Pillar 3 Disclosures

for the year ended 31 December 2019

COVENTRY
Building Society

Contents

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Please note the term Society is used in this Pillar 3 document to refer to the activities of the Society and its subsidiaries except where the context indicates otherwise.

Updates for Bank of England measures announced on 11 March 2020

This document has been prepared as at 31 December 2019. All tables present the Society's position and regulatory requirements at that date. Changes to requirements in response to Covid-19 which were announced by the Bank of England on 11 March 2020 have been addressed where appropriate in these disclosures. As a result, information within this document may differ from that included in the Society's 2019 Annual Report & Accounts.

1. Overview

1.1 Background

This Pillar 3 document sets out disclosure requirements under the Capital Requirements Regulation (CRR) and Capital Requirements Directive (together referred to as CRD IV).

These are known as Pillar 3 disclosures because they complement the minimum capital requirements in Pillar 1 and the supervisory review process in Pillar 2. The Pillar 3 disclosures are aimed at promoting market discipline by providing information on risk exposures and the management of those risks.

CRD IV requires a concise risk statement approved by the management body which describes the institution's overall risk profile associated with its business strategy. The Society has a risk philosophy to be a below median risk building society. This is evidenced by its simple business model and prudent lending policy with a conservative balance weighted indexed loan to value of 55.4% (2018: 54.6%) and low levels of arrears. At 31 December 2019, 0.08% of mortgage balances were 2.5% or more in arrears (2018: 0.10%) compared to the latest available industry average of 0.67%[1]. The Society's Common Equity Tier 1 capital ratio was 32.0% at 31 December 2019 (2018: 33.9%[2]), this is amongst the highest reported in the UK[3]. Additional information on the risks the Society is exposed to and how it manages these risks is included in this document and also within the Risk Management Report in the 2019 Annual Report & Accounts (Accounts) which is published on the Society's website (www.coventrybuildingsociety.co.uk).

1.2 Policy and frequency of disclosures

The CRR requires the Society to adopt a formal policy to comply with Pillar 3 disclosure requirements and the European Banking Authority has issued guidelines on materiality, proprietary and confidential information and on disclosure frequency. The Board has put in place such a policy and confirms that no disclosures have been omitted as either being proprietary or confidential. The only omissions on materiality grounds relate to those which would be disclosed under Article 447 'Exposures in equities not included in the trading book'. The fair value of these investments is £4.1 million (0.008% of the Society's total assets) and they are made up of shares in Visa Inc. and VocaLink Holdings Limited. Further information on these investments can be found in the Accounts. In addition, the regulatory capital ratios disclosed in this report do not include the impact of IFRS 9 transitional relief as this relief is not material for the Society.

Pillar 3 disclosures are published on an annual basis in conjunction with the Accounts in accordance with regulatory guidelines.

1.3 Verification

These disclosures have been reviewed by the Board Audit Committee on behalf of the Board. These disclosures have not been, and are not required to be, subject to independent external audit, and do not constitute any part of the Society's financial statements.

1.4 Governance arrangements and remuneration

Disclosure requirements relating to governance arrangements under CRR Part Eight Article 435, and in particular the declaration approved by the Board of the adequacy of risk management arrangements, are included in the Directors' Report on Corporate Governance and Annual Business Statement within the 2019 Accounts published on the Society's website (www.coventrybuildingsociety.co.uk).

1. Source: Prudential Regulation Authority – latest available information at 30 September 2019.
2. 2018 CET 1 Ratio is restated following a correction to the calculation of risk weighted assets which was announced in December 2019. See section 3 for more information.
3. Source: Common Equity Tier 1 ratio for the UK Finance 2018 top 20 mortgage lenders (balance outstanding) – latest published CET 1 data as at 27 March 2020.

The disclosures required under CRR Part Eight Article 450 and the Prudential Regulation Authority's (PRA) Remuneration Code are included in the Directors' Remuneration Report within the 2019 Accounts.

1.5 Scope of disclosures

The Society is a European Economic Area (EEA) parent institution that is regulated by the PRA and Financial Conduct Authority (FCA). The CRD IV framework therefore applies to the Society and its subsidiary undertakings. Information on these subsidiaries is set out in note 17 to the 2019 Accounts. There are no differences between the basis of consolidation of the Group for accounting and CRD IV purposes in preparing the Pillar 3 disclosures.

Regulatory capital ratios are calculated on both a Group and an Individual Consolidated (or solo) basis. The subsidiaries included in the Individual Consolidated basis are Godiva Mortgages Limited and ITL Mortgages Limited.

The Society does not foresee any practical or legal impediments to the transfer of capital resources or the repayment of liabilities between the Society and the entities included in the Individual Consolidated basis.

The Group consolidation also includes structured entities used by the Society in its wholesale funding programmes. These entities have minimal levels of retained capital and risk weighted assets. As a result there are no significant differences between the Individual Consolidated basis and the Group. For this reason, the disclosures in this document are made on a Group basis only and the term Society is used as a reference for the Group.

1.6 European Banking Authority Guidelines on Pillar 3 disclosures

The Society is not a Globally or Other Systemically Important Institution and, taking account of its simple business model and low risk profile, has chosen not to reflect the 2016 and 2017 EBA Guidelines for such institutions in its 2019 disclosures other than abbreviated disclosures of the Liquidity Coverage Ratio (LCR) in Appendix 6.

1.7 New and amended IFRS in 2019 – Impact on regulatory capital

The Society implemented IFRS 16 on 1 January 2019. This resulted in recognition on the balance sheet of a right of use asset of £29.6 million and lease liabilities of £32.8 million. There was a reduction of £0.8 million to reserves on transition. In addition the Society also implemented amendments to IAS 12 from 1 January 2019 and early adopted amendments to IFRS 9, IAS 39 and IFRS 7 during 2019. Information on the impact of adoption of these new or amended accounting standards is in note 1 to the 2019 Accounts.

These changes did not have a material impact on the reserves of the Society and the impact on regulatory capital was negligible.

2. Risk management policies and objectives

2.1 Overview

The Society is a mutual organisation run for the long-term benefit of its members. In keeping with this, the Board adopts a prudent approach to managing risk.

2.2 The Society's mission and objectives

The Society's purpose is giving people the power to be better off through life. As a member owned business its mission is Putting Members First. The Society does this through providing simple, straightforward and transparent products that offer superior long term value coupled with excellent service.

The Society's strategic priorities in pursuit of its mission are:

- A commitment to remaining an independent mutual, owned by and serving its members.
- Driving long term sustainable growth in mortgages and savings demonstrating the value of our products and giving us economies of scale.
- Returning superior value to members through products which are simple and transparent.
- Providing a service which is easy to use and valued by our members whether in a branch, by telephone or online.
- Running our business cost effectively to allow us to invest in future services whilst providing enhanced returns to our members.
- Being one of the safest and most secure UK financial institutions.
- Working effectively with all our stakeholders to deliver our mission.

Financially, the Society seeks to retain only the profit it needs to maintain capital ratios whilst investing to improve services and providing favourable pricing to members.

More information on the Society's strategy, business model and values are in the Strategic Report in the 2019 Accounts.

2.3 Principal and inherent risks

Whilst the Society's risk categories under its Enterprise Risk Management Framework tend to be stable, the principal or main risks, which could impact its financial performance, vary over time. These principal risks and the Society's mitigation of them are outlined below:

Principal Risks	Mitigation
UK political and economic uncertainty The political environment could impact the wider economy. Whilst the outcome of the General Election provided some clarity over the path of Brexit, uncertainty remains over future trading relationships. This, and weak global economic growth, could indirectly impact the Society's business model, creating strategic, credit or funding risks for the Society. For example, if access to the wholesale funding market is disrupted or a combination of falling house prices and rising unemployment impacts mortgage demand and increases credit risk.	The simple low risk business model is resilient to both economic and credit downturns. Regular stress testing informs the Board and management that this remains the case even in extreme stress scenarios. Robust lending affordability assessments protect against deterioration in the credit environment, as does the geographically diversified and low loan to value mortgage book. Strong levels of risk based capital (CET 1) and liquidity (LCR) mean that the Society has enough resources to deal with financial and funding challenges that may emerge. The Society has taken steps in 2019 to diversify its wholesale funding arrangements to ensure that it has more funding options available ahead of sector wide repayment of Term Funding Scheme balances by 2022.

Market environment risk There are a number of factors which could put pressure on the Society's net interest margin or its ability to return superior value to savings members, creating strategic risk. These include a continuation of the pricing pressures in the mortgage market, the impact of persistently low interest rates, or a prolonged slowdown of house purchases.	The Society's low cost operating model means that it can operate effectively in a low margin environment whilst still returning value to its members and maintaining capital ratios as demonstrated again in 2019. The financial planning process includes rigorous tests for a number of scenarios, including continued market pricing pressures. All these scenarios demonstrate the capacity to operate at low margin levels whilst accommodating planned investment spend.
Change and execution risk The Society continues to invest in significant levels of technology and business change and it expects this to continue for a number of years. Whilst the Society change programmes will deliver additional resilience and flexibility and reduce risk once implemented, much of the change is complex and the extent of the change creates a number of operational risks. These include dependency risk from the need to make changes to legacy systems alongside managing a number of other change initiatives in parallel. In addition, there is a risk that change costs increase or that the change activity needed is underestimated, increasing both project costs and delivery timescales. Whilst using trusted third parties to help deliver change projects can protect against this risk, a greater reliance on third parties also raises security and other risks, such as risks of supplier failure.	In 2019, the Society embarked on a programme of uplifting change capability to improve both change delivery and management of execution and cross dependency risks. The Society has enhanced its procurement and supplier management processes to make sure it works with the right partners and have controls in place which mitigate third party reliance risks. Finally, the Society is enhancing risk oversight of its change programmes. Taken together, these measures are designed to ensure change is delivered safely, without disruption to core operations, and within expectations, reducing the execution risk of change.
Need to keep pace with changing customer demands Customer expectations and the increased use of technology are changing the way in which both savings and mortgage products are designed and delivered. Whilst the Society has a significant number of change programmes under way, external factors, such as regulatory development could require further change investment. There is a risk that the scale of change the Society could face leaves it with insufficient capacity to develop new products and services in an increasingly digital world or could jeopardise its low cost operating model and its ability to return superior value to members.	The Society focuses on the need to develop its products and services to meet changing needs, whilst preserving its purpose and heritage. The Society continually engages with its members to identify product and service enhancements that they need and value in order to make sure it focuses on the right changes. In 2019, a roadmap of strategic change was developed, setting out how the Society would deliver the resilient and flexible operating environment and service and product enhancements it needs. The strategic plan continues to balance shorter term change with longer term strategic investment requirements within the low cost operating model.

As a UK Building Society there are a number of risks that the Society it is inherently exposed to. These risk categories are summarised below, in addition to information on how the Society mitigates and manages them.

Inherent risk categories	Mitigation
Credit risk The risk that borrowers or counterparties do not meet their financial obligations.	Robust underwriting and affordability assessment together with appropriate credit policies mean that the Society lends responsibly and remains low risk.
Market risk The risk of a reduction in Society earnings and/or value as a result of financial market movements.	The Society operates within Board approved limits and uses interest rate swap agreements to mitigate the impact of changes in interest rates.
Liquidity and Funding risk The risk that the Society has insufficient funds to meet its obligations falling due or the inability to access funding at reasonable cost or risk.	The Society holds sufficient liquidity to withstand a severe but plausible stress and operates within limits set by the Board. The Society maintains a diversified funding base to avoid over reliance on any funding source, type or term.
Conduct risk The risk that the Society's behaviour or decision making fails to deliver good customer outcomes.	The Society places good customer outcomes at the heart of its decision making. In line with Putting Members First, this reduces conduct risk. This ethos directly impacts the design of products and services and is embedded in the Society's people and communication strategies.
Operational risk The risk of loss arising from inadequate internal processes, systems or people, or from external events.	The Society actively identifies, assesses and manages the risks to which it is exposed. In addition, the Society has built business continuity capability to ensure that it can continue to serve members in the event of an operational risk event delivering operational resilience.
Model risk The risk that an ineffective model or incorrectly interpreted model output leads to a loss, reputational damage or regulatory censure.	The Society operates robust model governance protocols, including sensitivity analysis on key assumptions, independent model validation and regular model monitoring.
Strategic risk The risk that the business model or strategy becomes inappropriate given changes to macroeconomic, geopolitical, regulatory or other factors	A simple business model which focuses on opportunities that are well understood is the main mitigant. In addition, the Society carries out a robust Strategic Planning process which is subject to capital and liquidity stress testing. The Strategic Planning assumptions are regularly reviewed to focus on risks which could become a threat to the business model over the medium to long term.

The Society also has a level of pension obligation risk in relation to the now closed defined benefit pension scheme which is not considered material.

Disclosures relating to market, liquidity and funding, conduct, operational, model and strategic risks (including climate change) are included in the Risk Management Report in the 2019 Accounts and are not duplicated in this document. The required Pillar 3 asset encumbrance disclosures are included in Appendix 3 and Pillar 3 Liquidity Coverage Ratio (LCR) disclosures in Appendix 6. This document does, however, include additional credit risk information to that in the 2019 Accounts given that credit risk is the principal driver of the Society's Pillar 1 capital requirement. In order to provide the reader with a comprehensive overview of credit risk, the 2019 Accounts disclosures on credit risk are also included in this document.

2.4 Controlling and managing risk - overview

The Society's Enterprise Risk Management Framework (ERMF) has continued to operate effectively during 2019. The ERMF sets out the Society's approach to managing and overseeing risk by: defining risk strategy; risk appetite; governance and control; and risk management in light of the Society's strategy. The ERMF is approved annually by the Board and the Society will continue to enhance the ERMF, as required, to ensure it identifies and manages risk within its low risk tolerance.

2.5 Risk strategy

The Board sets the Society's risk strategy and risk management approach. The strategy includes establishing a robust risk culture, setting the Board's risk appetite and ensuring the 'three lines of defence' model operates effectively, in order to meet the Society's risk philosophy of being a below median risk Building Society.

Risk culture

Risk culture is reflected in the behaviour and approach to risk awareness, risk taking and risk management. A strong risk culture helps the Society to achieve its strategy within acceptable risk levels.

The Society's risk culture is built on the following three elements:

- **Tone from above** – the Board and executive management act and encourage employees to act with openness and integrity, especially in the fair treatment of members. Employees are encouraged to report observed non-compliance with policies, risk incidents and 'near misses'.
- **Accountability** – employees understand both the core values of the Society and its approach to risk. Where individuals have specific risk management responsibilities, these are included within role profiles and objectives, and employees understand that they will be held accountable for their actions and risk taking behaviours. The vast majority of Society roles are covered by the 'Strengthening Accountability in Banking' regulatory framework, which sets standards for those working within financial services.
- **Incentives** – the Society makes sure that its performance management and reward frameworks promote its desired risk management behaviours and attitudes. In particular, the Society does not pay any sales incentives to employees.

Board risk appetite

The Board articulates the risks it is willing to take in delivering the Strategic Plan through risk appetite statements which create a framework for business decision making. Where management can meet strategic objectives without using the full extent of the Society's risk appetite, the Board expects it to do so.

The Executive Risk Committee (ERC), the Board Risk Committee (BRC) and the Board all review performance and adherence to Board limits.

Three lines of defence

The Society uses the 'three lines of defence' model which is recognised as an industry standard for risk management.

The key accountabilities of the three lines of defence within the Society are illustrated below.

First line of defence	Second line of defence	Third line of defence
The business	**Risk oversight**	**Internal Audit**
• Owns and manages the Society's risks. • Is responsible for compliance with relevant regulation and legislation. • Identifies, manages and mitigates the risks of the Society. • Defines and operates controls. • Assesses key risk indicators and market conditions. • Produces management information and reports on risk.	• Designs, interprets and develops the Enterprise Risk Management Framework, and monitors business as usual adherence to the framework. • Provides oversight, challenge and assurance over the management of risks. • Develops compliance policies, supports delivery of regulatory change and monitors and reports on regulatory issues. • Is responsible for overseeing effective compliance with relevant regulation and legislation. • Identifies, manages and mitigates the risks of the Society.	• Conducts independent testing and verification of the efficiency of the Society's business model, controls, policies, processes and business line compliance. • Provides assurance that the risk management process is functioning as designed. • Is responsible for providing assurance over compliance with relevant regulation and legislation.

2.6 Governance and control

The Society has a number of committees which oversee and monitor risk as set out below. The Board delegates to the Board Risk Committee (BRC) oversight of the Society's risk management arrangements as a whole. The Chief Risk Officer (CRO) has an independent reporting line directly to the Chair of BRC in addition to reporting to the Chief Executive.

The Internal Audit function provides independent assurance and the Chief Internal Auditor has an independent reporting line to the Chair of the Board Audit Committee (BAC).

Further information on the BRC and BAC is included in the Board Risk Committee Report and in the Board Audit Committee Report respectively in the Accounts.

