Coventry Building Society

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COVENTRY Building Society

Overview

Overview

COVENTRY Building Society

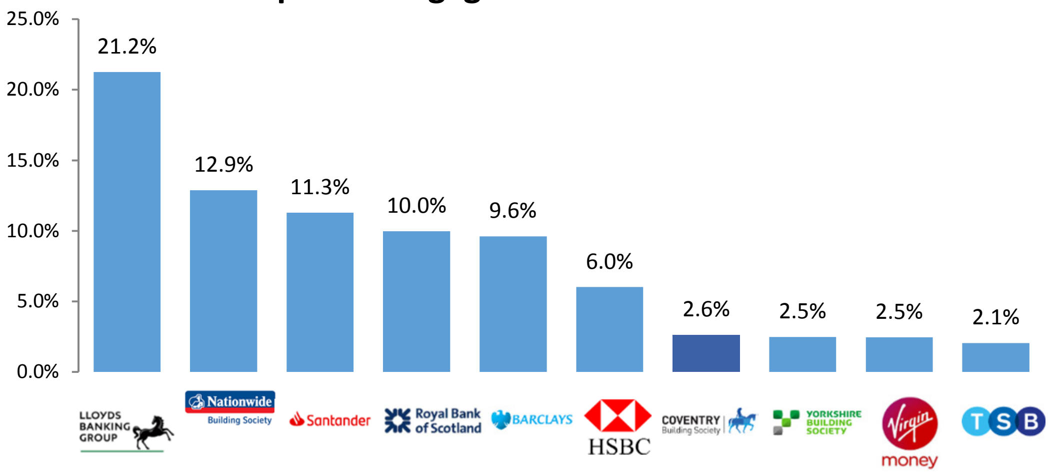
What is a Building Society

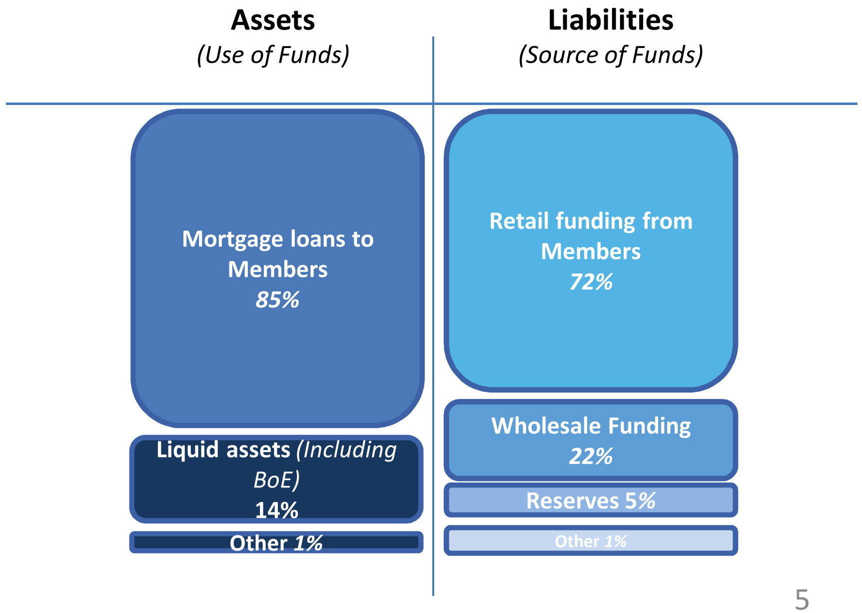
- Building societies are mutuals - owned by their members, both savers and borrowers.
- There are no external shareholders, therefore no external dividends are paid out, with all profits retained in the business for the benefit of members.
- A safe home for savers is the primary driver, together with the provision of mortgage loans.
- Focus on profit optimisation rather than maximisation.
- **Coventry** is the 2nd largest building society and the 7th biggest lender in the UK[1]

Regulation

- Governed by the Building Societies Act 1986.
- Regulated by the FCA & PRA.
- Minimum of 50% of funding must come from retail markets *(actual 76.1%).*
- Additional controls in place from PRA to enhance safety

Top 10 mortgage lenders market share[1]





1. Source: CML Gross Lending 2017

Overview

COVENTRY Building Society

Simple business model

- Providing simple, transparent retail savings products which offer long term value.
- Helping customers buy residential properties through low risk mortgage lending primarily through intermediaries.
- Delivering sustainable organic growth without taking on higher levels of risk to protect existing members during periods of economic stress, and to safeguard the Society's future.
- Ensuring operations are cost efficient, allowing the society to pay above market interest rates to savers, whilst investing in the future and maintaining capital strength.
- Underpinned by our CARES values which shapes decision making and focuses on putting members first.

Financial Strength

Strong CET1 ratio highest reported by any top 20 lender.[1]	**35.5%**
Management expense ratio lowest reported by any top 10 UK building society.	**0.46%**
Leverage ratio exceeds regulatory requirements.[3]	**4.6%**

The 2nd Largest Building Society in the UK

	Long term	Short term	Last credit opinion
Moody's	**A2**	**P-1**	June 2018
Fitch[2]	**A**	**F1**	May 2018

Low risk

- Low LTV lending and third party distribution provides resilience to the business model if the market deteriorates.
- Strong margin management capability, with the capacity to increase margin if needed.
- 28% of mortgages and 63% of savings on administered rates at 30 June 2018.
- Nationwide distribution of savings and mortgage avoids geographical concentration.

Member Focus

- Mortgage and savings rates remain competitive with pricing supported by low levels of operating costs, impairments and conduct provisions.
- The Society paid an average 1.49% interest on savings in 2017, compared to the market average 0.63%.[4]
- Awarded Fairer Finance Clear and Simple Mark for our General Terms for savers.

