data

The Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU) requires the Society to disclose aggregate remuneration data for all staff and separately for all Board directors, senior management and members of staff whose actions have a material impact on the risk profile of the firm (Code Staff). The total fixed pay paid to all employees in 2012 was £46.8 million and variable pay was £4.6 million. Details of remuneration to Code Staff are detailed on page 52.

2012 Annual performance bonus - summary of performance

The Society has performed strongly in 2012, exceeding each of its key performance targets. Details of this performance are set out in the Chairman's Statement (pages 2 and 3), Chief Executive's Review (pages 4 to 12), and Directors' Report (pages 13 to 22) with highlights also included on page 1.

This outstanding performance gave rise to a calculated bonus for all 1,794 eligible members of staff equivalent to 12% of base salary. The bonus percentage payable to each of the executive directors is the same as all other eligible staff.

2010-2012 Long Term Incentive Plan - summary of performance

The Society has achieved outstanding results throughout the period of assessment, underpinning Coventry's pre-eminent position in the UK building society sector. The Society exceeded substantially each of the targets set in its plans for the period, including: growth in savings and mortgage market share, competitive products, record of member service, low complaints, maintenance of the Society's sector-leading cost-efficiency and capital position, sustained profitability, and strong ratings from credit rating agencies that rate the building society sector. (Moody's 'A3', Fitch 'A').

Further information in respect of this performance is provided in the Chairman's Statement (pages 2 and 3), Chief Executive's Review (pages 4 to 12), and Directors' Report (pages 13 to 22) with highlights also included on page 1.

The Remuneration Committee considers that Coventry's performance, during a period of continued economic uncertainty which has resulted in significant challenges for all financial institutions, compares favourably with that of all major banks and building societies.

Taking into account both overall performance and that against the specific 2010 LTIP targets, the Remuneration Committee approved a payment for each participant equivalent to 38.9% of base salary at the date of the 2010-2012 Deed of Grant. No targets were adjusted from those originally set in 2009.

The 2012 annual bonus and LTIP award will be paid in the month of March consistent with previous years.

The remuneration relevant to Code Staff, comprising senior management and other material risk takers was as follows for 2012 and 2011:

	Aggregate remuneration data for Jan-Dec 2012		
		Fixed pay[3]	**Variable pay[4]**
2012	**Number of staff**	**£m**	**£m**
Senior managers[1]	**20**	**2.7**	**0.5**
Other material risk takers[2]	**13**	**1.1**	**0.1**
Total	**33**	**3.8**	**0.6**

1. Non-executive directors, executive directors and senior managers. Non-executive directors' fees are included under fixed pay; no variable pay is awarded to non-executive directors.
2. Other Code Staff to cover those whose actions have a material impact on the risk profile of the Society.
3. Fixed pay includes basic pay, allowances and employer pension contributions.
4. Variable pay includes the annual performance related bonus (£0.3 million) for 2012 (paid March 2013) and the LTIP 2012-2014 payment granted (not paid) in 2012 (£0.3 million). The LTIP payment included above is the maximum possible under the scheme (40% executive directors and 20% senior managers of salary as at the Grant Date); the actual payment will be subject to the performance criteria outlined on page 50.

	Aggregate remuneration data for Jan-Dec 2011		
		Fixed pay[3]	Variable pay[4]
2011	Number of staff	£m	£m
Senior managers[1]	23	2.9	0.5
Other material risk takers[2]	14	0.9	0.1
Total	37	3.8	0.6

1. Non-executive directors, executive directors and senior managers including Stroud & Swindon executives for period January to May 2011. Non-executive directors' fees are included under fixed pay; no variable pay is awarded to non-executive directors.
2. Other Code Staff to cover those whose actions have a material impact on the risk profile of the Society, including Stroud & Swindon Code Staff.
3. Fixed pay includes basic pay, allowances and employer pension contributions.
4. Variable pay includes the annual performance related bonus (£0.3 million) for 2011 (paid March 2012) and the LTIP 2011-2013 payment granted (not paid) in 2011 (£0.3 million). The LTIP payment included above is the maximum possible under the scheme (40% executive directors and 20% senior managers of salary as at the Grant Date); the actual payment will be subject to the performance criteria outlined on page 50.

On behalf of the Board

Bridget Blow
Chairman of the Remuneration Committee
28 February 2013

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The following statement, which should be read in conjunction with the statement of the auditors' responsibilities on page 54, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Accounts, Annual Business Statement and Directors' Report.

The directors are responsible for preparing the Annual Report, Annual Business Statement, Directors' Report and the Annual Accounts in accordance with applicable law and regulations.

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

The Group and Society Annual Accounts are required by law and IFRS as adopted by the EU to present fairly the financial position and the performance of the Group and the Society; the Building Societies Act 1986 provides in relation to such Annual Accounts that references in the relevant part of that Act to Annual Accounts giving a true and fair view are references to their achieving a fair presentation.

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

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRS as adopted by the EU; and
- prepare the Annual Accounts on the going concern basis, unless it is inappropriate to presume that the Group and Society will continue in business.

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

The directors are responsible for ensuring that the Group:

- keeps proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and Society, in accordance with the Act; and
- takes reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business (in accordance with the rules made by the FSA under the Financial Services and Markets Act 2000).

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

The directors are satisfied that the Group has adequate resources to continue in business for the foreseeable future. For this reason, the Annual Accounts continue to be prepared on the going concern basis (See Directors' Report).

INDEPENDENT AUDITORS' REPORT

Independent auditors' report to the members of Coventry Building Society

We have audited the Group and Society financial statements of Coventry Building Society for the year ended 31 December 2012 which comprise the Group and Society Income Statements, Group and Society Statements of Comprehensive Income, Group and Society Statements of Financial Position, the Group and Society Statements of Changes in Members' Interests, the Group and Society Statements of Cash Flows and the related notes 1 to 45. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the society's members, as a body, in accordance with Section 78 of the Building Societies Act 1986. Our audit work has been undertaken so that we might state to the society's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the society and the society's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement as set out on page 53, the directors are responsible for the preparation of the financial statements which give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and Society's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- Give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's and the Society's affairs as at 31 December 2012 and of the Group's and the Society's income and expenditure for the year then ended; and

- Have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the group financial statements, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Building Societies Act 1986
In our opinion:

- The Annual Business Statement and the Directors' Report have been prepared in accordance with the requirements of the Building Societies Act 1986;
- The information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the accounting records and the financial statements; and
- The information given in the Annual Business Statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given.

Matters on which we are required to report by exception
We have nothing to report in respect of the following matters where the Building Societies Act 1986 requires us to report to you if, in our opinion:

- Proper accounting records have not been kept by the Society; or
- The Society financial statements are not in agreement with the accounting records; or
- We have not received all the information and explanations and access to documents we require for our audit.

Peter Wallace (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
London

28 February 2013

INCOME STATEMENTS

for the year ended 31 December 2012

	Notes	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Interest receivable and similar income	3	**846.5**	**900.9**	730.0	808.1
Interest payable and similar charges	4	**(659.6)**	**(768.7)**	(562.5)	(676.8)
Net interest income		**186.9**	**132.2**	167.5	131.3
Fees and commissions receivable	5	**14.6**	**13.4**	15.0	14.0
Fees and commissions payable	6	**(3.6)**	**(3.5)**	(3.1)	(3.0)
Other operating income	7	**1.5**	**10.7**	0.9	0.7
Net gains from derivative financial instruments	8	**0.1**	**2.8**	0.5	0.5
Total income		**199.5**	**155.6**	180.8	143.5
Administrative expenses	9	**(89.0)**	**(84.2)**	(77.7)	(74.8)
Amortisation of intangible assets	21	**(3.8)**	**(3.8)**	(3.5)	(3.5)
Depreciation of tangible fixed assets	22,23	**(5.8)**	**(5.8)**	(5.1)	(5.0)
Operating profit before impairments and exceptional items		**100.9**	**61.8**	94.5	60.2
Impairment losses on loans and advances to customers	13	**(9.6)**	**(6.1)**	(9.9)	(6.3)
Operating profit after impairments and before exceptional items		**91.3**	**55.7**	84.6	53.9
Provision for FSCS levies	32	**(10.2)**	**(10.2)**	(13.4)	(13.4)
Integration and merger related costs		**-**	**-**	(10.7)	(10.7)
Gain on pension curtailment	12	**9.3**	**9.3**	-	-
Operating profit after impairments and exceptional items		**90.4**	**54.8**	60.5	29.8
Charitable donation to Poppy Appeal	14	**(1.9)**	**(1.9)**	(1.0)	(1.0)
Profit before tax		**88.5**	**52.9**	59.5	28.8
Taxation	15	**(21.0)**	**(8.8)**	(12.9)	(5.0)
Profit for the financial year		**67.5**	**44.1**	46.6	23.8

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

STATEMENTS OF COMPREHENSIVE INCOME

for the year ended 31 December 2012

	Notes	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Profit for the financial year		**67.5**	**44.1**	46.6	23.8
Other comprehensive income					
Actuarial loss on retirement benefit obligation:					
Actuarial loss on defined benefit pension plan	12	**(5.0)**	**(5.0)**	(4.3)	(4.3)
Tax credit on actuarial loss on defined benefit pension plan	12,15	**1.0**	**1.0**	1.1	1.1
Available-for-sale investments:					
Fair value movements on Available-for-sale assets taken to reserves		**34.5**	**34.5**	177.0	177.0
Amount transferred to income statement	35	**(41.2)**	**(41.2)**	(157.4)	(157.4)
Tax credit/(charge) on fair value movements	15	**0.8**	**0.8**	(5.2)	(5.2)
Other comprehensive income for the year, net of tax		**(9.9)**	**(9.9)**	11.2	11.2
Total comprehensive income for the year, net of tax		**57.6**	**34.2**	57.8	35.0

The accounting policies and notes on pages 60 to 110 form part of these Accounts.

STATEMENTS OF FINANCIAL POSITION

as at 31 December 2012

	Notes	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Assets					
Cash in hand and balances with the Bank of England	16	**1,814.2**	**1,730.3**	1,607.0	1,600.1
Loans and advances to credit institutions	17	**323.7**	**220.3**	388.3	319.3
Debt securities	18	**2,338.2**	**2,313.2**	2,846.3	2,846.3
Other liquid assets		**-**	**-**	0.5	0.5
		4,476.1	**4,263.8**	4,842.1	4,766.2
Non-current assets held for sale	23	**-**	**-**	2.5	2.5
Loans and advances to customers	19	**22,018.9**	**14,937.1**	19,240.0	14,023.0
Hedge accounting adjustment		**86.8**	**86.8**	68.7	68.7
Derivative financial instruments	30	**279.6**	**177.8**	259.7	169.4
Investments in subsidiary undertakings	20	**-**	**11,178.9**	-	9,758.0
Intangible assets	21	**9.2**	**9.2**	9.5	9.5
Property, plant and equipment	22	**30.5**	**30.5**	32.8	32.8
Investment properties	23	**5.4**	**0.3**	5.7	0.6
Pension benefit surplus	12	**10.1**	**10.1**	3.9	3.9
Deferred tax assets	24	**9.1**	**5.7**	14.5	6.7
Prepayments and accrued income		**8.1**	**7.1**	7.2	6.8
Total assets		**26,933.8**	**30,707.3**	24,486.6	28,848.1
Liabilities					
Shares	25	**20,110.5**	**20,110.5**	18,964.1	18,964.1
Deposits from banks	26	**715.9**	**715.9**	510.9	510.9
Other deposits	27	**9.5**	**9.5**	23.0	23.0
Amounts owed to other customers	28	**450.0**	**450.0**	549.3	549.3
Debt securities in issue	29	**3,874.7**	**3,139.5**	2,863.8	2,863.8
Hedge accounting adjustment		**240.4**	**160.6**	201.5	148.4
Derivative financial instruments	30	**411.2**	**374.4**	336.0	299.8
Current tax liabilities		**3.8**	**0.5**	5.1	1.6
Deferred tax liabilities	24	**3.7**	**3.7**	3.0	3.0
Accruals and deferred income		**48.0**	**14.6**	16.1	13.2
Other liabilities	31	**21.7**	**4,724.6**	19.8	4,494.5
Provisions for liabilities and charges	32	**23.1**	**23.1**	20.3	20.3
Subordinated liabilities	33	**58.1**	**58.1**	68.2	68.2
Subscribed capital	34	**161.4**	**161.4**	161.3	161.3
Total liabilities		**26,132.0**	**29,946.4**	23,742.4	28,121.4
Equity					
General reserve		**811.4**	**770.5**	747.9	730.4
Available-for-sale reserve	35	**(9.6)**	**(9.6)**	(3.7)	(3.7)
Total liabilities and equity		**26,933.8**	**30,707.3**	24,486.6	28,848.1
Memorandum item					
Financial commitments	36	**110.5**	**83.7**	125.9	93.4

The accounting policies and notes on pages 60 to 110 form part of these Accounts.

Approved by the Board of directors on 28 February 2013.

Ian Pickering	David Stewart	John Lowe
Chairman	Chief Executive	Finance Director

STATEMENTS OF CHANGES IN MEMBERS' INTERESTS

for the year ended 31 December 2012

Group	Notes	General reserve £m	Available-for-sale reserve £m	Total £m
As at 1 January 2012		**747.9**	**(3.7)**	**744.2**
Profit for the financial year		**67.5**	**-**	**67.5**
Actuarial loss on defined benefit pension plan (net of tax)	12,15	**(4.0)**	**-**	**(4.0)**
Net movement in Available-for-sale reserve (net of tax)		**-**	**(5.9)**	**(5.9)**
As at 31 December 2012		**811.4**	**(9.6)**	**801.8**
As at 1 January 2011		704.5	(18.1)	686.4
Profit for the financial year		46.6	-	46.6
Actuarial loss on defined benefit pension plans (net of tax)	12,15	(3.2)	-	(3.2)
Net movement in Available-for-sale reserve (net of tax)		-	14.4	14.4
As at 31 December 2011		747.9	(3.7)	744.2

Society	Notes	General reserve £m	Available-for-sale reserve £m	Total £m
As at 1 January 2012		**730.4**	**(3.7)**	**726.7**
Profit for the financial year		**44.1**	**-**	**44.1**
Actuarial loss on defined benefit pension plan (net of tax)	12,15	**(4.0)**	**-**	**(4.0)**
Net movement in Available-for-sale reserve (net of tax)		**-**	**(5.9)**	**(5.9)**
As at 31 December 2012		**770.5**	**(9.6)**	**760.9**
As at 1 January 2011		709.8	(18.1)	691.7
Profit for the financial year		23.8	-	23.8
Actuarial loss on defined benefit pension plans (net of tax)	12,15	(3.2)	-	(3.2)
Net movement in Available-for-sale reserve (net of tax)		-	14.4	14.4
As at 31 December 2011		730.4	(3.7)	726.7

The accounting policies and notes on pages 60 to 110 form part of these Accounts.

STATEMENTS OF CASH FLOWS

for the year ended 31 December 2012

	Notes	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Cash flows from operating activities					
Profit before tax		**88.5**	**52.9**	59.5	28.8
Adjustments for:					
Net increase in impairment provisions		**9.6**	**6.1**	9.9	6.3
Depreciation and amortisation		**9.6**	**9.6**	10.9	10.8
Interest on subordinated liabilities		**4.6**	**4.6**	5.1	5.1
Interest on subscribed capital		**12.2**	**12.2**	12.2	12.2
Increase in fair value adjustment of hedged risk		**34.9**	**19.1**	5.0	6.0
Other non-cash movements		**1.7**	**0.1**	16.7	16.7
Non-cash items included in profit before tax		**72.6**	**51.7**	59.8	57.1
(Increase)/decrease in loans to credit institutions and other liquid assets		**(243.7)**	**(208.3)**	111.6	111.6
Increase in loans and advances to customers		**(2,788.5)**	**(920.2)**	(1,676.2)	(505.6)
Increase in prepayments and accrued income		**(0.9)**	**(0.3)**	(0.2)	(0.2)
Increase in other assets		**(8.6)**	**(8.6)**	(1.0)	(1.0)
Changes in operating assets		**(3,041.7)**	**(1,137.4)**	(1,565.8)	(395.2)
Increase in shares		**1,148.2**	**1,148.2**	1,331.5	1,331.5
Increase/(decrease) in deposits and other borrowings		**93.0**	**93.0**	(910.6)	(910.6)
(Decrease)/increase in debt securities in issue		**(126.1)**	**(124.3)**	25.4	25.4
Increase in accruals and deferred income		**31.9**	**1.4**	35.0	34.5
(Decrease)/increase in other liabilities		**(5.5)**	**2.1**	(9.1)	(4.4)
Changes in operating liabilities		**1,141.5**	**1,120.4**	472.2	476.4
Interest paid on subordinated liabilities		**(4.6)**	**(4.6)**	(5.1)	(5.1)
Interest paid on subscribed capital		**(12.2)**	**(12.2)**	(12.2)	(12.2)
Taxation		**(14.4)**	**(14.4)**	(19.7)	(19.7)
Net cash flows from operating activities		**(1,770.3)**	**56.4**	(1,011.3)	130.1
Cash flows from investing activities					
Purchase of investment securities		**(3,104.3)**	**(3,104.3)**	(7,276.7)	(7,276.7)
Sale and maturity of investment securities		**3,645.6**	**3,670.6**	7,468.8	7,468.8
Sale of properties		**3.6**	**3.6**	-	-
Purchase of property, plant and equipment		**(3.7)**	**(3.7)**	(8.8)	(8.8)
Purchase of intangible assets		**(3.5)**	**(3.5)**	(3.1)	(3.1)
Net cash flows from investing activities		**537.7**	**562.7**	180.2	180.2
Cash flows from financing activities					
Loans from connected undertakings		**-**	**228.6**	-	1,323.8
Loans to connected undertakings		**-**	**(1,420.9)**	-	(2,540.7)
Repurchase of subordinated liabilities		**(10.0)**	**(10.0)**	-	-
Repurchase and repayment of debt securities		**(564.6)**	**(500.0)**	(45.0)	(45.0)
Issue of debt securities		**1,705.6**	**905.6**	1,316.5	1,316.5
Net cash flows from financing activities		**1,131.0**	**(796.7)**	1,271.5	54.6
Net (decrease)/increase in cash		**(101.6)**	**(177.6)**	440.4	364.9
Cash and cash equivalents at start of year		**1,978.2**	**1,902.3**	1,537.8	1,537.4
Cash and cash equivalents at end of year	45	**1,876.6**	**1,724.7**	1,978.2	1,902.3

The accounting policies and notes on pages 60 to 110 form part of these Accounts.

NOTES TO THE ACCOUNTS

1. Accounting policies

The following accounting policies have been applied consistently in dealing with items that were considered material in relation to the Accounts.

Basis of preparation

These Accounts have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU; interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC); and with those parts of the Building Societies (Accounts and Related Provisions) Regulations 1998 applicable to organisations reporting under IFRS.

The Accounts have been prepared on an historical cost basis, as modified by the revaluation of Available-for-sale debt securities and certain financial instruments which are measured at fair value. The carrying values of recognised assets and liabilities that are hedged items in fair value hedges and are otherwise carried at cost are adjusted to record changes in the fair values attributable to the risks that are being hedged. These hedge accounting adjustments are recorded in the statement of financial position.

