NEWS RELEASE

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COVENTRY BUILDING SOCIETY REPORTS STRONG RESULTS

Coventry Building Society has today announced its results for the year ended 31 December 2014. Highlights include:

Robust financial performance

- Underlying profit[1] increased by 51% to £217.8 million.
- Profit before tax was £201.8 million (2013: £132.1 million).
- Cost to mean asset ratio was 0.42%, the lowest reported by a UK building society (2013: 0.39%).
- Impairment charge just £5.4 million from a loan book of £27.0 billion, reflecting the Society's consistent low risk lending (2013: £6.3 million on a loan book of £24.1 billion).
- Common Equity Tier 1 (CET 1) ratio of 25.4% remains the highest reported by any top 10 building society.
- Leverage ratio of 3.9%[2], comfortably above proposed regulatory minimum requirement.
- Maintained strong 'A' credit ratings – Fitch (A) and Moody's (A3).

Growth in mortgage and savings balances

- New mortgage lending increased by 25% to £7.4 billion.
- Mortgage assets increased by £2.8 billion (12%) to £27.0 billion.
- Net mortgage lending equivalent to 13% of all net mortgage lending in the UK[3].
- Savings balances up by £2.1 billion (10%) to £23.4 billion.

Doing the right thing for members and the community

- Consumer champion, Which?, rated Coventry the highest scoring UK building society featured in the Which? results table for customer satisfaction.
- 89% of the Society's variable rate savings balances pay equal to or above the best buy rates offered by any major UK bank or building society[4].
- Over 99% of variable rate cash ISA balances paid equal to or more than 2%, with a weighted average ISA rate on all ISA balances of 2.55% compared to 1.05% in the market[5].
- Coventry cash ISAs have been in the national press best buy tables every week for nearly three years, and non-ISA savings products every week for over two years.
- Moneywise Customer Service Awards rated the Society the 'Most Trusted Cash ISA Provider' in 2014 and also 'Best Junior ISA 2014' for an account which has been a best buy since it launched in April 2012.
- Mortgages offered by the Society were in the national press best buy tables every week of 2014.
- During the first half of 2014, the Financial Ombudsman asked for the outcome on complaints referred to it for review to be changed on just five occasions, representing 3% of referred cases compared with 57% for all financial services providers[6].
- Staff engagement at 84% is 10% higher than the average financial services benchmark group used by an independent third party.
- The Society, on behalf of its members, has donated nearly £11 million to The Royal British Legion's Poppy Appeal since October 2008.

Mark Parsons, Coventry Building Society Chief Executive said:

"Coventry Building Society is a strong organisation, with a clear and consistent record of success. In 2014, we once again proved that a business model based on doing the right things for members can flourish.

In this regard the continuing strong financial performance of the Society with an increase in profit before tax of 53% to £201.8 million has been achieved whilst still providing long-term value to our saving and borrowing members.

In 2014 we continued to grow our mortgage lending with a record £7.4 billion of advances, a 25% increase on 2013. The overall growth in mortgages held was £2.8 billion, a 35% increase on 2013 growth, and equivalent to 13% of UK net mortgage lending[3]. With total mortgage balances up 12%, the Society now accounts for 2.1% of all UK mortgage balances[3], more than double our market share seven years ago when the financial crisis began.

While the general UK interest rate environment continues to favour borrowers, the Society has again delivered in supporting its savers. In 2014, the overall growth in savings balances was £2.1 billion, a 10% increase on 2013, compared with a growth in the UK market[3] of 5%, resulting in a record of £23.4 billion total savings balances.

This growth was achieved in a market that continues to be influenced by a low Bank of England Base Rate and the Funding for Lending Scheme. The fact that we continued to attract additional deposits during this period demonstrates our intent to offer long-term value to savers despite the availability of cheaper alternative funding. This is underpinned by more than 99% of variable rate cash ISA customers receiving an interest rate of 2.0% or more, and our non-ISA savings products featuring in national press best buy tables every week for over two years.