- 1. Source: CML Top 20 mortgage lenders (as published August 2017) - latest published CET 1 data As at 30/06/18 2.Fitch rating unchanged for 20 years 3.Under the BoE modified calculation excluding Central bank exposure less than 3 months
- 4. The Society's average month end savings rate (society mix of products) compared to BoE WA rate for household interest bearing deposit (market mix of products)

Financial performance

COVENTRY Building Society

Capital	**Financially safe and strong institution with a CET1 ratio, the highest reported by top 20 lender[1] at 35.5% and a leverage ratio of 4.6%[2] , reflecting the low credit risk business model.**
Cost	**Continued focus on cost control with the costs to mean assets ratio at 0.46%, the lowest reported by any UK building society. [1]**
Impairments	**Impairment credit of £1.0m, strong asset performance continues.**
Growth	**Mortgage assets have increased by £1.5bn and Savings balances increased by £0.4bn. Mortgage balance growth 4.1% in H1, Savings growth of 1.3%.**
NIM	**Net interest margin at 100bps, in line with expectations, as the Society continues to reward members with competitive products.**
Profit	**Profit before tax of £113.1m - 0.6% increase on H1 2017.**

1. Source: CML Top 20 mortgage lenders (as published August 2017) - latest published CET 1 data As at 30/06/2018 2.Under the BoE modified calculation excluding Central bank exposure less than 3 months

Financial performance

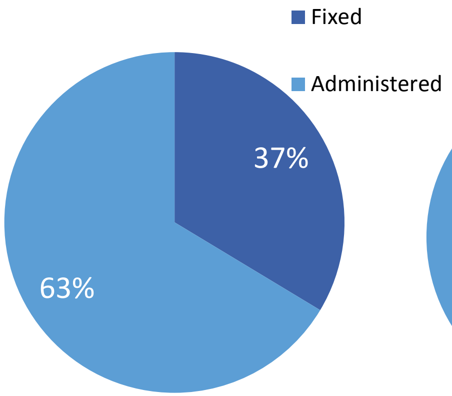
Large Proportion of Administered Rates

- Whilst margins have benefitted from the effects of government funding on retail pricing, the proportion of administered products allows commercial scope to manage margin if required.
- Coventry's Flexx for Term mortgage offering, attracts borrowers to administered rate products.
- Retail savings growth of 5% over the previous 12 months versus market growth of 2.7%.[2]
- Over 90% of mortgages are funded by retail savings or capital.

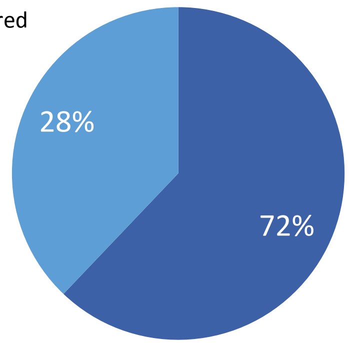
Retail Funding led Lending Strategy

- Consistent growth in mortgage balances growing by over 4.1% in 2018.
- Mortgage assets continue to be of very high quality with the balance weighted average indexed LTV of the mortgage book at just 53.7% as at 30 June 2018.
- Competition continues to return to the mortgage market and we have seen a focus from other lenders on higher LTV lending and first time buyers. However our resilient business model, focused on low risk, low LTV lending, has remained.

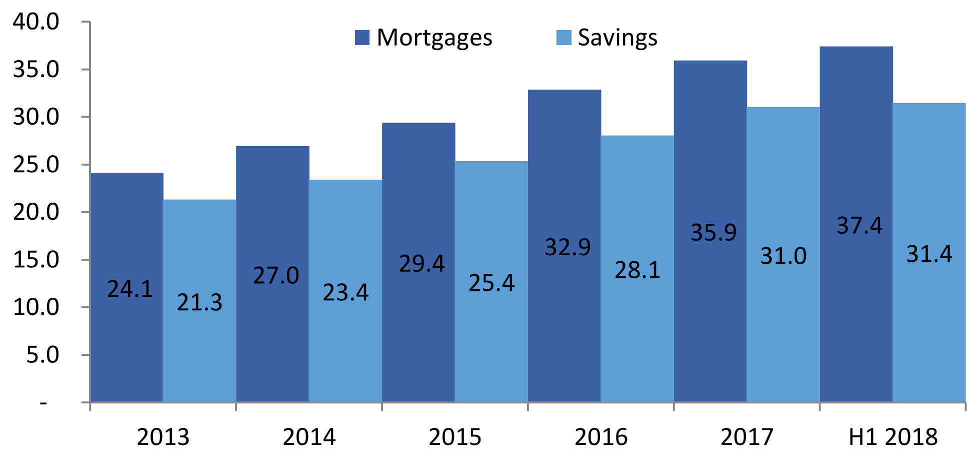
Savings



Mortgages



Retail balances growth



1. The Society's average month end savings rate (society mix of products) compared to BoE WA rate for household interest bearing deposit (market mix of products) 2.Source: Bank of England

Financial performance

COVENTRY Building Society

Investment for the Future to create competitive advantage

- Level of IT and technology change is rising as a result of:
  - Rising customer expectations for service delivery and enhanced functionality;
  - Higher levels of cyber threat;
  - Increased expectations from regulators.
- Our capital strength, low cost base and long term view enable us to invest despite a competitive market.

Branch network re-design

- Important face of the Society with the membership which builds trust and engages the community.
- Branches account for over 30% of retail savings acquisition each year and manage around £10.5bn of the total retail book.
- 70 branches concentrated in our heartland.
- The re-design of the branch network will meet evolving needs of members and better reflect the future of branch engagement
- Flexible design principles will future proof our branches.

Infrastructure Transformation Programme

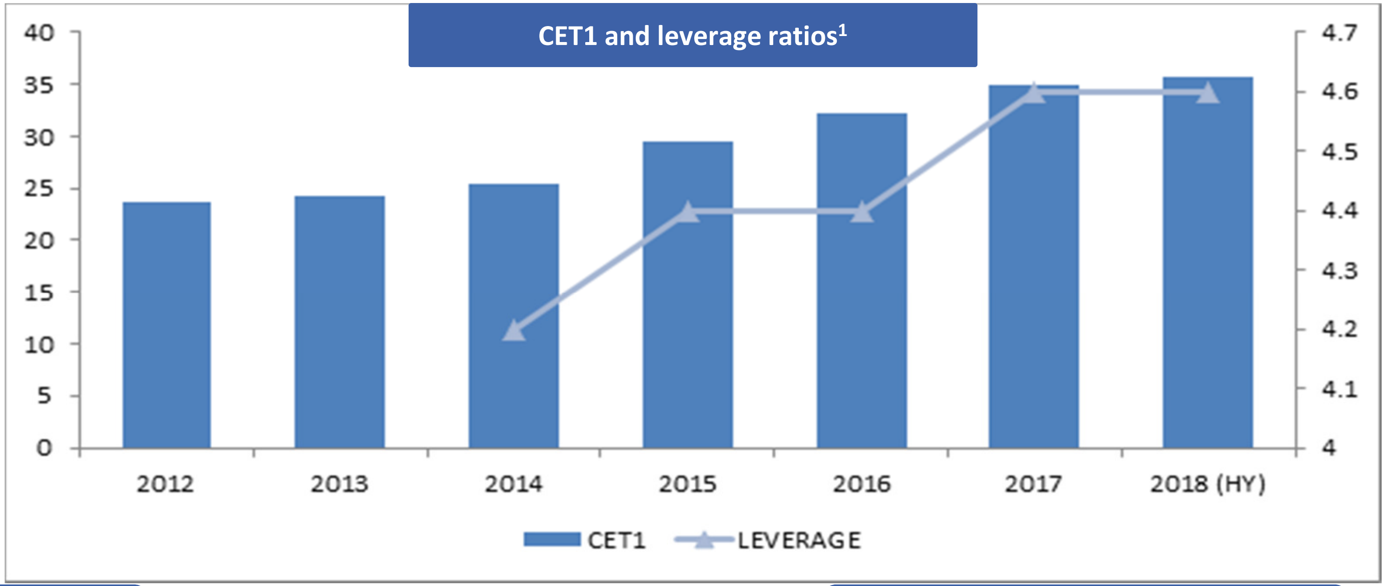
- To enhance operational resilience we are progressing a move to a co-located / cloud hybrid datacentre environment.
- Will provide dedicated and resilient point to point connectivity.
- Cloud technology adopted subject to rigorous risk assessment.
- Enable scalability of operation, and achieve economies of scale in a safe and secure way.