Changes in accounting policy

The following standards and interpretations, relevant to the Group have been adopted during the year:

Pronouncement	Nature of change	Periods beginning on or after
IFRS 7 *Disclosures – Transfers of Financial Assets*	Requires additional disclosures to help evaluate risk exposures relating to the transfer of financial assets and the effect of those risks on an entity's financial position, particularly those that involve securitisations of financial assets (see note 41).	1 July 2011
IAS 12 *Income taxes (Amendments)*	Provides a practical approach for measuring deferred tax liabilities and assets when investment property is measured using the fair value model in IAS 40 Investment Property. As the Group adopts the amortised cost model there is no impact on profit and reserves.	1 January 2012

Future accounting developments

The following standards and interpretations, relevant to the Group, were not effective as at 31 December 2012 and have not been applied in preparing these financial statements. The anticipated impact of these standards and interpretations are listed below:

Pronouncement	Nature of change	Periods beginning on or after
IAS 1 *Presentation of Financial Statements (Amendment)*	The amendments to IAS 1 require changes to the presentation of the statement of comprehensive income. Items that could be reclassified to profit or loss at a future point in time would be presented separately from items that will never be reclassified. The adoption of these amendments will only affect the presentation of the statement of comprehensive income.	1 July 2012
IFRS 7 *Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities (Amendment)*	The amendment requires new disclosures for all financial instruments that are set-off in the statement of financial position. As amounts presented within the Group's statement of financial position are shown as gross before set-off, the standard will have no impact.	1 January 2013
IFRS 13 *Fair Value Measurement*	Replaces guidance on fair value measurement in existing IFRS accounting literature with a single standard. The standard provides guidance on how fair value should be measured, but does not change the requirements regarding which items should be measured or disclosed at fair value. In addition the standard requires enhanced disclosures. The guidance is expected to result in additional volatility to the income statement resulting from the valuation of derivatives. The standard will also require additional disclosures on the valuation of financial instruments.	1 January 2013

Pronouncement	Nature of change	Periods beginning on or after
IAS 19 *Employee Benefits (Amendments)*	The amendments to IAS 19 remove the option to defer the recognition of actuarial gains and losses; the corridor approach. All changes in the value of defined benefit plans will be recognised in profit or loss and other comprehensive income. As the Group recognises all actuarial gains and losses immediately, the removal of the corridor approach will have no impact on the results of the Group.	1 January 2013
Annual Improvements to IFRSs 2009 -2011	Contains several small amendments to its existing standards. The amendments will not have a significant impact for the Group.	1 January 2013
IFRS 10,11,12 and amendments to IAS 27 and 28	A package of five new and revised standards addressing the accounting for consolidation, involvements in joint ventures and disclosure of involvements with other entities. With the exception of additional disclosure requirements, the new and revised standards will not have a significant impact for the Group.	1 January 2014
IAS 32 *Offsetting Financial Assets and Financial Liabilities*	Clarifies existing offsetting criteria. The amendment is not expected to have a significant impact for the Group.	1 January 2014
IFRS 9 *Financial Instruments: Classification and Measurement*	IFRS 9 as issued, reflects the first phase of the International Accounting Standards Board's (IASB) work on the replacement of IAS 39 Financial Instruments: Recognition and measurement and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The adoption of IFRS 9 will have an effect on the classification and measurement of the Group's financial assets and financial liabilities. However, the Group has determined that the effect will be quantified in conjunction with the other phases when issued, to present a comprehensive picture.	1 January 2015

Basis of consolidation

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

The financial statements are presented in sterling millions (£m), and are rounded to the nearest hundred thousand except where otherwise indicated.

Subsidiaries are all entities, including special purpose entities (SPE), controlled by the Society. Control exists when the Society has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The Society's investment in its subsidiaries is recognised in the statement of financial position at cost. Intra-Group transactions, balances and unrealised gains on transactions between intra-Group companies are eliminated in the consolidated accounts.

Securitisation transactions

The Group has securitised certain mortgage loans by the transfer of the loans to special purpose entities (SPEs) controlled by the Group. The securitisations enable subsequent issuance of debt to investors, who gain the security of the underlying assets as collateral. The SPEs are fully consolidated into the Group accounts.

The transfers of the mortgage loans to the SPEs are not treated as sales by the Society. The Society continues to recognise the mortgage loans on its own balance sheet after the transfer because it retains the risks and rewards of the mortgage loans through the receipt of substantially all of the profits of the SPEs. In the accounts of the Society, the proceeds received from the transfer are accounted for as a deemed loan repayable to the SPEs disclosed within 'Other liabilities'.

The Group has also entered into issuances of debt to be used as collateral for central government schemes or sale and repurchase agreements ('repo') and similar transactions. Some or all of the issuances of debt may be retained by the Society (self issued debt).

1. Accounting policies (continued)

Investments in self issued debt and the equivalent deemed loan, together with the related income, expenditure and cash flows are not recognised in the Society's financial statements. This avoids the 'grossing up' of the financial statements that would otherwise arise.

To manage interest rate risk, the Society enters into derivative transactions with the SPEs, receiving a rate of interest based on the securitised mortgages and paying a rate inherent in the debt issuances. In accordance with IAS 39, these internal derivatives are treated as part of the deemed loan and not separately fair valued because the relevant mortgage loans are not derecognised. Cash flows arising from these internal derivatives are accounted for on an accruals basis. All other derivatives relating to securitisations are treated as explained in the derivatives (see page 66) and hedging accounting policy (see page 66).

Funding for Lending Scheme (FLS)

The Society participates in the Funding for Lending Scheme (FLS), which provides Treasury bills in return for eligible collateral including approved mortgage portfolios, self-issued covered bonds and self-issued Residential Mortgage Backed Securities (RMBS). FLS transactions do not involve the transfer of risk on the collateral and hence fail the derecognition criteria under IAS 39. Therefore, for accounting purposes, the underlying collateral is retained on balance sheet and the Treasury bills are not recognised on the balance sheet.

Interest receivable and interest payable

For instruments measured at amortised cost the effective interest rate method is used to measure the carrying value of a financial asset or a liability and to allocate associated interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset.

In calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes the spread of various incentives, fees and charges, both paid and received by the Group, across the expected life of the loan account. Items spread in this way include:

- initial interest rate discounts;
- cash backs and other customer incentives; and
- certain fees and charges paid and received by the Group.

The purpose of using the effective interest rate method is to recognise interest income at a more level yield across the expected life of the product than would be obtained by recognising income as it is received.

Discounts received on loans and advances to customers which were acquired as a result of the merger with Stroud and Swindon Building Society, are recognised over the life of the asset, in line with the effective interest rate method and are recognised within interest receivable and similar income.

Interest income on Available-for-sale debt securities is included in 'Interest receivable and similar income'.

Fees and commissions

Fees and commissions receivable and payable that are not spread across expected asset lives under the effective interest rate method are taken to income on an accruals basis as services are provided, or on the completion of an act to which the fee relates.

Fees and commissions payable also include volume based transaction charges in respect of the use by customers of the ATM network which were previously included within administrative expenses. The comparative period has been restated by £1.2 million to reflect this change in accounting policy and to bring the presentation in line with the current year.

Taxation including deferred tax

Corporation tax on the profits for the year comprises current and deferred taxation.

Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities, based on tax rates and laws that are enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements, with the exception that deferred tax assets are recognised only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, carried forward tax credits or tax losses can be utilised.

Deferred tax assets and liabilities are measured on a non-discounted basis at the tax rates that are expected to apply when the related asset is realised or liability settled, based on tax rates and laws enacted or substantively enacted by the balance sheet date.

Corporation tax is charged or credited directly to equity if it relates to items that are credited or charged to equity. Otherwise corporation tax is recognised in the income statement.

Exceptional items

Exceptional items are items of income and expenditure that are disclosed separately on the basis that they are material, either by their nature or their size, to the understanding of the Group's financial performance.

In 2012, exceptional items included a 'Gain on pension curtailment' resulting from the closure of the Coventry Building Society Superannuation Fund to future service accrual (see note 12). In 2011, exceptional items included costs incurred relating directly to the merger with Stroud & Swindon Building Society, such as deal costs, integration costs, and overhead costs which do not form part of the long-term ongoing business.

Segmental reporting

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

Liquid assets

Liquid assets consist of cash in hand and balances with the Bank of England, loans and advances to credit institutions, debt securities and other liquid assets. Other liquid assets consists of amounts advanced to non-credit institutions.

Financial assets

Financial assets comprise liquid assets, loans and advances to customers and derivative financial instruments.

The Group classifies its financial assets at inception into the following categories:

Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Group's residential mortgage loans, unsecured lending and loans to credit institutions are classified as loans and receivables.

Loans are recognised when the funds are advanced to customers. Loans and receivables are carried at amortised cost using the effective interest rate method.

Loans and receivables acquired through a business combination or portfolio acquisition are recognised at fair value at the acquisition date. The fair value at acquisition becomes the new amortised cost for acquired loans and receivables. Fair value adjustments are made to reflect both credit and interest rate risk associated with the acquired loan assets. Any discount between book value and the fair value is recognised in 'Interest receivable and similar income' using the effective interest rate method, save for any specific credit impairment provisions which are either utilised against non performing assets or released to 'Interest receivable and similar income' if assumptions around the future asset performance are revised.

For a portfolio acquisition the fair value is normally assumed to be the transaction price (i.e. the consideration paid). However, the fair value may differ from the transaction price in certain circumstances. Where the valuation technique is based on observable market data only, the gain or loss arising from the difference between the fair value and the transaction price is recognised immediately. In circumstances where other inputs are required in the valuation of the portfolio, the gain or loss arising from the difference between the fair value and the transaction price is recognised over an appropriate period of time.

1. Accounting policies (continued)

Fair value through profit or loss
This category consists of derivative financial assets. Derivative financial assets are carried at fair value. Gains and losses arising from changes in the fair values are recognised in the income statement.

Available-for-sale
Available-for-sale assets are non-derivative financial assets that are designated as such or not classified into either of the two categories above. Available-for-sale assets comprises debt securities, such as certificates of deposit and gilts.

Available-for-sale assets are initially measured at fair value. Subsequently, Available-for-sale assets are carried at fair value. The fair values, in the majority of cases, are based on quoted market prices or prices obtained from market intermediaries. In cases where quoted market prices are not available, discounted cash flow valuations are used.

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

When a decline in the fair value of an Available-for-sale financial asset has been recognised directly in equity reserves and there is objective evidence that the asset is impaired, the cumulative loss recognised in equity reserves is removed and recognised in the income statement.

Purchases and sales of financial assets are accounted for at the trade date.

Derecognition
Financial assets are derecognised when the rights to receive cash flows have expired or where substantially all of the risks and rewards of ownership have been transferred. In respect of the Group's secured funding structure, an entity of the Group (the 'Originator') sells to another entity, the right to receive the cash flows arising on the loans which have been transferred. However, other than in a default or insolvency scenario, the Originator receives substantially all of the profit of that entity, and hence retains substantially all of the risks and rewards of the transferred loans. Therefore, the transferred loans are retained on the Originator's balance sheet. See pages 103 and 104 for further details.

Hedging
The impact of hedging on the measurement of financial assets is detailed in the derivatives and hedge accounting policy note (page 66).

Impairment of loans and advances to customers

The Group assesses its loans and advances to customers for objective evidence of impairment at each balance sheet date. An impairment loss is recognised if, and only if, there is a loss event (or events) that has occurred after initial recognition and before the balance sheet date and has a reliably measurable impact on the estimated future cash flows of the loan amount.

Impairment is categorised as either individual impairment (where individual assets have been assessed for loss) or collective impairment (where losses are assessed as being present in a portfolio of loans, but they cannot be attributed to individual accounts). As well as loans that are individually or collectively identified as being impaired, recognition is also made of accounts where forbearance has been exercised and agreement has been reached with customers in financial difficulty to temporarily forego some element of the payment due or where other impairment indicators are present.

If there is objective evidence that an impairment loss on loans and advances to customers has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred).

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

- All properties being used as security are valued at the outset of the loan and, if a further advance is made during the lifetime of the loan, at the time of the further advance.
- Once the value of the property has been established, the Nationwide regional house price index is used to provide an updated estimate of the property's value, on a quarterly basis.
- Assumptions are continuously updated to reflect the time taken to sell a repossessed property and the likely discount to the latest property valuation. Typically, the forced sale discount averages at 27% of the property value.
- No assumptions are made as to the future value of properties, beyond the estimation of a discount for the forced sale that results from a repossession of a mortgaged property.

Individual assessment of impairment

The identification of loans for individual assessment of impairment is via a set days-past-due trigger being met or if, in the opinion of management, there is evidence that individually identifiable loans are impaired even if a set days-past-due trigger has not yet been met. For example, a small number of customers have been declared bankrupt but continue to make their mortgage repayments as scheduled. These customers can be individually identified and therefore an individual assessment can be made as to the level of impairment.

The Group employs various models to assess the level of impairment. These include models to predict roll rates to default, the likelihood of possession given default, and shortfalls in property values over loan balances (after accounting for expected costs, the effects of forced sale, and updated valuations including via house price indexation). The assumptions in these models capture the differing experience of different mortgage types, and are updated regularly to reflect ongoing experience, with appropriate management overlays to ensure appropriate judgement is reflected in the final assessment of impairment.

Collective assessment of impairment

A variety of collective impairment assessments have been made against segments of the mortgage book where there is objective evidence of an impairment event impacting that segment, but which cannot be individually attributed, or more generally where there is evidence of an increased risk of credit losses but, again, where the risks cannot be individually attributed. Examples of segments where collective assessments of impairment have been conducted include provisions held to collectively address the risk that in a downturn issues will emerge that will adversely affect value and saleability of properties that would otherwise be masked in a growing housing market.

Forbearance impairment assessment

Assessment has also been made of customers who are undergoing some measure of forbearance. Since the previous measurement of forbearance impairment, significant additional analysis of the mortgage book has been undertaken with evidence based results being used to identify potential forbearance indicators, measure the performance of accounts with these indicators, and determine the level of impairment provision required.

Use of management overlays

Management overlays to assumptions are applied to ensure that an appropriate level of conservatism is employed. For instance, current point-in-time experience may be for an improvement in a particular roll rate, but if the longer term view is that the risk remains higher than the short term experience, an overlay may be applied to maintain a more conservative position. An example is in values applied in the 'probability of possession from default' assumption. The applied probabilities of possession are generally more conservative than the current experience to accommodate the fact that the likelihood of possession may increase in the event of a further economic downturn.

Recognition of post-impairment improvement

Impairment provisions are raised as the risk is recognised and measured. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the customer's credit rating), the previously recognised impairment loss is reversed by adjusting the impairment provision. The amount of the reversal is recognised in the income statement.

Write-off policy and recognition of post-loss recoveries

When a loan is not collectable, it is written off against the related provision for loan impairment (see note 13). Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recorded in the income statement.

NOTES TO THE ACCOUNTS
(continued)

1. Accounting policies (continued)

Sale and repurchase agreements

Securities lent or sold subject to a commitment to repurchase them (a 'repo') are retained on the balance sheet when substantially all the risks and rewards of ownership remain within the Group. The counterparty liability is included separately in the balance sheet, as appropriate. The difference between the sale and repurchase price is accrued over the life of the agreements using the effective interest rate method.

Derivative financial instruments

The Group holds derivative financial instruments for the purposes of managing the risks associated with its various fixed and capped rate assets, its fixed rate liabilities and its foreign currency transactions. In accordance with legislation and its treasury policy, the Group holds derivative financial instruments only for risk management and not for speculative or trading purposes.

All derivative financial instruments are stated in the Accounts at fair value, with movements in fair value taken through the income statement under 'Net gains from derivative financial instruments' in the period in which the movement occurred. Fair values are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations from counterparties.

Hedge accounting

All derivatives entered into by the Group are for the purpose of providing an economic hedge. Full details of hedging activities are contained in note 30. Hedge accounting is an optional treatment, subject to the satisfaction of specific rules and conditions set out in IAS 39. The Group periodically tests hedge effectiveness and applies fair value hedge accounting, so that changes in the fair value of the underlying asset or liability that are attributable to the hedged risk are recorded in the income statement to offset the fair value movement of the related derivative.

The Group uses derivative financial instruments to mitigate the interest rate risk and foreign currency risk that arises from the Group's lending and funding activities. The Group elects to treat all such derivatives as fair value hedges and adopts the fair value hedge accounting provisions of IAS 39. This treatment is consistent with the economic purpose of using the derivative instruments, which is to provide a hedge against the movement in the fair value of fixed rate and foreign currency assets and liabilities. The Group recognises movements on the balance sheet in respect of the hedged portion of the fair values of the underlying assets and liabilities that should materially offset the volatility that may arise from recognising the fair value movements of the derivatives themselves.

Leases and contract purchase agreements

The determination of whether an arrangement is, or contains, a lease, is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Where the Group enters into a lease that entails taking substantially all the risks and rewards of ownership of an asset, the agreement is treated as a finance lease. The asset is recorded in the balance sheet within property, plant and equipment and is depreciated over its estimated useful life. If there is no reasonable certainty that the Group will obtain ownership by the end of the lease term, the asset is depreciated over the shorter of the lease term and its useful life. Future instalments under such leases, net of finance charges, are included within creditors. Rentals payable are apportioned between the finance element, which is charged to the income statement at a constant annual rate, and the capital element which reduces the outstanding obligation for future instalments.

All other leases are accounted for as operating leases and payments are charged to administrative expenses on a straight line basis over the period of the lease. Rents receivable are credited to other operating income on a straight line basis over the period of the lease.

Intangible assets

Intangible assets consist of software development costs and other intangible assets. Software development costs and purchased software that is not an integral part of a related hardware purchase are recognised as an intangible asset. Amortisation of such assets is charged to the income statement on a straight line basis over the useful life of the asset. The useful life of computer software is between three and eight years.

Other intangible assets arise from retail deposits acquired by the Group. Other intangible assets were fully amortised by 31 December 2011.

Investment properties and property, plant and equipment

Investment property is property held to earn rentals or for capital appreciation or for both, rather than for sale or use in the business. The Group recognises investment properties at cost less accumulated depreciation and any accumulated impairment. The carrying values of investment properties are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

Property, plant and equipment is stated at cost less accumulated depreciation and any accumulated impairment. The carrying values of property, plant and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

An asset's carrying value is written down immediately to its recoverable amount if the asset's carrying value is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing the net disposal proceeds with the carrying value of the asset and are included within the income statement.

Depreciation is provided on a straight line basis over the anticipated useful life of the asset as follows:

• Freehold buildings (including investment properties)	Over a period of 50 years
• Leasehold buildings	Shorter of remaining term of the lease and useful life
• Equipment, fixtures, fittings and vehicles	Three to eight years

Non-current assets held for sale

A non-current asset is classified as held for sale if the Group will recover the carrying amount principally through a sale transaction rather than through continuing use. A non-current asset classified as held for sale is measured at the lower of the carrying amount and fair value less costs to sell. If the asset is acquired as part of a business combination it is initially measured at fair value less costs to sell. Assets classified as held for sale are shown separately on the face of the statement of financial position.

Pension costs

The Group operates a defined benefit pension scheme and a defined contribution scheme for members of staff.

Contributions to the defined contribution pension scheme are recognised as an expense in the income statement as incurred, on an accruals basis.

The Group's net obligation under the defined benefit pension scheme is assessed annually by an independent qualified actuary. The net obligation is calculated as the difference between the fair value of the scheme's assets and the amount of future entitlements earned by scheme members from service in the current and prior periods, discounted back to present values using a rate based on an index of long-dated AA rated corporate bonds. This calculation allows the net obligations of the scheme to be expressed as either a surplus or deficit, which is recognised as respectively either an asset or liability in the Group's Accounts at the balance sheet date.

Pension costs for service in the period are assessed in accordance with advice from a qualified actuary and are recognised in the income statement. Pension fund actuarial gains or losses are recognised in full in the year they occur in the statement of comprehensive income.

A curtailment may occur when the Group is demonstrably committed to make a significant reduction in the number of employees covered by the plan or when amendments to the terms of the plan result in changes to future benefits. The Group recognises gains or losses on curtailment of a defined benefit scheme in the income statement immediately when the curtailment occurs.

1. Accounting policies (continued)

Financial liabilities

Financial liabilities incorporates shares, bank and other deposits, amounts owed to other customers, debt securities in issue, derivative financial liabilities, subordinated liabilities and subscribed capital. The Group classifies its financial liabilities into the following categories:

Amortised Cost
This category consists of all financial liabilities other than derivative financial liabilities. Financial liabilities (other than derivatives) are measured on an amortised cost basis. This represents the face value adjusted for any unamortised premiums, discounts and transactions costs directly attributable to the acquisition or issue. The amortisation is recognised in 'Interest payable and similar charges' using the effective interest rate method.

Financial liabilities are derecognised when the obligation is discharged, cancelled or has expired.