The Board

Board Risk Committee (BRC) Chair: Martin Stewart, Non-executive Director	Board Audit Committee (BAC) Chair: Iraj Amiri, Non-executive Director
See BRC report	See BAC report

Chief Executive

Executive Risk Committee (ERC)	Chair: Mark Parsons, Chief Executive
• Oversees and monitors strategic risk. • Ensures that risk is being identified and managed effectively across the Society. • Exercises executive risk oversight for each of the Society's principal risks. • Ensures that the Society's Risk Management Framework remains effective.	• Considers any emerging risks which may impact the Society's Strategic Plan. • Considers reports from the various Risk Committees and CRO. These reports are also submitted directly to BRC to ensure independent non-executive committee oversight of the Society's risk exposures.

Risk Oversight Committee (ROC) Chair: Fraser McNeill, Chief Risk Officer	Conduct Risk and Compliance Committee (CRCC) Chair: Mark Parsons, Chief Executive	Asset and Liability Committee (ALCO) Chair: Michele Faull, Chief Financial Officer	Retail Credit Risk Committee (RCRC) Chair: Fraser McNeill, Chief Risk Officer	Operational Risk Committee (ORC) Chair: Peter Frost, Chief Operating Officer
• Provides independent oversight of the management of risk throughout the Society and ensures that risks are identified, assessed, managed, monitored and reported effectively and consistently.	• Oversees and monitors the Society's delivery of good customer outcomes consistent with the conduct risk appetite statement approved by the Board. • Oversees the management of conduct risk and the Society's compliance with applicable conduct regulation.	• Oversees the Balance Sheet risks faced by the Society. • Oversees market risk, treasury credit risk and liquidity and funding risk. • Ensures the robustness of capital and liquidity stress testing. • Oversees financial model risk management. • Oversees prudential regulatory risk and treasury conduct risk.	• Monitors the management of retail credit risk across the Society and the performance of the mortgage book to ensure compliance with risk limits approved by the Board. • Oversees management of model risk through its subcommittee, the Models and Ratings Committee, which is chaired by Michele Faull.	• Provides primary oversight of all operational risk categories. • Ensures compliance with limits approved by the Board.

2.7 Risk management

The Society identifies, assesses, manages, monitors, escalates and reports risks through risk and control self-assessment, risk indicators and risk management information.

These processes deliver risk management objectives to:

- Identify risks to the Strategic Plan and Society objectives.
- Assess risk exposures by impact and likelihood.
- Respond to risks by evaluating them against the Society's risk appetite, formulating associated management responses and monitoring progress against agreed management action plans.

Stress testing and planning

Stress testing, for both internal and external shocks, is used to understand the potential impact of inherent risks crystallising and options to manage them. This includes scenario and contingency planning for a range of risk events from credit risks to operational risks.

Stress testing is a key part of the Society's capital and liquidity assessments and allows the Board to be satisfied that the Society has sufficient capital and liquidity resources even under a range of severe forward looking scenarios.

The Internal Capital Adequacy Assessment Process (ICAAP) is the Society's evaluation of its capital position and requirements. Additional information is available in Sections 4.1 and 4.2.

More detail on the Internal Liquidity Adequacy Assessment Process (ILAAP) together with reverse stress testing and the Society's Recovery Plan is set out in the Liquidity and Funding risk section in the Risk Management Report in the 2019 Accounts.

3. Capital resources

3.1 Total available capital and compliance with capital requirements

As at 31 December 2019 and throughout the financial year, the Society complied with the capital requirements in force.

As explained in Section 1, the capital information in this section is set out on a Group basis only and the term 'Society' is used as a reference for the Group and the regulatory ratios disclosed do not include IFRS 9 transitional relief as this is not material.

The Society continues to use an Internal Ratings Based (IRB) approach for over 99% of its retail credit risk exposures. For all other lending exposures and for operational risk the Society follows the standardised approach. The standardised approach uses capital risk weighting percentages set by CRD IV to calculate capital requirements.

From January 2008, the Financial Services Authority granted the Society permission to use the IRB approach. This was extended by the PRA in July 2013 to include the majority of mortgages transferred from the merger with the Stroud & Swindon Building Society in 2010. These permissions were updated to become a CRR IRB permission from 1 January 2014 and further extended during 2015 to include the then £0.5 billion mortgage book acquired from the Bank of Ireland in 2012.

These IRB models are used to calculate capital requirements for prime owner-occupier and buy to let mortgage exposures which account for around 99% of lending exposures throughout 2019 (2018: 99%). The remaining retail credit risk exposures on legacy closed products are modelled using the standardised approach.

There have been a number of changes to the regulations since the current, or incumbent, IRB models were developed. As a result, the Society has developed new IRB models to fully reflect the latest guidance. Once the Society has received permission from the PRA, they will replace the existing models. The Society expects that on adopting the new models, its RWAs will increase modestly and its CET 1 ratio will fall by between 1% and 3%. The comparatively minor adjustment arises because the Society's incumbent models already assess risks 'through the cycle' rather than solely on a 'point in time' basis.

During the process of updating these models it was identified the Society had made an omission in connection with its historic calculation of its RWAs. Specifically, the necessary 6% scalar was not applied to the core IRB model outputs. The core IRB models themselves were not impacted. The application of the 6% scalar increased total RWAs by 4.7% as at 31 December 2018, resulting in a 1.6% reduction in the CET1 ratio. Where relevant, comparative information has been restated throughout this document to include the impact of the 6% scalar.

Table 1 shows the composition of capital resources for the Society as at 31 December 2019 on a CRD IV basis on both a transitional and end-point basis (i.e. assuming all CRD IV requirements were in force with no transitional provisions permitted).

No transitional provisions apply to the Society's Common Equity Tier 1 (CET 1) capital and CET 1 ratio and there is therefore no difference between the end-point and transitional disclosures for CET 1. Additional Tier 1 (AT 1) and Tier 2 capital (and therefore total capital ratios) include instruments that are grandfathered and are therefore disclosed on both a transitional and end-point basis. The transition period ends on 31 December 2021.

Table 1: CRD IV – transitional and end-point analysis

	Notes	Transitional 2019 £m	Transitional 2018 restated £m	End-point 2019 £m	End-point 2018 restated £m
Common Equity Tier 1 (CET 1)					
General reserve		**1,773.3**	1,693.5	**1,773.3**	1,693.5
Fair value through other comprehensive income reserve		**3.7**	5.6	**3.7**	5.6
Cash flow hedge reserve		**10.8**	24.4	**10.8**	24.4
Common Equity Tier 1 prior to regulatory adjustments		**1,787.8**	1,723.5	**1,787.8**	1,723.5
Common Equity Tier 1 regulatory adjustments					
Prudent additional valuation adjustment	1	**(1.3)**	(0.9)	**(1.3)**	(0.9)
Intangible assets	2	**(30.4)**	(33.1)	**(30.4)**	(33.1)
Cash flow hedge reserve	2	**(10.8)**	(24.4)	**(10.8)**	(24.4)
Excess of expected loss over impairment	3	**(24.5)**	(23.5)	**(24.5)**	(23.5)
Pension fund surplus adjustment	2	**(19.2)**	(17.5)	**(19.2)**	(17.5)
Foreseeable distributions	4	**(10.6)**	(9.3)	**(10.6)**	(9.3)
Common Equity Tier 1 capital		**1,691.0**	1,614.8	**1,691.0**	1,614.8
Additional Tier 1 capital (AT 1)					
Permanent Interest Bearing Shares (PIBS)		**40.0**	40.0	**–**	–
Additional Tier 1 - Perpetual Capital Securities (PCS)		**415.0**	396.9	**415.0**	396.9
Total Additional Tier 1 capital		**455.0**	436.9	**415.0**	396.9
Total Tier 1 capital		**2,146.0**	2,051.7	**2,106.0**	2,011.7
Tier 2					
Subordinated debt		**16.6**	22.2	**–**	–
Total Tier 2 capital		**16.6**	22.2	**–**	–
Total capital		**2,162.6**	2,073.9	**2,106.0**	2,011.7
Risk weighted assets					
IRB approach					
Credit risk - retail exposures	5,6	**4,213.9**	3,804.6	**4,213.9**	3,804.6
Standardised approach					
Credit risk - retail exposures	7	**146.5**	140.7	**146.5**	140.7
Credit risk - liquidity book		**153.8**	86.4	**153.8**	86.4
Credit risk - other		**98.1**	68.3	**98.1**	68.3
Credit valuation adjustment risk	8	**60.8**	48.7	**60.8**	48.7
Operational risk		**610.5**	612.0	**610.5**	612.0
Total risk weighted assets		**5,283.6**	4,760.7	**5,283.6**	4,760.7
Capital ratios (as a percentage of risk weighted assets)	9				
Common Equity Tier 1		**32.0 %**	33.9 %	**32.0 %**	33.9 %
Total Tier 1		**40.6 %**	43.1 %	**39.9 %**	42.3 %
Total capital		**40.9 %**	43.6 %	**39.9 %**	42.3 %

Notes
1. A prudent valuation adjustment is applied in respect of assets and liabilities held at fair value.
2. Items do not form part of regulatory capital, net of associated deferred tax.
3. The expected loss over accounting provisions is deducted gross of tax.
4. Foreseeable distributions in respect of AT 1 securities (Perpetual Capital Securities) are deducted, net of tax.
5. 2018 Risk Weighted Assets have been restated. 2018 reported numbers were £3,767.6 million for Credit Risk – retail exposure under IRB approach, £4,548.5 million Total Risk Weighted Assets and a CET 1 ratio of 35.5%.
6. The Society refined its calculation of this measure in 2019. Had this applied in 2018 the comparative figures would be £3,802.1 million with negligible impact on CET 1 ratio.
7. The Society refined its calculation of this measure in 2019. Had this applied in 2018 the comparative figures would be £160.4 million, the impact on CET 1 ratio would have been a reduction of 0.01%.
8. The Society refined its calculation of this measure in 2019. Had this applied in 2018 the comparative figures would be £59.6 million, the impact on CET 1 ratio would have been a reduction of 0.01%.
9. CRD IV sets a minimum for Tier 1 capital of 6% of risk weighted assets (RWAs) of which CET 1 is required to be a minimum of 4.5% of RWAs. The total of Tier 1 and Tier 2 capital must be a minimum of 8% RWAs.

Appendix 1 sets out this information in the template format published by the EBA in 'Implementing Technical Standard (ITS) 2013/01'. CET 1 capital, Tier 1 capital and total capital have increased primarily as a result of retained profits for the year of £121.7 million. Total risk weighted assets have increased by 11% reflecting growth in the mortgage book of 8% and a modest increase in LTV of newly originated mortgages. As a result, the CET 1 ratio has reduced to 32.0 % (2018 restated: 33.9%).

The Individual Consolidated CET 1 ratio on an end-point basis at 31 December 2019 was 0.8% higher than the Group ratio due to assets held by entities that sit outside of the Individual Consolidation.

Table 2 shows the movement in capital during 2019. CET 1 capital is the same on an end-point and transitional basis. Additional Tier 1 (AT 1) and Tier 2 capital (and therefore total capital) are disclosed on a transitional basis.

Table 2: Regulatory capital flow statement

	£m
Common Equity Tier 1 capital at 31 December 2018	1,614.8
Retained profit for the year	121.7
Other changes to General reserves	(41.9)
Change in foreseeable distributions	(1.3)
Change in prudent valuation adjustments	(0.4)
Change in intangible assets	2.7
Change in Fair value through other comprehensive income reserve	(1.9)
Change in expected loss over impairment	(1.0)
Change in pension fund surplus adjustment	(1.7)
Common Equity Tier 1 capital at 31 December 2019	**1,691.0**
Additional Tier 1 capital at 1 January 2019	436.9
Repurchase of 2014 AT 1 capital	(396.9)
Issuance of 2019 AT 1 capital	415.0
Additional Tier 1 capital at 31 December 2019	**455.0**
Total Tier 1 capital at 31 December 2019	**2,146.0**
Tier 2 capital at 1 January 2019	22.2
Amortisation of subordinated debt	(5.6)
Tier 2 capital at 31 December 2019	**16.6**
Total regulatory capital at 31 December 2019	**2,162.6**

3.2 Tier 1 capital

Tier 1 capital comprises:

- General reserve;
- Fair value through other comprehensive income reserve;
- AT 1 capital – Perpetual Capital Securities (PCS);
- AT 1 capital – Permanent Interest Bearing Shares (PIBS) on a transitional basis only; and
- Adjustments as set out by the regulatory requirements governing capital resources – see Table 1.

The General reserve represents the Society's accumulated accounting profits.

The Society issued £400.0 million of PCS capital in June 2014 at a cost of £3.1 million resulting in net AT 1 capital of £396.9 million. Following receipt of permission from the PRA, a tender offer for the PCS was completed in April 2019 with £385.1 million of the £400.0 million PCS tendered, which the Society repurchased for £391.3 million (net of tax). The remaining £14.9 million was redeemed by the Society in November 2019 on the optional redemption date of the bonds.

In April 2019, the Society issued £415.0 million of new PCS capital. These PCS pay a fully discretionary, non-cumulative fixed coupon at an initial rate of 6.875% per annum with an optional redemption in September 2024. The PCS are convertible into Core Capital Deferred Shares (the equivalent of common shares for a building society) if the Society's CET 1 capital ratio should fall below 7%. The combined cost of the tender and new issuance fees has been recognised within the Society's General reserves.

More information on the key features of these securities is included in Appendix 2.

3.3 Tier 2 capital

Tier 2 capital comprises Subordinated debt (transitional basis only).

Subordinated debt instruments are unsecured and rank behind the claims of all depositors, creditors and shareholders in the Society other than holders of PIBS and PCS.

Appendix 2 shows the key features of the Society's Tier 1 and Tier 2 capital instruments and more information can be found in notes 26, 27 and 28 to the 2019 Accounts.

3.4 Leverage ratio

The PRA has implemented the Financial Policy Committee's (FPC) direction to introduce a UK leverage ratio framework. This currently only applies to banks and building societies with retail deposits of £50 billion or more. The Society is not currently captured by this requirement but is highly likely to be subject to the leverage ratio regime in line with EU regulations from 2021. The Society's focus on low risk assets means that the leverage requirement will be more onerous and become the binding capital requirement on the Society.

The UK leverage ratio requires a minimum ratio of 3.25% calculated on the basis that exposures exclude central bank reserves. Of the UK leverage requirement, a maximum of 25% may be met using high quality Additional Tier 1 capital. Neither of these modifications exists in the CRR leverage measure where the minimum 3% requirement can be met by Tier 1 capital (CET 1 and AT 1) without restriction.

There are two additional buffers. These are a Supplementary Leverage Ratio Buffer (SLRB), which does not impact the Society, and a macro-prudential Countercyclical Leverage Buffer (CCLB). The levels of these buffers are set at 35% of the corresponding CET 1 buffers – see section 4.4.

Whilst the UK leverage requirement for firms with 100% UK credit exposures and total assets of less than £175 billion was 3.6% at 31 December 2019, the CCLB will decrease from March 2020 to 0% as a result of changes to the requirements which were announced by the Bank of England in response to Covid-19. This will reduce the Society's minimum UK Leverage requirement to 3.25%. The Board is confident that the Society will continue to meet both UK and CRR Leverage requirements on an ongoing basis.

The Society has policies and procedures in place to manage the risk of excessive leverage through maintaining a prudent balance between the pace of growth and the pace of capital accumulation. This includes consideration through the ICAAP of the impact of stress events on leverage. This is explicitly incorporated into the Society's strategic planning process (see section 4.2.2). ICAAP stress testing considers the impact of stress events on leverage.

The Society's leverage ratio position on an end-point basis is set out below on both a UK and CRR basis.

Both the UK and CRR leverage ratios have remained broadly static at 4.4% and 4.1% respectively (2018: 4.6% and 4.2% respectively) as the increase in eligible Tier 1 capital was matched by an increase in leverage ratio exposures, largely driven by the growth in the mortgage book. This reflects the Society's strategy to remain low risk whilst retaining only sufficient profits to support leverage ratio at required levels.