Summit Replacement Programme

- Planning the upgrade of our core banking platform to provide greater flexibility in responding to changing customer needs and regulatory requirements, more quickly and cheaply.
- Enhancements will create future competitive advantage.
- Supports product and change agility and cost efficiency
- Is a better base on which to build out digital capabilities, streamline customer journeys and integrate into an Open Banking market
- Build resilience of both architecture and software

Capital and Liquidity

Capital



Capital and Reserves

- The Society has been issued with a TCR by the regulator of 11.3% of RWAs, which is comfortably exceeded. This was a reduction of the previous ICG of 12.8%
- Retained earnings from strong profitability are Coventry's primary source of CET1 capital, currently c. £1.54bn.
- Internally generated capital is augmented by £400m of AT1 issuance.
- The whole loan sale of non-member buy-to-let mortgages to a third party in 2015 and 2018 provide further capital management options.

Leverage Ratio Framework

- A binding UK leverage ratio applies to firms with retail deposits of £50bn or more. This is not expected to be binding until at least 2020.
- The components of the UK leverage ratio framework are a minimum ratio of 3.25% (excluding Central Bank exposures below 3 months to maturity). The CCyB is set by the FPC and is currently 1% not enforced until November 2018. [2]
- The modified leverage ratio on a PRA basis at 30 June 2018 is 4.6% (4.1% when Bank of England reserve account is included), comfortably above the 3.25% minimum level (3.6% including the CCyB).

1.The BoE modified calculation excluding Central bank exposure less than 3 months 2.For Leverage Counter cyclical leverage buffer (CCLB) is calculated as 35% of 1% CCyB

Capital and Accounting Future

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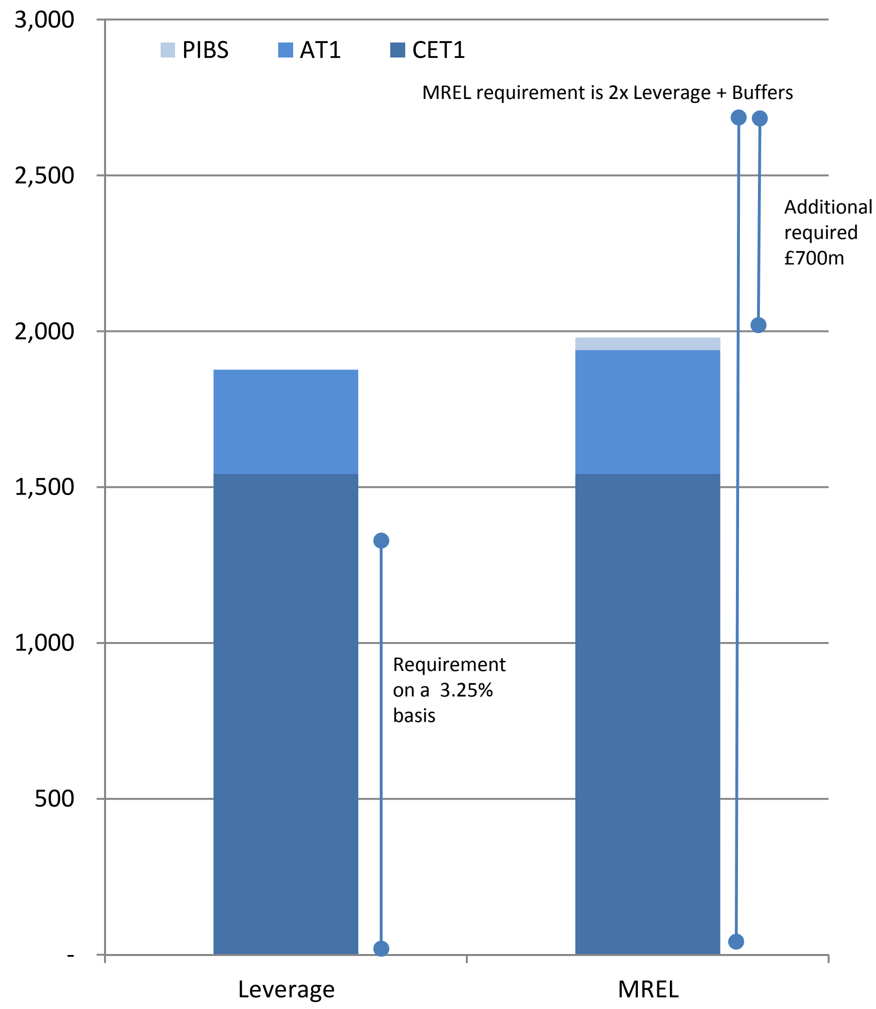
MREL

- Under the rules the Society is required to meet an interim MREL requirement of 18% of risk weighted assets by 1 January 2020. The indicative end-state MREL requirement for all firms will be twice the binding capital requirement, for the Society this is currently two times Pillar 1 and Pillar 2a or 22.3% of risk weighted assets. The Society currently exceeds this constraint. If leverage becomes the binding constraint for the Society, this will result in the need to raise MREL eligible debt.
- As at H1 2018, an additional requirement of £700m of MREL would be required to meet 2x leverage constraint
- This requirement will be expected to grow in the years leading up to 2022, as the balance sheet grows, however, this equates to a manageable 3 to 4 MREL transactions