Fair value through profit or loss
This category consists of derivative financial liabilities. Derivative financial liabilities are carried at fair value. Gains and losses arising from changes in the fair values are recognised in the income statement.

Hedging
The impact of hedging on the measurement of financial liabilities is detailed in the derivatives and hedge accounting policy note (page 66).

Provisions and contingent liabilities

A provision is recognised when there is a present obligation as a result of a past event, it is probable that the obligation will be settled and the amount can be estimated reliably.

Contingent liabilities are potential obligations from past events which shall be confirmed by future events. Contingent liabilities are not recognised within the balance sheet.

Foreign currency translation

The consolidated financial statements are presented in sterling, which is the functional currency of the Group.

Foreign currency transactions are translated into sterling using the exchange rates prevailing at the dates of the transactions. Monetary items denominated in foreign currencies are retranslated at the rate prevailing at the year end. Foreign exchange gains and losses resulting from the retranslation and settlement of these items are recognised in the income statement.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash and non-restricted balances with central banks and loans and advances to credit institutions.

2. Significant accounting judgements and estimates

Judgements

In the process of applying the Group's accounting policies, the directors have made the following judgements and estimates that have the most significant effect on the amounts recognised in the financial statements.

Debt securities

The Group maintains a portfolio of liquid assets to ensure it has sufficient funds available to meet its financial commitments as they fall due. A large part of this portfolio is made up of debt securities, for which there are various accounting treatments permitted under IAS 39. The Group has adopted the 'Available-for-sale' treatment as this most closely matches the way debt securities are used within the business, with a portfolio of assets maintained for continuing use, and individual assets available to be sold depending on particular requirements for funding or the maintenance of interest yields. This treatment requires that debt securities are recognised at fair value with movements in fair value taken to equity reserves.

The determination of whether Available-for-sale instruments are impaired is assessed based on similar criteria to financial assets carried at amortised cost.

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded on the balance sheet cannot be derived from active markets, they are determined using interest rate yield curves and other relevant market data. These are judged to be the most appropriate valuation inputs. The valuation of financial instruments, and the associated inputs are disclosed in more detail in note 42.

Deferred tax

The Group recognises deferred tax on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available to utilise the asset. The Group considers that sufficient future taxable profit will, in fact, be available to utilise all the Group's deferred tax assets and the Group has therefore recognised deferred tax assets where they have arisen.

Estimation uncertainty

The key assumptions regarding the future and other key sources of estimation uncertainty at the balance sheet date that have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year are discussed below.

Pension schemes

The Group's defined contribution and defined benefit pension schemes are accounted for under the terms of IAS 19. The standard requires the calculation of the net assets or liabilities of the defined benefit scheme and its inclusion in the statement of financial position. The result is dependent in part on the interest rate used to discount scheme liabilities back to present value. IAS 19 requires that this should equate to a rate available on an AA rated corporate bond. In practice, the rates available on such bonds cover a wide range and there is therefore a range of possible outcomes that could be disclosed as the pension scheme's net position. In order to avoid this uncertainty, the directors have selected a rate from within a narrow range recommended by the Group's professional pension scheme advisors. This range has been based on an index of related corporate bond yields. The impact of a 0.1% decrease in the rate used to discount the future value of the benefit obligation would be to increase the present value of the liability by £3.0 million. The impact of increasing life expectancy by an additional year, increases the present value of the scheme liability by £3.0 million.

Loan impairment and other provisions

IAS 39 requires that loan losses are only recognised where there is objective evidence of impairment. The Group has applied this requirement in determining the level of losses present in its loans and advances to customers, but has been required to apply management judgement in determining the financial impact of this impairment. IAS 39 makes a distinction between individual and collective impairment. Individual impairment relates to situations where individual assets are assessed for loss. The Group has used this approach on loans in possession, those in arrears or where other potential impairment indicators have been identified. Estimates that have been applied include, assessing the likelihood of the loan going into possession for those cases currently in arrears, the length of time expected to be required to complete the sale of properties in possession, and the expected realisable value net of costs. Collective impairment relates to cases where losses are assessed as being present in a loan portfolio, but they

NOTES TO THE ACCOUNTS

(continued)

2. Significant accounting judgements and estimates (continued)

cannot be identified to individual accounts. This approach has been used to calculate a value of incurred but not reported losses, where statistical analysis using historical performance data has been used to determine a value for losses where a loss event has already impacted an account, but has not yet manifested itself in arrears data. A portfolio approach is also used on sections of the loan book where there are known problems but individual accounts are again as yet not identifiable. This method has been applied to a small number of loans advanced on city centre buy-to-let flats where a problem of oversupply has had a negative effect on prices and ease of sale, with the result that the Group has made an impairment provision against these assets. If future house price movements differ from expectations by 1%, the impact on the impairment provision would be £0.5 million.

Estimated asset lives

The Group recognises interest on loans and advances to customers on the basis of their effective interest rate. This is a constant rate that averages out the effect of incentives and fees across the expected life of the loan account. A critical assumption in the calculation is the expected life, as this determines the assumed period over which customers may be paying various differentiated interest rates. The calculation of the effective interest rate uses assumptions on expected life that are based on the historic experience of similar products. These assumptions are monitored to ensure their ongoing appropriateness. Changes in the amortised cost balance arising from actual product life experience differing from the assumed life, are periodically calculated and an adjustment made to the loan balance, with a corresponding adjustment to 'Interest receivable and similar income'. An increase in projected redemption rates of 1% per annum would result in a decrease in loans and advances to customers of £2.0 million. Also within the calculations, provision has been made for the uncertainty of the estimates in order to reduce the risk of overstatement of interest income.

Fair value adjustments in relation to acquired assets

Where assets are acquired as a result of merger or via the purchase of mortgage portfolios, management are required to estimate the expected life and associated cashflows of the assets and amortise the fair value adjustments over this period. Similarly management are required to estimate a suitable period to amortise the impact of any transactions where the transaction price differed from fair value. If different assumptions were made then the impact of these adjustments would be recognised over longer or shorter periods. The impact of increasing the length of these assumptions by one year would have reduced profit in 2012 by £2.8 million.

Valuation of derivatives and Available-for-sale assets

The fair values of derivative financial instruments, Available-for-sale assets, and hedged items for hedge accounting purposes are based on open market prices, where available. If open market prices are not available, the Group uses valuation techniques which comprise discounted cash flow valuation models. The valuation of caps and floors also take account of the optionality within these instruments. The assumptions in these models are periodically reviewed to ensure that they remain relevant.

FSCS levy provision

The Society is committed to paying levy charges of the UK Financial Services Compensation Scheme (FSCS). All deposit-taking institutions who are members of the FSCS are required to contribute to the interest, capital and administrative costs of the FSCS in safeguarding the deposits of savers in failed financial institutions. The Society is, and continues to be, a member of the FSCS (see note 32).

Contributions to the FSCS are calculated according to a prescribed formula using the retail savings balances of all deposit-taking institutions that are members of the FSCS. The provision for these costs in this year's Accounts relates to payments to be made in future periods. The actual payments to be made are subject to change because they are based on estimations of the repayments by failed institutions and future interest rates. The impact of a 50bp increase in the interest rate assumption would result in increasing the carrying value of the FSCS provision by approximately £2.0 million.

3. Interest receivable and similar income

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
On loans fully secured on residential property	**813.3**	**512.4**	730.5	501.7
On other loans				
Connected undertakings	**-**	**301.1**	-	230.9
Other	**3.7**	**2.3**	3.9	2.8
	817.0	**815.8**	734.4	735.4
Interest and other income on debt securities	**94.2**	**74.3**	77.7	77.7
Interest and other income on other liquid assets	**7.3**	**6.5**	5.8	5.5
Net (expense)/income on financial instruments hedging assets	**(72.0)**	**4.3**	(87.9)	(10.5)
Total	**846.5**	**900.9**	730.0	808.1

Included within 'Interest receivable and similar income' is interest accrued of £8.6 million (2011: £8.3 million) for the Group and £5.3 million (2011: £5.8 million) for the Society on impaired financial assets. In addition, £8.0 million has been recognised in respect of excess credit adjustments relating to the subsequent performance of assets acquired as part of the merger with Stroud & Swindon Building Society.

4. Interest payable and similar charges

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Bank and customer				
Subordinated liabilities	**4.6**	**4.6**	5.1	5.1
Other	**7.3**	**7.2**	11.6	11.6
Debt securities in issue	**148.4**	**99.2**	95.5	74.1
Other borrowed funds				
On shares held by individuals	**552.0**	**552.0**	511.5	511.5
On other shares	**0.1**	**0.1**	0.1	0.1
On subscribed capital	**12.2**	**12.2**	12.2	12.2
On loans from connected undertakings	**-**	**65.3**	-	46.3
Net (income)/expense on financial instruments hedging liabilities	**(65.0)**	**28.1**	(73.5)	15.9
Total	**659.6**	**768.7**	562.5	676.8

5. Fees and commissions receivable

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Mortgage related fees	**4.0**	**2.8**	3.6	2.6
General insurance commissions	**6.4**	**6.4**	6.0	6.0
Other fees and commissions	**4.2**	**4.2**	5.4	5.4
Total	**14.6**	**13.4**	15.0	14.0

NOTES TO THE ACCOUNTS
(continued)

6. Fees and commissions payable

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Funding related fees	**0.2**	**0.2**	0.2	0.2
Other fees and commissions	**3.4**	**3.3**	2.9	2.8
Total	**3.6**	**3.5**	3.1	3.0

7. Other operating income

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Rents receivable	**0.5**	**0.3**	0.7	0.4
Other	**1.0**	**10.4**	0.2	0.3
Total	**1.5**	**10.7**	0.9	0.7

During the year, the Society recognised dividend income of £9.4 million (2011: £nil) from its subsidiaries (see note 44). 'Other' also contains £0.8 million (2011: £nil) relating to profits from the disposals of a non-current asset held for sale and an investment property held by the Society.

8. Net gains from derivative financial instruments

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
(Losses)/gains on derivatives designated as fair value hedges	**(2.6)**	**(26.6)**	12.3	(40.9)
Movement in fair value of hedged items attributable to hedged risk	**3.0**	**29.7**	(11.6)	41.6
	0.4	**3.1**	0.7	0.7
Losses on other derivatives	**(0.3)**	**(0.3)**	(0.2)	(0.2)
Total	**0.1**	**2.8**	0.5	0.5

9. Administrative expenses

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Employee costs				
Wages and salaries	**46.7**	**46.7**	42.4	42.4
Social security costs	**4.7**	**4.7**	4.2	4.2
Pension costs				
Defined benefit plan (note 12)	**2.1**	**2.1**	(0.3)	(0.3)
Defined contribution plan	**1.1**	**1.1**	0.8	0.8
	54.6	**54.6**	47.1	47.1
Other expenses	**34.4**	**29.6**	30.6	27.7
Total	**89.0**	**84.2**	77.7	74.8

The remuneration of the auditors, Ernst & Young LLP, is set out below.

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Audit of the annual accounts	**0.2**	**0.2**	0.2	0.2
Audit related assurance services – subsidiary audits	**0.1**	**0.1**	-	-
Tax compliance services	**-**	**-**	0.1	0.1
Tax advisory services	**-**	**-**	0.2	0.2
Other assurance services	**0.1**	**0.1**	0.2	0.2
Total	**0.4**	**0.4**	0.7	0.7

The Group's policy in relation to the use of its auditors on non-audit engagements sets out the nature of services they are generally precluded from performing. Further details on the Society's policy is included within the Corporate Governance Report on page 43. All non-audit engagements provided by the Group's auditors, are subject to pre-approval by either the Audit Committee or the Finance Director (on a delegated basis from the Audit Committee), depending upon the nature of the non-audit engagement.

10. Staff numbers

Group and Society	2012 Full-time	2012 Part-time	2011 Full-time	2011 Part-time
The average number of persons employed during the year (including executive directors) was:				
Head office and administrative centres	**892**	**277**	889	306
Branches	**391**	**228**	416	236
Total	**1,283**	**505**	1,305	542

NOTES TO THE ACCOUNTS
(continued)

11. Directors' emoluments

The emoluments of the Group's directors are listed below:

	Salary £000	Annual bonus[1,2] £000	Long Term Incentive Plan[2,3] £000	Pension contributions[4] £000	Increase in accrued pension £000	Taxable benefit £000	Total £000
Executive directors:							
2012							
David Stewart	**377**	**47**[5]	**124**	**33**	**1**	**79**	**661**
John Lowe	**250**	**31**	**72**	**24**	**-**	**12**	**389**
Colin Franklin	**143**	**16**	**53**	**34**	**4**	**16**	**266**
Peter Frost (appointed 01.11.2012)	**37**	**4**	**-**	**4**	**-**	**4**	**49**
Total	**807**	**98**	**249**	**95**	**5**	**111**	**1,365**
2011							
David Stewart	335	44	44	58	2	42	525
John Lowe	215	29	-	19	-	11	274
Colin Franklin	140	18	20	33	3	14	228
Phil Vaughan (resigned 28.04.2011)	93	-	-	8	-	7	108
Total	783	91	64	118	5	74	1,135

1. The performance of the Society during 2012 gave rise to a payment for all 1,794 eligible members of Coventry staff (2011: 1,749), including executive directors, equivalent to 12% (2011: 13%) of basic salary.
2. As in previous years, all payments made under the annual bonus and LTIP will be paid in March.
3. Payments made under the Long Term Incentive Plan are in relation to the performance of the three financial years 2010, 2011 and 2012. The Remuneration Committee approved a payment of 38.9% (2011: 15%) of base salary at the date of the Deed of Grant to participants in the scheme at that date, reflecting the Group's performance over this period. John Lowe was not a participant in the 2009 to 2011 scheme.
4. David Stewart, John Lowe and Peter Frost are active members of the Group's funded defined contribution pension scheme.
5. David Stewart elected to waive his entitlement to the annual bonus. The Society has donated an amount equivalent to the remuneration waived, to the Coventry Building Society Charitable Foundation.

Defined benefit scheme

Pension benefits earned by directors	Director's contribution £000	Accrued pension per annum at 31.12.2012 £000	Transfer value of accrued benefits 31.12.2011 £000	Transfer value of accrued benefits 31.12.2012 £000	Difference in transfer value less contributions £000
David Stewart[1]	**-**	**42**	**828**	**816**	**(12)**
Colin Franklin	**11**	**59**	**1,442**	**1,534**	**92**

1. David Stewart is also a deferred member of the Group's contributory final salary pension scheme, having left the final salary pension scheme immediately before being appointed Chief Executive in July 2006.

Details of the executive directors' service contracts are contained in section 3 of the Annual Business Statement.

11. Directors' emoluments (continued)

	2012 £000	2011 £000
Non-executive directors:		
Ian Pickering (Appointed as Chairman, 01.01.2013)	**62**	50
David Harding (Chairman, retired 31.12.2012)	**100**	78
Bridget Blow (Deputy Chairman, Senior Independent Director and Chairman of the Remuneration Committee)	**53**	50
Roger Burnell (Chairman of the Board Risk Committee)	**41**	40
Ian Geden	**41**	40
Fiona Smith	**41**	40
Glyn Smith (Chairman of the Audit Committee)	**53**	41
Total	**391**	339

During the year the Chairman's salary was rebased using external benchmarking data. As noted in the Directors' Remuneration Report, no director is involved in the setting of his/her own remuneration. No pension contributions were made for non-executive directors.

For further information on the dates of appointments and retirements of the non-executive directors and the Society's committees, please see the Corporate Governance Report on pages 38 to 45.

12. Pension scheme

The Group operates a funded defined benefit and a funded defined contribution pension scheme for employees and executive directors. The Coventry defined benefit scheme has been closed to new members since December 2001. The defined benefit scheme provide benefits based on final pensionable salary with assets held in separate trustee-administered funds.

On 31 December 2011, the Coventry Building Society Superannuation Fund merged with Stroud & Swindon Building Society Retirement Benefit Plan. On 31 December 2012, the Coventry Building Society defined benefit scheme closed to future service accrual. As a result, a gain on pension curtailment of £9.7 million (net of associated costs of £0.4 million) was recognised in the income statement.

The cost of the defined benefit scheme was assessed in accordance with the advice of a qualified actuary on the basis of valuations using the projected unit method. The main assumptions used in the valuations were:

i) an investment return pre-retirement of 0.5% (2011: 0.8%) per annum in excess of projected salary increases; and
ii) for the Coventry Building Society Superannuation Fund an investment return post-retirement of 1.5% (2011: 1.8%) per annum in excess of guaranteed pension increases in respect of pensionable service accrued prior to 6 April 2006 and 2.3% (2011: 2.6%) per annum in excess of guaranteed pension increases in respect of pensionable service accrued after 6 April 2006.

The Group contributed 24.5% (2011: 24.5%) of members' pensionable salaries over the year to 31 December 2012 into the fund. The Group estimates its contribution into the fund for the following 12 months will be £2.2 million.

12. Pension scheme (continued)

Group and Society	2012 £m	2011 £m
Present value of funded obligations	**(147.9)**	(142.9)
Fair value of plan assets	**158.0**	146.8
Funded status/Pension benefit surplus	**10.1**	3.9
Amounts recognised in the income statement		
Current service cost	**2.3**	2.1
Interest cost on benefit obligations	**6.8**	7.0
Expected return on plan assets	**(7.0)**	(8.2)
Gain on curtailment	**-**	(1.2)
Total charge/(credit) within administrative expenses	**2.1**	(0.3)

A curtailment gain of £9.3 million (net of costs) was recognised as an exceptional gain following the closure of the Coventry Building Society Superannuation Fund to future service accrual.

Group and Society	2012 £m	2011 £m
Actual return on plan assets	**11.4**	7.8
Changes in the present value of the defined benefit obligations		
Defined benefit obligation at 1 January	**142.9**	133.8
Gain on curtailment	**(9.7)**	(1.2)
Current service cost	**2.3**	2.1
Interest cost	**6.8**	7.0
Employee contributions	**0.7**	0.7
Actuarial losses	**9.4**	3.9
Benefits paid	**(4.5)**	(3.4)
Defined benefit obligation at 31 December	**147.9**	142.9
Changes in the fair value of plan assets		
Fair value of plan assets at 1 January	**146.8**	137.9
Expected return on plan assets	**7.0**	8.2
Actuarial gains/(losses)	**4.4**	(0.4)
Contributions by employer	**3.6**	3.8
Employee contributions	**0.7**	0.7
Benefits paid	**(4.5)**	(3.4)
Fair value of plan assets at 31 December	**158.0**	146.8
The amount recognised in the statements of other comprehensive income		
Actuarial losses	**(5.0)**	(4.3)
Tax credit on actuarial losses	**1.0**	1.1
Actuarial loss net of tax	**(4.0)**	(3.2)

12. Pension scheme (continued)

The major categories of plan assets as a percentage of the fair value of total plan assets are:

	Plan assets at 31.12.2012 %	Expected return at balance sheet date %	Plan assets at 31.12.2011 %
Equities	**17**	7.2	19
Corporate bonds	**43**	4.8	20
Government bonds	**23**	3.2	33
Alternatives	**17**	4.9	28
	100		100

Under IAS 19 *Employee Benefits*, the expected return on plan assets at the 31 December 2012 is required to be consistent with the estimated discount rate of 4.4%.

At 31 December 2012, the Coventry Building Society Superannuation Fund held assets totalling £0.5 million which were invested in Coventry Building Society Permanent Interest Bearing Shares (PIBS) (2011: £0.5 million).

The principal actuarial assumptions used are as follows:

Weighted average assumptions used to determine benefit obligations at	**31.12.2012**	31.12.2011
	%	%
Discount rate	**4.4**	4.8
Rate of pensionable salary increase	**3.9**	4.0

Weighted average assumptions used to determine net pension cost for the year ended	**31.12.2012**	31.12.2011
	%	%
Discount rate	**4.8**	5.5
Expected long-term return on fund assets	**4.8**	5.8
Rate of pensionable salary increase	**4.0**	4.3
Rates of inflation (Retail Price Index)	**3.0**	3.5

Weighted average life expectancy for mortality tables used to determine benefit obligations at	**31.12.2012**		31.12.2011	
	Male	**Female**	Male	Female
Member age 60 (current life expectancy)	**26.8**	**29.4**	26.2	28.9
Member age 45 (life expectancy at age 60)	**28.3**	**31.0**	28.3	30.9

The assumptions on mortality are determined by the actuarial tables known as S1PXA with CMI 2011 projections with a 1.25% p.a. long term improvement rate (2011: S1PXA (YOB) medium cohort 1% underpin for current and future pensioners).