Table 3: Leverage ratio

	Notes	**End-point 2019 £m**	End-point 2018 £m
Total Tier 1 capital – used in CRR calculation		**2,106.0**	2,011.7
Adjustment for AT 1 restriction		**(35.2)**	(47.4)
Total Tier 1 capital – used in UK calculation		**2,070.8**	1,964.3
Leverage ratio exposures			
Total balance sheet assets		**49,530.8**	46,070.9
Mortgage pipeline	1	**328.3**	338.9
Other committed facilities (undrawn lending)	1	**17.1**	20.0
Repurchase agreements	2	**1,817.5**	1,711.1
Netted derivative adjustments	3	**51.6**	(39.8)
Other adjustments	4	**(240.0)**	(155.1)
Total leverage ratio exposures – used in CRR calculation		**51,505.3**	47,946.0
Adjustment to exclude central bank reserves		(4,760.3)	(4,930.2)
Total leverage ratio exposures – used in UK calculation		**46,745.0**	43,015.8
CRR leverage ratio	5	**4.1%**	4.2%
UK leverage ratio		**4.4%**	4.6%

Notes

1. Mortgage pipeline are assessed at 20% and other commitments at 50% (2018: 20% for both) as per the delegated regulation amending CRD IV.
2. Repurchase agreements represent the extent to which collateral provided on repurchase agreements exceeds the amount borrowed.
3. The netted derivative adjustment figure converts the accounting value of derivatives to an exposure measure.
4. Other adjustments predominantly relate to asset balances that have already been included in the capital calculation and these are therefore removed from the total Balance Sheet assets figure.
5. The CRR leverage ratio is calculated in accordance with the definition of CRD IV as amended by the European Commission delegated regulations.

The CRR leverage ratio disclosures using the European Banking Authority Templates are in Appendix 4.

4. Capital requirements

4.1 Pillar 1

4.1.1 Introduction

The primary purpose of capital is to absorb any losses that might arise from risks. For the Society, capital is principally held for 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 Society manages its capital structure to ensure it continues to hold sufficient capital to meet its business objectives, regulatory requirements and the expectations of other key stakeholders.

The Society employs a number of tools to support the management of capital. The Board is responsible for setting risk appetite with respect to capital and defines minimum levels of capital, primarily by reference to capital ratios, leverage ratios and surplus over regulatory capital requirements. These minimum levels are translated into specific risk metrics which are monitored by the Board Risk Committee, Executive Risk Committee and the Asset and Liability Committee. Day to day capital management is delegated to the Chief Financial Officer and Treasurer and overseen by the Risk Function, ALCO, BRC and ultimately the Board.

The Society assesses its capital position and risks through an annual Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP considers the key capital risks and the amount of capital the Society should retain to cover these risks. These requirements are assessed against the current position and throughout the five year Strategic Plan. Regular stress testing is undertaken to enhance the understanding of any potential vulnerabilities to stressed market conditions or tail-risks and management actions that could be deployed to manage these. The ICAAP and stress testing are considered further in section 4.2 below.

4.1.2 Minimum capital requirement – Pillar 1

The Society's minimum capital requirement under Pillar 1 is the sum of the credit risk capital requirement and the operational risk capital requirement. Market risk arises from foreign exchange risk and is calculated in accordance with the Standardised Approach but is set at zero as it falls below the threshold for recognition. The Society does not have a trading book and foreign exchange risk is negligible.

The credit risk capital requirement is largely dependent upon residential mortgage capital calculated under the Internal Ratings Based (IRB) approach. The remaining credit risk capital requirement is calculated using the Standardised approach. The capital requirement under both the IRB and Standardised approach is calculated as 8% of the risk weighted exposure amounts for each credit risk exposure class.

The operational risk capital requirement is calculated using the Standardised approach based on total income averaged over three years.

The following table shows the Society's assessment of its overall minimum capital requirement.

Table 4: Minimum capital requirement – Pillar 1

	RWA 2019 £m	RWA 2018 restated £m	Minimum capital requirements 2019 £m	Minimum capital requirements 2018 restated £m
Credit risk (excluding counterparty credit risk (CCR))	**4,550.2**	4,050.9	**364.0**	324.0
Of which standardised approach	**336.3**	246.3	**26.9**	19.7
Of which the advanced IRB approach	**4,213.9**	3,804.6	**337.1**	304.3
Counterparty credit risk (CCR)	**114.2**	93.7	**9.1**	7.6
Of which mark to market	**35.9**	43.8	**2.9**	3.6
Of which the standardised approach	**17.5**	1.2	**1.4**	0.1
Of which credit valuation adjustment	**60.8**	48.7	**4.8**	3.9
Securitisation exposures	**2.8**	1.6	**0.2**	0.1
Of which standardised approach (SA)	**2.8**	1.6	**0.2**	0.1
Operational risk	**610.5**	612.0	**48.9**	49.0
Of which standardised approach	**610.5**	612.0	**48.9**	49.0
Amounts below the threshold for deduction (subject to 250%) risk weight	**5.9**	2.5	**0.5**	0.2
Total	**5,283.6**	4,760.7	**422.7**	380.9

4.1.3 Minimum capital requirement – credit risk

The following table shows the composition of the minimum capital required for credit risk (excluding credit valuation adjustment included in counterparty credit risk in Table 4) at 31 December 2019.

Table 5: Minimum capital requirement for credit risk

	Notes	2019 £m	2018 restated £m
Internal Ratings Based (IRB)			
Retail mortgages (prime secured against residential property)		**337.1**	304.3
Standardised exposure classes			
Mortgages and loans		**11.7**	11.4
Of which:			
Retail mortgages secured against residential property		**9.9**	9.3
Corporates (commercial lending)		**0.1**	0.1
Other retail (unsecured loans)		**1.2**	1.4
Past due		**0.5**	0.6
Treasury		**12.3**	6.9
Of which:			
Institutions	1	**12.1**	6.8
Securitisation positions		**0.2**	0.1
Other		**7.9**	5.4
Of which:			
Non-credit obligation assets (fixed assets and other)		**7.4**	5.2
Amounts below the threshold for deduction		**0.5**	0.2
Total minimum capital requirement Standardised		**31.9**	23.7
Total minimum capital requirement IRB and Standardised		**369.0**	328.0

Notes:
1. Other institutions includes minimum capital requirement of £1.9 million (2018: £0.1 million) for covered bonds, £0.1 million for central clearing counterparties (2018: £0.1 million) and £0.3 million (2018: £0.2 million) for equity.

4.1.4 Movement in credit risk – Risk Weighted Assets (RWAs)

The following table shows the movement in credit risk RWAs (excluding credit valuation adjustment) over 2019.

Table 6: Risk Weighted Assets (RWA) flow statement

	IRB mortgages		Standardised mortgages and loans		Treasury		Other		Total	
	RWA amount £m	Capital r'ment £m	RWA amount £m	Capital r'ment £m	RWA amount £m	Capital r'ment £m	RWA amount £m	Capital r'ment £m	RWA amount £m	Capital r'ment £m
RWAs at 1 January 2019[1]	3,804.6	304.4	140.7	11.3	86.4	6.9	68.3	5.5	4,100.0	328.1
Book size increase/(decrease)	555.6	44.4	(19.5)	(1.6)	12.6	1.0	29.8	2.4	578.5	46.2
Book quality (improvement)/ deterioration	(146.3)	(11.7)	25.3	2.0	54.8	4.4	-	-	(66.2)	(5.3)
RWAs at 31 December 2019	**4,213.9**	**337.1**	**146.5**	**11.7**	**153.8**	**12.3**	**98.1**	**7.9**	**4,612.3**	**369.0**

1. The 2018 number for RWAs have been restated to include the 6% scalar within IRB mortgages.

The increase in IRB RWAs attributable to book size is driven by growth of the Society's mortgage book. All new lending is on an IRB basis. Book quality improvements reflect an increase in house prices and lower arrears.

The majority of the treasury book is made up of exposures to central banks and sovereigns, which are zero risk weighted. The book quality deterioration relates to an increase in exposures to financial institutions subject to a higher risk weighting but which nonetheless are very low risk and are categorised as High Quality Liquid Assets for Liquidity Coverage Ratio purposes.

4.2 Pillar 2

4.2.1 Introduction

The Pillar 2 capital requirement reflects the Society's ICAAP assessment and any capital add-ons from the supervisory review of those assessments. The Pillar 2 requirement is divided into capital held against risks not captured or not fully captured by Pillar 1 (Pillar 2A – see section 4.3) and risks to which a firm may become exposed under a severe but plausible stress (Pillar 2B).

4.2.2 Internal Capital Adequacy Assessment Process (ICAAP) and stress testing

The Board determines the level of capital required to support the Society's business objectives by undertaking an annual ICAAP in line with the PRA requirements. The ICAAP considers the key capital risks and the amount of capital the Society should retain to cover these risks. These requirements are assessed against the current position and throughout the five year Strategic Plan. The ICAAP includes consideration of Pillar 1 and Pillar 2 requirements.

The calculation of the Pillar 2 requirement examines the Society's business plans in detail, subjecting them to economic and operational stresses over a five year planning horizon. This stress testing is a major part of the ICAAP, it assesses whether capital requirements would be met under severe but plausible stress scenarios specified by the regulator and considers what management actions are available to mitigate the impacts of a stress. In 2019, these stresses included both a low and high Bank of England Base Rate scenario. In addition, the stress tests incorporate further negative trading assumptions to simulate a comprehensive stress on the Society's business model.

The ICAAP also incorporates alternative, more targeted, stress scenarios as part of the overall assessment of capital adequacy risks. Reverse stress testing is also performed to identify very extreme events that have the capacity to 'break' the Society to identify risks and control mechanisms which might otherwise be missed.

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.

Although the stress tests indicate that the Society remains above regulatory minima, potential management actions that could be deployed in a capital stress are considered including the ability to control the rate of asset growth.

Capital levels for the Society are reported to, and monitored by the Board regularly. The Society continues to be strongly capitalised and maintains capital substantially above current regulatory requirements. The Society's Common Equity Tier 1 ratio is amongst the highest reported in the UK[3]. The Society's level of regulatory capital surplus will tend to be driven by non-risk based measures such as the leverage ratio and in the future the minimum requirement for own funds and eligible liabilities (MREL). The impact of potential regulatory reforms including the Basel Committee on Banking Supervision review of the Standardised approach for calculating credit risk capital requirements and the replacement of the Basel 1 floor is covered in section 4.6 Future regulatory developments.

4.3 Pillar 2A

In assessing capital adequacy the Society reviews each of the material inherent risks within its business model. It also reviews the capital needed to support planned growth in lending and operations.

The Society is currently only formally bound by its Total Capital Requirement (TCR) which is set by the PRA. The TCR was last set in 2019 and equates to 11.2% of risk weighted assets or £590.2 million based on year end RWAs (2018: £511.2 million). The Society comfortably meets this requirement out of its CET 1 capital resources. However, in anticipation of them becoming binding, the Society monitors and seeks to maintain capital sufficient to meet both the non-risk based leverage ratio (both under CRR and UK leverage definitions) and standardised risk weighted floors that are part of the Basel IV reforms package.

The PRA Pillar 2A risk factors include those not fully covered by Pillar 1 such as credit concentration and operational risks and those risks outside the scope of Pillar 1 such as pension and interest rate risk.

3. Source: Common Equity Tier 1 ratio for the UK Finance 2018 top 20 mortgage lenders (balance outstanding) – latest published CET 1 data as at 27 March 2020.

4.4 Regulatory capital buffers

CRD IV requires lenders, to hold supplementary capital buffers. These comprise a Capital Conservation Buffer (CCoB); a Systemic Risk Buffer (SRB); and a macro-prudential Countercyclical Buffer (CCyB). At 31 December 2019 the CCoB was set at 2.5 % and the CCyB was 1% (decreasing to 0% from March 2020 following measures announced by the Bank of England in response to Covid-19). The SRB, which came into force from 1 January 2019, does not impact the Society as it has total assets of less than £175 billion.

Appendix 5 discloses information relevant for the calculation of the CCyB as at 31 December 2019 in accordance with Regulation (EU) 2015/1555.

4.5 Minimum Requirement for Own Funds and Eligible Liabilities (MREL)

MREL requirements are being introduced by regulators to ensure that taxpayers no longer absorb losses when a bank or building society fails. MREL requirements reflect how complex or important to the wider economy an institution is.

The Society's resolution strategy as set by the Bank of England is 'bail-in', and as such as of 1 January 2020, the Society will need to meet an interim MREL requirement of 18% of risk weighted assets. The indicative end-state MREL requirement for bail-in firms will be twice their binding capital requirement; currently this equates to 22.3% of risk weighted assets[4] for the Society. This requirement will increase from 2022 due to the new Basel IV rules on risk weighted asset output floors. In addition, if leverage becomes the binding capital measure as expected, this will increase the requirement and the Society will need to issue MREL eligible debt. The Society's financial plan provides for these outcomes.

4.6 Future regulatory developments

The Society continues to monitor regulatory developments that could lead to increased capital requirements including any changes to leverage requirements.

The Basel Committee published their final reforms to the Basel III framework in December 2017. The amendments include changes to the standardised approaches for credit and operational risks and the introduction of a new RWA output floor. The rules are subject to a transitional period from 2022 to 2027. In addition, in June 2017, the PRA published a policy statement relating to residential mortgage risk-weights, including proposals to align firms' IRB modelling approaches for residential mortgage risk-weighted assets. This sets out a number of modifications to the IRB modelling methodologies for residential mortgages, and sets the expectation for firms to update IRB models by the end of December 2020.

These reforms represent a re-calibration of regulatory requirements with no underlying change in the capital resources the Society holds or the risk profile of its assets. The final impacts are subject to uncertainty for future balance sheet size and mix, and because the final detail of some elements of the regulatory changes remain at the PRA's discretion. The Society currently expects that introduction of these RWA floors and IRB calibration changes will result in a significant reduction of its capital ratios as compared to its reported ratios as at 31 December 2019. On an indicative basis and for illustrative purposes only, the Society anticipates that if these amendments (as the Society understands them) had been applied as at 31 December 2019 (i) with the initial transitional 50% floor, its reported CET 1 ratio as at that date would have reduced to approximately 25 per cent; or (ii) on an end-point basis (i.e. ignoring the transitional provisions through to 2027), its reported CET 1 ratio as at that date would have reduced to approximately 17%. On such end-state basis, the Society's surplus over the revised CET 1 ratio would have remained over 11 times the aggregate credit losses incurred in the last ten years (or, if applying the initial transitional floor of 50%, would have remained over 14 times the aggregate credit losses incurred in the last ten years).

4. Two times Pillar 1 and Pillar 2a.

5. Credit risk

5.1 Overview

5.1.1 Credit risk overview and exposures

Credit risk is the risk that customers or counterparties will not be able to meet their financial obligations to the Society as they fall due. Credit risk is sub-divided into:

- Credit risk for retail exposures (covered in section 5.2); and
- Credit risk for the treasury liquidity book and derivatives (covered in section 5.3).

5.1.2 Credit risk exposures

The exposures presented below relate to on balance sheet exposures only. Exposures are presented net of impairment provisions. The limited number of classes disclosed illustrates the Society's very simple business model. All retail credit risk exposures are in the United Kingdom. A distribution of this lending by region is provided in Table 13.

Table 7: Credit risk exposure

	Notes	**Average during 2019 £m**	**As at 31 December 2019 £m**	Average during 2018 £m	As at 31 December 2018 £m
Residential mortgages	1,3	**40,645.6**	**42,135.7**	37,483.0	39,155.5
Unsecured and other lending	1,3	**23.0**	**21.3**	27.4	24.7
Total retail credit risk exposures		**40,668.6**	**42,157.0**	37,510.4	39,180.2
Treasury:					
Central banks and sovereigns	1,2	**5,811.0**	**5,736.1**	5,809.5	5,886.0
Multilateral development banks (supranational bonds)	2	**120.3**	**165.5**	37.5	75.1
Financial institutions	1,2	**682.7**	**932.8**	449.2	432.6
Residential Mortgage Backed Securities (RMBS)	1,2	**14.3**	**20.3**	9.5	8.2
Total treasury credit risk exposures		**6,628.3**	**6,854.7**	6,305.7	6,401.9
Total credit risk exposures		**47,296.9**	**49,011.7**	43,816.1	45,582.1

Table 8a: Geographical distribution of credit risk 2019

As at 31 December 2019	Notes	**United Kingdom £m**	**Rest of Europe £m**	**Rest of the World £m**	**Total £m**
Residential mortgages	1	**42,135.7**	**–**	**–**	**42,135.7**
Unsecured and other lending	1	**21.3**	**–**	**–**	**21.3**
Total retail credit risk exposures		**42,157.0**	**–**	**–**	**42,157.0**
Treasury:					
Central banks and sovereigns	1,2	**5,736.1**	**–**	**–**	**5,736.1**
Multilateral development banks (supranational bonds)	2	**–**	**115.4**	**50.1**	**165.5**
Financial institutions	1,2	**839.1**	**90.2**	**3.5**	**932.8**
Residential Mortgage Backed Securities (RMBS)	1	**20.3**	**–**	**–**	**20.3**
Total treasury credit risk exposures		**6,595.5**	**205.6**	**53.6**	**6,854.7**
Total credit risk exposures		**48,752.5**	**205.6**	**53.6**	**49,011.7**

Notes
1. Held at amortised cost using the effective interest method and after deduction of impairment provisions where appropriate.
2. Held at fair value.
3. Comparative information has been adjusted to remove the EIR asset and fair value and other adjustments which were previously apportioned across gross balances. The previously disclosed total retail credit risk exposure was £39,264.6 million with an average for the year of £37,597.7 million.