The Society's responsibility to protect the interests of members requires strong financial foundations. We expect the Society's risk weighted capital ratio to remain the strongest reported by any top 10 UK building society and also took steps to increase our leverage ratio to 3.9%[2] (2013: 2.9%) at the end of 2014 well above the proposed minimum level of 3%.

The primary source of capital to support future growth will continue to be retained profits. The Society's ability to provide attractive savings and mortgage products whilst building capital is supported by its sector-leading cost-efficiency and low level of mortgage arrears and impairment charges.

This strong financial performance has been achieved whilst also delivering the right outcomes to our members. We believe this is evidenced by research undertaken in October 2014 by consumer champion Which? who ranked the Society as the highest scoring building society for customer satisfaction. We are also proud that we not only have one of the lowest number of recordable complaints per member of any top 10 building society, but only 3% of complaints referred to the Financial Ombudsman Service were changed in favour of the complainant, compared with an industry average of 57%[6].

To achieve the right outcomes for members consistently, the Society relies on the commitment and enthusiasm of every member of staff. The 2014 employee opinion survey underlined the strength of our staff engagement with a score of 84% being 10 percentage points higher than a financial services benchmark group used by an independent third party. This engagement is also shown by our support for charitable activities which, in 2014, resulted in an overall community investment of over £2.2 million, with more than 250 organisations benefiting from volunteering, fundraising or other direct involvement by staff.

Coventry Building Society is a 130 year old mutual and proud of it. We are also a growth business and the 2014 results continue a trend of growth which was maintained throughout the financial crisis. Our ability to grow rests, as it always has done, on retaining the loyalty of existing members and attracting new members to the Society. I believe that staying true to our principles, which protect the interests of all of our members, means we are well placed to continue this growth."

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[1] Underlying profit before tax excludes net (losses)/gains from derivative financial instruments and provision for the Financial Services Compensation Scheme levy.
[2] The leverage ratio calculations shown are in accordance with the definitions of CRD IV, on an end-point basis, as amended by the European Commission delegated regulation. The calculation reflects constraints on the inclusion of Additional Tier 1 capital as proposed by the Financial Policy Committee's review of the leverage ratio. The ratio for 2013 has been updated to reflect this definition.
[3] Source: Bank of England
[4] As at 31 December 2014. Average deposit assumed as follows: Variable – £10,000 and ISAs £15,000. Excludes competitor products with restricted availability (e.g. existing customers only or reliant on maintaining or opening another product with the same provider) and Offset accounts. Source: Moneyfacts data.
[5] Source: Bank of England. Average quoted interest rate on all variable rate cash ISAs including bonus as at 31 December 2014.
[6] Source: Financial Ombudsman Service data from 1 January 2014 to 30 June 2014.

Financial Review

Income Statement

Overview

Statutory profit before tax has increased by 53% to £201.8 million. Whilst the Society does not aim to maximise profit, it is the key source of capital to protect members' interests and to support growth. In this context both underlying and statutory profit measures show a strong performance in 2014. This continues a track record of sustainable profitability that has seen the Society achieve satisfactory levels of profits throughout the financial crisis.

Statutory and underlying profit are set out in the summarised Income Statement below:

Year to 31 December 2014	Statutory profit £m	Financial Services Compensation Scheme levy £m	Movements on derivatives and hedge accounting £m	Underlying profit £m
Net interest income	341.3	–	–	341.3
Other income	8.2	–	–	8.2
Losses on derivatives and hedge accounting	(0.7)	–	0.7	–
Total income	348.8	–	0.7	349.5
Management expenses	(124.6)	–	–	(124.6)
Impairment charges	(5.4)	–	–	(5.4)
Provisions	(15.3)	15.3	–	–
Charitable donation to Poppy Appeal	(1.7)	–	–	(1.7)
Profit before tax	201.8	15.3	0.7	217.8

Year to 31 December 2013	Statutory profit £m	Financial Services Compensation Scheme levy £m	Movements on derivatives and hedge accounting £m	Underlying profit £m
Net interest income	253.1	–	–	253.1
Other income	9.3	–	–	9.3
Gains on derivatives and hedge accounting	2.8	–	(2.8)	–
Total income	265.2	–	(2.8)	262.4
Management expenses	(108.9)	–	–	(108.9)
Impairment charges	(6.3)	–	–	(6.3)
Provisions	(16.3)	15.4	–	(0.9)
Charitable donation to Poppy Appeal	(1.6)	–	–	(1.6)
Profit before tax	132.1	15.4	(2.8)	144.7

Net interest income

Net interest income at £341.3 million is £88.2 million higher than the previous year and was the primary driver in the increase in both underlying and statutory profit before tax.