		Financial year ending			
	2012	2011	2010	2009	2008
Fund history					
Fair value of fund assets at end of year (£m)	**158.0**	146.8	137.9	95.9	80.4
Benefit obligation at end of year (£m)	**147.9**	142.9	133.8	89.0	71.5
Surplus (£m)	**10.1**	3.9	4.1	6.9	8.9
Difference between expected and actual return on fund assets					
Amount (£m)	**4.4**	(0.4)	4.9	9.5	(20.8)
Percentage of fund assets (%)	**2.8**	(0.3)	3.6	9.9	(25.9)
Actuarial losses/(gains) on fund liabilities					
Amount (£m)	**9.4**	3.9	(0.2)	12.8	(16.4)
Percentage of fund liabilities (%)	**6.4**	2.7	(0.1)	14.4	(22.9)

13. Impairment provisions on loans and advances to customers

Group	Loans fully secured on residential property £m	Other loans £m	Total £m
At 1 January 2012			
Individual impairment	13.8	0.8	14.6
Collective impairment	6.1	0.4	6.5
	19.9	1.2	21.1
Charge for the year			
Individual impairment	7.6	2.2	9.8
Collective impairment	(0.2)	-	(0.2)
	7.4	2.2	9.6
Amounts written off individual impairment	(6.4)	(1.8)	(8.2)
At 31 December 2012			
Individual impairment	15.0	1.2	16.2
Collective impairment	5.9	0.4	6.3
Total	20.9	1.6	22.5

Society	Loans fully secured on residential property £m	Other loans £m	Total £m
At 1 January 2012			
Individual impairment	9.8	0.7	10.5
Collective impairment	3.5	0.2	3.7
	13.3	0.9	14.2
Charge for the year			
Individual impairment	4.9	1.3	6.2
Collective impairment	(0.2)	0.1	(0.1)
	4.7	1.4	6.1
Amounts written off individual impairment	(4.9)	(1.0)	(5.9)
At 31 December 2012			
Individual impairment	9.8	1.0	10.8
Collective impairment	3.3	0.3	3.6
Total	13.1	1.3	14.4

When arriving at the impairment provision, the Group has considered accounts with forbearance and other potential impairment indicators. See note 39 for further details.

The provisions above have been deducted from the appropriate asset values in the statement of financial position.

13. Impairment provisions on loans and advances to customers (continued)

Group	Loans fully secured on residential property £m	Other loans £m	Total £m
At 1 January 2011			
Individual impairment	14.3	0.6	14.9
Collective impairment	5.4	0.8	6.2
	19.7	1.4	21.1
Charge for the year			
Individual impairment	7.8	1.8	9.6
Collective impairment	0.7	(0.4)	0.3
	8.5	1.4	9.9
Amounts written off individual impairment	(8.3)	(1.6)	(9.9)
At 31 December 2011			
Individual impairment	13.8	0.8	14.6
Collective impairment	6.1	0.4	6.5
Total	19.9	1.2	21.1

Society	Loans fully secured on residential property £m	Other loans £m	Total £m
At 1 January 2011			
Individual impairment	10.5	0.5	11.0
Collective impairment	3.9	0.6	4.5
	14.4	1.1	15.5
Charge for the year			
Individual impairment	5.8	1.3	7.1
Collective impairment	(0.4)	(0.4)	(0.8)
	5.4	0.9	6.3
Amounts written off individual impairment	(6.5)	(1.1)	(7.6)
At 31 December 2011			
Individual impairment	9.8	0.7	10.5
Collective impairment	3.5	0.2	3.7
Total	13.3	0.9	14.2

14. Charitable donation to Poppy Appeal

During 2012 the Society again partnered with The Royal British Legion to raise funds for the annual Poppy Appeal. The Society has provided for a donation of £1.9 million (2011: £1.0 million) to the Poppy Appeal.

15. Taxation

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Current tax				
UK corporation tax at 24.5% (2011: 26.5%)	**15.5**	**8.8**	11.9	6.8
UK corporation tax - adjustment in respect of prior years	**(0.7)**	**(1.7)**	(2.4)	(1.8)
Total current tax	**14.8**	**7.1**	9.5	5.0
Deferred tax				
Current year	**6.5**	**1.8**	4.9	1.6
Adjustment in respect of prior years	**(0.3)**	**(0.1)**	(1.5)	(1.6)
Total deferred tax	**6.2**	**1.7**	3.4	-
Total	**21.0**	**8.8**	12.9	5.0

The effective tax rate for the year is 23.7% for the Group and 16.6% for the Society (2011: 21.7% for the Group and 17.4% for the Society). Further information relating to deferred tax is presented in note 24.

The tax on items reported through other comprehensive income is as follows:

Statement of comprehensive income	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Tax credit on actuarial loss on defined benefit pension plan	**(1.0)**	**(1.0)**	(1.1)	(1.1)
Tax (credit)/charge on fair value movements	**(0.8)**	**(0.8)**	5.2	5.2
Total	**(1.8)**	**(1.8)**	4.1	4.1

The actual tax charge for the period differs from the UK standard corporation tax rate of 24.5% (2011: 26.5%). The differences are explained below:

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Profit before tax (PBT)	**88.5**	**52.9**	59.5	28.8
Tax at UK standard rate of corporation tax on PBT of 24.5% (2011: 26.5%)	**21.7**	**13.0**	15.8	7.6
Adjustments in respect of prior years	**(1.0)**	**(1.8)**	(3.9)	(3.4)
Gain on liquidation of group entities	**-**	**(2.3)**	-	-
Effect of rate change	**0.3**	**(0.1)**	1.0	0.3
Expenses not deductible for tax purposes	**-**	**-**	-	0.5
Total	**21.0**	**8.8**	12.9	5.0

On 21 March 2012, the Chancellor announced a reduction in the standard rate of corporation tax to 24% from April 2012. This was a reduction of 1% from the 25% rate previously announced in the March 2011 budget.

It was also announced that over the next two years the standard rate of corporation tax would be reduced to 23% then 22%. This was revised further in the 2012 autumn statement to a rate of 21% by April 2014.

The 23% rate was substantively enacted in July 2012. The Group considers that the temporary differences included in the deferred tax calculations will, for the most part, reverse after 1 April 2013 and therefore the deferred tax assets and liabilities have been calculated using a rate of 23%.

If the 21% rate had already been substantively enacted, this would have reduced the net deferred tax as at 31 December 2012 by £0.5 million. We do not expect the proposed reductions in the statutory rate to 21%, once substantively enacted, to have a material effect on the Group's current or deferred tax charge.

16. Cash in hand and balances with the Bank of England

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Cash in hand and balances with the Bank of England other than mandatory reserve deposits	**1,793.6**	**1,709.7**	1,591.1	1,584.2
Mandatory reserve with the Bank of England	**20.6**	**20.6**	15.9	15.9
Total	**1,814.2**	**1,730.3**	1,607.0	1,600.1

The mandatory reserve deposits with the Bank of England of £20.6 million (2011: £15.9 million) are not available for use in the Group's day-to-day operations. All other balances with the Bank of England are not mandatory and are readily accessible. As at the balance sheet date, £99.5 million (2011: £21.2 million) is excluded from liquid resources due to amounts held in the Group's covered bonds and RMBS programmes (see page 19).

17. Loans and advances to credit institutions

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Loans and advances to credit institutions have remaining maturities as follows:				
Accrued interest	**0.1**	**-**	0.1	0.1
Repayable on demand	**203.6**	**205.3**	143.6	143.6
Other loans and advances by residual maturity repayable				
In not more than three months	**95.0**	**15.0**	243.6	174.6
In more than three months but not more than one year	**25.0**	**-**	1.0	1.0
Total	**323.7**	**220.3**	388.3	319.3

As at the balance sheet date, the Group and Society deposited £203.6 million and £205.3 million (Group 2011: £143.6 million, Society 2011: £143.6 million) in collateral accounts with counterparties relating to interest rate swap agreements and sale and repurchase transactions. As at 31 December 2012, £308.7 million (2011: £212.7 million) are excluded from liquid resources due to amounts held in collateral accounts and in the Group's covered bonds and RMBS programmes (see page 19).

18. Debt securities

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Available-for-sale:				
UK Government investment securities	**1,597.7**	**1,597.7**	1,781.4	1,781.4
Analysis of transferable debt securities				
Listed	**589.4**	**564.4**	786.5	786.5
Unlisted	**151.1**	**151.1**	278.4	278.4
Total	**2,338.2**	**2,313.2**	2,846.3	2,846.3
Debt securities have remaining maturities as follows:				
In not more than one year	**263.8**	**238.8**	560.5	560.5
In more than one year	**2,074.4**	**2,074.4**	2,285.8	2,285.8
Total	**2,338.2**	**2,313.2**	2,846.3	2,846.3

18. Debt securities (continued)

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Movements during the year of transferable securities are analysed below:				
At 1 January	**2,846.3**	**2,846.3**	2,864.0	2,864.0
Additions	**3,104.3**	**3,104.3**	7,276.7	7,276.7
Maturities and disposals	**(3,645.6)**	**(3,670.6)**	(7,468.8)	(7,468.8)
Gains from changes in fair value	**33.2**	**33.2**	174.4	174.4
At 31 December	**2,338.2**	**2,313.2**	2,846.3	2,846.3

As at the balance sheet date, £25.0 million (2011: £nil) is excluded from liquid resources due to amounts held in the Group's covered bonds and RMBS securitisation programmes (see page 19).

19. Loans and advances to customers

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Loans fully secured on residential property	**21,951.1**	**14,896.5**	19,163.4	13,977.1
Other loans				
Loans fully secured on land	**10.1**	**1.5**	11.4	1.1
Other loans	**57.7**	**39.1**	65.2	44.8
	67.8	**40.6**	76.6	45.9
Total	**22,018.9**	**14,937.1**	19,240.0	14,023.0

Other loans incorporate £0.7 million (2011: £0.9 million) of loans that are fully secured on residential property and that were made to corporate bodies such as Housing Associations prior to 1 July 1998, the date upon which the Society became subject to the powers of the Building Societies Act 1997. Although the classification of these assets is not consistent with similar loans made after 1 July 1998 that are included in 'Loans fully secured on residential property', this treatment has been adopted in order to comply with the requirements of the Building Societies Act 1997. Other loans also include unsecured personal loans.

During June 2012, a wholly owned subsidiary of the Society, ITL Mortgages Limited, acquired a £0.5 billion portfolio of buy-to-let mortgages from the Bank of Ireland. Acquired loans and receivables are recognised at fair value at the acquisition date. This fair value becomes the opening amortised cost for these assets.

The acquisition of this portfolio has been accounted for as an acquisition under International Accounting Standard 39 *Financial Instruments: Recognition and Measurement.* IAS 39 permits the rebuttal of the presumption that the cash price paid represents the fair value of an acquired portfolio. In such circumstances the fair value of an acquired portfolio is calculated using a valuation technique based on observable market data and other inputs. The Society has accordingly valued the portfolio based upon its yield and expected behavioural life using observable market data where available. The fair value of the portfolio calculated was higher than the cash price paid. The resulting difference was recorded as a deferred gain on acquisition and will be recognised over future periods from the point of acquisition.

19. Loans and advances to customers (continued)

Maturity analysis

The remaining maturity of loans and advances to customers at the balance sheet date is as follows:

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
In not more than one year	139.2	99.6	104.8	91.7
In more than one year	21,902.2	14,851.9	19,156.3	13,945.5
	22,041.4	14,951.5	19,261.1	14,037.2
Impairment provision (note 13)	(22.5)	(14.4)	(21.1)	(14.2)
Total	22,018.9	14,937.1	19,240.0	14,023.0

The maturity analysis is based on contractual maturity not actual redemption levels experienced by the Group or Society.

Certain loans and advances have been pledged to the Group's asset backed funding programmes. Coventry Building Society Covered Bonds LLP, Leofric No.1 plc and Mercia No.1 plc were established for the Group's covered bonds and RMBS programmes, into which the assets have been pledged. Note 41 details the extent to which these assets are encumbered.

20. Investments in subsidiary undertakings

Society	Shares £m	Loans £m	Total £m
Cost and net book value			
At 1 January 2012	13.2	9,744.8	9,758.0
Additions	7.0	1,711.8	1,718.8
Disposals/repayment	(12.2)	(285.7)	(297.9)
At 31 December 2012	8.0	11,170.9	11,178.9

During the year, the Society simplified its Group structure, resulting in the repayment of intercompany loans from its subsidiaries, and payment of dividends. Stroud and Swindon Funding Company and Stroud and Swindon Funding Company (No.2) Limited are in members' voluntary liquidation. As a result, ITL Mortgages Limited is now recognised as a direct subsidiary of the Society (see note 44).

The Society has the following subsidiary undertakings all of which are consolidated:

Subsidiary undertakings	Principal activity
Godiva Mortgages Limited	Mortgage lending
ITL Mortgages Limited	Mortgage lending and mortgage acquisition vehicle
Stroud and Swindon Funding Company	In members' voluntary liquidation
Stroud and Swindon Funding Company (No.2) Limited	In members' voluntary liquidation
Five Valleys Property Company Limited	Investment properties holding company
Coventry Financial Services Limited	Non-trading
Coventry Property Services Limited	Non-trading
Godiva Financial Services Limited	Non-trading
Godiva Housing Developments Limited	Non-trading
Godiva Savings Limited	Non-trading
Godiva Securities and Investments Limited	Non-trading
Coventry Building Society Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds
Leofric No.1 plc	Funding vehicle
Mercia No.1 plc	Funding vehicle

20. Investments in subsidiary undertakings (continued)

All the companies are registered in England and operate in the United Kingdom.

All the entities are either 100% directly or indirectly owned by Coventry Building Society, except for Coventry Building Society Covered Bonds LLP, Leofric No.1 plc and Mercia No.1 plc. The Society's interests in these entities are, in substance, no different than if they were 100% held subsidiary undertakings and consequently are consolidated in the Group accounts.

21. Intangible assets

Group	Software expenditure 2012 £m	Other intangible assets 2012 £m	Total 2012 £m	Software expenditure 2011 £m	Other intangible assets 2011 £m	Total 2011 £m
Cost						
At 1 January	**12.7**	**3.0**	**15.7**	13.4	3.0	16.4
Additions	**3.5**	**-**	**3.5**	3.1	-	3.1
Retirements	**(2.8)**	**(3.0)**	**(5.8)**	(3.8)	-	(3.8)
At 31 December	**13.4**	**-**	**13.4**	12.7	3.0	15.7
Amortisation						
At 1 January	**3.2**	**3.0**	**6.2**	3.5	0.7	4.2
Charge for the year[1]	**3.8**	**-**	**3.8**	3.5	2.3	5.8
Amortisation on retirements	**(2.8)**	**(3.0)**	**(5.8)**	(3.8)	-	(3.8)
At 31 December	**4.2**	**-**	**4.2**	3.2	3.0	6.2
Net book value at 31 December	**9.2**	**-**	**9.2**	9.5	-	9.5

Society	Software expenditure 2012 £m	Other intangible assets 2012 £m	Total 2012 £m	Software expenditure 2011 £m	Other intangible assets 2011 £m	Total 2011 £m
Cost						
At 1 January	**12.2**	**3.0**	**15.2**	12.9	3.0	15.9
Additions	**3.5**	**-**	**3.5**	3.1	-	3.1
Retirements	**(2.8)**	**(3.0)**	**(5.8)**	(3.8)	-	(3.8)
At 31 December	**12.9**	**-**	**12.9**	12.2	3.0	15.2
Amortisation						
At 1 January	**2.7**	**3.0**	**5.7**	3.0	0.7	3.7
Charge for the year[1]	**3.8**	**-**	**3.8**	3.5	2.3	5.8
Amortisation on retirements	**(2.8)**	**(3.0)**	**(5.8)**	(3.8)	-	(3.8)
At 31 December	**3.7**	**-**	**3.7**	2.7	3.0	5.7
Net book value at 31 December	**9.2**	**-**	**9.2**	9.5	-	9.5

1. The amortisation charge of 'Other intangible assets' has been included within 'Integration and merger related costs' within the income statement.

22. Property, plant and equipment

Group and Society	Land and buildings Freehold £m	Long leasehold £m	Short leasehold £m	Equipment, fixtures fittings and vehicles £m	Total £m
Cost					
At 1 January 2012	**9.3**	**3.9**	**3.4**	**48.7**	**65.3**
Additions	**-**	**-**	**-**	**3.7**	**3.7**
Disposals	**-**	**-**	**-**	**(4.3)**	**(4.3)**
At 31 December 2012	**9.3**	**3.9**	**3.4**	**48.1**	**64.7**
Depreciation					
At 1 January 2012	**1.3**	**0.6**	**2.2**	**28.4**	**32.5**
Charge for the year	**0.1**	**0.1**	**0.1**	**5.5**	**5.8**
Depreciation on disposals	**-**	**-**	**-**	**(4.1)**	**(4.1)**
At 31 December 2012	**1.4**	**0.7**	**2.3**	**29.8**	**34.2**
Net book value at 31 December 2012	**7.9**	**3.2**	**1.1**	**18.3**	**30.5**

Disposals relate to assets that were retired during the year.

Group and Society	Land and buildings Freehold £m	Long leasehold £m	Short leasehold £m	Equipment, fixtures fittings and vehicles £m	Total £m
Cost					
At 1 January 2011	7.9	3.9	3.2	43.0	58.0
Additions	-	-	0.2	8.6	8.8
Transferred from non-current assets held for sale	1.4	-	-	-	1.4
Disposals	-	-	-	(2.9)	(2.9)
At 31 December 2011	9.3	3.9	3.4	48.7	65.3
Depreciation					
At 1 January 2011	1.1	0.4	2.1	26.3	29.9
Charge for the year	0.2	0.2	0.1	4.5	5.0
Depreciation on disposals	-	-	-	(2.4)	(2.4)
At 31 December 2011	1.3	0.6	2.2	28.4	32.5
Net book value at 31 December 2011	8.0	3.3	1.2	20.3	32.8

Equipment, fixtures, fittings and vehicles includes assets held under finance leases as follows:

Group and Society	2012 £m	2011 £m
Net book value	**1.5**	0.9
Accumulated depreciation	**0.6**	0.6

The net book value of land and buildings occupied by the Group for its own activities is as follows:

Group and Society	2012 £m	2011 £m
At 31 December	**11.6**	11.6

23. Investment properties

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Cost				
At 1 January	**5.9**	**0.7**	5.9	0.7
Disposals	**(0.3)**	**(0.3)**	-	-
At 31 December	**5.6**	**0.4**	5.9	0.7
Amortisation				
At 1 January	**0.2**	**0.1**	0.1	0.1
Charge for the year	**-**	**-**	0.1	-
At 31 December	**0.2**	**0.1**	0.2	0.1
Net book value at 31 December	**5.4**	**0.3**	5.7	0.6
Fair value at 31 December	**6.1**	**0.5**	6.9	1.3

Investment properties generally include residential properties and offices ancillary to branch premises which are not occupied by the Group.

Depreciation is provided by the Group to write off the cost less the estimated residual value of investment properties (excluding land) by equal instalments over their useful economic life of 50 years. Land is not depreciated. Any impairment in the value of properties is dealt with through the income statement as it arises.

The investment properties were valued by a qualified chartered surveyor, who is a member of the Royal Institute of Chartered Surveyors (RICS). The properties were valued on the basis of market value, and the valuation was carried out in accordance with the RICS Appraisal and Valuation Standards. As the investment properties are held at depreciated historical cost less impairment, this valuation has not been reflected in the carrying value of the assets. No impairment of the investment properties was made during the year.

Non-current assets held for sale
As at 31 December 2011, non-current assets held for sale comprised of one freehold property. The property was sold in January 2012.