Table 8b: Geographical distribution of credit risk 2018

As at 31 December 2018	Notes	United Kingdom £m	Rest of Europe £m	Rest of the World £m	Total £m
Residential mortgages	1,3	39,155.5	–	–	39,155.5
Unsecured and other lending	1,3	24.7	–	–	24.7
Total retail credit risk exposures		39,180.2	–	–	39,180.2
Treasury:					
Central banks and sovereigns		5,886.0	–	–	5,886.0
Multilateral development banks (supranational bonds)	1,2	–	50.1	25.0	75.1
Financial institutions	1,2	372.6	60.0	–	432.6
Residential Mortgage Backed Securities (RMBS)	2	8.2	–	–	8.2
Total treasury credit risk exposures		6,266.8	110.1	25.0	6,401.9
Total credit risk exposures		45,477.0	110.1	25.0	45,582.1

The maturity of exposures is shown on a contractual basis:

Table 9a: Residual maturity of credit risk 2019

As at 31 December 2019	**Notes**	**Up to 12 months £m**	**1-5 years £m**	**5-10 years £m**	**More than 10 years £m**	**Total £m**
Residential mortgages	1	**3,032.6**	**10,724.0**	**11,071.3**	**17,307.8**	**42,135.7**
Unsecured and other lending	1	**1.9**	**6.1**	**6.7**	**6.6**	**21.3**
Total retail credit risk exposures		**3,034.5**	**10,730.1**	**11,078.0**	**17,314.4**	**42,157.0**
Treasury:						
Central banks and sovereigns	1,2	**5,421.7**	**50.8**	**263.6**	**–**	**5,736.1**
Multilateral development banks (supranational bonds)	2	**0.2**	**165.3**	**–**	**–**	**165.5**
Financial institutions	1,2	**534.2**	**395.6**	**3.0**	**–**	**932.8**
Residential Mortgage Backed Securities (RMBS)	1	**0.1**	**7.5**	**12.7**	**–**	**20.3**
Total treasury risk credit exposures		**5,956.2**	**619.2**	**279.3**	**–**	**6,854.7**
Total credit risk exposures		**8,990.7**	**11,349.3**	**11,357.3**	**17,314.4**	**49,011.7**

Table 9b: Residual maturity of credit risk 2018

As at 31 December 2018	Notes	Up to 12 months £m	1-5 years £m	5-10 years £m	More than 10 years £m	Total £m
Residential mortgages	1,3	2,844.7	10,013.8	10,339.4	15,957.6	39,155.5
Unsecured and other lending	1,3	2.1	6.9	7.3	8.4	24.7
Total retail credit risk exposures		2,846.8	10,020.7	10,346.7	15,966.0	39,180.2
Treasury:						
Central banks and sovereigns	1,2	5,134.7	309.1	442.2	–	5,886.0
Multilateral development banks (supranational bonds)		0.2	74.9	–	–	75.1
Financial institutions	1,2	424.6	5.0	3.0	–	432.6
Residential Mortgage Backed Securities (RMBS)	2	–	–	–	8.2	8.2
Total treasury risk credit exposures		5,559.5	389.0	445.2	8.2	6,401.9
Total credit risk exposures		8,406.3	10,409.7	10,791.9	15,974.2	45,582.1

Notes
1. Held at amortised cost using the effective interest method and after deduction of impairment provisions where appropriate.
2. Held at fair value.
3. Comparative information has been adjusted to remove EIR and fair value and other adjustments which were previously apportioned across gross balances. The previously disclosed total retail credit risk exposure was £39,264.6 million.

5.2 Retail credit risk

5.2.1 Management of retail credit risk

Credit risk in the Society's mortgage book only crystallises in the event that a borrower is unable to repay the mortgage and, as a result, the property on which the mortgage is secured has to be repossessed and sold at a price which is insufficient to allow the borrower to repay the loan.

The Retail Credit Risk Committee (RCRC) and ultimately the Board oversee the Society's credit risk management supported by a specialist retail credit risk department reporting to the Chief Risk Officer.

The Board sets prudent credit risk limits within the context of the Society's overall risk appetite and these are reflected in the Society's lending policy and credit controls.

All mortgage applications are assessed against the Society's lending policy criteria to ensure consistent credit decision making, and lending within the Society's credit risk appetite. This assessment uses stressed interest rates to ensure affordability even if interest rates increase. Assurance that lending decisions are robust and within the Society's policy is provided through the three lines of defence model.

All underwriting is done by the Society and its key lending criteria include:

- Prudent loan to value limits.
- A requirement that buy to let loans are against properties which are readily saleable into the owner-occupier market.
- Restrictions on the maximum number of properties in buy to let portfolios.

The lending criteria in 2019 included the following additional items:

- Lower LTV limits on some types of property such as new build flats.
- An expansion to lending limits for portfolio landlords allowing the Society to lend on up to 5 properties while continuing to apply prudent income coverage and LTV limits to remain within risk appetite.

The Society ensures that there is no over-exposure to any geographical region or counterparty and that its mortgage portfolio as a whole can withstand a range of macroeconomic and specific stress scenarios.

The Society's track record of above market growth means that a relatively large proportion of its mortgage book may not have had sufficient time for its performance to be established. However, the quality of the mortgage book remains very high and arrears from new lending are negligible.

Inevitably, despite the Society's prudent lending approach, on occasion members experience financial difficulty. In these cases, the Society seeks to work with each borrower to reach a sustainable and fair arrangement to regularise the position in a timeframe which is acceptable to both the Society and the borrower.

The Society proactively contacts borrowers most at risk of experiencing potential payment difficulties to minimise the risk of future affordability issues, seeking to protect the interests of individual borrowing members whilst at the same time mitigating the risk of credit losses to the membership as a whole.

The Society will only seek repossession of a property when all reasonable efforts have failed or where the mortgage is unsustainable in the longer term.

The arrears position has improved from historically low levels. Arrears on accounts which are three months or more past due have decreased to £1.7 million (2018: £1.9 million) and the gross balance of these accounts has also reduced to £54.0 million (2018: £60.7 million).

Table 10a: Analysis of Society arrears

	2019		2018	
	Gross balance £m	**Arrears balance £m**	Gross balance £m	Arrears balance £m
Greater than three months	**54.0**	**1.7**	60.7	1.9
Greater than six months	**22.3**	**1.0**	21.5	1.1
Greater than one year	**5.1**	**0.4**	5.1	0.4
In possession	**4.6**	**0.2**	6.7	0.4

The accounts in arrears as a percentage of loans and advances to customers has also improved in 2019 and remains significantly lower than the UK Finance average as shown below.

Table 10b: Analysis of Society arrears compared with UK Finance

	2019		2018	
	Society %	**UK Finance[1] %**	Society %	UK Finance[1] %
Greater than three months	**0.16**	**0.72**	0.18	0.79
Greater than six months	**0.06**	**0.43**	0.06	0.47
Greater than one year	**0.01**	**0.22**	0.01	0.25
In possession	**0.01**	**0.02**	0.01	0.02

1. UK Finance data as at 31 December 2019 (31 December 2018).

Extent and use of forbearance

The Society exercises forbearance if it is in the best interests of both the borrower and the Society and may offer:

- Arrangements, where monthly payments are maintained and the arrears are repaid over a period of time.
- Concessions, where the Society agrees to accept either the normal monthly payment with no contribution towards paying off the outstanding arrears, reduced payments, or in exceptional circumstances no repayments for a short period.
- Mortgage term extensions to reduce the amount of the monthly payment as part of a longer-term solution.

On very rare occasions, arrears may be capitalised or the Society may agree to change repayment mortgages to interest only terms for a temporary period as a means of exercising forbearance.

Where a loan is up to date, the Society may agree a short-term payment holiday as a way of allowing borrowers to resolve financial difficulties, in which case this is treated as a forbearance measure rather than as one where the borrower is using a product feature. Forbearance payment holidays are for a maximum of three months and are only given where the borrower can afford the post-holiday monthly repayments.

Details of loans subject to forbearance are set out in the table below:

Table 11: Forbearance

	2019		2018	
	No. of accounts	**Carrying value £m**	No. of accounts	Carrying value £m
Forbearance: Accounts past due				
Arrangements	**542**	**58.0**	656	72.9
Concessions	**20**	**3.7**	38	5.8
Term extensions[1]	**6**	**0.9**	4	0.5
Forbearance indicators: Accounts not past due				
Payment holidays granted by Collections department[1]	**191**	**22.7**	286	33.1
Term extensions[1]	**154**	**30.0**	164	28.7
Capitalisation of arrears[1]	**5**	**0.6**	2	0.2

Note:
1. Granted in the last 12 months.

The number of loans in forbearance has fallen compared to 2018 reflecting the improved economic environment and credit risk profile of the Society's borrowers. The Society has continued to issue term extensions to customers not past due, reflecting ongoing proactive engagement with interest only borrowers unable to repay interest only loans at the end of the original term.

In 2019 arrears were capitalised five times (2018: twice) and temporary transfer to interest only terms was agreed ten times (2018: nil).

Accounts subject to forbearance are assessed as either stage 2 or 3 under IFRS 9 and the Society recognises a lifetime expected credit loss for these as an impairment provision. More information on expected credit losses is included below.

Retail credit risk profile

The Society continues to focus on low risk, high quality owner-occupier and buy to let mortgages. Non-traditional mortgage lending outside these core segments was discontinued in 2008 and balances on these legacy products, including those acquired as a result of the merger with Stroud & Swindon Building Society in 2010, continue to fall, comprising just 0.6% (2018: 0.7%) of total gross balances at 31 December 2019.

During 2019, arrears continued to fall from the already low levels seen in 2018, reflecting continued low unemployment and strong affordability derived from the Society's prudent underwriting. The Society expects that its mortgage book will continue to perform well even if there are pressures on affordability from increased unemployment or inflation.

The Society withdrew from interest only lending in the owner occupier sector in 2012. As a result exposure to this type of business continued to reduce in 2019 and only 5.4% of the owner-occupier portfolio was on interest only terms as at 31 December 2019 (2018: 6.8%) with an average loan to value of 39.4% (2018: 39.1%). The Society has operated a contact programme for members nearing the end of term on interest only owner-occupier loans for a number of years which helps members assess their ability to repay the loan when due or, if needed, seek suitable solutions. At the end of 2019, there were 200 owner-occupier interest only loans that were past term (2018: 268).

In line with market practice, buy to let lending continues to be provided mainly on an interest only basis reflecting the underlying investment nature of buy to let properties which can be sold to repay the capital amount.

Loans and advances to customers are shown below. The effective interest rate (EIR) asset and fair value and other adjustments have been presented separately from gross balances in order to aid understanding. Previously these were apportioned within gross balances. Where relevant, comparative information has been adjusted to reflect this.

Table 12: Credit risk profile

Loans and advances to customers	2019 £m	2019 %	2018[2] £m	2018[2] %
Residential mortgages: owner-occupier	**25,198.9**	**59.7**	23,177.0	59.0
Residential mortgages: buy to let	**16,732.6**	**39.6**	15,738.3	40.1
Total traditional residential mortgages	**41,931.5**	**99.3**	38,915.3	99.1
Residential near-prime mortgages	**59.2**	**0.1**	66.3	0.2
Residential self-certification mortgages	**156.3**	**0.4**	184.2	0.4
Commercial mortgages[1]	**2.0**	**–**	2.2	–
Total non-traditional mortgages	**217.5**	**0.5**	252.7	0.6
Unsecured personal loans[1]	**20.0**	**–**	23.8	0.1
Total gross balance	**42,169.0**	**99.8**	39,191.8	99.8
Impairment	**(12.0)**	**–**	(11.6)	–
EIR asset	**75.8**	**0.2**	84.2	0.2
Fair value and other adjustments	**1.9**	**–**	0.2	–
Total net balance	**42,234.7**	**100.0**	39,264.6	100.0

Note:
1. Legacy books of unsecured personal loans and commercial mortgages.
2. Comparative information has been adjusted to remove the EIR asset and fair value and other adjustments which were previously apportioned across gross balances.

Residential mortgages: owner-occupier includes £223.9 million (2018: £248.4 million), less than 1% of the total gross balances, of 'equity-release mortgages', where 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. The Society is therefore exposed to the risk that the value of the property at the time of redemption is lower than the loan including accumulated interest. The Society mitigated this risk by granting loans at a relatively low loan to value and has not offered new mortgages on this basis since 2009. The weighted average loan to value of the equity release book is 40.0% (2018: 38.1%).

Geographical concentration

The mortgage portfolio is well diversified and reflects the national coverage of the Society's distribution channels. The geographical split of mortgages by balance, gross of impairment provisions is shown below and has remained broadly stable:

Table 13: Geographical distribution of residential mortgages

Region	2019 %	2018 %
London	**27.6**	27.1
South East England	**18.7**	18.5
Central England	**14.2**	14.6
Northern England	**13.1**	13.4
East of England	**11.7**	11.5
South West England	**8.9**	9.0
Scotland	**3.4**	3.5
Wales and Northern Ireland	**2.4**	2.4
Total	**100.0**	100.0

Loan to value and income multiples

The Society updates the estimated value of the properties securing the mortgage portfolio on a quarterly basis using regional house price indices. The low loan to value (LTV) profile of the mortgage book, as shown in the following tables, is a reflection of the Society's low risk approach to lending.

The standard maximum income multiple for owner-occupier mortgages is 4.5. The Society lends on multiples of up to 5.0 for very low (50% or lower) loan to value cases and for high loan to value (95% or higher) uses a maximum multiple of 4. Any lending at or above 4.5 times income is closely monitored and 3.4% (2018: 3.4%) of advances were made at or above this level in 2019, which is well below the maximum limit of 15% set by the Bank of England's Financial Policy Committee. The Society reduces maximum income multiples offered if the loan term extends significantly into retirement to ensure it remains affordable.

The Society is a responsible lender and operates robust affordability checks before advancing any loans. For owner-occupier mortgages, ensuring a borrower has sufficient net income, both at the time of application and in a future higher interest rate environment, is a key part of this. For buy to let loans the Society sets minimum interest coverage ratios which reflect amongst other things the tax status of borrowers. The Society's actual average interest coverage ratio at the end of the year using a stressed 5% interest rate was 175.4% (2018: 175.7 %), significantly above its lending criteria. The Society also lends to portfolio landlords within the buy to let segment and takes a prudent approach to assessing portfolio LTV and income coverage ratios. There are also limits on the number of properties in the portfolio both in total and those which the Society will lend on. Each loan in a portfolio is assessed on a standalone basis on rental income of the property with no allowance being made in the affordability assessment for other income of the borrower.

The loan to value distribution of the mortgage book as at 31 December 2019 has remained broadly stable as shown below. The following tables and disclosures calculate LTV based on the weighted average loan balances unless stated otherwise:

Table 14: Total mortgage book loan to value (number of accounts)

Total mortgage book profile	**2019 %**	2018 %
Indexed loan to value:		
< 50%	**49.7**	50.2
50% to 65%	**25.0**	25.9
65% to 75%	**14.7**	14.2
75% to 85%	**7.4**	6.7
85% to 95%	**3.1**	2.9
> 95%	**0.1**	0.1
Total	**100.0**	100.0
Average indexed loan to value of stock	**55.4**	54.6

For the London region, the average indexed loan to value of stock is 54.1% (2018: 52.3%) with small house price falls seen in London in the year and for regions outside of London it is broadly stable at 55.9% (2018: 55.2%).

The loan to value profile of gross new lending in 2019 is shown below. In 2019 there has been a continuation of the trend towards remortgaging with the percentage of new owner-occupier lending relative to buy to let lending increasing after very strong buy to let lending in 2018. The average loan to value of the new lending book has increased marginally but remains within the Society's risk appetite.

Table 15: Gross lending new business profile

Gross lending	**2019 %**	2018 %
Owner-occupier purchase	**33.9**	31.6
Owner-occupier remortgages	**30.7**	24.1
Owner-occupier further advances	**2.0**	1.7
Buy to let purchase	**7.7**	9.3
Buy to let remortgages	**25.0**	32.8
Buy to let further advances	**0.7**	0.5
Total	**100.0**	100.0
Average loan to value	**63.7**	62.6

5.2.2 IRB rating system

The Society has used the retail IRB approach since January 2008 to determine the required level of capital for the vast majority of its retail credit exposures. Across the Society, 99% of on balance sheet exposures as at December 2019 (2018: 99%) were assessed on the IRB approach.

Capital is calculated using the Standardised approach on certain small legacy portfolios. No new lending has been originated on these products for a number of years (a drawdown facility is available for a small element of existing equity release customers).

The internal rating model and process

Three models provide the rating of credit risk:

- The Probability of Default model;
- The Loss Given Default model; and
- The Exposure at Default model.