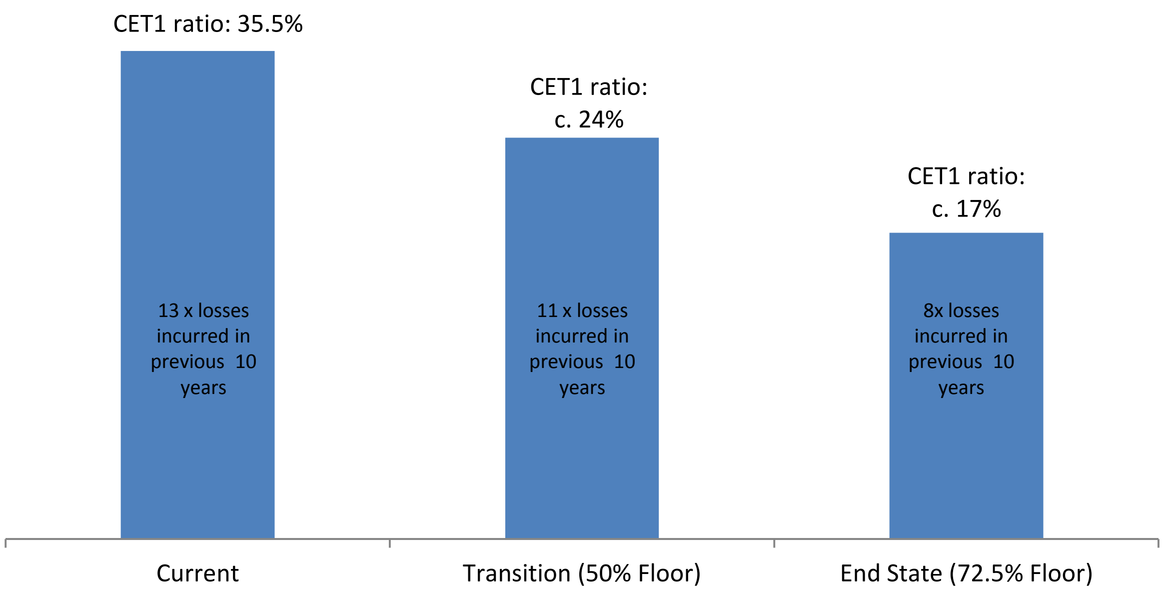
Basel IV Capital implications

COVENTRY Building Society

Basel IV

- BCBS Paper released in December 2017 outlining Standardised Risk Weights and output floors that seek to remove variability in internal models (IRB).
- Regulation and implications still need finalising and have national discretion (especially in the treatment of differing mortgage types).
- Output floor phased in from 50% in 2022 to 72.5% in 2027.
- Assuming the implementation of 50% output floor, the CET1 ratio reduces materially but remains above 22% reflecting the impacts of the flooring on a low risk business model.
- Surplus to regulatory minima remains considerable, equal to over 8 times the actual credit losses experienced in the last 10 years.

Surplus over Basel IV Requirement[1]



1. Based on Portfolio Landlords (landlords with 4 or more properties) risk weighted as real estate exposures with repayment materially dependant on cash flows generated by property

Liquidity

COVENTRY Building Society

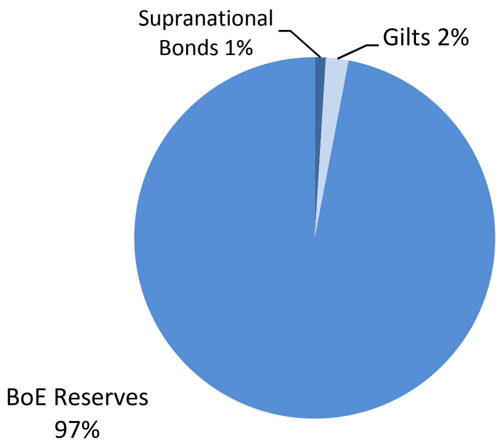
Liquidity

- Over 99% of core liquidity is eligible as High Quality Liquidity Assets Buffer and consists of UK Government or Bank of England assets.
- Core liquidity holdings are solely UK exposure, the Society has no direct exposure to peripheral Eurozone countries.
- The UK authorities have placed increased emphasis on contingent liquidity, from central bank facilities via the pre-positioning of loan books, retained bonds and other assets. The Society prepositioned additional mortgage assets in January 2018 as part of its ongoing liquidity management strategy.

LCR / NSFR

- The Society maintains liquidity considerably above regulatory requirements with LCR 177% as at 30th June 2018.
- The NSFR was 144% as at 30 June 2018, which is consistent with the year-end position (145%).
- The Loan to Deposit ratio was 116% reflecting the stable funding profile of the Society

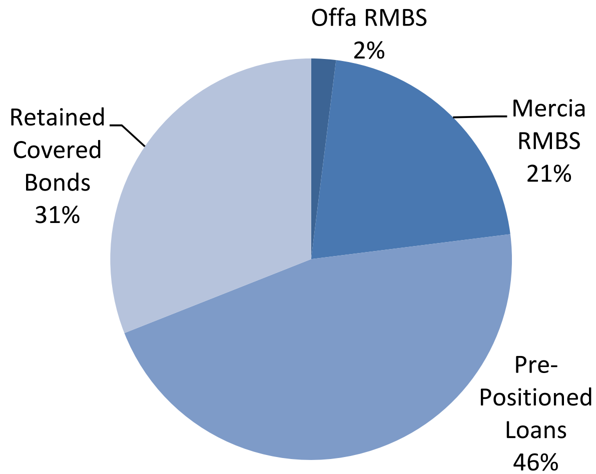
Core Liquidity[1]



£4.6bn
Core Liquidity

£4.6bn
Contingent Liquidity[2]

Contingent Liquidity[2]



1.Showing value of unencumbered assets as at 30 June 2018 – The Society held £750m Gilts in repurchase agreements as at 30 June 2018. 2. including £2.1bn unencumbered prepositioned loans at the BoE