24. Deferred tax

Deferred tax assets and liabilities are attributable to the following items:

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Deferred tax assets				
Provisions	**0.5**	**0.5**	0.5	0.5
IFRS transitional fair value adjustments	**0.9**	**0.6**	0.9	0.9
Excess of depreciation over capital allowances	**0.9**	**0.8**	0.3	0.3
Transfer of engagements - fair value adjustments	**6.8**	**3.8**	12.8	5.0
Total	**9.1**	**5.7**	14.5	6.7
Deferred tax liabilities				
IFRS transitional fair value adjustments	**1.0**	**1.0**	1.5	1.5
Defined benefit pension plan surplus	**2.3**	**2.3**	1.0	1.0
Transfer of engagements - fair value adjustments	**0.4**	**0.4**	0.5	0.5
Total	**3.7**	**3.7**	3.0	3.0

25. Shares

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Held by individuals	**20,103.0**	**20,103.0**	18,956.0	18,956.0
Other shares	**7.5**	**7.5**	8.1	8.1
Total	**20,110.5**	**20,110.5**	18,964.1	18,964.1

Shares are repayable from the balance sheet date in the ordinary course of business as follows:

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Accrued interest	**164.1**	**164.1**	165.9	165.9
Repayable on demand	**16,438.9**	**16,438.9**	14,297.0	14,297.0
Shares with residual maturity repayable:				
In not more than three months	**7.5**	**7.5**	-	-
In more than three months but not more than one year	**2,607.3**	**2,607.3**	3,596.0	3,596.0
In more than one year but not more than five years	**892.7**	**892.7**	905.2	905.2
Total	**20,110.5**	**20,110.5**	18,964.1	18,964.1

26. Deposits from banks

Deposits from banks are repayable from the balance sheet date in the ordinary course of business as follows:

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Accrued interest	**0.5**	**0.5**	0.8	0.8
Repayable on demand	**2.4**	**2.4**	3.1	3.1
Other amounts owed to banks with residual maturity repayable:				
In not more than three months	**713.0**	**713.0**	507.0	507.0
Total	**715.9**	**715.9**	510.9	510.9

As at the balance sheet date, deposits from banks include £676.3 million (2011: £500.8 million) in respect of sale and repurchase agreements. The Group also held £1.2 million (2011: £nil) of collateral deposited by counterparties under sale and repurchase agreements.

As at 31 December 2012, £1.2 million (2011: £3.1 million) was held by the Group as amounts deposited by counterparties under interest rate swap collateralisation agreements.

27. Other deposits

Other deposits are repayable from the balance sheet date in the ordinary course of business as follows:

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Amounts owed to depositors with residual maturity repayable:				
In not more than three months	**6.5**	**6.5**	23.0	23.0
In more than three months but not more than one year	**3.0**	**3.0**	-	-
Total	**9.5**	**9.5**	23.0	23.0

28. Amounts owed to other customers

Amounts owed to other customers are repayable from the balance sheet date in the ordinary course of business as follows:

	Group 2012 £m	**Society 2012 £m**	Group 2011 £m	Society 2011 £m
Accrued interest	**1.4**	**1.4**	1.9	1.9
Repayable on demand	**19.5**	**19.5**	25.2	25.2
Other amounts due to customers with residual maturity repayable:				
In not more than three months	**316.9**	**316.9**	451.8	451.8
In more than three months but not more than one year	**111.2**	**111.2**	61.3	61.3
In more than one year but not more than five years	**1.0**	**1.0**	9.1	9.1
Total	**450.0**	**450.0**	549.3	549.3

29. Debt securities in issue

	Group 2012 £m	**Society 2012 £m**	Group 2011 £m	Society 2011 £m
Certificates of Deposit	**73.8**	**73.8**	192.4	192.4
Covered Bonds	**1,805.3**	**1,805.3**	1,318.6	1,318.6
Medium Term Notes	**1,260.4**	**1,260.4**	1,352.8	1,352.8
Residential Mortgage Backed Securities	**735.2**	**-**	-	-
Total	**3,874.7**	**3,139.5**	2,863.8	2,863.8

Debt securities in issue are repayable from the balance sheet date in the ordinary course of business as follows:

	Group 2012 £m	**Society 2012 £m**	Group 2011 £m	Society 2011 £m
Accrued interest	**42.0**	**40.4**	46.0	46.0
Other debt securities in issue with residual maturity repayable:				
In not more than one year	**71.2**	**71.2**	701.6	701.6
In more than one year	**3,761.5**	**3,027.9**	2,116.2	2,116.2
Total	**3,874.7**	**3,139.5**	2,863.8	2,863.8

30. Derivative financial instruments

	2012			2011		
Group	**Contract/ notional amount £m**	**Fair value assets £m**	**Fair value liabilities £m**	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Derivatives designated as fair value hedges						
Interest rate swaps	**11,414.0**	**279.3**	**369.8**	11,854.0	258.6	299.8
Interest rate caps	**458.0**	**-**	**-**	748.0	0.3	-
Cross currency swaps	**975.1**	**-**	**41.4**	570.1	-	36.2
Other derivatives						
Interest rate floors	**40.0**	**0.3**	**-**	40.0	0.8	-
Total	**12,887.1**	**279.6**	**411.2**	13,212.1	259.7	336.0

30. Derivative financial instruments (continued)

Contract/notional amount indicates the amount on which payment flows are derived at the balance sheet date and does not represent amounts at risk.

Group	2012 Contract/ notional amount £m	2012 Fair value assets £m	2012 Fair value liabilities £m	2011 Contract/ notional amount £m	2011 Fair value assets £m	2011 Fair value liabilities £m
Derivatives have remaining maturities as follows:						
In not more than one year	**4,404.6**	**3.7**	**11.4**	5,006.2	13.9	14.8
In more than one year	**8,482.5**	**275.9**	**399.8**	8,205.9	245.8	321.2
Total	**12,887.1**	**279.6**	**411.2**	13,212.1	259.7	336.0

Society	2012 Contract/ notional amount £m	2012 Fair value assets £m	2012 Fair value liabilities £m	2011 Contract/ notional amount £m	2011 Fair value assets £m	2011 Fair value liabilities £m
Derivatives designated as fair value hedges						
Interest rate swaps	**10,664.0**	**175.7**	**369.8**	11,104.1	168.3	299.8
Interest rate caps	**458.0**	**-**	**-**	748.0	0.3	-
Cross currency swaps	**405.0**	**-**	**4.6**	-	-	-
Other derivatives						
Interest rate floors	**40.0**	**0.3**	**-**	40.0	0.8	-
Interest rate basis swaps	**500.0**	**1.8**	**-**	-	-	-
Total	**12,067.0**	**177.8**	**374.4**	11,892.1	169.4	299.8

Derivatives have remaining maturities as follows:

Society	2012 Contract/ notional amount £m	2012 Fair value assets £m	2012 Fair value liabilities £m	2011 Contract/ notional amount £m	2011 Fair value assets £m	2011 Fair value liabilities £m
In not more than one year	**4,404.6**	**3.7**	**11.4**	5,006.2	13.9	14.8
In more than one year	**7,662.4**	**174.1**	**363.0**	6,885.9	155.5	285.0
Total	**12,067.0**	**177.8**	**374.4**	11,892.1	169.4	299.8

Hedging activities

Fair value hedges

At 31 December 2012 the Group held the following interest rate derivative contracts which qualify for hedge accounting:

- Interest rate swap agreements under which the Group pays a fixed rate of interest and receives interest based on LIBOR. These swaps are used to hedge the exposure to changes in the fair value of fixed rate mortgage assets as a result of changes in market interest rates. These swaps have a nominal principal amount of £5,276.9 million (2011: £3,792.7 million) and a net negative fair value of £114.6 million (2011: net negative £98.2 million).

30. Derivative financial instruments (continued)

- Interest rate swap agreements under which the Group receives a fixed rate of interest and pays interest based on LIBOR. These swaps are used to hedge the exposure to changes in the fair value of fixed rate share liabilities as a result of changes in market interest rates. These swaps have a nominal principal amount of £3,075.0 million (2011: £4,465.0 million) and a net positive fair value of £37.0 million (2011: net positive £37.0 million).

- Interest rate swap agreements under which the Group pays a fixed rate of interest and receives interest based on LIBOR. These swaps are used to hedge the exposure to changes in the fair value of fixed rate gilts, Government guaranteed bonds, bonds issued by supranational organisation or covered bonds, purchased in the wholesale market as a result of changes in market interest rates. These swaps have a nominal principal amount of £1,398.0 million (2011: £1,448.0 million) and a net negative fair value of £254.8 million (2011: net negative £196.9 million).

- Interest rate swap agreements under which the Group receives a fixed rate of interest and pays interest based on LIBOR. These swaps are used to hedge the exposure to changes in the fair value of fixed rate bonds or liabilities issued in the wholesale market as a result of changes in market interest rates. These swaps have a nominal principal amount of £1,664.1 million (2011: £2,148.3 million) and a net positive fair value of £241.9 million (2011: net positive £216.9 million).

- Interest rate cap agreements under which the Group pays an initial premium and is subsequently compensated to the extent that LIBOR exceeds the cap strike rate. These caps are used to hedge changes in the fair value of exposure to the risk that market rates exceed the cap on capped rate mortgage assets. These caps have a nominal principal amount of £458.0 million (2011: £748.0 million) and a net positive fair value of £nil (2011: net positive £0.3 million).

- Cross currency swaps under which the Group receives interest at a fixed rate of euros and pays interest based on LIBOR. These swaps are used to hedge the exposure to changes in the fair value of euro denominated bonds issued in the wholesale market as a result of changes in market interest rates and exchange rates. These cross currency swaps have a nominal principal amount of £975.1 million (2011: £570.1 million) and a net negative fair value of £41.4 million (2011: £36.2 million).

- The derivative gains and losses for the year in respect of fair value hedges comprise losses on derivatives of £2.6 million (2011: £12.3 million gains) and associated gains on hedged items of £3.0 million (2011: £11.6 million losses).

Hedges not qualifying for hedge accounting

At 31 December 2012 the Group held the following interest rate derivative contracts which do not qualify for hedge accounting:

- Interest rate floor agreements under which the Group pays an initial premium and is subsequently compensated to the extent that LIBOR falls below the floor strike rate. These floors are used to hedge the risk of long-term low rates of interest. These floors have a nominal principal amount of £40.0 million (2011: £40.0 million) and a net positive fair value of £0.3 million (2011: £0.8 million).

- The derivative gains and losses for the year in respect of hedges that do not qualify for hedge accounting comprise losses on derivatives of £0.3 million (2011: losses of £0.2 million).

At 31 December 2012 the Society held the following interest rate derivative contracts, which do not qualify for hedge accounting:

- Intra-group interest rate swaps with the subsidiary that operates the Group's covered bond programme. Under this agreement, the Society receives interest based on three-month LIBOR and pays interest based on one-month LIBOR. These swaps have a nominal principal amount of £500.0 million (2011: £nil) and a positive net positive fair value of £1.8 million (2011: £nil) at Society level but are eliminated at Group level.

In addition to the above, the Society also has intra-group interest rate swaps with the subsidiaries that operate the Group's covered bonds and RMBS programmes. Under these agreements, the Society receives the interest income of the subsidiaries' mortgage books and pays LIBOR on the same basis as the subsidiaries' interest expense. These swaps have a nominal principal amount of £5,365.9 million (2011: £4,487.9) and are accounted for on an accruals basis, in accordance with IAS 39.

31. Other liabilities

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Other liabilities falling due within one year are as follows:				
Amounts due to connected undertakings	**-**	**4,703.3**	-	4,474.7
Tax deducted at source from interest paid	**16.4**	**16.4**	14.3	14.3
Other taxation and social security	**2.1**	**2.1**	2.2	2.2
Finance leases	**0.5**	**0.5**	0.4	0.4
Other creditors	**1.6**	**1.2**	2.4	2.4
	20.6	**4,723.5**	19.3	4,494.0
Other liabilities falling due after more than one year but in less than five years:				
Finance leases	**1.1**	**1.1**	0.5	0.5
Total	**21.7**	**4,724.6**	19.8	4,494.5

32. Provisions for liabilities and charges

Group and Society	**FSCS 2012 £m**	**Other provisions 2012 £m**	**Total 2012 £m**	FSCS 2011 £m	Other provisions 2011 £m	Total 2011 £m
At 1 January	**18.5**	**1.8**	**20.3**	10.5	5.4	15.9
Charge for the year	**10.2**	**-**	**10.2**	13.4	0.2	13.6
Provisions utilised	**(6.6)**	**(0.8)**	**(7.4)**	(5.4)	(3.8)	(9.2)
At 31 December	**22.1**	**1.0**	**23.1**	18.5	1.8	20.3

FSCS Levy

All deposit-taking institutions that are members of the UK Financial Services Compensation Scheme (FSCS) are required to contribute to the costs of the FSCS in safeguarding the deposits of savers in financial institutions. The Society is, and continues to be, a member of the FSCS.

Contributions to the FSCS are calculated according to a prescribed formula using the retail savings balances of all deposit-taking institutions who are members of the FSCS.

The Group has provided £10.2 million in its 2012 Accounts with respect to the estimated levies for the period 2013/14 and revisions for the levy estimate for the period 2012/13 previously provided in its 2011 Accounts (2011: £13.4 million for the period 2012/13 and revisions for the period 2011/12). The FSCS provision is expected to be utilised in two payments of £15.0 million and £7.1 million in September 2013 and September 2014 respectively, to cover the FSCS levy periods 2012/13 and 2013/14.

These costs are 'exceptional' because they are outside of the Group's control and are dependent upon the extent of failures of other deposit-taking institutions who are members of the FSCS.

Other provisions

Other provisions have also been recognised in respect of the Stroud & Swindon merger restructuring and circumstances that may give rise to various customer claims.

The Stroud & Swindon merger is now complete and as a result the Society released £0.5 million relating to a restructuring provision.

During the year, the Society raised a £0.5 million provision for Payment Protection Insurance (PPI) redress to customers. It is expected that the liability will mainly crystallise over the next five years.

The Group has no contingent liabilities to report.

33. Subordinated liabilities

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Subordinated liabilities owed to note holders are as follows:				
Fixed rate subordinated notes 2016 - 12.25%	**7.0**	**7.0**	7.0	7.0
Fixed rate subordinated notes 2017 - 8.37%	**-**	**-**	10.0	10.0
Fixed rate subordinated notes 2021 - 6.12%	**10.1**	**10.1**	10.1	10.1
Fixed rate subordinated notes 2022 - 6.469%	**15.5**	**15.5**	15.5	15.5
Fixed rate subordinated notes 2026 - 6.33%	**10.1**	**10.1**	10.2	10.2
Fixed rate subordinated notes 2032 - 7.54%	**15.4**	**15.4**	15.4	15.4
Total	**58.1**	**58.1**	68.2	68.2

All the subordinated liabilities are denominated in sterling. The notes are repayable in the years stated, or earlier in accordance with their terms at the option of the Society, with the prior consent of the FSA.

In June 2012 the Society, with the consent of the FSA, redeemed early the £10.0 million 8.37% subordinated loan due 3 June 2017 at par.

The rights of repayment of the holders of the notes are subordinated to the claims of all depositors, creditors and members holding shares as to principal and interest.

34. Subscribed capital

	Call date	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Subscribed capital owed to permanent interest holding members is as follows:					
Permanent Interest Bearing Shares 1992 - 12 1/8%	n/a	**41.6**	**41.6**	41.6	41.6
Permanent Interest Bearing Shares 2006 - 6.092%	June 2016	**119.8**	**119.8**	119.7	119.7
Total		**161.4**	**161.4**	161.3	161.3

Interest is paid in arrears on £40 million Permanent Interest Bearing Shares at the rate of 12 1/8% per annum in half-yearly instalments, and on £120 million Permanent Interest Bearing Shares at the rate of 6.092% per annum in half-yearly instalments. The shares are repayable only in the event of a winding up of the Society or otherwise with the prior consent of the FSA. In a winding up or dissolution of the Society the claims of the holders of Permanent Interest Bearing Shares would rank behind all other creditors of the Society including subordinated liabilities and the claims of members holding shares as to principal and interest. The holders of Permanent Interest Bearing Shares are not entitled to any share in any final surplus upon a winding up or final dissolution of the Society.

35. Available-for-sale reserve

Amounts within the Available-for-sale reserve are transferred to the income statement upon the disposal of debt securities, and where a hedging relationship exists between the debt securities and a derivative instrument.

During the year, £26.1 million (2011: £143.4 million) was transferred to 'Net gains from derivative financial instruments' in the income statement with respect of hedge accounting adjustments to offset the effect of changes in the fair value of derivatives hedging Available-for-sale debt securities. Amounts transferred to 'Interest receivable and similar income' totalled £15.1 million (2011: £14.0 million) in respect of the disposal of Available-for-sale debt securities.

36. Financial commitments

Subject to the satisfaction of previously agreed loan to value ratios, the Group and Society are committed to the following undrawn mortgage loan facilities relating to lifetime and flexible mortgage products.

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Undrawn mortgage loan facilities	**110.5**	**83.7**	125.9	93.4

37. Capital and leasing commitments

Capital commitments	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Capital expenditure contracted for but not provided for in the Accounts	**0.8**	**0.8**	0.2	0.2

Leasing commitments	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Future minimum lease payments under non-cancellable operating leases relating to land and buildings were as follows:				
Within one year	**3.2**	**3.2**	3.2	3.2
Between one and five years	**9.6**	**9.6**	9.6	9.6
After five years	**9.1**	**9.1**	8.7	8.7
Total	**21.9**	**21.9**	21.5	21.5
Lease payments recognised as an expense in the period	**3.7**	**3.7**	3.7	3.7
Leasing payments due as lessor				
At the balance sheet date, future minimum sub-leasing payments receivable under non-cancellable subleases were as follows:				
Within one year	**0.1**	**0.1**	0.2	0.2
Between one and five years	**0.4**	**0.4**	0.5	0.5
Total	**0.5**	**0.5**	0.7	0.7
At the balance sheet date, future minimum lease payments receivable under non-cancellable leases were as follows:				
Within one year	**0.1**	**0.1**	0.2	0.2
Between one and five years	**-**	**-**	0.4	0.4
After five years	**-**	**-**	0.2	0.2
Total	**0.1**	**0.1**	0.8	0.8

38. Financial instruments - market risk

Use of financial instruments

The risks of the organisation are managed on a Group basis and therefore all risk disclosures in this note have been presented on a consolidated basis. The term 'Group' is used in the remainder of this note to cover the activities of both the Group and the Society.

Deposits are accepted from customers at both fixed and variable interest rates for various periods. The Group earns interest margin on these deposits by investing in mortgages.

The Group holds derivative financial instruments for the purposes of managing the risks associated with its various fixed and capped rate assets and liabilities and its foreign currency transactions. In accordance with its treasury policy, and the Building Societies Act 1986, the Group holds derivative financial instruments only for risk management and not for speculative or trading purposes.

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

The accounting policy for derivatives and hedge accounting is described in the Accounting Policies in note 1.

Interest rate risk

The Group evaluates the impact on margin of various interest rate scenarios to monitor interest rate risk. The Group uses basis point sensitivity analysis to assess the change in the value of the Group's balance sheet net worth against a 100 basis point (1.0%) parallel shock to interest rates.

Details of this sensitivity analysis are set out below. The limits around these scenarios are proposed by ALCO and approved by the Board. The Group's approach surrounding the management of interest rate risk is detailed within the Risk Management Report (see page 30).

All exposures include investment of the Group's reserves.

38. Financial instruments - market risk (continued)

The following table shows the impact on net worth through the reporting period:

	+100bps 2012 £m	-100bps 2012 £m	+100bps 2011 £m	-100bps 2011 £m
Impact on equity reserves	(5.1)	5.0	(13.7)	14.0
Impact on profit and loss	19.2	(10.1)	11.1	(6.4)

The impact on equity reserves considers movements in the underlying value of assets and liabilities carried at fair value, based on the shift in market interest rates, whereas the impact on profit or loss considers the impact on the Group results in respect of shift in the return on the Group's assets and liabilities.