The calculated risk weighted assets for capital are a combination of the above model outputs with the application of a 6% scalar. In December 2019 it was identified that this scalar had not been applied to the calculation resulting in a restatement of the Society's Risk Weighted Assets and CET 1 ratio. The Core IRB models themselves were not impacted by this omission.

Probability of default model

Credit scores are used to allocate exposures to risk grades. There are separate scorecards for the buy-to-let and owner-occupier portfolios. Once allocated to a risk grade, the probability of default (PD) model provides a "long run" estimate of the PD for the grade i.e. the average PD across an economic cycle. It is this PD that is used in the capital calculation.

The credit scores of new applications generated by the application scorecards are determined using a combination of loan data, borrower credit details, and, in the case of the buy to let model, information about the rental property.

Behavioural scores are calculated using a combination of internal mortgage performance data together with regular updates of the borrower's credit behaviour with other lenders.

Depending on the length of time the account has been on the books, the application credit score, behavioural credit score, or a blend of the two is used to determine the risk grade for the account and therefore the long run PD to be used in the capital calculation.

In addition, the application and behavioural scores also produce a point-in-time estimate of the probability of an account defaulting. The point-in-time estimates are compared with actual default rates to test the performance of the scorecards.

Loss given default model

The loss given default (LGD) model uses internal data and is calibrated to downturn economic conditions for use in the regulatory capital calculations.

The model assesses the likelihood of repossession once an account defaults, the forced sale discount that is likely to be experienced in selling a property from possession (the 'haircut') and, if repossessed, the likelihood and amount of loss.

Exposure at default (EAD) model

The exposure at default (EAD) model calculates the balance of accounts at the point of default using a combination of estimated time to default and the interest payments that will be missed.

The combination of PD, LGD and EAD models is used to determine the expected loss and capital requirement for all mortgages within the retail IRB exposure class.

Comparison of impairment provisions with regulatory expected losses

The £9.1 million IFRS 9 impairment provision on IRB loans recognised in the financial statements at 31 December 2019 differs from the £33.6 million determined from the IRB regulatory expected loss models due to the methodology differences set out below. The Society envisages that IRB expected losses will continue to exceed IFRS 9 expected losses.

The IFRS 9 / IRB methodology differences are as follows:

- The IFRS 9 PD is an estimate of the residual lifetime probability of default based on expectations for future economic conditions at the balance sheet date. The first 12 months of the residual lifetime PD estimate is utilised for accounts in Stage 1 whilst the full residual lifetime PD is used for accounts in Stages 2 and 3. The regulatory PD is a long run average throughout a full economic cycle;
- The IFRS 9 EAD has been modelled based on expected payments over the term up to the point of default. The regulatory EAD cannot be lower than the current balance;
- The IFRS 9 LGD includes the impact of future economic conditions such as changes in value of collateral and does not include any floors. Only costs associated with obtaining/selling the collateral are included and the discounting of the expected cash flows is performed using the effective interest rate of the loan. The regulatory LGD is based on downturn conditions and includes all collection costs, is subject to regulatory floors and is discounted using a stressed measure of the cost of capital; and
- IFRS 9 also requires the use of multiple economic scenarios to calculate a probability weighted forward looking ECL.

Allocation of exposures to risk grades by the IRB rating system

The following table shows the Society's retail exposures under IRB.

Table 16: Allocation of exposures (including undrawn) to IRB risk band

PD bands up to and including:	Exposure at default estimate 2019 £m	Average loss given default 2019 %	Average risk weight 2019 %	RWAs 2019 £m	Exposure at default estimate 2018 £m	Average loss given default 2018 %	Restated Average risk weight 2018 %	Restated RWAs 2018 £m
0.10	**32,607.6**	**15.1**	**5.5**	**1,795.6**	30,148.9	14.6	5.3	1,607.2
0.20	**8,235.6**	**20.4**	**12.8**	**1,055.0**	7,628.1	19.5	11.8	901.0
0.30	**2,142.7**	**21.8**	**19.0**	**407.6**	2,082.8	21.1	18.1	375.9
0.50	**1,370.8**	**22.3**	**26.1**	**358.1**	1,345.3	21.7	24.3	326.8
1.00	**638.6**	**23.1**	**40.2**	**256.7**	616.2	22.7	39.5	243.3
3.00	**187.3**	**23.0**	**57.5**	**107.7**	195.9	24.0	59.8	117.0
9.99	**95.1**	**16.3**	**66.6**	**63.3**	84.8	16.2	64.8	55.0
99.99	**129.0**	**17.8**	**93.4**	**120.5**	136.5	16.9	89.2	121.8
In Default	**31.2**	**17.2**	**158.3**	**49.4**	35.9	18.0	157.5	56.6
Total	**45,437.9**			**4,213.9**	42,274.4			3,804.6

The PDs disclosed in the table above are on a point in time basis. The average loss given default and the average risk weights increased during 2019 as a result of the increased stock of buy to let lending.

The 2018 comparative figures in the table above have been restated following the discovery of an error in the RWA calculation that was disclosed in December 2019. The error related to the omission of a 6% scaling factor in the final RWA calculation and led to an understatement of RWAs. The core IRB models themselves were not impacted. Application of the 6% scalar has increased total RWAs as at 31 December 2018 by 4.7%.

Once permission is obtained from the PRA, the Society will transition to new IRB models which are expected to meet the latest regulatory requirements contained in supervisory statement SS11/13. The expected impact of these new models is a modest increase in RWAs and a reduction to the Society's CET 1 ratio of up to 3%.

Treatment of undrawn exposures

At any point the Society has a number of undrawn exposures that it assigns ratings to using the IRB rating system. These undrawn exposures relate to mortgage applications that have reached the 'offer' stage, where the Society has agreed to advance the funds, but completion of the mortgage has not yet taken place. An offer will generally only be cancelled if adverse information is received after the offer has been made or if it has not been taken up by the customer and hence expires. To assess credit risk it is assumed that all offers will complete, and therefore a conservative conversion factor of 100% is assigned to these undrawn exposures.

At 31 December 2019, the value of undrawn exposures being rated under the IRB approach was £1,675.9 million (2018: £1,729.2 million).

5.2.3 Controls and governance

The Society has a Board approved policy on model risk which sets out the minimum controls and standards to be applied to mitigate risk. These standards and controls are designed to conform to the regulatory expectations for model risk management practices. Within this, the Society has a comprehensive model governance framework which sets out policies and statements that govern all models including the IRB models throughout their life cycle.

The Retail Credit Risk Committee oversees management of model risk through its sub-committee, Models and Ratings Committee (MRC). MRC is chaired by the Chief Financial Officer and includes in its membership the Chief Risk Officer and senior managers from the Prudential & Enterprise Risk and Retail Credit Risk functions. Internal Audit also attends the MRC. MRC is responsible for ensuring that the retail credit risk model governance framework is operating effectively.

The Society categorises its models and complex calculators dependent on their criticality and complexity and the framework operates to require increased controls on more critical and more complex models. Techniques used to assess and manage model risk include:

- Requirements on model development and documentation.
- Sensitivity analysis of key assumptions.
- Independent validation.
- Increasing focus on data governance.

Model developments and ongoing performance monitoring are undertaken in the first line by the Retail Credit Risk function. Additionally, throughout the year, the various elements of the retail credit model governance framework are reviewed by Retail Credit Risk function and on an annual basis are assessed and presented to MRC for approval.

The first line undertakes an annual detailed review of the regulatory requirements over IRB models, which includes assessment against the EU Capital Requirements Regulations and the PRA's supervisory statements and guidance, in accordance with its Model Risk Framework. The second line risk function independently reviews this work, and both the annual review and the second line opinion is presented to MRC.

MRC's responsibilities in relation to IRB models include:

- Agreeing the scope and design of the models, including key assumptions and judgements;
- Reviewing progress updates during model development;
- Considering the results of independent second line model validation and confirming that the models are fit for purpose. The validation assesses the quality of data used in the model development and model documentation;
- Reviewing ongoing model performance monitoring reports, to ensure that the models are operating as designed. If model performance deteriorates beyond expectation, a review of the model may be triggered which could result in a recalibration or redevelopment; and
- Approving the submission of any new IRB models and material changes to existing models to the regulator.

As part of its third line responsibilities, Internal Audit undertakes an annual review of the effectiveness of the controls governing the use of IRB models. Following this self-assessment, the Chief Risk Officer attests compliance with IRB regulatory requirements.

Governance over the IFRS 9 ECL calculation is the responsibility of the Expected Credit Loss Group (ECLG). This group is chaired by the Chief Financial Officer and attendees include the Chief Risk Officer, Chief Internal Auditor and other senior managers from the Finance, Credit Risk and Risk functions. ECLG monitors the adequacy of historic ECL projections, comparing actual losses as they emerge with the estimated losses that were set aside as provisions. Detailed model performance monitoring as well as oversight and approval of the IFRS 9 models is the responsibility of the Models & Ratings Committee.

ECLG also proposes the economic scenarios and weightings used to determine the forward looking views that are required by IFRS 9, as well as the key judgments and assumptions supporting the calculation. These scenarios, weightings and judgements are approved by the Society's Board Audit Committee.

During 2019, the Society announced that it had made a historic error in the calculation of Risk Weighted Assets on its retail credit risk portfolio. The relevant calculator has been updated and tested and the Society is undertaking further activity to strengthen the implementation of its model risk framework as a result of this incident.

The Society anticipates that usage of models within the business will continue to increase. As a result it will continue to develop its controls over and oversight of models and complex calculators and the data that populates them.

5.2.4 IRB model performance over time

Back testing methodologies are applied to assess model performance. Results from these exercises continue to show that models are conservative against actual outcomes.

For capital calculations, the PD and LGD models are calibrated to long run or downturn conditions respectively. This means that in current economic conditions the outputs of both models are significantly higher than actual outcomes.

In order to provide an assessment of the accuracy of the PD and LGD models, point-in-time calibrations are used. For the PD model, the predicted default rate for accounts not in default at the start of the year is compared against the actual rate of default that emerged over the following twelve months. With respect to the LGD model, the actual losses incurred during 2019 are compared against the predicted loss on these accounts at the start of the year without the additional downturn parameters required in the regulatory capital calculation. The accuracy of the EAD estimate is calculated by comparing the balance of accounts that went into default during the year with the predicted balance 12 months prior to the account defaulting.

Point in time PD and LGD predictions against actual results are shown below. The ratio of estimated to actual EAD is also shown (a ratio of greater than 1 indicates that estimated EAD was greater than actual EAD).

Table 17: Actual Probability of Default (PD), Loss Given Default (LGD) and Exposure At Default (EAD) against predicted

IRB retail mortgages	Actual 2019 %	Predicted 2019 %	Actual 2018 %	Predicted 2018 %
PD	**0.07**	**0.16**	0.09	0.16
LGD	**3.99**	**3.99**	3.94	3.95
EAD (Estimated to actual)	**1.03**	**N/A**	1.04	N/a

Note: The PD model predicts defaults from performing (up-to-date) accounts, with a separate roll-rate model used to predict default from accounts already in arrears. The PD predictions shown above relate to performing accounts. Including non-performing accounts the actual PD was 0.13% (2018: 0.15%). As at 31 December 2019 the projected portfolio average long run PD was 0.38% (2018: 0.40%).

The predicted PD rate has remained consistent with the prior period however the actual rate has fallen reflecting the improved credit risk profile of the book. The point in time predicted PD is conservatively above actual PD in both years. Predicted and actual LGD have remained broadly in line with 2018, with prediction and actual continuing to correlate.

5.2.5 Credit risk mitigation

The Society does not employ credit risk mitigation techniques in relation to retail credit risk apart from taking a first legal charge on each property being offered as security for a mortgage.

All properties taken as security are valued at the outset of the loan and when any further advance is made during the lifetime of the loan.

The initial valuations of properties are determined the Credit Risk function using a variety of techniques. These techniques include internal physical inspection with written reports by a qualified Royal Institutions of Chartered Surveyors (RICS) surveyor as well as Automated Valuation Models or drive by valuations. The Head of Credit risk oversees the techniques used, and independently assesses the accuracy of valuations which are performed

All buy to let properties are valued at origination by a qualified RICS surveyor who makes a physical internal inspection of the property.

Regular reviews of the appropriateness and accuracy of the various valuation methods used by the Society are undertaken, to ensure these remain appropriate.

Assumptions regarding realisation (or work-out) costs, the time it takes to effect repossession and sale, and the effect of forced sale on estimated property values are updated regularly and are used in the impairment model to determine the realistic value that could be achieved upon repossession and sale of a property. Conservative, stressed values for these assumptions are used in calculating the regulatory capital requirement.

5.2.6 Identifying impaired loans

Under IFRS 9 the Society calculates impairment provisions on loans and advances to customers on an expected credit loss (ECL) basis. ECL impairment provisions are based on an assessment of probability of default, loss given default and exposure at default in a range of forward looking scenarios.

IFRS 9 requires the Society to categorise customer loans into one of three stages at the balance sheet date. Assets that are ‘performing’ are shown in stage 1; assets where there has been a significant increase in credit risk since initial recognition or ‘deteriorating’ assets are in stage 2; and accounts which are credit impaired or in ‘default’ are in stage 3. Under IFRS 9, loans are generally treated as being in ‘default’ if they are three or more months in arrears, have been three or more months in arrears in the last 12 months or have other specific unlikeliness to pay indicators1. IFRS 9 requires a 12 month ECL provision on all stage 1 assets and a lifetime expected credit loss provision on all stage 2 and 3 assets. At 31 December 2019, 97.0% of the Society’s loans and advances to customers were within the stage 1 ‘performing’ category which is slightly better than in 2018 (96.6%), reflecting improved arrears.

Information on how the Society has applied the requirements of IFRS 9 including the calculation of ECLs is set out in note 1 to the Accounts. Note 13 to the Accounts provides further information on the forward looking information used in the ECL calculations and sensitivities.

The table below shows gross loans and advances to customers split by IFRS 9 stage at 31 December 2019. For stages 2 and 3, further analysis of accounts which are past due and not past due is also shown.

Table 18a: Gross loans and advances to customers split by IFRS 9 stage 2019

2019	**Stage 1 'Performing' £m**	**Stage 2 'Deteriorating' £m**	**Of which: Not past due £m**	**Of which: Past due £m**	**Stage 3 'Default' £m**	**Of which: Not past due £m**	**Of which: Past due £m**	**Total £m**
Residential mortgages:								
Owner-occupier	24,433.1	644.5	588.5	56.0	121.3	48.2	73.1	**25,198.9**
Buy to let	16,350.4	340.7	307.9	32.8	41.5	19.7	21.8	**16,732.6**
Total traditional residential mortgages	**40,783.5**	**985.2**	**896.4**	**88.8**	**162.8**	**67.9**	**94.9**	**41,931.5**
Non-traditional mortgages:								
Residential near-prime	26.5	16.3	14.2	2.1	16.4	5.2	11.2	**59.2**
Residential self-certified	63.5	75.2	72.0	3.2	17.6	6.7	10.9	**156.3**
Commercial lending	–	1.6	1.6	–	0.4	0.4	–	**2.0**
Total non-traditional mortgages	**90.0**	**93.1**	**87.8**	**5.3**	**34.4**	**12.3**	**22.1**	**217.5**
Unsecured loans	**19.6**	**0.3**	**–**	**0.3**	**0.1**	**–**	**0.1**	**20.0**
Total gross loans	**40,893.1**	**1,078.6**	**984.2**	**94.4**	**197.3**	**80.2**	**117.1**	**42,169.0**
	%	**%**	**%**	**%**	**%**	**%**	**%**	**%**
% Total gross loans	**97.0**	**2.5**	**2.3**	**0.2**	**0.5**	**0.2**	**0.3**	**100.0**

Table 18b: Gross loans and advances to customers split by IFRS 9 stage 2018

2018	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Of which: Not past due £m	Of which: Past due £m	Stage 3 'Default' £m	Of which: Not past due £m	Of which: Past due £m	Total £m
Residential mortgages:								
Owner-occupier	22,363.8	682.3	628.1	54.2	130.9	49.8	81.1	23,177.0
Buy to let	15,324.1	375.6	353.0	22.6	38.6	14.6	24.0	15,738.3
Total traditional residential mortgages	37,687.9	1,057.9	981.1	76.8	169.5	64.4	105.1	38,915.3
Non-traditional mortgages:								
Residential near-prime	28.7	17.7	14.3	3.4	19.9	5.3	14.6	66.3
Residential self-certified	113.7	51.8	46.4	5.4	18.7	7.9	10.8	184.2
Commercial lending	–	1.8	1.6	0.2	0.4	0.4	–	2.2
Total non-traditional mortgages	142.4	71.3	62.3	9.0	39.0	13.6	25.4	252.7
Unsecured loans	23.3	0.4	–	0.4	0.1	–	0.1	23.8
Total gross loans	37,853.6	1,129.6	1,043.4	86.2	208.6	78.0	130.6	39,191.8
	%	%	%	%	%	%	%	%
% Total gross loans	96.6	2.9	2.7	0.2	0.5	0.2	0.3	100.0

At the reporting date, 97.0% of loans are in stage 1 with only 2.5% in stage 2 and 0.5% in stage 3 (2018: 96.6%, 2.9% and 0.5%). Cure periods are applied to accounts in stages 2 and 3 that have hit certain quantitative triggers such as arrears. These cure periods delay transition of loans to a lower credit risk classification (i.e. from stage 3 to stage 2 or from stage 2 to stage 1) by requiring 12 months of sustained performance before a loan is reassessed. As a result, loans can be recorded in stage 2 or stage 3 despite otherwise performing at the reporting date.