	Year to 2014 £m	Year to 2013 £m
Net interest income	341.3	253.1
Average total assets	29,766	27,594
	%	%
Net interest margin	1.15	0.92

The Society's net interest margin has increased by 23 basis points to 1.15% in the year to 31 December 2014; the most significant driver for this was the continuing impact of the Government's Funding for Lending Scheme (FLS) which has driven down the cost of retail savings and wholesale funding. The Board believes the alignment of rates with the market is now largely complete and does not anticipate any further material increases in net interest margin.

Although the Society's net interest margin has benefited from the FLS, it has taken decisions to restrict the growth in net interest margin, thereby delivering value to individual members through attractive savings rates and competitive mortgage products. The Board has balanced this with the need to protect the overall financial strength of the organisation by increasing reserves through retained profits, providing reassurance and security to all members and in order to meet increasing capital requirements.

The Society's rates of interest paid to members remain extremely competitive with it paying the highest average rate of interest of any top 10 building society over the period 2011 to 2013[1]. At the end of the year, over 99% of variable rate cash ISA balances were paid at least 2% against the market rate of 1.05%[2]. Furthermore, a non-ISA savings account has been in the national press best buy tables every week for over two years.

Of the Society's variable rate balances 89% pay equal to or above the best buy rates offered by any major UK bank or building society[3] and it is estimated that if these variable rates were aligned to best buy rates, interest payable to members would be £60 million less per year (based on interest rates, balances and the market as at 31 December 2014). This demonstrates the delivery of a key strategic goal.

Other income

Other income is not a strategic priority for the Society, which remains focused on the provision of mortgage and savings products.

Following the decision during 2014 by a third party to withdraw the provision of investment advice from the branch network, other income of £8.2 million is marginally lower than in 2013 (£9.3 million).

Derivatives and hedge accounting

The Society uses derivative financial instruments to manage various aspects of risk and in doing so complies with the Building Societies Act 1986, which limits the use of derivatives to the reduction of risk (hedging) arising from changes in interest rates, exchange rates or other market indices.

Even though the Society uses derivatives exclusively for risk management purposes, Income Statement volatility arises due to the accounting ineffectiveness of designated hedges. Management believes that this volatility arises from application of the accounting rules rather than reflecting economic reality and consequently it is excluded from underlying performance.

Management expenses

Total expenses for 2014 were £124.6 million (2013: £108.9 million). The increase is equivalent to a 0.03% increase in the ratio of costs to mean assets and reflects the Society's continued growth, increasing regulation and focus on customer service.

There has been significant growth in staff costs in order to respond to new regulations, but also to improve the quality of service offered in customer facing areas. The Society has also invested in ensuring that its core IT infrastructure and systems are robust and secure and are able to support increased functionality and methods of distribution, including developments in online services. This is an area where investment is likely to increase. During 2014, significant cost was also incurred in meeting the requirements of the Mortgage Market Review, which has led to the introduction of an enhanced affordability assessment and all mortgage lending being undertaken on a fully advised basis. Depreciation and amortisation of property, plant and equipment and intangibles has also increased to £12.3 million (2013: £10.7 million).

However, the Society's reputation for rigorous cost control is well founded. For over 10 years it has achieved the lowest reported cost to mean asset ratio of all UK building societies and comfortably expects to retain this position in 2014, despite an increase from 0.39% to 0.42%.

We expect to see continuing cost pressures within the business arising from sustained levels of investment in technology, increased regulation and organic growth, but the Society's ability to grow whilst retaining control of costs continues to represent a significant competitive advantage.