The following table sets out the carrying amount of the Group's financial instruments that are exposed to interest rate risk and the expected interest reset date of those instruments.

At 31 December 2012	Three months or less £m	More than three months less than six months £m	More than six months less than one year £m	More than one year less than five years £m	More than five years £m	Non-interest bearing £m	Total £m
Assets							
Liquid assets	2,679	30	25	235	1,203	304	4,476
Loans and advances to customers	14,579	626	1,442	4,866	480	26	22,019
Fixed assets	-	-	-	-	-	45	45
Other assets and adjustments	-	-	-	-	-	394	394
Total assets	17,258	656	1,467	5,101	1,683	769	26,934
Liabilities and equity							
Shares	(11,136)	(1,296)	(5,592)	(1,929)	(3)	(155)	(20,111)
Deposits, amounts owed to customers and debt securities	(2,390)	(111)	(38)	(959)	(1,500)	(52)	(5,050)
Other liabilities and adjustments	-	-	-	-	-	(752)	(752)
Subordinated liabilities	-	-	-	-	(58)	-	(58)
Subscribed capital	-	-	-	(120)	(41)	-	(161)
Reserves	-	-	-	-	-	(802)	(802)
Total liabilities and equity	(13,526)	(1,407)	(5,630)	(3,008)	(1,602)	(1,761)	(26,934)
Derivative financial instruments	(1,678)	807	1,701	(923)	93	-	-
Interest rate sensitivity gap	2,054	56	(2,462)	1,170	174	(992)	-

NOTES TO THE ACCOUNTS
(continued)

38. Financial instruments - market risk (continued)

Interest rate risk (continued)

At 31 December 2011	Three months or less £m	More than three months less than six months £m	More than six months less than one year £m	More than one year less than five years £m	More than five years £m	Non-interest bearing £m	Total £m
Assets							
Liquid assets	2,951	-	-	355	1,278	258	4,842
Loans and advances to customers	12,652	931	1,051	3,939	621	46	19,240
Fixed assets	-	-	-	-	-	48	48
Other assets and adjustments	-	-	-	-	-	357	357
Total assets	15,603	931	1,051	4,294	1,899	709	24,487
Liabilities and equity							
Shares	(9,816)	(1,028)	(4,780)	(2,997)	(24)	(319)	(18,964)
Deposits, amounts owed to customers and debt securities	(1,188)	(566)	(73)	(554)	(1,500)	(66)	(3,947)
Other liabilities and adjustments	-	-	-	-	-	(603)	(603)
Subordinated liabilities	-	-	-	-	(68)	-	(68)
Subscribed capital	-	-	-	(120)	(41)	-	(161)
Reserves	-	-	-	-	-	(744)	(744)
Total liabilities and equity	(11,004)	(1,594)	(4,853)	(3,671)	(1,633)	(1,732)	(24,487)
Derivative financial instruments	(2,658)	524	2,904	(761)	142	(151)	-
Interest rate sensitivity gap	1,941	(139)	(898)	(138)	408	(1,174)	-

Foreign currency risk

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

The risk is managed through the use of currency swaps and foreign currency forward contracts and also, where appropriate, by the matching of foreign currency liabilities with assets denominated in the same currency.

After taking into account the effects of cross currency swaps, the Group has no material net exposure to foreign exchange risk fluctuations or changes in foreign currency interest rates. ALCO sets limits on the level of exposure by currency which are monitored daily.

House price risk

House price risk arises from the value of the property forming the security for the mortgage being insufficient to repay the loan in the event of default and subsequent repossession. The Group manages this risk through a combination of prudent loan to value limits at inception and constant monitoring to ensure that bad debt provisions are sufficient to cover the potential losses that may arise in repossession situations. Further details of the Group's policies for managing house price risk are set out within the Risk Management Report (see page 31).

39. Financial instruments - retail credit risk

The risks of the organisation are managed on a Group basis and therefore all risk disclosures in this note have been presented on a consolidated basis. The term 'Group' is used in the remainder of this note to cover the activities of both the Group and the Society.

Credit risk is the risk that customers or counterparties will be unable to meet their financial obligations to the Group as they fall due. Provisions are raised where there is evidence of impairment at the balance sheet date (see note 13). The Group's policies in respect of managing credit risk are detailed in the Risk Management Report (see pages 28 to 30).

Maximum credit risk exposure at 31 December 2012 approximates to the carrying value for all assets and loan commitments.

Of the £22,018.9 million 'Loans and advances to customers', £21,961.2 million (99.7%) (2011: 99.7%) is fully secured on residential property and land and £57.7 million (0.3%) (2011: 0.3%) relates to unsecured personal loans.

The Group's number of customers in arrears as a percentage of loans and advances to customers compared to the Council of Mortgage Lenders' (CML) data is shown below:

	Group 2012 %	**CML[1] 2012 %**	Group 2011 %	CML[1] 2011 %
Greater than three months	**1.08**	**1.91**	1.16	1.98
Greater than six months	**0.51**	**1.05**	0.56	1.12
Greater than one year	**0.14**	**0.43**	0.14	0.48
In possession	**0.03**	**0.10**	0.05	0.12

1. Council of Mortgage Lenders' data as at 31 December 2012 (31 December 2011).

Below is an analysis of the collateral, the payment due status and the associated impairment provision held against loans and advances to customers.

	Not impaired		**Impaired**				
At 31 December 2012 Indexed Loan to value:	**Not past due £m**	**Past due less than three months £m**	**Past due over three to six months £m**	**Past due over six months or in litigation £m**	**In possession £m**	**Impairment provision £m**	**Total £m**
< 50%	5,978.0	101.9	14.5	13.7	0.2	(0.4)	**6,107.9**
50% to 65%	5,935.3	149.5	19.5	17.4	-	(1.8)	**6,119.9**
65% to 75%	3,948.9	148.0	25.0	15.1	0.2	(2.2)	**4,135.0**
75% to 85%	2,980.9	182.9	24.7	21.8	0.2	(3.1)	**3,207.4**
85% to 95%	1,333.4	84.2	23.0	24.8	0.1	(3.3)	**1,462.2**
> 95%	792.6	62.1	34.0	40.1	10.1	(10.1)	**928.8**
Unsecured	53.8	4.2	0.7	0.6	-	(1.6)	**57.7**
Total	**21,022.9**	**732.8**	**141.4**	**133.5**	**10.8**	**(22.5)**	**22,018.9**

The Group uses the Nationwide regional house price index to provide an updated estimate of the property's value, on a quarterly basis.

The Group held properties valued at £8.4 million (2011: £11.6 million) pending their sale as collateral against loan repossession cases of £7.5 million (2011: £10.6 million), (net of impairment provisions) which are classified in 'Loans and advances to customers' in the statement of financial position.

39. Financial instruments - retail credit risk (continued)

At 31 December 2011 Indexed Loan to value:	Not impaired: Not past due £m	Not impaired: Past due less than three months £m	Impaired: Past due over three to six months £m	Impaired: Past due over six months or in litigation £m	Impaired: In possession £m	Impairment provision £m	Total £m
< 50%	5,701.4	100.5	15.7	11.9	0.2	(0.2)	5,829.5
50% to 65%	4,927.5	130.5	19.1	15.3	0.1	(1.9)	5,090.6
65% to 75%	3,243.6	121.6	21.4	16.9	0.1	(2.1)	3,401.5
75% to 85%	2,413.9	123.9	21.6	20.0	0.3	(2.8)	2,576.9
85% to 95%	1,203.9	105.3	26.0	25.4	0.7	(3.2)	1,358.1
> 95%	787.2	60.0	27.2	40.3	13.2	(9.7)	918.2
Unsecured	63.0	2.2	0.6	0.6	-	(1.2)	65.2
Total	18,340.5	644.0	131.6	130.4	14.6	(21.1)	19,240.0

Loan to value analysis on advances to customers for new lending:

Original Loan to value:	**2012 %**	2011 %
< 50%	**25.63**	32.48
50% to 65%	**40.28**	37.58
65% to 75%	**14.07**	17.56
75% to 85%	**15.19**	11.07
85% to 95%	**4.83**	1.31
> 95%	**-**	-
Total	**100.00**	100.00

Forbearance

The table below presents an analysis of accounts subject to forbearance indicators:

	No of accounts 2012	**Carrying value 2012 £m**
Forbearance indicators: Accounts past due		
Arrangements	**3,099**	**360.9**
Concessions	**242**	**28.7**
Term extensions[1]	**122**	**12.4**
Capitalisation of arrears[1]	**2**	**0.3**
Temporary transfer to interest only[1,2]	**2**	**0.2**
Forbearance indicators: Accounts not past due		
Payment holidays granted by collections department[1]	**1,213**	**137.1**
Term extensions[1]	**50**	**5.2**
Capitalisation of arrears[1]	**10**	**1.2**
Temporary transfer to interest only[1,2]	**35**	**4.7**
Total	**4,775**	**550.7**

1. Granted in the last 12 months.
2. The Group no longer offers temporary transfer to interest only.

The Group offers payment holidays as a contractual feature on most mortgage products. Where there are concerns that the borrower may be experiencing financial difficulties, they are referred to the Group's collection department, and recorded as forbearance.

40. Financial instruments - wholesale credit risk

The risks of the organisation are managed on a Group basis and therefore all risk disclosures in this note have been presented on a consolidated basis. The term 'Group' is used in the remainder of this note to cover the activities of both the Group and the Society.

	Exposure value by Moody's rating					
2012	**Aaa-Aa3 £m**	**A1-A3 £m**	**Baa1-Baa3 £m**	**Other £m**	**Unrated £m**	**Total £m**
Central banks and sovereigns	**3,316.7**	**-**	**-**	**-**	**-**	**3,316.7**
Multilateral development banks (supranational bonds)	**217.2**	**-**	**-**	**-**	**-**	**217.2**
Financial institutions	**320.1**	**396.3**	**4.9**	**-**	**16.7**	**738.0**
Mortgage-backed securities	**198.9**	**5.3**	**-**	**-**	**-**	**204.2**
Local authorities	**-**	**-**	**-**	**-**	**-**	**-**
Total	**4,052.9**	**401.6**	**4.9**	**-**	**16.7**	**4,476.1**

'Unrated' institutions comprise smaller building societies and local authorities.

No impairment provisions have been raised in relation to the Group's liquid assets. When assessing whether liquid assets are impaired, the Group reviews the credit ratings of the counterparties, current market valuations (such as negative fair value adjustments), as well as the extent to which coupon payments have been made on a timely basis.

	Exposure value by Moody's rating					
2011	Aaa-Aa3 £m	A1-A3 £m	Baa1-Baa3 £m	Other £m	Unrated £m	Total £m
Central banks and sovereigns	3,365.1	-	-	-	-	3,365.1
Multilateral development banks (supranational bonds)	188.7	-	-	-	-	188.7
Financial institutions	625.4	348.2	35.0	17.7	27.8	1,054.1
Mortgage-backed securities	228.7	5.0	-	-	-	233.7
Local authorities	-	-	-	-	0.5	0.5
Total	4,407.9	353.2	35.0	17.7	28.3	4,842.1

Exposures rated as 'Other', comprise of Irish financial institutions and other rated UK building societies.

40. Financial instruments - wholesale credit risk (continued)

The following section summarises the Group's exposure to institutions split by geographic domicile.

2012	Liquid Assets Sovereign £m	Supra-national £m	Financial institutions £m	Mortgage backed securities £m	Local authority £m	**Total lending £m**	Of which, debt securities Amortised cost £m	Fair value £m	**Total £m**
UK	3,316.7	-	469.3	204.2	-	**3,990.2**	1,813.5	170.5	**1,984.0**
Europe									
Belgium	-	-	54.7[2]	-	-	**54.7**	55.1	(0.4)	**54.7**
Denmark	-	-	4.9	-	-	**4.9**	-	-	**-**
France	-	-	16.4	-	-	**16.4**	-	-	**-**
Germany	-	-	55.7	-	-	**55.7**	53.3	-	**53.3**
Ireland	-	-	-	-	-	**-**	-	-	**-**
Netherlands	-	-	109.0	-	-	**109.0**	28.0	-	**28.0**
Norway	-	-	-	-	-	**-**	-	-	**-**
Sweden	-	-	-	-	-	**-**	-	-	**-**
Switzerland	-	-	2.4	-	-	**2.4**	-	-	**-**
Supranational[1]	-	217.2	-	-	-	**217.2**	209.1	8.1	**217.2**
Total	-	217.2	243.1	-	-	**460.3**	345.5	7.7	**353.2**
Rest of world	-	-	25.6	-	-	**25.6**	1.0	-	**1.0**
Total	**3,316.7**	**217.2**	**738.0**	**204.2**	**-**	**4,476.1**	**2,160.0**	**178.2**	**2,338.2**

1. Supranational relates to amounts held with European Investment Bank, which is guaranteed by a number of European Sovereigns.
2. Consists of amounts (£54.7 million) invested with Financial institutions, which are guaranteed by Sovereigns (Belgium and France).

40. Financial instruments - wholesale credit risk (continued)

2011	Liquid Assets Sovereign £m	Supra-national £m	Financial institutions £m	Mortgage backed securities £m	Local authority £m	Total lending £m	Of which, debt securities Amortised cost £m	Fair value £m	Total £m
UK	3,365.1	-	539.2[2]	233.7	0.5	4,138.5	2,166.7	158.2	2,324.9
Europe									
Belgium	-	-	58.0[3]	-	-	58.0	60.2	(2.2)	58.0
Denmark	-	-	1.9	-	-	1.9	-	-	-
France	-	-	64.4	-	-	64.4	10.7	-	10.7
Germany	-	-	240.4	-	-	240.4	158.2	-	158.2
Ireland	-	-	7.7	-	-	7.7	8.4	(0.7)	7.7
Netherlands	-	-	50.1	-	-	50.1	10.1	-	10.1
Norway	-	-	25.0	-	-	25.0	25.0	-	25.0
Sweden	-	-	15.0	-	-	15.0	15.0	-	15.0
Switzerland	-	-	4.3	-	-	4.3	-	-	-
Supranational[1]	-	188.7	-	-	-	188.7	185.7	3.0	188.7
Total	-	188.7	466.8	-	-	655.5	473.3	0.1	473.4
Rest of world	-	-	48.1	-	-	48.1	48.0	-	48.0
Total	3,365.1	188.7	1,054.1	233.7	0.5	4,842.1	2,688.0	158.3	2,846.3

1. Supranational relates to amounts held with European Investment Bank, which is guaranteed by a number of European Sovereigns.
2. Consists of amounts (£205.8 million) invested with Financial institutions, which is guaranteed by a UK Sovereign.
3. Consists of amounts (£53.0 million) invested with Financial institutions, which are guaranteed by Sovereigns (Belgium and France).

The table below analyses net amounts held as collateral against derivatives entered into by the Group by geographic domicile.

	Derivatives Fair value asset 2012 £m	**Fair value liability 2012 £m**	**Net collateral 2012 £m**	Derivatives Fair value asset 2011 £m	Fair value liability 2011 £m	Net collateral 2011 £m
UK	**234.0**	**341.4**	**176.5**	219.5	275.2	113.0
Europe						
Denmark	**-**	**4.4**	**4.9**	-	2.0	1.9
France	**38.0**	**52.0**	**16.4**	32.0	45.5	15.7
Germany	**-**	**2.4**	**2.4**	-	2.9	7.1
Switzerland	**0.1**	**4.2**	**2.4**	0.8	5.4	4.3
Total	**38.1**	**63.0**	**26.1**	32.8	55.8	29.0
Rest of world	**7.5**	**6.8**	**(0.6)**	7.4	5.0	(1.5)
Total	**279.6**	**411.2**	**202.0**	259.7	336.0	140.5

The Group utilises a small number of swap counterparties with whom collateral is pledged and held on a net basis, in accordance with contractual terms. Accordingly net collateral positions are presented above. Amounts deposited as collateralisation against the net exposure of financial derivatives consists of £203.2 million included within 'Loans and advances to credit institutions' (note 17), and £1.2 million included within 'Deposits from banks' (note 26).

41. Financial instruments - liquidity risk

Liquidity risk is the risk that the Group has insufficient funds to meet its financial obligations as they fall due. This could manifest itself in extreme scenarios such as an inability to raise new wholesale funding to replace existing funding as it matures, or a run on retail funds. Details of the Group's approach for managing liquidity risk are detailed in the Risk Management Report (see pages 31 to 33).

The risks of the organisation are managed on a Group basis and therefore all risk disclosures in this note have been presented on a consolidated basis. The term 'Group' is used in the remainder of this note to cover the activities of both the Group and the Society.

Liquidity risk – maturity analysis
For each material class of financial liability the contractual maturity analysis is provided in notes 25 to 30. In practice, customer deposits will be repaid later than on the contractual date on which the repayment can be required.

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

At 31 December 2012	**Repayable on demand £m**	**Up to three months £m**	**More than three months less than six months £m**	**More than six months less than one year £m**	**More than one year less than five years £m**	**More than five years £m**	**Total £m**
Liabilities							
Shares	**16,571**	**12**	**312**	**2,376**	**923**	**-**	**20,194**
Deposits, amounts owed to customers and debt securities	**22**	**1,132**	**198**	**161**	**2,558**	**1,694**	**5,765**
Other liabilities and adjustments	**-**	**116**	**32**	**70**	**373**	**173**	**764**
Subordinated liabilities	**-**	**1**	**1**	**2**	**47**	**39**	**90**
Subscribed capital	**-**	**2**	**4**	**6**	**158**	**64**	**234**
Total liabilities	**16,593**	**1,263**	**547**	**2,615**	**4,059**	**1,970**	**27,047**
Undrawn loan facilities	**111**	**-**	**-**	**-**	**-**	**-**	**111**
Leasing commitments	**-**	**1**	**1**	**1**	**10**	**9**	**22**

At 31 December 2011	Repayable on demand £m	Up to three months £m	More than three months less than six months £m	More than six months less than one year £m	More than one year less than five years £m	More than five years £m	Total £m
Liabilities							
Shares	14,423	7	539	3,212	950	-	19,131
Deposits, amounts owed to customers and debt securities	25	1,099	588	94	671	1,500	3,977
Other liabilities and adjustments	-	102	57	45	240	163	607
Subordinated liabilities	-	1	11	2	34	57	105
Subscribed capital	-	2	4	6	165	42	219
Total liabilities	14,448	1,211	1,199	3,359	2,060	1,762	24,039
Undrawn loan facilities	126	-	-	-	-	-	126
Leasing commitments	-	1	1	2	10	8	22

41. Financial instruments - liquidity risk (continued)

Repayments of shares which are subject to notice are treated as if the notice were to be given immediately. In practice, deposits in the form of fixed bonds, notice accounts, regular savings accounts and some other transactional accounts are held by customers over the longer term and for this reason the table does not reflect the expected cash flows indicated by the Group's deposit retention history.

The tables above exclude cash flows beyond five years (other than the repayment of principal) that relate to subscribed capital.

Pledged assets ('Encumbrance') – Loans and advances to customers

Certain debt securities in issue (funding) are secured against the Group's assets as part of the Group's asset backed funding programmes. The programmes have enabled the Group to obtain secured funding or to create additional collateral which could be used to source additional funding.

The table below illustrates the balances of external funding secured on the Group's loans and advances:

2012	**Mortgages pledged £m**	**Held by third parties £m**	**Held by the Group drawn £m**	**Held by the Group undrawn £m**	**Total £m**
Loans and advances to customers					
Covered bonds programme	**4,397.2**	**1,805.3**	**-**	**1,400.0**	**3,205.3**
Securitisation programme – Leofric No.1 plc	**1,015.7**	**735.2**	**-**	**122.7**	**857.9**
Securitisation programme – Mercia No.1 plc	**1,571.3**	**-**	**-**	**1,436.4**	**1,436.4**
Total	**6,984.2**	**2,540.5**	**-**	**2,959.1**	**5,499.6**

Securities held by the Group reflect notes issued under the covered bonds and securitisations programmes which have been retained to provide eligible collateral to access central government schemes such as the Funding for Lending Scheme (FLS). The Group also has other approved mortgage pools totalling £988.4 million which can be used as collateral for FLS. In December 2012, the Group used assets from these approved mortgage pools as collateral in exchange for £100.0 million of Treasury bills. The Treasury bills are not recognised in the statement of financial position in accordance with IAS 39.