Of the balances in stage 2 at the reporting date, only £94.4 million or 8.8% are in arrears by 30 days or more continuing to demonstrate that the major drivers for stage 2 classification are factors other than arrears (2018: £86.2 million or 7.6%).

Of the £197.3 million of loans which are classified as stage 3 at the reporting date, only 29.8% or £58.7 million were greater than three months in arrears, and 40.2% (£80.2 million) of stage 3 assets were paid up to date. This is an improvement compared to the position in 2018 when 32.4% (£67.7 million) of the £208.6 million of loans which were classified in stage 3 at 31 December 2018 were greater than three months in arrears and 37.4% (£78.0 million) were up to date.

At 31 December 2019, £58.7 million of loans were more than three months in arrears and subject to litigation or in possession, a decrease of £8.9 million on 2018.

Possession levels have remained low and only £4.6 million of stage 3 loans are in possession (2018: £6.7 million). This represents 33 individual cases and only 0.01% of the total mortgage book (or 2.3% of the stage 3 book) by balance, a decrease on 2018 when there were 34 possession cases representing 0.02% of the total mortgage book and 3.2% of stage 3 loans. As at 31 December 2019, properties in possession were valued at £5.4 million (2018: £6.2 million) against balances net of provisions of £4.2 million (2018: £4.7 million).

The table below shows total impairment provision split by IFRS 9 stage at 31 December 2019. For stages 2 and 3, further analysis of accounts which are past due and not past due is also shown.

Table 19a: Impairment on loans and advances to customers split by IFRS 9 stage 2019

			Of which			Of which		
Impairment provision as at 31 December 2019	**Stage 1 12 month ECL £m**	**Stage 2 lifetime ECL £m**	**Not past due £m**	**Past due £m**	**Stage 3 lifetime ECL £m**	**Not past due £m**	**Past due £m**	**Total £m**
Residential mortgages:								
Owner-occupier	0.5	2.0	1.8	0.2	3.7	2.3	1.4	**6.2**
Buy to let	0.2	0.8	0.7	0.1	3.5	2.1	1.4	**4.5**
Total traditional residential mortgages	**0.7**	**2.8**	**2.5**	**0.3**	**7.2**	**4.4**	**2.8**	**10.7**
Non-traditional mortgages:								
Residential near-prime	–	0.1	0.1	–	0.1	–	0.1	**0.2**
Residential self-certified	–	0.1	0.1	–	0.2	–	0.2	**0.3**
Commercial lending	–	0.2	0.2	–	0.2	0.2	–	**0.4**
Total non-traditional mortgages	**–**	**0.4**	**0.4**	**–**	**0.5**	**0.2**	**0.3**	**0.9**
Unsecured loans	**0.2**	**–**	**–**	**–**	**0.1**	**–**	**0.1**	**0.3**
Mortgage pipeline	**0.1**	**–**	**–**	**–**	**–**	**–**	**–**	**0.1**
Total impairment provision	**1.0**	**3.2**	**2.9**	**0.3**	**7.8**	**4.6**	**3.2**	**12.0**
	%	%	%	%	%	%	%	%
Total impairment provision	**8.3**	**26.7**	**24.2**	**2.5**	**65.0**	**38.3**	**26.7**	**100.0**

Table 19b: Impairment on loans and advances to customers split by IFRS 9 stage 2018

Impairment provision as at 31 December 2018	Stage 1 12 month ECL £m	Stage 2 lifetime ECL £m	Of which: Not past due £m	Of which: Past due £m	Stage 3 lifetime ECL £m	Of which: Not past due £m	Of which: Past due £m	Total £m
Residential mortgages:								
Owner-occupier	0.6	2.1	1.9	0.2	3.3	1.0	2.3	6.0
Buy to let	0.4	1.1	1.0	0.1	2.3	0.6	1.7	3.8
Total traditional residential mortgages	1.0	3.2	2.9	0.3	5.6	1.6	4.0	9.8
Non-traditional mortgages:								
Residential near-prime	–	–	–	–	0.2	0.1	0.1	0.2
Residential self-certified	–	0.1	0.1	–	0.1	–	0.1	0.2
Commercial lending	–	0.5	0.5	–	0.3	0.3	–	0.8
Total non-traditional mortgages	–	0.6	0.6	–	0.6	0.4	0.2	1.2
Unsecured loans	0.3	0.1	–	0.1	0.1	–	0.1	0.5
Mortgage pipeline	0.1	–	–	–	–	–	–	0.1
Total impairment provision	1.4	3.9	3.5	0.4	6.3	2.0	4.3	11.6
	%	%	%	%	%	%	%	%
Total impairment provision	12.1	33.6	30.2	3.4	54.3	17.2	37.1	100.0

Incorporated within the IFRS 9 impairment numbers above are £4.0 million of post model adjustments. These adjustments are applied by the Society where it considers that there are potentially additional risks that have not been identified or that cannot be adequately modelled. Examples of these post model adjustments are in respect of small loan portfolios where there is insufficient data on which to build statistically robust models and the risk of buy to let interest only customers not repaying the capital at maturity. The assumptions applied as part of IFRS 9 are regularly reviewed and further information can be found in note 13 to the Accounts.

A reconciliation of movements in gross exposures and impairment provision by IFRS 9 stage from 1 January to 31 December 2019 is as follows:

Table 20a: Reconciliation of movements in gross exposures and impairment provision by IFRS 9 stage 2019

	Stage 1		Stage 2		Stage 3		Total	
	Gross balance 12 month ECL £m	Provision 12 month ECL £m	Gross balance lifetime ECL £m	Provision lifetime ECL £m	Gross balance lifetime ECL £m	Provision lifetime ECL £m	Gross balance £m	Provision £m
At 1 January 2019	**37,853.6**	**1.4**	**1,129.6**	**3.9**	**208.6**	**6.3**	**39,191.8**	**11.6**
Movements with Income Statement impact:								
Transfer from stage 1 to stage 2	(570.0)	(0.1)	570.0	1.1	–	–	–	1.0
Transfer from stage 1 to stage 3	(39.6)	–	–	–	39.6	1.1	–	1.1
Transfer from stage 2 to stage 3	–	–	(49.9)	(0.3)	49.9	0.3	–	–
Transfer from stage 3 to stage 2	–	–	38.2	0.5	(38.2)	(0.5)	–	–
Transfer from stage 3 to stage 1	11.8	–	–	–	(11.8)	(0.1)	–	(0.1)
Transfer from stage 2 to stage 1	465.2	0.1	(465.2)	(0.5)	–	–	–	(0.4)
Net movement arising from transfer of stages	**(132.6)**	**–**	**93.1**	**0.8**	**39.5**	**0.8**	**–**	**1.6**
New loans originated[1]	8,582.4	0.6	4.2	–	0.1	–	8,586.7	0.6
Remeasurement of ECL due to changes in risk parameters	–	(0.1)	–	(0.3)	–	0.6	–	0.2
Increase/(decrease) in post model adjustments	–	–	–	(0.3)	–	3.1	–	2.8
Remeasurement of ECL due to model refinements[2]	–	(0.4)	–	(0.6)	–	(0.1)	–	(1.1)
Loans derecognised in the period	(3,752.7)	(0.4)	(103.4)	(0.3)	(40.6)	(0.7)	(3,896.7)	(1.4)
Other items impacting income statement charge/(reversal)	–	–	–	–	–	(0.3)	–	(0.3)
Net write offs directly to Income Statement	–	0.1	–	–	–	(0.4)	–	(0.3)
Income Statement charge for the period		**(0.2)**		**(0.7)**		**3.0**		**2.1**
Repayment and charges	(1,657.3)	–	(44.9)	–	(7.9)	–	(1,710.1)	–
Net write offs	(0.3)	(0.2)	–	–	(2.4)	(1.5)	(2.7)	(1.7)
At 31 December 2019	**40,893.1**	**1.0**	**1,078.6**	**3.2**	**197.3**	**7.8**	**42,169.0**	**12.0**

1. New mortgages originated in stages 2 and 3 relate to further advances on accounts which are performing at the date of origination but are in the 12 month cure period for IFRS 9 staging.
2. A number of refinements to the Society's ECL models have been made during 2019. These include an update to the calculation of the Probability of Default and an enhancement to the regional house price index modelling capability. In the year these refinements decreased ECLs by £1.1 million at Group and £0.4 million within the Society.

The impact of post model adjustments on the impairment provision has increased by £2.8 million to £4.0 million during 2019.

Table 20b: Reconciliation of movements in gross exposures and impairment provision by IFRS 9 stage 2018

	Stage 1		Stage 2		Stage 3		Total	
	Gross balance 12 month ECL £m	Provision 12 month ECL £m	Gross balance lifetime ECL £m	Provision lifetime ECL £m	Gross balance lifetime ECL £m	Provision lifetime ECL £m	Gross balance £m	Provision £m
At 1 January 2018	34,391.1	1.3	1,235.0	3.9	232.9	8.3	35,859.0	13.5
Movements with Income Statement impact:								
Transfer from stage 1 to stage 2	(575.4)	(0.1)	575.4	1.1	–	–	–	1.0
Transfer from stage 1 to stage 3	(33.7)	–	–	–	33.7	0.8	–	0.8
Transfer from stage 2 to stage 3	–	–	(46.3)	(0.2)	46.3	0.2	–	–
Transfer from stage 3 to stage 2	–	–	40.5	0.5	(40.5)	(0.5)	–	–
Transfer from stage 3 to stage 1	13.6	–	–	–	(13.6)	(0.1)	–	(0.1)
Transfer from stage 2 to stage 1	524.2	0.1	(524.2)	(0.5)	–	–	–	(0.4)
Net movement arising from transfer of stages	(71.3)	–	45.4	0.9	25.9	0.4	–	1.3
New loans originated[1]	9,164.5	0.6	26.0	–	0.2	–	9,190.7	0.6
Remeasurement of ECL due to changes in risk parameters	–	(0.1)	–	(0.3)	–	0.4	–	–
Increase/(decrease) in post model adjustments	–	–	–	(0.4)	–	–	–	(0.4)
Loans derecognised in the period	(4,089.8)	(0.4)	(131.6)	(0.2)	(42.1)	(1.0)	(4,263.5)	(1.6)
Net write offs directly to Income Statement	–	0.1	–	–	–	(0.4)	–	(0.3)
Income Statement charge for the period		0.2		–		(0.6)		(0.4)
Repayment and charges	(1,540.8)	-	(45.1)	–	(6.3)	–	(1,592.2)	–
Net write offs	(0.1)	(0.1)	(0.1)	–	(2.0)	(1.4)	(2.2)	(1.5)
At 31 December 2018	37,853.6	1.4	1,129.6	3.9	208.6	6.3	39,191.8	11.6

1. New mortgages originated in stages 2 and 3 relate to further advances on accounts which are performing at the date of origination but are in the 12 month cure period for IFRS 9 staging.

The loan to value (LTV) distribution of the mortgage book by IFRS 9 stage has remained broadly stable during 2019 with 85.0% of the mortgage book having an LTV of 75% or lower (2018: 87.1%). This is shown by IFRS 9 stage below:

Table 21a: Loan to value distribution by IFRS 9 stage 2019

As at 31 December 2019 Indexed loan to value	**Stage 1 'Performing' £m**	**Stage 2 'Deteriorating' £m**	**Stage 3 'Default' £m**	**Impairment £m**	**Total £m**
< 50%	**15,352.0**	**403.7**	**70.7**	**(1.0)**	**15,825.4**
50% to 65%	**12,112.9**	**326.1**	**61.9**	**(1.7)**	**12,499.2**
65% to 75%	**7,272.0**	**195.5**	**29.2**	**(1.4)**	**7,495.3**
75% to 85%	**4,098.4**	**102.2**	**21.0**	**(2.5)**	**4,219.1**
85% to 90%	**1,720.2**	**39.9**	**7.2**	**(1.2)**	**1,766.1**
90% to 95%	**309.5**	**7.0**	**1.4**	**(0.8)**	**317.1**
95% to 100%	**5.9**	**1.9**	**1.7**	**(0.9)**	**8.6**
> 100%	**2.6**	**2.0**	**4.0**	**(2.0)**	**6.6**
Unsecured loans	**19.6**	**0.3**	**0.2**	**(0.4)**	**19.7**
Mortgage pipeline	**–**	**–**	**–**	**(0.1)**	**(0.1)**
Total	**40,893.1**	**1,078.6**	**197.3**	**(12.0)**	**42,157.0**

Table 21b: Loan to value distribution by IFRS 9 stage 2018

As at 31 December 2018 Indexed loan to value	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Stage 3 'Default' £m	Impairment £m	Total £m
< 50%	14,713.9	383.7	77.8	(0.6)	15,174.8
50% to 65%	11,791.9	347.9	62.7	(1.3)	12,201.2
65% to 75%	6,487.8	222.7	26.8	(1.7)	6,735.6
75% to 85%	3,242.1	108.4	20.9	(2.1)	3,369.3
85% to 90%	1,199.4	47.3	6.1	(1.2)	1,251.6
90% to 95%	381.7	12.1	6.2	(1.2)	398.8
95% to 100%	7.4	4.6	2.0	(0.9)	13.1
> 100%	6.1	2.5	5.8	(2.0)	12.4
Unsecured loans	23.3	0.4	0.3	(0.5)	23.5
Mortgage pipeline	–	–	–	(0.1)	(0.1)
Total	37,853.6	1,129.6	208.6	(11.6)	39,180.2

The credit quality of the mortgage book in 2019 has improved compared to 2018 as shown by lifetime probability of default (PD) by stage set out below. This table reflects the PD of a given loan over its life (e.g. PD of less than or equal to 0.25 indicates a 0.25% or lower chance of default). Default includes cases which are three or more months in arrears, have been three or more months in arrears at some point in the last 12 months and cases which have triggered a specified unlikeliness to pay indicator. This shows that the mortgage book has a very low underlying risk of default, with 95.6% of the book having a PD of 0.5% or less compared to 91.7% last year.

Table 22a: Lifetime probability of default by IFRS 9 stage 2019

As at 31 December 2019 **Probability of default (%)**	**Stage 1** **'Performing'** **£m**	**Stage 2** **'Deteriorating'** **£m**	**Stage 3** **'Default'** **£m**	**Impairment** **£m**	**Total** **£m**
<=0.25	**39,482.1**	**58.7**	**–**	**(0.4)**	**39,540.4**
0.26 to 0.50	**698.3**	**63.9**	**–**	**(0.1)**	**762.1**
0.51 to 1.50	**313.2**	**114.7**	**–**	**(0.1)**	**427.8**
1.51 to 5.00	**62.5**	**261.9**	**–**	**(0.1)**	**324.3**
5.01 to 20.00	**51.9**	**396.5**	**–**	**(0.5)**	**447.9**
20.01 to 100.00	**49.4**	**176.2**	**–**	**(0.7)**	**224.9**
Other[1]	**235.7**	**6.7**	**3.1**	**(5.5)**	**240.0**
Default	**–**	**–**	**194.2**	**(4.5)**	**189.7**
Mortgage pipeline	**–**	**–**	**–**	**(0.1)**	**(0.1)**
Total	**40,893.1**	**1,078.6**	**197.3**	**(12.0)**	**42,157.0**

1. Including mortgage portfolios and other loans where the probability of default is not assessed.

Table 22b: Lifetime probability of default by IFRS 9 stage 2018

As at 31 December 2018 Probability of default (%)	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Stage 3 'Default' £m	Impairment £m	Total £m
<=0.25	33,601.0	19.1	–	(0.3)	33,619.8
0.26 to 0.50	2,258.7	40.9	–	(0.2)	2,299.4
0.51 to 1.50	1,392.3	136.9	–	(0.2)	1,529.0
1.51 to 5.00	234.2	329.4	–	(0.3)	563.3
5.01 to 20.00	57.0	404.3	–	(0.7)	460.6
20.01 to 100.00	46.6	192.3	–	(1.0)	237.9
Other[1]	263.8	6.7	3.1	(2.9)	270.7
Default	–	–	205.5	(5.9)	199.6
Mortgage pipeline	–	–	–	(0.1)	(0.1)
Total	37,853.6	1,129.6	208.6	(11.6)	39,180.2

1. Including mortgage portfolios and other loans where the probability of default is not assessed.

5.3 Treasury credit risk

5.3.1 Management of treasury credit risk

Treasury credit risk is the risk that the Society is unable to recover the principal or interest due from a wholesale debtor, or that the liquidity or value of a wholesale asset or instrument suffers materially due to changes in the creditworthiness of the counterparty.