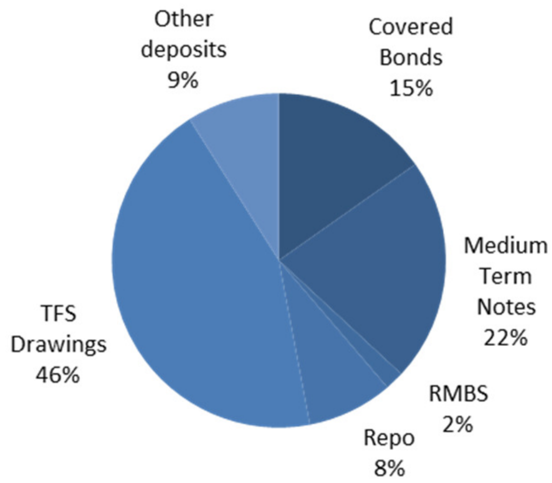
Wholesale funding

COVENTRY Building Society

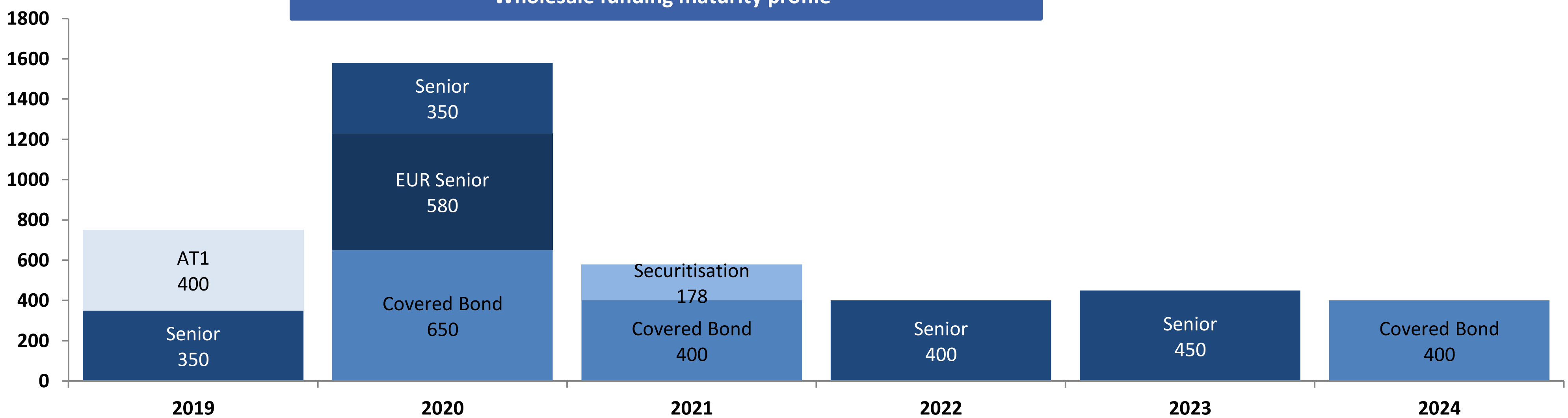
Funding Strategy

- Retail deposits are supplemented by a number of wholesale funding options.
- Wholesale market access provides competitive advantage and diversification of funding via:
    - MTNs.
    - Covered Bonds.
    - Securitisation.
- Continued move towards longer dated wholesale deals providing reliable long term funding.
- Wholesale funding ratio 23.9% as at 30 June 2018.
- TFS drawings of £4.25bn as at 30 June 2018, No FLS remaining.

Wholesale Funding as at 30 June 2018



Wholesale funding maturity profile[2]



1. Current value after amortisation 2. In GBP, excluding TFS

Asset Quality

Asset quality - Origination

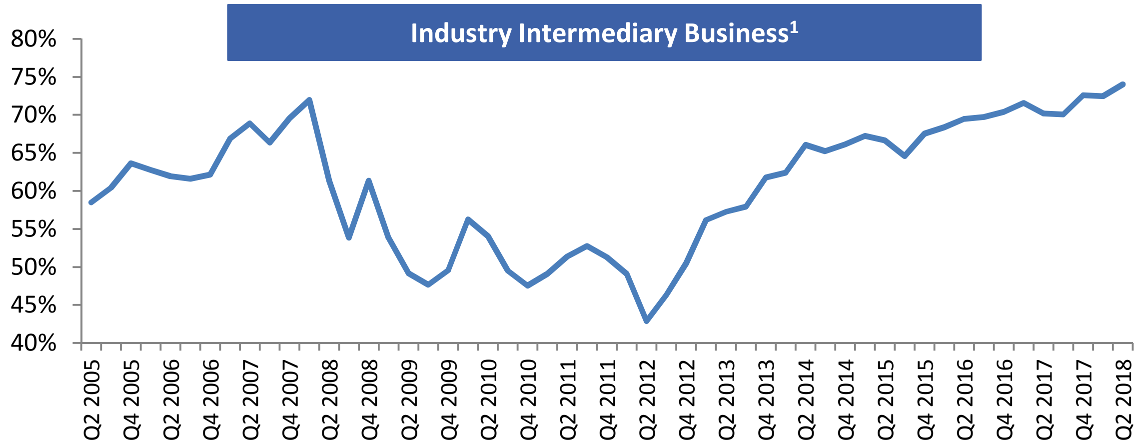
COVENTRY Building Society

Coventry Origination

Intermediaries	Telephone / Post	Branch
91.2%	8.0%	0.8%
Relationship management team	Inbound call centre	70 branches, 21 agencies
BDMs – UK wide	CeMap qualified mortgage advisors	CeMap qualified mortgage advisors
Intermediary Support		

Industry Origination

- Mortgage market reforms favours independent advice
- Intermediaries advise customer for best outcome
- Search whole of market for customer
- Gives national distribution to lenders



1. Source: CML by Value

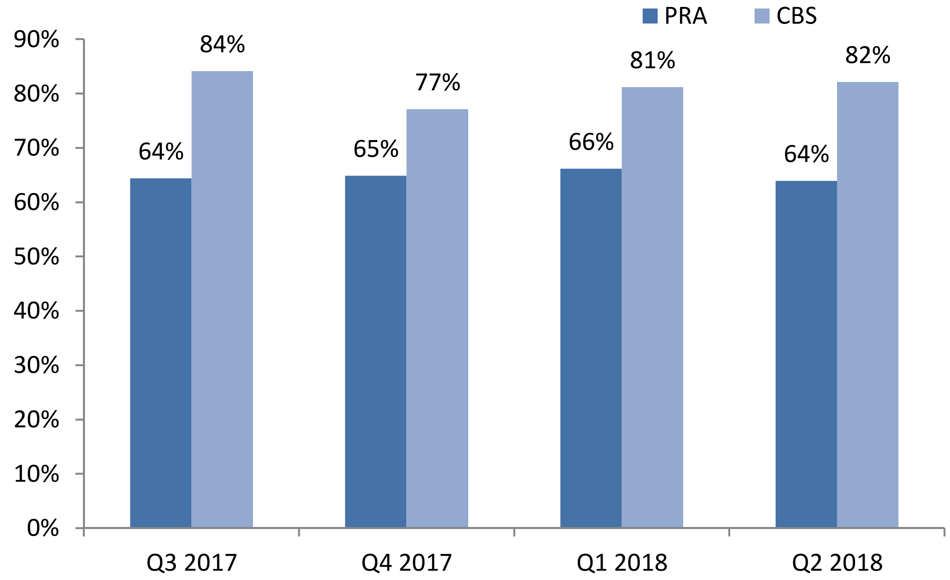
Asset quality

COVENTRY Building Society

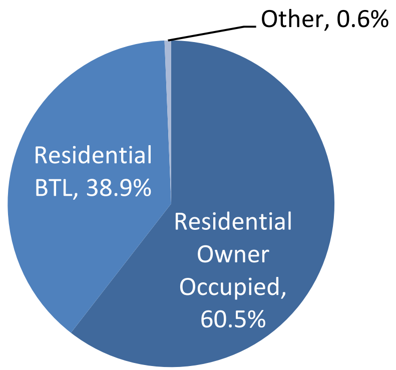
Low Risk Loan-to-Value (LTV)