2011	Mortgages pledged £m	Held by third parties £m	Held by the Group drawn £m	Held by the Group undrawn £m	Total £m
Loans and advances to customers					
Covered bonds programme	4,474.7	1,318.6	-	1,450.0	2,768.6
Total	4,474.7	1,318.6	-	1,450.0	2,768.6

Mortgages have been pledged by the Society and its subsidiary, Godiva Mortgages Limited (Godiva) to special purpose entities (SPEs) in order to raise wholesale funding. The pledged mortgages remain on the balance sheet of the entity pledging the mortgages (the 'Originator') within 'Loans and advances to customers', as the Originator has retained substantially all the risks and rewards of ownership. These assets cannot be used to provide further funding due to the legal restrictions in place as part of these funding programmes.

41. Financial instruments - liquidity risk (continued)

As the mortgages continue to be recognised in the balance sheets of the Originators, an amount equivalent to the value of the pledged mortgages is recognised in the Originators' balance sheets, within 'Other liabilities', representing the non-derecognised mortgages still owing to the SPE. In addition to this, the Originator also recognises within 'Investment in subsidiary undertakings' its investments in the SPEs, which consists of intercompany loans and investments in debt securities that were issued by the SPEs.

Notes in issue and 'Held by third parties' are included within 'Debt securities in issue' (note 29) and represent external funding received by the Group in respect of the Group's Covered Bond and Securitisation programmes. Notes in issue, 'Held by the Group undrawn' are debt securities issued by the programmes to the Society, which are held to provide collateral for potential future use in sale and repurchase agreements ('repo') or central bank operations.

In accordance with accounting standards, notes in issue and held by the Group are not recognised by the Group in its statement of financial position.

Covered Bonds
The Group established Coventry Building Society Covered Bonds LLP (LLP) in July 2008, initially in order to provide security for issues of self issued covered bonds and subsequently for external issuances.

In February 2012, the Coventry Building Society issued a £500 million three year covered bond. In April 2011, the Society issued a £750 million seven year deal and a further €650 million three year deal in October 2011. As at the year end, the Society had in issue £2,650.0 million and €650.0 million (2011: £2,200.0 million and €650.0 million) of covered bonds. The LLP is consolidated by the Group.

Securitisation – Leofric No.1 plc
Leofric No.1 plc ('Leofric') was incorporated in November 2011. In May 2012, Leofric issued £933.5 million of listed debt securities secured against certain loans of the Society and its subsidiary Godiva Mortgages Limited, of which £133.5 million was retained by the Group. Under the terms of the Securitisation programme, the nominal amount of the debt securities is paid down to match the payment profile of the mortgages pledged to the programme. As at 31 December 2012, listed debt securities in issue had fallen to £857.9 million of which £122.7 million was held by the Group.

Securitisation – Mercia No.1 plc
Mercia No.1 plc ('Mercia') was incorporated in October 2012. In December 2012, Mercia issued £1,436.4 million of listed debt securities in issue, all of which remain held by the Group. As at 31 December 2012, listed debt securities totalled £1,436.4 million.

Pledged assets ('Encumbrance') – Sale and repurchase transactions of debt securities
As part of its liquidity management, the Group enters into sale and repurchase agreements (repo), whereby the Group sells but agrees to repurchase assets at a future date, typically up to 3 months. Both UK Government investment securities and listed transferable debt securities (see note 18) includes items which have been sold under sale and repurchase agreements. These assets have not been derecognised, as the Group has retained substantially all the risks and rewards of ownership. Proceeds of these sale and repurchase agreements are included within 'Deposits from banks' (see note 26).

	Pledged 2012 £m	Proceeds 2012 £m	Pledged 2011 £m	Proceeds 2011 £m
Available-for-sale:				
UK Government investment securities	**591.1**	**596.2**	439.2	400.4
Analysis of transferable debt securities				
Listed	**95.6**	**80.1**	104.5	100.4
Total	**686.7**	**676.3**	543.7	500.8

41. Financial instruments - liquidity risk (continued)

As at 31 December 2012 15.5% (2011: 11.1%) of the Group's balance sheet was encumbered. This excludes assets encumbered against notes in issue 'Held by the Group undrawn' and proportions of other approved mortgage pools that remain unutilised.

The fair value of assets that have been pledged and their associated liabilities where recourse is limited to the underlying asset have been presented in the table below:

	Fair value assets pledged 2012 £m	**Fair value liabilities 2012 £m**	**Fair value net position 2012 £m**	Fair value assets pledged 2011 £m	Fair value liabilities 2011 £m	Fair value net position 2011 £m
Loans and advances to customers	**1,015.4**	**886.8**	**128.6**	-	-	-

42. Financial instruments - fair values

Set out below is a comparison by category of the carrying amounts and the fair values of all the Group's, and shown separately the Society's, non-derivative financial instruments.

Group	**Carrying amount 2012 £m**	**Fair value 2012 £m**	Carrying amount 2011 £m	Fair value 2011 £m
Financial assets				
Cash	**1,814.2**	**1,814.2**	1,607.0	1,607.0
Debt securities - Available-for-sale:				
UK Government investment securities	**1,597.7**	**1,597.7**	1,781.4	1,781.4
Analysis of transferable debt securities				
Listed	**589.4**	**589.4**	786.5	786.5
Unlisted	**151.1**	**151.1**	278.4	278.4
Total	**2,338.2**	**2,338.2**	2,846.3	2,846.3
Loans and advances at amortised cost				
Loans and advances to credit institutions	**323.7**	**323.7**	388.3	388.2
Loans and advances to customers	**22,018.9**	**21,710.8**	19,240.0	19,836.5
Other deposits	**-**	**-**	0.5	0.5
Total	**22,342.6**	**22,034.5**	19,628.8	20,225.2
Financial liabilities				
Financial liabilities at amortised cost				
Shares	**20,110.5**	**20,140.7**	18,964.1	18,782.0
Deposits, amounts owed to customers and debt securities	**5,050.1**	**5,369.7**	3,947.0	4,301.3
Subordinated liabilities	**58.1**	**61.3**	68.2	92.2
Permanent Interest Bearing Shares	**161.4**	**181.1**	161.3	238.3
Total	**25,380.1**	**25,752.8**	23,140.6	23,413.8

Loans and advances to customers - fair values

The fair value of loans to customers is assessed as the value of the expected future cash flows. Future cash flows are projected using contractual interest payments, contractual repayments and the expected prepayment behaviour of borrowers. Prudent assumptions are applied regarding expected levels of customer prepayments and the risk of defaults. The resulting estimated future cash flows are discounted at current market rates to determine a fair value. These fair values have been adjusted where necessary to reflect any observable market conditions at the time of valuation.

42. Financial instruments - fair values (continued)

Customer shares and deposits
Shares and deposits from customers are valued in accordance with the cash flows projected from the contractual terms of the deposits. The fair value of shares and deposits that are available on demand is the amount repayable on demand. The fair value of fixed term or restricted access deposits is determined from the estimated projected cash flows from those deposits discounted at the current market rates for those types of deposit.

In 2012, the Group refined its fair value methodology for financial assets and financial liabilities' in light of the forthcoming accounting standard IFRS 13 *Fair Value Measurement*, which formalises the framework for measuring fair value and establishes it as an 'exit price' in the principal market. Valuations therefore incorporate and reflect observed pricing, conditions and expectations in the current market.

Society	**Carrying amount 2012 £m**	**Fair value 2012 £m**	Carrying amount 2011 £m	Fair value 2011 £m
Financial assets				
Cash	**1,730.3**	**1,730.3**	1,600.1	1,600.1
Debt securities - Available-for-sale:				
UK Government investment securities	**1,597.7**	**1,597.7**	1,781.4	1,781.4
Analysis of transferable debt securities				
Listed	**564.4**	**564.4**	786.5	786.5
Unlisted	**151.1**	**151.1**	278.4	278.4
Total	**2,313.2**	**2,313.2**	2,846.3	2,846.3
Loans and advances at amortised cost				
Loans and advances to credit institutions	**220.3**	**220.3**	319.3	319.2
Loans and advances to customers	**14,937.1**	**14,708.2**	14,023.0	14,287.3
Other deposits	**-**	**-**	0.5	0.5
Total	**15,157.4**	**14,928.5**	14,342.8	14,607.0
Financial liabilities				
Financial liabilities at amortised cost				
Shares	**20,110.5**	**20,140.7**	18,964.1	18,782.0
Deposits, amounts owed to customers and debt securities	**4,314.9**	**4,517.5**	3,947.0	4,301.3
Subordinated liabilities	**58.1**	**61.3**	68.2	92.2
Permanent Interest Bearing Shares	**161.4**	**181.1**	161.3	238.3
Total	**24,644.9**	**24,900.6**	23,140.6	23,413.8

Determination of fair value and fair value hierarchy

The Group uses the following hierarchy for determining and disclosing financial instruments which are carried at fair value:

Level 1: quoted prices in active markets for the same instrument;

Level 2: quoted prices in active markets for similar assets or liabilities or other valuation techniques for which all significant inputs are based on observable market data; and

Level 3: valuation techniques for which any significant input is not based on observable market data.

42. Financial instruments - fair values (continued)

31 December 2012	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total fair value £m**
Financial assets				
Derivative financial instruments				
Interest rate swaps	**-**	**279.3**	**-**	**279.3**
Interest rate caps	**-**	**-**	**-**	**-**
Interest rate floors	**-**	**0.3**	**-**	**0.3**
Total	**-**	**279.6**	**-**	**279.6**
Debt securities - Available-for-sale:				
UK Government investment securities	**1,597.7**	**-**	**-**	**1,597.7**
Analysis of transferable debt securities				
Listed	**589.4**	**-**	**-**	**589.4**
Unlisted	**-**	**151.1**	**-**	**151.1**
Total	**2,187.1**	**151.1**	**-**	**2,338.2**
Financial liabilities				
Derivative financial instruments				
Interest rate swaps	**-**	**323.5**	**46.3**	**369.8**
Interest rate caps	**-**	**-**	**-**	**-**
Currency swaps	**-**	**41.4**	**-**	**41.4**
Total	**-**	**364.9**	**46.3**	**411.2**

31 December 2011				
Financial assets				
Derivative financial instruments				
Interest rate swaps	-	258.6	-	258.6
Interest rate caps	-	0.3	-	0.3
Interest rate floors	-	0.8	-	0.8
Total	-	259.7	-	259.7
Debt securities - Available-for-sale:				
UK Government investment securities	1,781.4	-	-	1,781.4
Analysis of transferable debt securities				
Listed	786.5	-	-	786.5
Unlisted	-	278.4	-	278.4
Total	2,567.9	278.4	-	2,846.3
Financial liabilities				
Derivative financial instruments				
Interest rate swaps	-	254.0	45.8[1]	299.8
Currency swaps	-	36.2	-	36.2
Total	-	290.2	45.8	336.0

1. Interest rate swaps previously classified as Level 2 have been restated to Level 3.

42. Financial instruments - fair values (continued)

Financial instruments recorded at fair value

The following is a description of the determination of fair value for financial instruments which are recorded at fair value using valuation techniques. These incorporate the Group's estimate of assumptions that a market participant would make when valuing the instruments.

Level 1 - Debt securities - Available-for-sale - Listed

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

Level 2 - Derivatives

Derivative products valued using a valuation technique with observable market inputs are interest rate swaps and cross currency swaps. The valuation techniques applied are swap models using present value calculations. The models incorporate various assumptions including interest rate curves and foreign exchange spot and forward rates.

Level 2 - Available-for-sale - Unlisted

Debt securities valued using a valuation technique with observable market inputs are certificates of deposits. The valuation techniques applied are models using present value calculations. The models incorporate various assumptions including interest rate curves. All inputs are based on observable market inputs.

Level 3 - Derivatives

Derivative products valued using a valuation technique with unobservable market inputs are interest rate swaps. The valuation techniques applied are swap models using present value calculations. The models incorporate various assumptions including interest rate curves which are observable, and unobservable inputs relating to the projected principal and expected life of the swap. The valuations applied were obtained from external parties.

The items included within Level 3 are balance tracking swaps, for which 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. As changes in the projection of the underlying mortgage portfolio impact the swap and hedged item equally, the net income statement impact would be negligible.

43. Capital management

The Group is subject to the capital requirements imposed by its regulator the Financial Services Authority (FSA).

As at 31 December 2012, and throughout the year, the Group complied in full with the capital requirements that were in force. Further information on the Group's capital resources and capital management can be found on pages 15 to 18 and pages 34 and 35.

44. Related party transactions

Ultimate controlling party

The Group is controlled by Coventry Building Society registered in England and Wales, which is also considered to be the ultimate parent.

Transactions with key management personnel

Transactions with key management personnel are on the same terms and conditions applicable to members and other employees within the Group. The directors are considered to be the only 'key management' for the purposes of the related party transactions disclosures under IAS 24. Key management personnel also incorporates non-executive directors.

In accordance with Section 68 of the Building Societies Act 1986, the Society maintains a register of loans falling within Section 65 made to directors and connected persons. A statement containing requisite particulars of such transactions may be inspected by members at the Society's AGM or at the Registered Office of the Society during the period 15 days prior to the AGM.

	2012 £000	2011 £000
Aggregate loans and deposits of directors		
Loans payable by directors to the Society		
Loans outstanding at 1 January	**1,235.7**	1,409.8
Loans issued during the year (including existing loans on appointment as director)	**-**	-
Loan repayments during the year (net of interest)	**(84.2)**	(174.1)
Loans outstanding at 31 December	**1,151.5**	1,235.7
Deposits payable by the Society		
Deposits outstanding at 1 January	**2,918.0**	2,758.9
Deposits issued during the year	**958.4**	1,248.5
Deposit repayments during the year (net of interest)	**(1,757.0)**	(1,089.4)
Deposits outstanding at 31 December	**2,119.4**	2,918.0
Net interest income/(expense)		
Interest receivable	**16.8**	18.3
Interest payable	**(50.4)**	(47.0)
Total	**(33.6)**	(28.7)

44. Related party transactions (continued)

Transactions with group companies

Transactions are entered into with related parties in the normal course of business. These include loans, deposits and the payment and recharge of interest and administrative expenses. The volumes of related party transactions, outstanding balances at the year end, and related income and expenses for the year are as follows:

	2012 £m	2011 £m
Loans payable to the Society		
Loans outstanding as at 1 January	**9,744.8**	7,204.1
Loans issued during the year	**1,711.8**	-
Repayments during the year	**(285.7)**	2,540.7
Loans outstanding as at 31 December	**11,170.9**	9,744.8
Net interest receivable	**396.2**	329.9
Fees and expenses paid to the Society	**4.6**	2.7
Dividends received by the Society	**9.4**	-

Interest on outstanding loans and deposits accrues at a transfer price rate agreed between the Society and its subsidiaries.

During the year, the Society underwent a simplification of its Group structure, resulting in the repayment of intercompany loans from its subsidiaries of £285.7 million, the declaration and payment of dividends totalling £9.4 million (2011: £nil), the members' voluntary liquidation of two subsidiaries of the Group (Stroud and Swindon Funding Company and Stroud and Swindon Funding Company No.2 Limited), and the recognition of a subsidiary entity at book value £7.0 million in the Society accounts as at the date of the restructure.

45. Cash and cash equivalents

	Group 2012 £m	Society 2012 £m	Group 2011 £m	Society 2011 £m
Cash and balances with the Bank of England (note 16)	**1,793.6**	**1,709.7**	1,591.1	1,584.2
Due from other banks	**83.0**	**15.0**	387.1	318.1
Total	**1,876.6**	**1,724.7**	1,978.2	1,902.3

Cash and cash equivalents excludes the balance which the Group is required to maintain with the Bank of England which, at 31 December 2012, amounted to £20.6 million (2011: £15.9 million).

Amounts due from other banks comprise of amounts deposited with less than three months' maturity from the date of acquisition.

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1. Statutory percentages

	2012 %	Statutory limits %
Lending limit	**2.3**	25.0
Funding limit	**20.1**	50.0

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986 as amended by the Building Societies Act 1997.

The lending limit measures the proportion of the business assets not in the form of loans fully secured on residential property and is calculated as (X-Y)/X where:

X = business assets, being the total assets of the Group plus loan impairment less liquid assets, intangible assets and property, plant and equipment. The value of X used is the value at 31 December 2012.

Y = the principal value of, and interest accrued on, loans owed to the Group which are fully secured on residential property. The value of Y used is the value at 31 December 2012.

The funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals and is calculated as (X-Y)/X where:

X = shares and borrowings, being the aggregate of:

i) the principal value of, and interest accrued on, shares in the Society;
ii) the principal value of, and interest accrued on, the amounts deposited with the Society by banks, credit institutions and other customers; and
iii) the principal value of, and interest accrued on, the amounts of debt securities of the Society.

The value of X used is the value at 31 December 2012.

Y = the principal value of, and interest accrued on, shares in the Society held by individuals other than bare trustees (or, in Scotland, simple trustees) for bodies corporate or for persons that include bodies corporate. The value of Y used is the value at 31 December 2012.

2. Other percentages

	2012 %	2011 %
As a percentage of shares and borrowings:		
Gross capital	**4.06**	4.25
Free capital	**3.90**	4.06
Liquid assets	**17.8**	21.1
As a percentage of mean total assets:		
Profit for the financial year	**0.26**	0.20
Management expenses	**0.38**	0.37

The above percentages have been calculated from the Group Accounts.

'Shares and borrowings' represents the total of shares, deposits from banks, other deposits, amounts owed to other customers and debt securities in issue.

'Gross capital' represents the aggregate of reserves, subordinated liabilities and subscribed capital.

'Free capital' represents the aggregate of gross capital and collective impairment less intangible assets and property, plant and equipment.

'Liquid assets' represent the total of cash in hand and balances with the Bank of England, loans and advances to credit institutions, debt securities and other liquid assets.

'Mean total assets' represent the average of the 2012 and 2011 total assets.

'Management expenses' represent the aggregate of administrative expenses, amortisation of intangible assets and depreciation of property, plant and equipment.

3. Information relating to directors and other officers

Part 1 - Directors

Name (Date of birth)	Occupation	Other directorships and appointments	Date of appointment as a director of the Society
David A Harding, JP, BA, MPhil, FCMA (Chairman) (29.07.1947)	Company Director	Enterprise Inns plc The Royal Mint Limited	01.10.1996 Retired 31.12.2012
Ian Pickering, MA (Cantab), FCA (Chairman) (16.10.1955)	Company Director	Electrocab Limited Latchways PLC	01.09.2005
Bridget P Blow (Deputy Chairman) (02.06.1949)	Company Director	Birmingham Hippodrome Limited Birmingham Hippodrome Theatre Trust Limited Bridget Blow Consulting Limited City of Birmingham Symphony Orchestra Kensington Green (Management) Limited Trustmarque Acquisitions Limited Trustmarque Group Limited Trustmarque Intermediary Limited Trustmarque Solutions Limited	01.02.2007
Roger D Burnell, BSc, FCA (08.04.1950)	Company Director	Thomas Cook Group plc Clarence Mansions Management Company Limited	01.09.2008
Colin T Franklin, FCIB (15.06.1955)	Building Society Sales & Marketing Director	Godiva Mortgages Limited Five Valleys Property Company Limited ITL Mortgages Limited	07.07.2009
Peter Frost, BA (Hons) (27.10.1965)	Building Society Chief Operating Officer		01.11.2012
Ian S Geden, BSc (Hons), FCII (08.07.1953)	Company Director	The Police Mutual Assurance Society Limited Faraday Underwriting Limited Syndicate 435 Faraday Reinsurance Limited	01.09.2008
John Lowe, BA (Oxon), ACA (26.10.1972)	Building Society Finance Director	Godiva Mortgages Limited Coventry Financial Services Limited Coventry Property Services Limited Godiva Financial Services Limited Godiva Housing Developments Limited Godiva Savings Limited Godiva Securities and Investments Limited Berry Birch & Noble Management Limited (in liquidation) Stroud and Swindon Funding Company (in members' voluntary liquidation) Stroud and Swindon Funding Company (No. 2) Limited (in members' voluntary liquidation) Coventry Building Society Covered Bonds LLP ITL Mortgages Limited	14.10.2010

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(continued)

3. Information relating to directors and other officers (continued)

Part 1 - Directors (continued)

Name (Date of birth)	Occupation	Other directorships and appointments	Date of appointment as a director of the Society
Fiona B Smith, LLB (03.01.1959)	General Counsel		01.12.2002
Glyn Smith, MA (Cantab), FCA (15.09.1952)	Company Director	Covent Garden Market Authority Bournemouth & Poole Teaching PCT Dorset PCT Examiner - ICAEW	22.09.2010
David Stewart, BA, ACA (18.08.1965)	Building Society Chief Executive	Godiva Mortgages Limited Coventry Financial Services Limited Coventry Property Services Limited Godiva Financial Services Limited Godiva Housing Developments Limited Godiva Savings Limited Godiva Securities and Investments Limited Stroud and Swindon Funding Company (in members' voluntary liquidation) Stroud and Swindon Funding Company (No. 2) Limited (in members' voluntary liquidation) Coventry Building Society Covered Bonds LLP ITL Mortgages Limited Council Member of the Building Societies Association Member of the Council of Mortgage Lenders Chairman's Committee Member of the Council of Mortgage Lenders Executive Committee	11.02.2002

Documents may be served on the above named directors at:
C/O Secretary and General Counsel, Oak Tree Court, Binley Business Park, Harry Weston Road, Coventry CV3 2UN.