The Society has a low appetite for treasury credit risk and restricts exposures to good quality counterparties with a low risk of failure.

Treasury investments in financial institutions are restricted to highly rated UK banks, with additional credit limits extended to a small number of highly rated and systemically important institutions in Europe, Australia, Canada and the United States and Multilateral development banks (MDBs). In addition, the Society invests in covered bonds and residential mortgage backed securities (RMBSs). The treasury credit limits are reviewed annually by BRC and the Board and reflect internal analysis, external credit ratings and any other relevant factors. Within the risk framework, detailed limit setting is delegated to the Asset and Liability Committee (ALCO) with oversight from the Risk function.

Exposures are reviewed continuously to ensure that they remain within the approved limits. Developments with treasury counterparties are closely monitored and limits are reduced or suspended where there are adverse changes including changes in the creditworthiness of counterparties or markets.

The Society has no exposure to emerging markets, hedge funds, non-UK RMBS, non-UK covered bonds or credit default swaps.

Treasury assets comprise cash and balances with the Bank of England, loans and advances to credit institutions and debt securities. Whilst the majority of liquidity continues to be held in UK central bank reserves and Government securities, during 2019 the Society increased its investment in MDBs, UK covered bonds and UK RMBS and entered into bi-lateral funding arrangements that required additional collateralisation. All of the Society's treasury exposures remain at investment grade as set out below:

Table 23a: Treasury assets exposure value by rating 2019

As at 31 December 2019	**Aaa–Aa3 £m**	**A1–A3 £m**	**Baa1–Baa3 £m**	**Unrated £m**	**Total £m**
Central banks and sovereigns	**5,736.1**	**–**	**–**	**–**	**5,736.1**
Multilateral development banks (supranational bonds)	**165.5**	**–**	**–**	**–**	**165.5**
Financial institutions	**678.9**	**197.0**	**56.9**[1]	**–**	**932.8**
Residential mortgage-backed securities	**20.3**	**–**	**–**	**–**	**20.3**
Total	**6,600.8**	**197.0**	**56.9**	**–**	**6,854.7**

Table 23b: Treasury assets exposure value by rating 2018

As at 31 December 2018	Aaa–Aa3 £m	A1–A3 £m	Baa1–Baa3 £m	Unrated £m	Total £m
Central banks and sovereigns	5,886.0	–	–	–	5,886.0
Multilateral development banks (supranational bonds)	75.1	–	–	–	75.1
Financial institutions	108.4	276.0	48.2[1]	–	432.6
Residential mortgage-backed securities	8.2	–	–	–	8.2
Total	6,077.7	276.0	48.2	–	6,401.9

1. Cash collateral held by counterparties under Credit Support Annexes (CSAs) in relation to derivative liabilities. The Baa1-Baa3 exposure relates to a single counterparty that was downgraded in 2018.

Capital for credit risk within the liquidity book is calculated using the Standardised approach. For central banks, sovereigns, and UK Financial Institutions with a residual maturity of less than three months, risk weights prescribed in CRD IV are used. At 31 December 2019, the exposure for UK Financial Institutions with a residual maturity of less than three months was £336.2 million (2018: £179.1 million) with a capital requirement of £5.4 million (2018: £2.9 million).

For covered bonds, RMBS and other Financial Institutions the Society uses credit ratings published by Moody's. Moody's is recognised as an eligible External Credit Assessment Institution (ECAI) for this purpose. The following table shows the exposure values and rating associated with each credit quality step. There is no credit risk mitigation applicable to these exposure values.

Table 24: ECAI exposure values and ratings

	Moody's rating	**Risk weight %**	**Exposure value 2019 £m**	**Minimum capital requirement 2019 £m**	Exposure value 2018 £m	Minimum capital requirement 2018 £m
Retail Mortgage Backed Securities (RMBS)						
Credit quality step 1[1]	Aaa-Aa3	10	**12.5**	**0.1**	–	–
Credit quality step 1	Aaa-Aa3	20	**7.8**	**0.1**	8.2	0.1
Total RMBS			**20.3**	**0.2**	8.2	0.1
Covered bonds						
Credit quality step 1	Aaa-Aa3	10	**242.8**	**1.9**	8.2	0.1
Total covered bonds			**242.8**	**1.9**	8.2	0.1
Financial institutions						
Credit quality step 1	Aaa-Aa3	20	**164.3**	**2.6**	46.0	0.7
Credit quality step 2	A1-A3	50	**39.7**	**1.6**	63.4	2.6
Credit quality step 3	Baa1	50	**1.6**	**0.1**	5.1	0.2
Total financial institutions			**205.6**	**4.3**	114.5	3.5
Total			**468.7**	**6.4**	130.9	3.7

1. STS mortgage backed securities not present in prior year

5.3.2 Counterparty credit risk mitigation

The Society enters into derivative transactions for risk management purposes. It undertakes sale and repurchase (repo) transactions to manage liquidity and raise longer term funding, where highly rated assets such as gilts are sold with an agreement to repurchase at an agreed price on a later date. Counterparty credit risk includes the risk of default by the derivative counterparty or the risk that cash received in a repo transaction is less than the market value of the asset.

The Society manages this risk by undertaking credit assessments of all counterparties and by exchanging collateral to mitigate any exposure. Daily collateralisation of repo transactions is carried out in accordance with the Global Master Repurchase Agreements to mitigate net exposure arising from changes in market value. Similarly, all derivatives have Credit Support Annexes (CSAs) in place to ensure they are collateralised to mitigate net mark-to-market credit exposures.

The Society has entered into International Swaps and Derivatives Association (ISDA) master netting agreements for all of its derivatives (other than swaps undertaken by Coventry Building Society Covered Bond LLP). These allow the Society to settle exposures ‘net’ in the event of a default or other predetermined event.

The Society is subject to mandatory central clearing of derivatives through a third party regulated central clearing counterparty to reduce systemic and operating risk. Under this, collateral is exchanged on a daily basis. The Society enters into a number of amortising swaps that are not currently cleared by any of the central clearing houses; these are all subject to daily exchange of collateral to better manage counterparty risk.

Coventry Building Society Covered Bonds LLP does not enter into a master netting agreement due to the structure of the covered bonds programme. However, it has entered into separate ISDA agreements in respect of each of the derivatives it has transacted with external counterparties. Each agreement includes a CSA which provides for full collateralisation of the swap exposure with exposure thresholds in place for a single agreement before collateral is exchanged. The £6.6 million net derivative credit exposure in the table below includes £3.6 million in respect of this arrangement which will only be fully collateralised if the counterparty is downgraded to below a specified credit rating.

5.3.3 Counterparty credit risk - derivatives

The balance sheet exposure values of derivative instruments are as follows. The net derivative credit exposure has reduced as a result of changes in the underlying derivative fair values during the year.

Table 25: Derivative counterparty credit exposure

	Exposure value As at 31 December 2019 £m	Exposure value As at 31 December 2018 £m
Gross positive fair value of contracts	**137.9**	268.9
Netting benefits	**(66.5)**	(85.5)
Net credit exposure	**71.4**	183.4
Collateral held	**(64.8)**	(166.0)
Net derivative credit exposure	**6.6**	17.4

As at 31 December 2019, £3.6 million of the £6.6 million exposure is to A1 rated institutions.

The derivative exposure can only be settled net following a default or other predetermined event and therefore there is no right of set-off in the balance sheet.

For regulatory capital purposes, the Society measures derivative counterparty credit exposure values using the counterparty credit risk mark to market method. The net exposure value of derivatives at 31 December 2019, which includes uplifts for Potential Future Credit Exposure (PFCE) under this method, totalled £163.8 million (2018: £150.6 million).

Wrong way risk occurs when exposure to a counterparty is adversely correlated with the credit quality of that counterparty. Hence, there is a tendency for the exposure to increase as the creditworthiness decreases. Wrong way credit risk can occur where transactions are collateralised by related party securities and the Society mitigates this by only accepting cash or UK government securities as collateral.

5.3.4 Analysis of treasury assets by IFRS stage and impairment

Under IFRS 9 the calculation of impairment on treasury assets is performed on an Expected Credit Loss (ECL) basis.

The Society determines whether there has been a significant increase in credit risk for treasury assets using a range of factors including counterparty credit ratings, internal monitoring processes and, for mortgage backed securities, stress testing. Exposures are monitored by the Treasury Credit Committee.

Given their low risk nature, all of the Society's treasury assets are stage 1 'performing' assets at both 1 January and 31 December 2019. Impairment is calculated applying an externally published probability of default for the applicable credit risk rating to the treasury exposure value. The resulting ECL remains immaterial at 31 December 2019 as it was at 31 December 2018. As at 31 December 2019, no treasury assets were past due.

More information on the impact of IFRS 9 on classification and measurement of the Society's treasury assets is included in note 1 to the Accounts.

5.3.5 Securitisation

Purchased securitisation positions

The exposure values relating to the Society's ownership of Residential Mortgage Backed Securities (RMBS) and their associated risk weightings for capital purposes are included in Table 27 in section 5.3.1. All exposures comprise senior tranche RMBS.

Purchases and retention of RMBS are undertaken within a clearly defined credit risk policy. RMBS are held at amortised cost on the Society's balance sheet. If the assets are sold before maturity, a gain or loss would be recognised in the Income Statement. RMBS are regularly reviewed in line with article 406 of the Capital Requirements Regulations, with pricing and credit conditions reviewed by the Society's Treasury Credit Committee.

As at 31 December 2019, no purchased securitisation positions were past due or impaired (2018: none). The Society uses the Standardised approach for calculating capital requirements on its purchased securitisation positions.

Originated securitisations

The Society has securitised certain mortgage loans by transferring the loans to structured entities under the Mercia and Offa securitisation programmes. The programmes enable the Society to obtain secured funding or to create collateral which can be used to source funding.

The transferred mortgages remain on balance sheet as the Society retains substantially all the risks and rewards of ownership. These assets are held at amortised cost. The structured entities are fully consolidated into the Group Accounts. The transfers of the mortgage loans to the structured entities are not treated as sales and therefore no gains or losses are recognised.

As there is not considered to be a transfer of significant credit risk, the Society does not calculate risk weighted exposure amounts for any positions it holds in the securitisations and these continue to be calculated in line with

CRD IV requirements, consistent with other mortgage assets. The risk relating to the underlying mortgage pool therefore remains with the Society and is included in ‘Residential mortgages’ detailed throughout this document.

The Society’s obligations in respect of the Mercia and Offa securitisation vehicles are limited to transferring cash flows from the underlying assets and the Society and its subsidiaries are under no obligation to support any losses that may be incurred by the securitisation programmes or holders of the issued notes. The parties holding the notes in issue are therefore only entitled to obtain payment to the extent of the resources in the Mercia and Offa securitisation vehicles respectively.

Mercia and Offa create a potential liquidity requirement for the Society due to legal covenants within the swap documentation which require the Society to post collateral with the entities under certain circumstances. The cash flows under these legal covenants are considered in the Society’s internal assessment of its liquidity requirements.

Following a credit rating downgrade in 2019, the Society is now required to post collateral under these transactions, totalling £88.8 million at 31 December 2019 (2018: £nil). At 31 December 2019, the impact of a one notch credit rating downgrade would require additional collateral to be posted of £23.1 million (2018: £89.1 million), with no further requirement for a two notch downgrade (2018: £23.7 million).

The Society’s covered bond programme gives rise to a similar requirement, and the Society posted collateral of £124.9 million with the Covered Bonds LLP at 31 December 2019 (2018: £nil). A one notch downgrade would require additional collateral of £8.9 million (2018: £151.4 million), with no additional requirement for a two notch downgrade (2018: £10.4 million). Following the credit rating downgrade in 2019, the Society no longer acts as bank account provider to the covered bond programme.

Additional information on the Mercia and Offa programmes and the Society’s covered bonds is contained in note 16 to the Accounts.

6. Operational risk

6.1 Operational risk profile

Operational risk is the risk of a loss arising from inadequate or failed internal processes, people and systems, or from external events.

One of the Society’s principles is to be safe and secure, which means managing operational risk on behalf of members to mitigate the risk of:

- Disruption to services;
- Loss of customer data or other forms of information security incidents; or
- Financial losses.

Operational risk appetite is driven internally by the Society’s mission of Putting Members First, and externally by consumer expectations and regulatory standards that increasingly focus on business resilience.

6.2 Management of operational risk

Operational risk is a main risk category in the Society’s Enterprise Risk Management Framework and is managed, reported and controlled across a number of sub-categories, consistent with the Basel risk classification, industry best practice, and the Society’s business model. The most significant operational risk sub-categories for the Society continue to relate to operational resilience, IT and change management, information security and financial crime, which are covered below.

Operational risk is managed within the Society's three lines of defence model (see section 2.5). Day to day management of operational risk is carried out as an integral part of conducting the Society's business by the relevant functional executives. The executives are responsible for identifying potential risks and ensuring that adequate controls are in place to mitigate risks in line with risk appetite, using the Society's Risk and Control Self-Assessment process.

The Operational Risk Committee, chaired by the Chief Operating Officer, provides primary oversight of all operational risk categories with further oversight provided by BRC and the Board.

The Society expects that operational resilience and the pace of both internally driven and regulatory change will continue to be significant factors in its operational risk agenda going forward. Protecting against information security and financial crime threats will also be a major part of its risk management activity. It expects to do this through targeted change programmes and continuous improvement of day to day controls as well as maintaining its business continuity capability in line with increasing service level expectations.

6.3 Operational risk measurement

The Society uses the standardised approach for calculating its Pillar 1 capital requirement for operational risk. The calculation uses total income averaged over a three year period. The reduction in the year to £610.5 million (2018: £612.0 million) is as a result of the reduction in profit in the year due to the continuation of low mortgage pricing combined with the Society strategy of paying the best possible interest rates to its saving members.

See additional information on Operational risk within the Risk Management Report in the 2019 Accounts.

Appendix 1: EBA Own Funds Disclosure Template

Any blank lines in the template have been removed.

		Transitional CRD IV		End-point CRD IV	
		2019 £m	2018 £m	**2019 £m**	2018 £m
Common Equity Tier 1 (CET1) Capital: instruments and reserves					
2	Retained earnings	**1,773.3**	1,693.5	**1,773.3**	1,693.5
3	Accumulated other comprehensive income (and other reserves)	**14.5**	30.0	**14.5**	30.0
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	**(10.6)**	(9.3)	**(10.6)**	(9.3)
6	Common Equity Tier 1 (CET1) capital before regulatory adjustments	**1,777.2**	1,714.2	**1,777.2**	1,714.2
Common Equity Tier 1 (CET1) capital: regulatory adjustments					
7	Additional value adjustments (negative amount)	**(1.3)**	(0.9)	**(1.3)**	(0.9)
8	Intangible assets (net of related deferred tax liability (negative amount)	**(30.4)**	(33.1)	**(30.4)**	(33.1)
11	Fair value reserves related to gains or losses on cash flow hedges	**(10.8)**	(24.4)	**(10.8)**	(24.4)
12	Negative amounts resulting from the calculation of expected loss amounts	**(24.5)**	(23.5)	**(24.5)**	(23.5)
15	Defined-benefit pension fund assets (negative amount)	**(19.2)**	(17.5)	**(19.2)**	(17.5)
28	Total regulatory adjustments to Common Equity Tier 1 (CET1)	**(86.2)**	(99.4)	**(86.2)**	(99.4)
29	Common Equity Tier 1 (CET1) capital	**1,691.0**	1,614.8	**1,691.0**	1,614.8
Additional Tier 1 (AT1) capital: instruments					
30	Capital instruments and the related share premium accounts	**415.0**	396.9	**415.0**	396.9
31	of which: classified as equity under applicable accounting standards	**415.0**	396.9	**415.0**	396.9
33	Amount of qualifying items referred to in Article 484 (4) and the related share premium accounts subject to phase out from AT1	**40.0**	40.0	**–**	–
36	Additional Tier 1 (AT1) capital before regulatory adjustments	**455.0**	436.9	**415.0**	396.9
44	Additional Tier 1 (AT1) capital	**455.0**	436.9	**415.0**	396.9
45	Tier 1 capital (T1 = CET1 + AT1)	**2,146.0**	2,051.7	**2,106.0**	2,011.7
Tier 2 (T2) capital: instruments and provisions					
47	Amount of qualifying items referred to in Article 484 (5) and the related share premium accounts subject to phase out from T2	**16.6**	22.2	**–**	–
51	Tier 2 (T2) capital before regulatory adjustments	**16.6**	22.2	**–**	–
58	Tier 2 (T2) capital	**16.6**	22.2	**–**	–
59	Total capital (TC = T1 + T2)	**2,162.6**	2,073.9	**2,106.0**	2,011.7
60	Total risk weighted assets (restated)	**5,283.6**	4,760.7	**5,283.6**	4,760.7

		Transitional CRD IV		End-point CRD IV	
		2019 £m	Restated 2018 £m	**2019 £m**	Restated 2018 £m
Capital ratios and buffers					
61	Common Equity Tier 1 (as a percentage of total risk exposure amount)	**32.0%**	33.9%	**32.0%**	33.9%
62	Tier 1 (as a percentage of total risk exposure amount)	**40.6%**	43.1%	**39.9%**	42.3%
63	Total capital (as a percentage of total risk exposure amount)	**40.9%**	43.6%	**39.9%**	42.3%
64	Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus systemically important institution buffer expressed as a percentage of risk exposure amount)	**8.0%**	7.375%	**8.0%**	7.375%
65	of which: capital conservation buffer requirement	**2.5%**	1.875%	**2.5%**	1.875%
66	of which: countercyclical buffer requirement	**1.0%**	1.0%	**1.0%**	1.0%
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	**27.5%**	29.4%	**27.5%**	29.4%
Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2014 and 1 Jan 2022)					
82	Current cap on AT1 instruments subject to phase out arrangements	**48.0**	64.0[1]	**–**	–
84	Current cap on T2 instruments subject to phase out arrangements	**16.6**	22.2	**–**	–
85	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities	**8.4**	2.8	**–**	–

1. 2018 balance has been restated. The 2018 balance previously disclosed was £40.0m.