Impairment charges

Impairment losses of £5.4 million were lower than in 2013 (£6.3 million). This equates to 0.02% of average loan balances in the year (2013: 0.03%) and 0.04% over five years[4].

The Society has a strong record on impairments, reflecting the success of its low risk lending strategy which has always been a key element of its business model. Other than as a result of small books acquired as part of the merger with Stroud & Swindon in 2010, the Society has not undertaken commercial lending or second charge lending and exposure to unsecured lending is negligible with no new lending of this type since 2009. Underlying profit before impairment and tax is over 40 times the impairment charge, reflecting the ability to remain profitable even in the event of a further downturn.

Provisions

The £15.3 million provision for liabilities and charges is in respect of the Financial Services Compensation Scheme (FSCS) levy. The £16.3 million charge in the prior year comprised £15.4 million for the FSCS and £0.9 million for Payment Protection Insurance (PPI).

The Society pays levies to the FSCS based on its share of protected deposits and such levies are excluded from underlying profit.

In contrast to the experience of many high street banks, PPI is not a material issue for the Society. This is a consequence of the design of the PPI product offered by the Society and the member focused offer process used. No further provision for PPI claims has been made during the year.

Charitable donation to Poppy Appeal

The Society donated £1.7 million to The Royal British Legion's Poppy Appeal during the year (2013: £1.6 million). The contribution to this appeal since 2008 now totals £10.8 million.

Taxation

The Board believes it should contribute its fair share of tax and in 2014 the corporation tax charge arising on profits earned was £43.3 million (2013: £30.8 million). This represents an effective rate of tax of 21.5% (2013: 23.3%) which is in line with the statutory corporate tax rate of 21.5% (2013: 23.25%).

Balance Sheet

Overview

Mortgage balances have grown by 12% from £24.1 billion to £27.0 billion in the year, primarily funded by an increase in retail funding of £2.1 billion. Wholesale funding and equity increased by £0.2 billion and £0.6 billion respectively.

	2014 £m	2013 £m
Assets		
Loans and advances to customers	26,959.6	24,117.1
Liquidity	3,950.2	3,887.4
Other	368.5	248.8
Total assets	31,278.3	28,253.3
Liabilities		
Retail funding	23,395.6	21,311.7
Wholesale funding	5,604.3	5,438.5
Subordinated liabilities and subscribed capital	219.8	219.7
Other	567.7	388.4
Total liabilities	29,787.4	27,358.3
Equity		
General Reserve	1,061.9	914.6
Other equity instruments	396.9	–
Other	32.1	(19.6)
Total equity	1,490.9	895.0
Total liabilities and equity	31,278.3	28,253.3
Unencumbered FLS Treasury bills (off-balance sheet liquidity)(Market value)	616.3	642.8

Treasury bills obtained under the FLS provide very high quality liquidity but, in accordance with accounting standards, are not recognised on the Balance Sheet as the Society does not retain the risk and rewards in relation to these assets.

Loans and advances to customers

The Society's lending strategy is focused on high quality, low loan to value owner-occupied and low loan to value buy to let loans within the prime residential market, through competitively priced mortgages.

These loans are primarily distributed through UK wide third party intermediaries, and to a lesser extent through a smaller number of advisors within the Society's network of branches and the Coventry based contact centre.

In 2014, the Society advanced £7.4 billion of mortgages, a 25% increase on the same measure in 2013 (2013: £5.9 billion), outperforming the market growth in gross advances of 14% year-on-year[5]. This once again represents a record performance and one that continues a trend of growth that has seen us more than double our market share of UK mortgage balances over the last seven years, exceeding 2% for the first time in our history[5].

The Society's mortgage balances increased as a result of organic growth by £2.8 billion (2013: £2.1 billion). This represents a 35% increase on 2013 net mortgage lending, and was equivalent to 13% of all UK net mortgage lending[5].

The growth in the mortgage book has been achieved whilst retaining the Society's focus on low risk lending. The result is an overall indexed loan to value of the mortgage book at 31 December 2014 of 49% (simple average), a position that is largely consistent with previous years (2013: 50%).