- 82% of lending in the first half of 2018 has been at LTVs of 75% or below, in comparison to the market average of 65%
- Market lending above 90% in the first half of 2018 was 3.9%[1]; Coventry lending above this LTV was nil.
- No sub-prime, commercial or second charge lending (legacy inherited commercial book currently £2.5m in run off).
- Negligible levels of unsecured lending (£26.1m: HY 2018, 31.8m: 2017).
- The balance weighted average indexed LTV of the entire mortgage book is 53.7% as at HY 2018.
- 97% of the overall book has an indexed LTV of 85% or less as at HY 2018.
- In the first half of 2018 circa 70% of all buy-to-let lending was originated at 65% LTV or less.

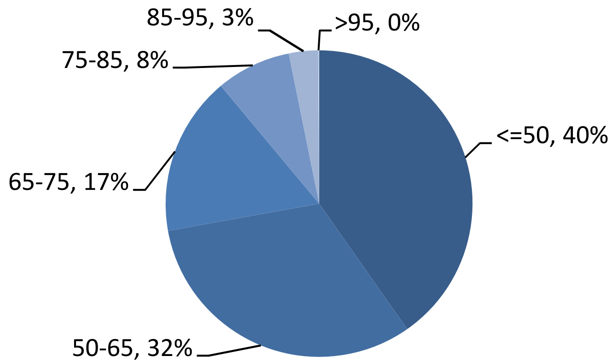
Gross lending ≤ 75% LTV[2]



Total book split by product[2]



Total book split by LTV[2]



1. Source CML as at 19/10/18 2.as at June 2018

Asset quality

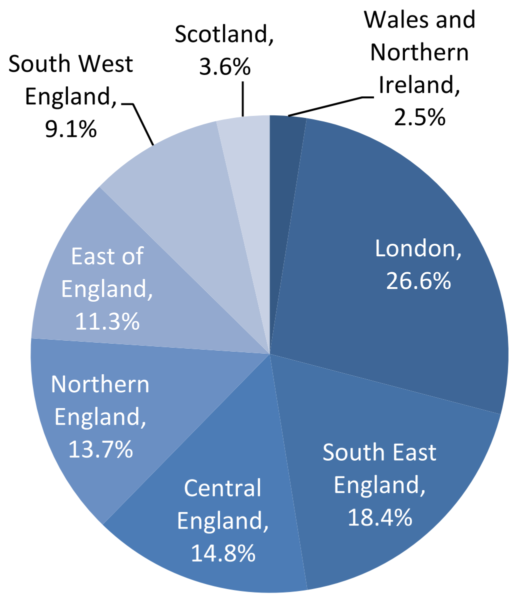
Geographic Split

- The majority of the UK mortgage market is introduced via intermediaries (e.g. independent financial advisors, mortgage brokers, estate agents).
- Intermediaries give national coverage and support the geographic diversification of the mortgage book.
- Crucially, all underwriting and servicing is performed by Coventry. There is no 'packaging'; the intermediary acts solely as an introducer.

Mortgage Book Performance

- The Society's arrears performance continues to improve and to be significantly better than the industry as a whole.
- The value of loans in arrears by ≥ 2.5% of the mortgage balance at 30 June 2018, as a proportion of the total book, has fallen to 0.12%.
- At 30 June 2018, only 37 properties were in possession.
- Arrears are very rarely capitalised. There was only 1 case in HY18 for Coventry versus 2,400 for the industry as a whole up to Q1.
- IFRS 9 introduced in 2018, with a small decrease of impairment for consumer loans and a negligible impact on regulatory capital.

Geographic distribution by value[1]



Arrears ≥ 2.5% of mortgage balance (including possessions)[1]

1. As at 30/06/18

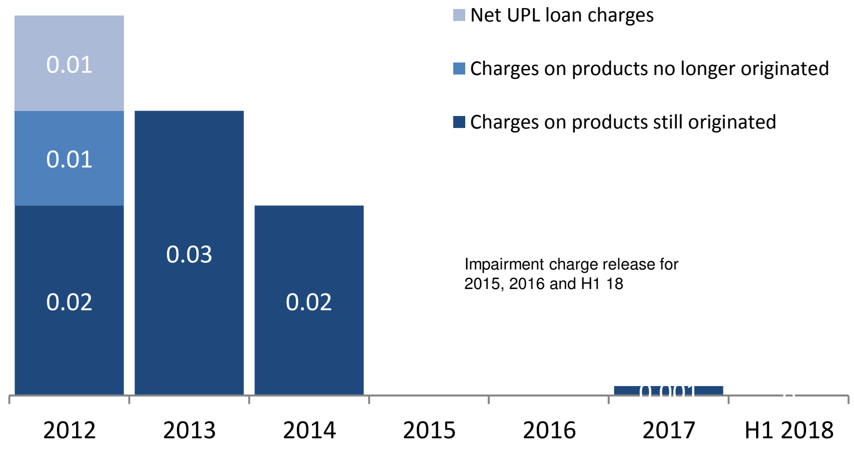
Asset quality

COVENTRY Building Society

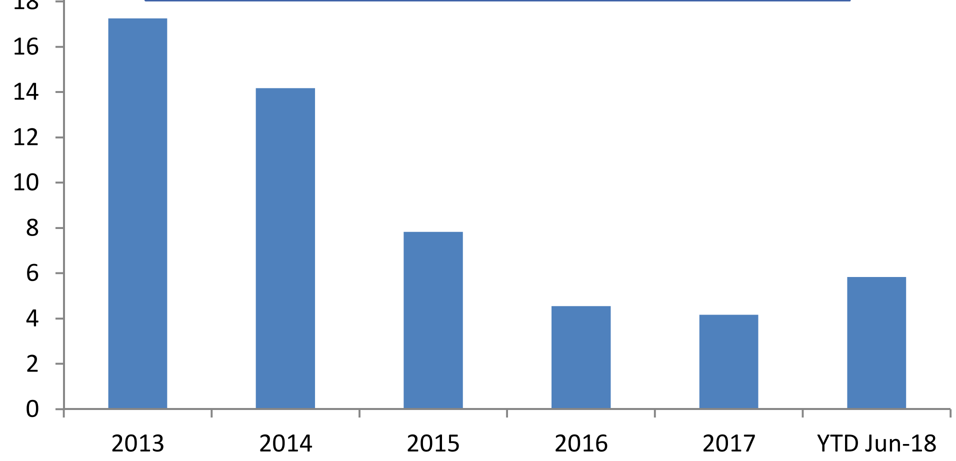
Robust Origination and Monitoring

- Coventry has strong and experienced central underwriting and collections teams, with no outsourcing.
- The Credit Risk department analyses the performance of the mortgage book and conducts quality assurance assessments.
- We consistently target low risk areas of the mortgage market, primarily low LTV owner occupier and buy-to-let.
- No lending has been advanced at more than 90% LTV since 2009.