3. Information relating to directors and other officers (continued)

In 2006 the Society appointed David Stewart as Chief Executive. A service contract was entered into which is terminable by David Stewart on six months' notice and by the Society on one year's notice.

In 2009 the Society appointed Colin Franklin (Sales and Marketing Director) to the Board. A service contract was entered into which is terminable by Colin Franklin on six months' notice and by the Society on one year's notice.

In 2010 the Society appointed John Lowe (Finance Director) to the Board. A service contract was entered into which is terminable by John Lowe on six months' notice and by the Society on one year's notice.

In 2012 the Society appointed Peter Frost (Chief Operating Officer) to the Board. A service contract was entered into which is terminable by Peter Frost on six months' notice and by the Society on one year's notice.

Part 2 - The Secretary

Name	Occupation	Directorships
Gill Davidson, LLB	Secretary and General Counsel	Wrendale Consulting Limited Coventry Building Society Covered Bonds LLP

Part 3 - Senior management team

Name	Occupation	Directorships
Julian M J Atkins, BSc, MBA, FCIPD, FCIB	Head of Human Resources	
Rachel C Haworth, BA, MCIM	Head of Marketing & Communications	Lyng Hall Trust
Darin J Landon	Head of Sales	
Steve A Oerton, BA	Head of Business Systems	

4. Principal office

Coventry Building Society is a building society, incorporated and domiciled in the United Kingdom. The address of the registered office is: Economic House, PO Box 9, High Street, Coventry CV1 5QN.

GLOSSARY

The following glossary defines terminology within the Annual Report & Accounts to assist the reader and to facilitate comparison with publications by other institutions:

Arrears	The financial value of unpaid obligations, which arises when contractual payments are not paid when they fall due.
Available-for-sale reserve	The Available-for-sale reserve contains unrealised gains and losses arising from changes in the fair values of non-derivative financial assets that are categorised as Available-for-sale.
Average loan to value (LTV)	The total outstanding balance on mortgages in relation to the aggregate value of the properties.
Basel II	The recommendations on banking regulation made by the Basel Committee on Banking Supervision, and implemented in the EU via the Capital Requirements Directive, which came into force on 1 January 2007. The Basel II framework introduced the concept of three 'pillars' for regulation. Pillar 1 sets out the minimum capital requirements for firms, and under Pillar 2 firms will take a view of whether additional capital is required for risks not covered in Pillar 1. Pillar 3 improves market information by requiring firms to publish details of risks and capital management.
Basel III	The Basel Committee on Banking Supervision issued strengthened proposals in response to the recent financial crisis, which are referred to as Basel III. These standards will be phased in gradually from 2013.
Basis point	One hundredth of a percent (0.01 percent). 100 basis points is one percent. Used in quoting movements in interest rates and yields on securities.
BIPRU	The Prudential sourcebook for Banks, Building Societies and Investment Firms, which sets out the FSA's rules regarding risk, capital and liquidity in particular.
BSA	Building Societies Association (BSA) represents mutual lenders and deposit takers across the UK.
Business risk	The risk that the external environment has the potential to affect the Society's business model.
Buy-to-let (BTL) mortgage	A mortgage secured on a residential property that is rented out to tenants.
Capital requirements	Amount to be held by the Group to cover the risk of losses.
Capital Requirements Directive IV (CRD IV)	CRD IV is the draft European Union legislation which will implement Basel III, revising the capital requirements framework and introduce liquidity requirements, which are used to regulate firms.
Capital resources	Capital held, less all required regulatory adjustments and deductions. Capital comprises general reserve, Permanent Interest Bearing Shares, subordinated debt and collectively assessed impairment allowances.
Certificates of Deposit	Bearer-negotiable instruments acknowledging the receipt of a fixed term deposit at a specified interest rate.
Charitable donation to Poppy Appeal	Represents the value of the donation made by the Society to The Royal British Legion Poppy Appeal.
Code Staff	A group of employees to which the FSA's Remuneration Code applies. Code staff consist of executive directors, non-executive directors and certain senior managers in control functions (e.g. human resources, audit, risk and compliance) who could have a material impact on the firm's risk profile.
Contractual maturity	The date in the terms of a financial instrument on which the last payment or receipt under the contract is due for settlement.
Core Capital Deferred Shares (CCDS)	A proposed new form of core tier 1 capital instrument.

Core tier 1 capital	Core tier 1 capital comprising general reserves, less intangible assets, pension surplus and other regulatory deductions.
Core tier 1 ratio	Core tier 1 capital as a percentage of risk-weighted assets.
Council of Mortgage Lenders (CML)	A trade association for the residential mortgage lending industry.
Covered bonds	Debt securities backed by a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds. The Society issues covered bonds as part of its funding activities.
Credit risk	The risk that the customer or wholesale counterparty is unable to honour their obligations as they fall due.
Currency swap	An arrangement in which two parties exchange specific principal amounts of different currencies at inception and subsequently exchange interest payments on the principal amounts. Often, one party will pay a fixed interest rate, while the other will pay a floating exchange rate (though there are also fixed-fixed and floating-floating arrangements). At the maturity of the swap, the principal amounts are usually re-exchanged.
Debt securities	Transferable instruments creating or acknowledging indebtedness. They include bonds, certificates of deposit and loan notes. The holder of a debt security is typically entitled to the payment of principal and interest, together with other contractual rights under the terms of the issue. Debt securities are generally issued for a fixed term and redeemable by the issuer at the end of that term. Debt securities can be secured on other assets or unsecured.
Debt securities in issue	Transferable certificates of indebtedness of the Group to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit.
Deferred tax asset/(liability)	Corporation tax recoverable (or payable) in future periods resulting from temporary or timing differences, between the accounting value of assets and liabilities and the tax base of those assets and liabilities.
Defined benefit obligation	The present value of expected future payments required to settle the obligations of a defined benefit plan resulting from past employee service.
Defined benefit plan	Pension or other post-retirement benefit plan offering guaranteed benefits usually as a fraction of the final salary.
Defined contribution plan	Pension or other post-retirement benefit plan where the employer's obligation is limited to its contributions to the fund.
Deposits from banks	Money deposited with the Group by banks and recorded as liabilities. They include money-market deposits, and other short-term deposits.
Derivative financial instrument	A contract or agreement, the value of which reflects changes in an underlying index such as an interest rate, foreign exchange rate or market index. The contract requires either no initial investment, or an initial investment that is smaller than would be required for other types of contracts with a similar response to market factors. The most common types of derivatives are interest rate swaps.
Effective interest rate method (EIR)	The method used to measure the carrying value of a financial asset or a liability. EIR allocates associated interest income or expense to produce a level yield, either to maturity or to the next re-pricing date.
Effective tax rate	The tax charge in the income statement as a percentage of profit before tax.
Eurozone	An economic and monetary union (EMU) of 17 EU member states that have adopted the euro (€) as their common currency and sole legal tender.
Expected loss (EL)	A Basel II calculation under the IRB approach to estimate the potential losses on current exposures due to potential defaults over a one year time period.
Exposure	The maximum loss that a financial institution might suffer if a borrower or wholesale counterparty fails to meet their obligations.
Fair value	The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
Final salary pension arrangements	A defined benefit pension arrangement where the pension payable is based on the employee's final pensionable salary.

GLOSSARY

(continued)

Financial Ombudsman Service (FOS)	Financial Ombudsman Service provides an independent and impartial service to resolve individual complaints that consumers and financial institutions have been unable to settle themselves.
Financial Services Authority (FSA)	Financial Services Authority (UK) is an independent non-governmental body, given statutory powers by the Financial Services and Markets Act 2000.
Financial Services Compensation Scheme (FSCS)	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every firm authorised by the FSA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.
Fitch Ratings	Fitch Ratings is a credit rating agency which provides credit ratings and research covering debt instruments and securities for financial institutions and governments.
Forbearance	Measures to assist customers in financial difficulty. Typically, this involves working with the customer to make arrangements where some element of contractually due amounts are temporarily forgone by the lender.
Foreign currency risk	The risk of loss arising as a result of adverse movements in exchange rates on investments in foreign currencies.
Free capital	The aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers, less; property, plant and equipment, investment properties, non-current assets held for sale and intangible assets.
Funding for Lending Scheme (FLS)	An initiative by the Bank of England and HM Treasury to incentivise banks and building societies to boost their lending to UK households and non-financial companies, by providing funding to banks and building societies for an extended period.
General reserve	The general reserve is the accumulation of historic and current year profits and includes actuarial gains and losses on the defined benefit pension plan (net of tax).
Gilts	Gilts refers to long term fixed income debt securities (bonds) issued by the UK government and listed on the London Stock Exchange.
Gross capital	The aggregate of equity, subscribed capital and subordinated liabilities.
Gross mortgage lending	New mortgage lending advanced during the year.
IAS	International Accounting Standards. A set of standards stating how particular types of transactions and other events should be reflected in financial statements.
IFRIC	International Financial Reporting Interpretations Committee. IFRIC interpret the application of IASs and IFRSs and provide timely guidance on financial reporting issues not specifically addressed in IASs and IFRSs, in the context of the International Accounting Standards Board framework.
IFRS	International Financial Reporting Standards. A set of international accounting standards stating how particular types of transactions and other events should be reported in financial statements.
Impaired loans	A loan is impaired if there is objective evidence that an impairment event has occurred, and that the event has an impact on the estimated future cash flows of the loan which can be reliably estimated. Impairment may be caused by a single event, or a combination of events.
Impairment losses	The reduction in value that arises following an impairment review of an asset that determines that the recoverable amount is less than its carrying value.
Impairment provision	Provisions held against impaired assets on the balance sheet. The provisions represent management's best estimate of losses incurred in the loan portfolio at the balance sheet date.
Impairment ratio	Impairment losses on loans and advances to customers as a percentage of average loans and advances to customers.

Indexed LTV (Loan to Value)	Loan to value (see below) calculated on an indexed basis. The property value is regularly updated to reflect changes in the house price index.
Individual Capital Guidance (ICG)	Guidance from the FSA on the levels of capital to be held by the Society to meet its minimum regulatory capital requirements.
Individual Liquidity Adequacy Assessment (ILAA)	The Society's own assessment of the liquidity resources it requires in order to remain within the risk tolerances it has set. This will include an evaluation of potential stresses based on regulatory benchmarks and on Society specific tests.
Individual liquidity guidance (ILG)	Guidance from the FSA on a company's required quantity of liquidity resources and funding profile.
Individual/collectively assessed loan impairment provisions	Impairment is measured individually for assets that are individually identified as at the balance sheet date as being impaired, and collectively for homogenous asset classes where there is evidence of impairment event(s) but these have not yet manifested themselves as individually identified impaired accounts.
Interest rate risk	The risk that income received or paid is adversely affected by interest rate fluctuations on the Society mortgage and savings products.
Interest rate swap	A contract under which two counterparties agree to exchange periodic interest payments based on a predetermined notional principal amount.
Internal capital adequacy assessment process (ICAAP)	The Society's own assessment of the amount of capital that it needs to hold in respect of its regulatory requirements (for credit, market and operational risks) and for other risks. This assessment includes determination of a capital buffer to be held in case of potential economic stress.
Internal ratings-based approach (IRB)	An advanced approach to measuring capital requirements in respect of credit risk under Pillar 1 of Basel II. The IRB approach may only be used with permission from the FSA.
International Accounting Standards Board (IASB)	An independent standard-setting body of the International Accounting Standards Committee Foundation. The members of the IASB are responsible for the development and publication of International Financial Reporting Standards (IFRS) and for approving interpretations of IFRS as developed by the International Financial Reporting Interpretations Committee (IFRIC).
Level 1 fair values	Fair value derived from unadjusted quoted prices in active markets for identical assets or liabilities.
Level 2 fair values	Fair value derived from inputs other than quoted prices that are observable for the asset or liability, either directly (i.e. a price) or indirectly (i.e. derived from prices).
Level 3 fair values	Fair value derived from inputs for the asset or liability that are not based on observable market data.
Leverage ratio	The ratio of tier 1 capital (see below) to total exposures. Where total exposures include on and off balance sheet items (after netting derivatives).
LIBOR	London Inter-Bank Offer Rate. The interest rate at which banks can borrow funds from other banks. The LIBOR is derived from a filtered average of the interbank deposit rates for large loans with maturities between overnight and one full year.
Liquid assets	An amount as defined by The Building Societies (Accounts and Related Provisions) Regulations 1998. This comprises cash in hand, balances with the Bank of England, debt securities (including gilts), loans to credit institutions and other liquid assets.
Liquidity and funding risk	Liquidity risk is the risk that the Society cannot meet its financial obligations as they fall due or can secure them only at excessive cost. Funding risk is the risk of an inability to raise new wholesale funding or to replace existing funding as it matures, or a loss of member confidence that causes a 'run' on retail funds.

GLOSSARY
(continued)

Liquidity resources	Assets held in order to manage liquidity risk. Liquidity resources comprises cash in hand and balances with the Bank of England, UK Government Securities and multi-lateral development banks, other securities and bank deposits and self issued covered bonds, RMBS and Bank of England approved mortgage portfolios. Further details are provided in 'Liquidity and Funding' on page 19.
Liquidity coverage ratio (LCR)	A measure which aims to ensure that an entity maintains an adequate level of liquidity to meet its needs for a 30 day period under severe stress conditions.
Loan to Value (LTV)	LTV is the amount of mortgage loan as a percentage of the value of the property.
Loans past due/past due loans	Loans are past due when a counterparty fails to make a payment when contractually due.
Management expenses	The aggregate of administrative expenses, depreciation and amortisation.
Market risk	The potential losses or decrease in value of the Group balance sheet as a result of adverse market movements. Specific types of market risk include interest rate risk, foreign exchange risk and house price risk.
Medium term notes (MTN)	Corporate notes continuously offered by a company to investors, through a dealer, across a range of maturity periods.
Member	A person who has a share investment or a mortgage loan with the Society.
Merger and integration related costs	Primarily consists of costs incurred during 2010 and 2011, relating directly to the merger with Stroud & Swindon Building Society.
Moody's Investor Services	Moody's Investor Services is a credit rating agency which provides credit ratings and research covering debt instruments and securities for financial institutions and governments.
Mortgage backed securities (MBS)	Asset backed securities that represent interests in a group of mortgages. Which give the investor the right to cash received from future mortgage payments both principal and interest.
Net assets	The difference between total assets and total liabilities.
Net interest income	The difference between interest receivable on assets and similar income and interest paid on liabilities and similar charges.
Net stable funding ratio (NSFR)	A liquidity ratio which calculates the proportion of long term assets that are funded by stable, long term funding sources (customer deposits and long term wholesale funding).
Operational risk	The risk of loss arising from inadequate or failed internal processes, people and systems, or from external events.
Parliamentary Commission on Banking Standards	The Parliamentary Commission on Banking standards was appointed by both Houses of Parliament to report on: professional standards and culture of the UK banking sector; and corporate governance, transparency and conflicts of interest and their implications for regulation and Government policy.
Past due	A financial asset such as a loan is past due when the counterparty has failed to make a payment when contractually due.
Pension fund surplus	The assets in a pension fund that are in excess of its liabilities.
Permanent Interest Bearing Shares (PIBS)	Unsecured, perpetual deferred shares of the Society offering a fixed coupon. These are a form of tier 1 capital. PIBS rank behind the claims of all subordinated debt holders, depositors, or creditors of the Society. PIBS are also known as subscribed capital.
Quantitative Easing	A central bank monetary policy used to increase the money supply by buying government securities or other securities from the market, in an effort to promote liquidity and in turn lending.
Redenomination risk	Redenomination risk is risk that in the event that the euro ceases to trade, or a particular country leaves the euro, previously matched foreign exchange positions, designated in euros, become unmatched when these are exchanged for an alternative currency (valued against a local currency equivalent).

Residential mortgage backed securities (RMBS)	Asset backed securities that represent interests in a group of residential mortgages. Which give the investor the right to cash received from future mortgage payments both principal and interest.
Retail deposits	Deposits from individuals, not from corporations, other financial institutions or sovereign entities.
Risk appetite	The articulation of the level of risk that the Society is willing to take (or not take) in order to safeguard the interests of the Society's members, whilst also achieving business objectives.
Risk-weighted assets (RWA)	The value of assets, after adjustment to reflect the degree of risk they represent in accordance with the relevant Basel II rules.
Sale and repurchase agreement (repo)	An agreement to sell a financial security together with a commitment by the seller to repurchase the asset at a specified price on a given date. In substance this forms a secured loan, with the difference between the purchase price and repurchase price being the interest rate.
Securitisation	A pool of loans used to back the issuance of new securities. The loans are transferred to a special purpose entity (SPE) which then issues securities backed by the assets. The Society has used retail mortgages as the loan pool.
Senior unsecured market	The market for bonds, issued by corporate bodies and financial institutions, which are not secured by any collateral and are not subordinated to any other liabilities of the issuer.
Shares	Funds deposited by a person in a retail savings account with the Society. Such funds are recorded as liabilities of the Society.
Shares and borrowings	The total of shares, deposits from banks, other deposits, amounts due to customers and debt securities in issue.
Special purpose entities (SPEs)	Entities that are created to accomplish a narrow and well defined objective. The Group uses SPEs to facilitate securitisation and covered bond programmes. Where the Group has control of these entities or retains risks and rewards relating to them they are consolidated within the Group results.
Standardised approach	The basic method used to calculate capital requirements for credit risk under Basel II. In this approach the risk weighting used in the capital calculation are determined by specified percentages.
Subordinated liabilities	Liabilities which, in the event of insolvency or liquidation of the issuer, are subordinated to the claims of depositors and other creditors of the issuer.
Subscribed capital	See Permanent Interest Bearing Shares (PIBS).
Tier 1 capital	A component of regulatory capital comprising core tier 1 capital and Permanent Interest Bearing Shares (PIBS).
Tier 2 capital	A component of regulatory capital comprising qualifying subordinated debt and eligible collective impairment allowances, less certain regulatory deductions.
Transfer of engagements	Assets and liabilities acquired as a result of the merger with Stroud & Swindon Building Society.
UK Corporate Governance Code (the Code)	Guidance issued by the Financial Reporting Council (formerly known as the Combined Code which was updated in 2010) on a number of key components of effective board practice such as: board leadership, remuneration, accountability and reporting transparency.
Underlying profit	Operating profit after impairments and before exceptional items.
Wholesale funding market	The market for lending and borrowing by large companies, financial institutions and sovereign entities.

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TLC not PLC

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