The result of this responsible lending approach is highlighted by an arrears performance which is significantly better than that of the industry as a whole and impairment charges which are consistently amongst the lowest reported by any top 10 mortgage lender.

As at 31 December 2014, 0.40% of mortgage balances were 2.5% or more in arrears (2013: 0.57%). At the time of the latest published data[6], arrears were 38% of the industry average. At the end of 2014, just 52 properties were in possession (2013: 67) from a total population of over 200,000 accounts.

This performance underlines the Society's commitment to the UK housing market during a period in which new mortgage lending as a whole still remains lower than pre-2008 levels[5].

Liquidity

On-balance sheet liquid assets have remained broadly unchanged at around £3.9 billion, despite the growth of the balance sheet, and continue to be held primarily in deposits at the Bank of England and UK government bonds. All regulatory requirements have been met throughout 2014 and the broadly unchanged balance reflects very high surpluses at 31 December 2013.

The credit quality of liquid assets remains high with 96% of the portfolio rated Aaa–Aa3 (2013: 98%) and 2% rated A1–A3 (2013: 2%). The Society has no direct exposure to the peripheral Eurozone countries. As at 31 December 2014 no amounts in the liquid asset portfolio were either past due or impaired and as such no impairment provision has been made.

Of the £4.0 billion liquid assets, £1.7 billion are held as Available-for-sale (AFS) and under IFRS are marked to market with any changes in value recorded through other comprehensive income. The non-AFS assets are loans and advances to credit institutions or deposits with the Bank of England. As at 31 December 2014, the balance on the AFS reserve was £0.7 million loss net of tax (2013: £12.1 million loss net of tax).

Retail funding

The Society continues to be predominantly funded by retail savings, which have increased by £2.1 billion to a balance of £23.4 billion at 31 December 2014 (2013: £21.3 billion). We estimate our share of the growth in the UK savings market for the year to be 3.7%, over double our 1.8% share of total UK savings balances[5].

As has been the case throughout the financial crisis, the Society has maintained a competitive stance in the retail savings market and has chosen to increase retail funding despite the availability of cheaper wholesale funding. This is a reflection of one of the core objectives; that as a building society we exist not only to provide mortgages but also to offer our members an attractive rate of interest and a safe home for their savings.

The growth in retail funding in the year was driven by maintaining very competitive savings rates for both new and existing members in both ISA and non-ISA markets.

In particular, given the strength of savings rates offered, the Society benefited from the changes to ISA legislation in July. These included an increase in the annual limit to £15,000 and the ability to transfer stocks and shares ISAs into cash ISAs, resulting in ISA balances at the Society growing by 71% year-on-year compared with growth of only 10% in overall UK cash ISA balances[5].

Wholesale funding

The Society uses wholesale funding to provide diversification by source and term and also to provide value to members through lowering the overall cost of funding.

During the year, on-balance sheet wholesale funding has increased marginally by £0.2 billion with a year end balance of £5.6 billion (2013: £5.4 billion). In November 2014 the Society raised €500 million of seven year funding issued from the covered bond programme, replacing the €650 million covered bond that matured at the end of October 2014. Off-balance sheet wholesale funding through FLS remained at similar levels to 2014, with a drawdown of £1.3 billion (2013: £1.3 billion).

The proportion of assets funded by wholesale activity remains broadly flat at 18% (2013: 19%).

Equity

The Society's equity is predominantly made up of its General reserve and Additional Tier 1 (AT 1) capital (other equity) but also includes the Available-for-sale reserve and cash flow hedge reserve. In June 2014, the Society issued £400 million of Perpetual Capital Securities, a form of AT 1 capital, in order to strengthen its leverage ratio. The discretionary coupon paid to investors on these securities will be treated as an appropriation of profit after tax, reflecting their categorisation as capital instruments, and hence is not reflected in net interest margin. The first coupon payment of £8.9 million, covering the period from issue to 31 October 2014, was paid on 3 November 2014.