Impairment charges as % of loans



Average Society Possessions per month



Very Low Impairments

- Impairments are very low on a mortgage book of £37.3bn.
- Impairment charges have fallen over the recent past with releases reported in 2015 and 2016.
- Impairment charges in the last recession between 2008 and 2012 averaged c. 8 bps per year. A significant proportion (55%) of the impairment charges seen in that period were on loan products that are no longer offered e.g. unsecured personal loans. Impairments have been consistently falling since exiting such markets, with the continued focus being on high quality lending.

Covered Bonds

Secured Funding Programs

COVENTRY Building Society

Sources of Funding

Offa *£475m*	**External issuances**
Leofric *£1,150m*	**External issuances**
Covered Bond LLP *£2,900m*	**External issuances**
Mercia *£1,165m*	**Retained notes** (Used for BoE facilities)
TFS *£4250m*	**Funding scheme usage** (Drawn against mortgage assets)

Overview

- Established wholesale programme, with first covered bond issued in 2008, followed by the inaugural RMBS of Leofric issued May 2012.
- External wholesale issuance compliments the overall retail funding strategy with approximately 80% of assets retail funded, even allowing for Coventry's strong year-on-year asset growth of c.10%.
- Diversifying funding allows us to utilise a range of sources for alternative purposes.
- Coventry Building Society has excellent ratings with both Fitch and Moody's and a proven funding track record.
- Multi access points to wholesale markets via EMTN, Regulated Covered Bonds and RMBS, both in Sterling and Euros.
- We are strongly motivated to maintain market access and investor confidence from a funding perspective.
- The Society has drawn down from the TFS scheme £4.25bn as at February 2018, using the funds to continuing to offer competitive member mortgages.
- Coventry Building Society has three platforms when utilising securitisation. It has separate programmes for external issuance in prime residential (Leofric) and buy-to-let assets (Offa) with no co-mingling of the two asset types, and Mercia which is used for buy-to-let retained issuance.

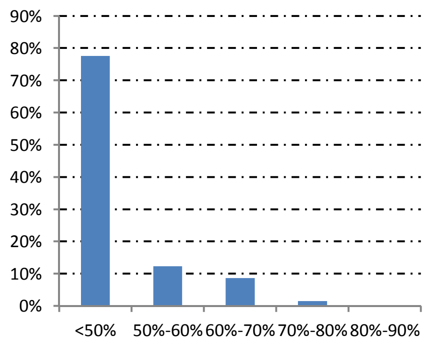
Covered Bonds

COVENTRY Building Society

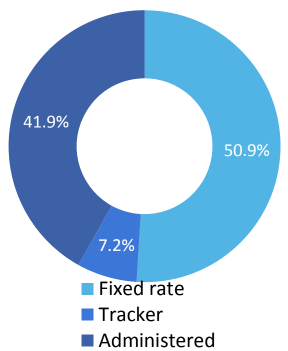
Covered Pool[1]

- Guaranteed by Coventry Covered Bonds LLP
- UK originated Owner Occupier Prime residential mortgages
- 8 Issuances across 2 Currencies established in 2008
- Regulated programme size of €7bn
- AAA rated by Moodys and Fitch
- Minimum Regulatory Overcollaterisation 108% vs CBS 140.8%
- Ring-fenced GIC account with HSBC Bank
- Coventry BS Asset Swaps

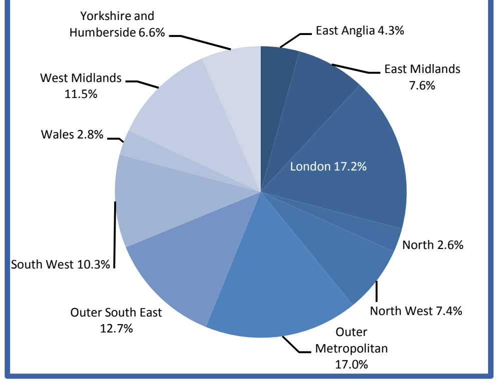
WA LTV %



Product Type



Geographical Distribution



Pool overview (as at 30-08-2018)

Pool size	£5,101,182,733
Average current balance	£120,615
Max current balance	£972,360
WA indexed LTV	43.4%
WA seasoning (mths)	50.9
Interest only	5.3%
Repayment	75.7%

Selected eligibility criteria

- Current balance <=£1,000,000.
- Less than 1 instalment in arrears.
- Borrower age >= 18 at origination.
- Loans relate to owner occupied residential properties in England or Wales.
- No buy-to-let, new build, offset or Right to Buy.
- No self certified or prior bankruptcy.

Issuance

Series 1 - £1.5bn
Issue 22/07/08
Maturity 24/07/22

Series 2 - £500m
Issued 20/11/08
Maturity 24/11/22

Series 3 - £750m
Issued 19/04/11
Maturity 19/04/18

Series 4 - €650m
Issued 24/10/11
Maturity 24/10/14

Series 5 - £500m
Issued 10/02/12
Maturity 10/02/15

Series 6 - €500m
Issued 03/11/14
Maturity 03/11/21

Series 7 - £650m
Issued 17/03/15
Maturity 17/03/20

Series 8 - €500m
Issued 12/01/17
Maturity 12/01/24

Covered Bonds

COVENTRY Building Society

UK RCB Regulation

The implementation of UK Regulated Covered Bond legislation is overseen by the FCA. The FCA conduct onsite visits to assess management of risks inherent in the programme, as well as reviewing:

- Appropriateness of the issuer's oversight and governance framework
- Appropriateness of systems, controls, policies and procedures in relation to risk management, underwriting, arrears and valuation
- Proficiency of cash management and servicing functions
- Quality of eligible assets to meet cover pool requirements (considering borrower history, income verification, LTV ratios, income multipliers, arrears, seasoning, loan purpose, property types and terms of the loans)
- Ability of the assets in the cover pool to mitigate the risk of asset-liability mismatches, the credit risk of assets, and other market value risks, concentration risks, currency risks, basis risks and counterparty risks
- Assets on the issuer's balance sheet available to be substituted in to meet ongoing cover pool requirements
- Ability of the programme to make timely payment on bonds (assessed separately by both the issuer and the FCA, through two independent cashflow models using multiple stressed scenarios)
- Compliance of the programme with the RCB Regulations (including the programme's remoteness from issuer insolvency)
- Existence of procedures for identification and rectification of any potential issues
- Independent legal and audit opinion on the compliance of the issuer and programme with RCB Regulations

FCA team monitors on an on-going basis:

- Ensure sufficient assets in the cover pool to mitigate risk of non-timely bond payments
- Provide independent assurance on further issuance that asset capability remains
- Monitor the impact of significant changes in asset/liability profiles of the programmes
- Receive and analyse individual loan and pool performance data
- Review any proposed material changes to the programme's contractual terms

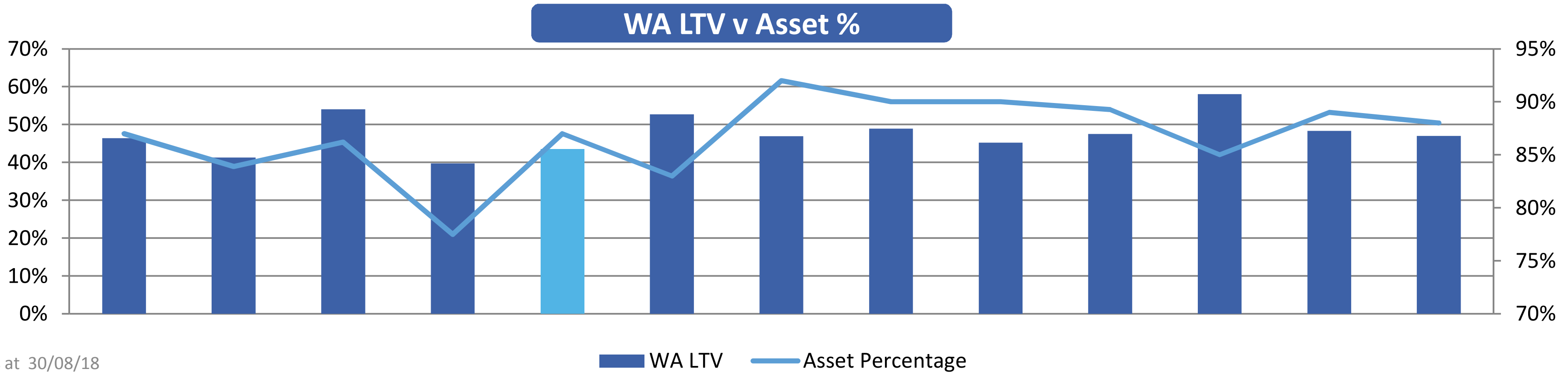
If an RCB issuer or RCB programme breaches any of the RCB Regulations, the FCA has the power to require correction of the breach (including by the transfer of additional assets into the cover pool), impose financial penalties or otherwise de-register or wind-up the programme.

Covered Bonds

COVENTRY Building Society

Comparison of Peers[1]

	Bank of Scotland plc	Barclays Bank plc	Clydesdale Bank plc	The Co-operative Bank plc	Coventry Building Society	Leeds Building Society	Lloyds Bank plc	Nationwide Building Society	Royal Bank of Scotland plc	Santander UK plc	Skipton Building Society	TSB Bank plc	Yorkshire Building Society
Programme Size	€60 billion	€35 billion	€10 billion	£4 billion	€7 billion	€7 billion	€60 billion	€45 billion	€25 billion	€35 billion	€7.5 billion	€5 billion	€7.5 billion
Covered bond ratings (S&P/Moody's/Fitch)	AAA/Aaa/ AAA	AAA/Aaa/ AAA	NR/Aaa/ AAA	NR/Baa2/A	NR/Aaa/AAA	NR/Aaa/AAA	NR/Aaa/ AAA	AAA/Aaa/ AAA	NR/Aaa/ AAA	AAA/Aaa/ AAA	NR/Aaa/ AAA	NR/Aaa/NR	NR/Aaa/ AAA
WA LTV (current)	60.20%	52.18%	60.89%	50.58%	48.80%	58.90%	60.20%	ND	55.73%	57.83%	65.43%	56.70%	56.00%
WA LTV (indexed)	46.40%	41.29%	54.00%	39.72%	43.40%	52.70%	46.90%	48.90%	45.20%	47.51%	58.05%	48.30%	46.97%
WA seasoning (months)	136	90.44	46.64	97	50.9	44.1	99.4	84	68.98	85.95	40	58.1	77.44
Buy to let (% amount)	0.00%	0.00%	13.94%	0.00%	0.00%	13%	0.00%	0.00%	14.57%	0.00%	8.16%	0.00%	0.00%
Interest Only	48.37%	28.82%	17.67%	21.23%	5.30%	20%	37.75%	8.32%	23.34%	22.84%	9.16%	17.73%	4.98%
Arrears (over 30 days)	1.13%	0.40%	0.44%	0.00%	0.00%	0.20%	1.82%	1.00%	0.25%	0.24%	0.07%	0.45%	0.22%
Asset Percentage	87.00%	83.90%	86.21%	77.50%	87.00%	83.00%	92.00%	90.00%	90.00%	89.28%	85.00%	89.00%	88.00%
Maximum LTV	60%	75%	75%	75%	75%	75%	75%	75%	75%	75%	75%	75%	75%
Repayment structure	Soft or Hard Bullet	Soft or Hard Bullet	Soft Bullet	Soft Bullet	Soft Bullet	Soft Bullet	Soft Bullet	Soft Bullet	Soft Bullet	Soft or Hard Bullet	Soft Bullet	Soft Bullet	Soft Bullet
Interest rate swap provider	Bank of Scotland plc	Barclays Bank plc	National Australia Bank Limited	J.P.Morgan	Coventry Building Society	Leeds Building Society & third parties	Lloyds Bank plc & third parties	Nationwide	Royal Bank of Scotland plc	Santander UK plc	Skipton Building Society	TSB Bank plc	Yorkshire Building Society
Covered Bond swap provider	Bank of Scotland plc	Barclays Bank plc & third parties	National Australia Bank Limited	HSBC Bank plc	Coventry Building Society, HSBC Bank plc, Natixis	Third parties	Lloyds Bank plc & third parties	Nationwide Building Society & third parties	Royal Bank of Scotland plc	Abbey National Treasury Services plc & third parties	N/A	N/A	Third parties



1. As at 30/08/18

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Useful links

- **Main website** http://www.coventrybuildingsociety.co.uk/
- **Financial results** http://www.coventrybuildingsociety.co.uk/your-society/financial-results.aspx