As a result of this issuance and retained profits generated during the period, the Society's total equity increased by £0.6 billion over the year to £1.5 billion (2013: £0.9 billion).

Regulatory capital

The Society's capital position was regulated under the Basel II framework during 2013, but in 2014 was regulated under the Basel III framework.

Basel III was implemented through the Capital Requirements Regulation and Capital Requirements Directive (CRD IV) and became effective on 1 January 2014. The impact of CRD IV is complex, but in summary it reduces the Society's regulatory capital resources primarily through the inclusion of the negative Available-for-sale reserve, and restricting the eligibility of Permanent Interest Bearing Shares and subordinated debt on a phased basis under transitional rules which extend to 31 December 2021.

CRD IV also introduces a non-risk based leverage ratio that is supplementary to the risk based capital requirements and was originally proposed as a 'backstop' measure. The calculation determines a ratio which measures the relationship between Tier 1 capital and exposures to on and off balance sheet items. The leverage ratio does not distinguish between unsecured and secured loans or recognise the ratio of loan to value of secured lending. The Financial Policy Committee (FPC) has reviewed the CRD IV requirements and has proposed that the minimum level of this ratio in the UK will be 3% with additional CET 1 buffers to be required in the future based on deemed systemic importance of individual institutions, or set more widely based on the FPC view of risks to financial stability.

The FPC review published in October 2014 also restricted the amount of AT 1 capital that could be included in meeting the proposed 3% minimum leverage ratio. Whilst all of the Society's recently issued AT 1 capital meets the Basel III requirements and therefore serves to protect members' interests, only £242.5 million is currently eligible for this particular measure.

The Society's capital position as at 31 December 2014 is summarised in the table below which shows CRD IV information for the current year on an end-point basis (i.e. assuming all CRD IV regulation were in force in full with no transitional provisions permitted) and on a proforma basis for the previous year.

The increase in CET 1 capital is primarily driven by retained profit of £158.5 million. Total Tier 1 capital and total regulatory capital have additionally been increased by the issue of £400 million of AT 1 capital.

Risk weighted assets have increased, reflecting continuing growth of the mortgage book.

The movements described above have resulted in an increase in the Society's CET 1 ratio from 22.8% to 25.4% and in its leverage ratio from 2.9% to 3.9%[7] (on an end-point basis). At 31 December 2014, and throughout the year, the Society complied in full with the capital requirements that were in force.

	End-point[8] 31 Dec 2014 £m	Proforma end-point[8] 1 Jan 2014 £m
Capital resources:		
Common Equity Tier 1 (CET 1) capital	1,011.2	855.2
Total Tier 1 capital	1,408.1	855.2
Total capital	1,414.2	857.2
Risk weighted assets	3,975.8	3,750.2
	%	%
CRD IV ratios:		
Common Equity Tier 1 (CET 1) ratio	25.4	22.8
Leverage ratio[7]	3.9	2.9

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[1] Average rate estimate based upon interest payable on shares divided by average of opening and closing share balances, as disclosed in Annual Report & Accounts (2011 to 2013).

[2] Source: Bank of England. Average quoted interest rate on all variable rate cash ISAs including bonus as at 31 December 2014.

[3] As at 31 December 2014. Average deposit assumed as follows: Variable – £10,000 and ISAs £15,000. Excludes competitor products with restricted availability (e.g. existing customers only or reliant on maintaining or opening another product with the same provider) and Offset accounts. Source: Moneyfacts data.

[4] Impairment losses on loans and advances to customers/Average loans and advances to customers.

[5] Source: Bank of England.

[6] As at 30 September 2014. Source: PRA.

[7] The leverage ratio calculations shown are in accordance with the definitions of CRD IV, on an end-point basis, as amended by the European Commission delegated regulation. The calculation reflects constraints on the inclusion of AT 1 capital as proposed by the Financial Policy Committee's review of the leverage ratio. The prior year ratio has been updated to reflect this definition.

[8] Grandfathered Tier 1 and Tier 2 instruments are fully amortised under the end-point basis.

For more information or additional comment please contact:

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