Appendix 2: Capital Instruments Key Features

1	Issuer	Coventry	Coventry	Coventry (Stroud & Swindon)	Coventry (Stroud & Swindon)
2	ISIN	XS1961836712	GB0002290764	N/a	N/a
3	Gov. law (sub)	English	English	English	English
	Regulatory treatment				
4	Trans. CRR rules	AT1	AT1	T2	T2
5	Post-transitional CRR rules	AT1	Ineligible	Ineligible	Ineligible
6	Eligible at Group (G), Individual Consolidated (IC) or Society (S)	G; IC; S	G; IC; S	G; IC; S	G; IC; S
7	Instrument type (types to be specified by each jurisdiction)	Perpetual Capital Security	PIBS	Sub Debt	Sub Debt
8	Regulatory capital value (£m)	415,000,000	40,000,000	9,986,940	6,657,960
9	Nominal amount of instrument	415,000,000	40,000,000	15,000,000	10,000,000
9a	Issue price	100	100.749	100	100
9b	Redemption price	100	100	100	100
10	Accounting classification	Shareholders' equity	Liability - amortised cost	Liability - amortised cost	Liability - amortised cost
11	Date of issue	02-Apr-19	28-May-92	23-Aug-01	29-Aug-03
12	Perpetual or dated	Perpetual	Perpetual	Dated	Dated
13	Original maturity	No maturity	No maturity	23-Aug-32	29-Aug-26
14	Issuer call	Yes	No	Yes	Yes
15	Optional call date, contingent call dates and redemption amount	18/09/2024; par regulatory/tax call	N/a	23-Aug-27	29-Aug-21
16	Subsequent call dates, if applicable	5 yearly	N/a	N/a	N/a
	Coupons / dividends				
17	Fixed or floating dividend/coupon	Fixed to fixed	Fixed	Fixed to fixed	Fixed to fixed
18	Coupon rate and any related index	6.875%	12.125%	7.540%	6.327%
19	Existence of a dividend stopper	No	No	No	No
20a/b	Fully discretionary, partially or mandatory (in terms of timing)	Fully discretionary	Partially discretionary	Mandatory	Mandatory
21	Existence of step up or other incentive to redeem	No	No	Yes	Yes
22	Non-cumulative or cumulative	Non-cumulative	Non-cumulative	N/a	N/a
23	Convertible or non-convertible	Convertible	Non-convertible	Non-convertible	Non-convertible
24	If convertible, conversion trigger(s)	Contractual - CET1 <7%	N/a	N/a	N/a
25	If convertible, fully or partially	Fully	N/a	N/a	N/a
26	If convertible, conversion rate	One for every £67 held	N/a	N/a	N/a
27	If convertible, mandatory or optional	Mandatory	N/a	N/a	N/a

	conversion				
28	Specify output instrument	CCDS	N/a	N/a	N/a
29	Specify issuer of output instrument	Coventry	N/a	N/a	N/a
30	Write-down features	Contractual: none; statutory: via bail-in	Contractual: none; statutory: via bail-in	Contractual: none; statutory: via bail-in	Contractual: none; statutory: via bail-in
31-34	If w/d, trigger(s), full/partial, PWD/TWD	N/a	N/a	N/a	N/a
35	Instrument type immediately senior	Sub Debt	Sub Debt	Senior Unsecured	Senior Unsecured
36	Non-compliant transitioned features	No	Yes	Yes	Yes
37	If yes, specify non-compliant features	N/a	No contractual write-down or conversion	Step-up reset rate	Step-up reset rate

Further information on Perpetual Capital Securities and PIBS is available on the Society's website (www.coventrybuildingsociety.co.uk/consumer/our-performance/treasury-services). Further information on the immaterial Tier 2 subordinated debt is available on request.

Appendix 3: Asset Encumbrance Disclosure Template

The templates below are as prescribed in updated EBA Guideline EBA/RTS/2017/03 on disclosure of encumbered and unencumbered assets. Prior year disclosures have been restated following a review of the requirements during 2019.

In all tables, the values reflect the median of the sums of the of the four quarter end-of-period values over the previous 12 months as prescribed by the EBA and therefore differ from encumbrance disclosures in the Accounts that are based on year end balances.

Template A – Encumbered and unencumbered assets

2019		Carrying amount of encumbered assets £m	of which notionally eligible EHQLA and HQLA £m	Fair value of encumbered assets £m	of which notionally eligible EHQLA and HQLA £m	Carrying amount of unencumbered assets £m	of which notionally eligible EHQLA and HQLA £m	Fair value of unencumbered assets £m	of which notionally eligible EHQLA and HQLA £m
		010	030	040	050	060	080	090	100
010	Assets of the reporting institution	12,018.2	316.5			36,714.0	5,719.5		
030	Equity instruments	–	–			4.0	–		
040	Debt securities	316.5	316.5	316.5	–	804.0	793.5	803.5	793.5
050	of which: covered bonds	–	–	–	–	166.1	166.1	166.1	166.1
060	of which: asset backed securities	–	–	–	–	10.5	–	9.5	–
070	of which: issued by general government	316.5	316.5	316.5	–	479.4	479.4	479.4	479.4
080	of which: issued by financial corporations	–	–	–	–	10.5	–	9.5	–
120	Other assets[1]	11,607.6	–			35,773.5	4,816.5		

1. All remaining balance sheet assets, predominantly loans and advances to customers.

2018		Carrying amount of encumbered assets £m	of which notionally eligible EHQLA and HQLA £m	Fair value of encumbered assets £m	of which notionally eligible EHQLA and HQLA £m	Carrying amount of unencumbered assets £m	of which notionally eligible EHQLA and HQLA £m	Fair value of encumbered assets £m	of which notionally eligible EHQLA and HQLA £m
		010	030	040	050	060	080	090	100
010	Assets of the reporting institution	10,278.0	545.8[3]			34,351.9	5,391.4[3]		
030	Equity instruments					2.9	–		
040	Debt securities[1]	545.8	545.8	545.8	545.8	388.6	380.4	387.6	380.4
050	of which: covered bonds[1]	4.1	4.1	4.1	4.1	4.1	4.1	4.1	4.1
060	of which: asset backed securities[1]	–	–	–	–	8.3	–	7.3	–
070	of which: issued by general government	541.6	541.6	541.6	541.6	312.9	312.9	312.9	312.9
080	of which: issued by financial corporations[1]	–	–	–	–	8.3	–	7.3	–
120	Other assets[2]	9,946.9	–[3]			34,054.0	5,011.0[3]		

1. 2018 amounts have been restated following a review of requirements and classifications performed in 2019.

2. All remaining balance sheet assets, predominantly loans and advances to customers.

3. 2018 balance has been restated. The 2018 balances included encumbered assets which are central bank eligible but do not meet the classification of EHQLA and HQLA.

Template B - Collateral received

The EBA Guidelines allow competent authorities to waive the requirement to disclose Template B – Collateral received and in Supervisory Statement SS 6/17 the PRA waived the Template B requirement subject to a firm meeting certain criteria. The Society meets the criteria and therefore Template B is not disclosed.

Template C – Encumbered assets/collateral received and associated liabilities

2019		Matching liabilities, contingent liabilities or securities lent £m	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m
		010	030
010	Carrying amount of selected financial liabilities	**7,716.1**	**11,405.6**
2018			
010	Carrying amount of selected financial liabilities	6,948.2	10,006.5

Template D – Information on importance of encumbrance

The most material sources of encumbrance for the Society are secured funding via the Society's covered bond and securitisation programmes which are supported by pledging mortgage assets. The Society has also utilised whole mortgage pools with the Bank of England to secure amounts drawn down under the Term Funding Scheme (TFS). Further detail on these activities is set out in note 16 to the 2019 Accounts. Assets are encumbered in accordance with the contractual requirements of these programmes. Furthermore, these programmes are continually assessed and a prudent buffer of over-collateralisation is voluntarily maintained for operational efficiency. The underlying assets and cover pool assets related to any securities retained by the Society are treated as unencumbered in both this disclosure and in the Accounts.

The Society also pledges debt securities as collateral in sale and repurchase transactions – see note 15 to the 2019 Accounts.

An additional source of encumbrance is the collateralisation of derivatives liabilities. The Society also treats some cash and balances with the Bank of England, some loans and advances to credit institutions and some debt securities as encumbered even though there are no associated liabilities. An example of this would be liquid assets held within the Society's covered bond and securitisation programmes as these are not available for use in the Society's day-to-day operations.

Encumbrance is not undertaken in any other currency other than sterling.

At the year end encumbered assets are predominantly all on the Society's own balance sheet other than around £0.2 billion of mortgage assets (2018: £0.2 billion) from its subsidiary Godiva Mortgages Limited and the liquid assets held within the Society's covered bond and securitisation programmes referenced above.

The over collateralisation of £3.7 billion in Template C (2018: £3.1 billion) predominantly represents over-collateralisation in respect of covered bonds, securitisations and whole mortgage pool operations.

The Society manages its levels of encumbrance in accordance with Board approved limits.

A general description of the terms and conditions of the collateralisation agreements entered into for securing liabilities are available in the 2019 Accounts as follows; for sale and repurchase transactions of debt securities in note 15; for covered bonds, securitisation and whole mortgage pools in note 16; and for derivatives in note 24.

Appendix 4: Leverage Ratio – Disclosure Templates

Reference date	31 December 2019 (31 December 2018 for comparatives)
Entity name	Coventry Building Society
Level of application	Consolidated

Template A: Table LRSum - Summary reconciliation of accounting assets and leverage ratio exposure

		Applicable Amount	
		2019 £m	2018 £m
1	Total assets as per published financial statements	**49,530.8**	46,070.9
4	Adjustments for derivative financial instruments	**51.6**	(39.8)
5	Adjustments for securities financing transactions "SFTs"	**1,817.5**	1,711.1
6	Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	**345.4**	358.9
7	Other adjustments	**(240.0)**	(155.1)
8	**Total leverage exposure**	**51,505.3**	47,946.0

Template B - Table LRCom: Leverage ratio common disclosures

		CRR leverage ratio exposures	
		2019 £m	2018 £m
	On balance sheet exposures (excluding derivatives and SFTs)		
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	**49,392.9**	45,802.0
2	(Asset amounts deducted in determining Tier 1 capital)	**(75.4)**	(75.0)
3	**Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets) (sum of lines 1 and 2)**	**49,317.5**	45,727.0
	Derivative exposures		
4	Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	**39.4**	82.2
5	Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	**150.1**	146.9
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	**(164.7)**	(80.1)
11	**Total derivative exposures (sum of lines 4 to 10)**	**24.8**	149.0
	Securities financing transaction exposures		
14	Counterparty credit risk exposure for SFT assets	**1,817.5**	1,711.1
16	**Total securities financing transaction exposures (sum of lines 12 to 15a)**	**1,817.5**	1,711.1
	Other off-balance sheet exposures		
17	Off-balance sheet exposures at gross notional amount	**1,675.9**	1,737.5
18	(Adjustments for conversion to credit equivalent amounts)	**(1,330.4)**	(1,378.6)
19	**Other off-balance sheet exposures (sum of lines 17 to 18)**	**345.5**	358.9
	Capital and total exposures		
20	Tier 1 capital	**2,106.0**	2,011.7
21	**Total leverage ratio exposures (sum of lines 3, 11, 16, 19, EU-19a and EU-19b)**	**51,505.3**	47,946.0
	Leverage ratio		
22	**Leverage ratio**	**4.4%**	4.2%
	Choice on transitional arrangements and amount of derecognised fiduciary items		
EU-23	Choice on transitional arrangements for the definition of the capital measure	**Fully phased in**	Fully phased in

Template C: Table LRSpl: - Split-up of on balance sheet exposures (excluding derivatives, SFTs and exempt exposures)

		CRR leverage ratio exposures	
		2019 £m	2018 £m
EU-1	Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	**49,392.9**	45,802.0
EU-3	Banking book exposures, of which:	**49,392.9**	45,802.0
EU-4	Covered bonds	**242.7**	8.2
EU-5	Exposures treated as sovereigns	**5,736.0**	5,886.1
EU-6	Exposures to regional governments, MDB, international organisations and PSE not treated as sovereigns	**165.5**	75.1
EU-7	Institutions	**672.3**	406.0
EU-8	Secured by mortgages of immovable properties	**42,356.4**	39,233.0
EU-9	Retail exposures	**19.6**	23.3
EU-10	Corporate	**1.6**	1.5
EU-11	Exposures in default (standardised)	**6.3**	6.7
EU-12	Other exposures (e.g. equity, securitisations, and other non-credit obligation assets)	**192.5**	162.1

Template D: Table LRQua – Qualitative information on risk of excessive leverage and factors impacting the leverage ratio

1: Description of the processes used to manage the risk of excessive leverage

How the Society manages the risk of excessive leverage is set out in section 3.4 Leverage ratio.

The maximum theoretical CRR leverage ratio requirement is 3.0%. The Board is confident that the Society will meet this requirement with an appropriate level of headroom.

2: Description of the factors that had an impact on the leverage Ratio during the period to which the disclosed leverage Ratio refers

The leverage ratio has remained broadly stable at 4.1% (2018: 4.2%) as the increase in eligible Tier 1 capital was matched by a slightly larger relative increase in leverage ratio exposures, largely driven by the growth in the mortgage book. This reflects the Society's strategy to remain low risk whilst retaining only sufficient profits to support leverage ratio at required levels.

Appendix 5: Countercyclical Capital Buffers - Disclosure Templates

The countercyclical buffer is an additional requirement introduced by CRD IV, calculated by applying a weighted average of country countercyclical buffer rates based on the geographical distribution of relevant exposures to the overall capital requirements of the Society. The following templates disclose information relevant for the calculation of the countercyclical buffer as at 31 December 2019 in accordance with Regulation (EU) 2015/1555 on a consolidated basis.

Template A: Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer

In accordance with Regulation (EU) 1152/2014, as foreign credit exposures represent less than 2% of the Society's aggregate risk weighted exposures, all exposures have been allocated to the UK. Exposures are as defined in Regulation (EU) 2015/1555 and in particular exclude exposures to sovereigns and supranationals.

Table 1: Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer

2019		General credit exposures		Trading book exposures		Securitisation exposures		Own funds requirements					
Row		Exposure value for SA	Exposure value for IRB	Sum of long and short positions of trading book	Value of trading book exposures for internal models	Exposure value for SA	Exposure value for IRB	Of which: General credit exposures	Of which: Trading book exposures	Of which: Securitisation exposures	Total	Own fund requirement weights	Countercyclical capital buffer rate
		010	020	030	040	050	060	070	080	090	100	110	120
		£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	Weighting	%
010	**Breakdown by country UK**	**1,322.6**	**45,437.9**	**–**	**–**	**20.3**	**–**	**368.8**	**–**	**0.2**	**369.0**	**1.0**	**1%**
020	**Total**	**1,322.6**	**45,437.9**	**–**	**–**	**20.3**	**–**	**368.8**	**–**	**0.2**	**369.0**	**1.0**	**1%**

2018		General credit exposures		Trading book exposures		Securitisation exposures		Own funds requirements					
Row		Exposure value for SA	Exposure value for IRB	Sum of long and short positions of trading book	Value of trading book exposures for internal models	Exposure value for SA	Exposure value for IRB	Of which: General credit exposures	Of which: Trading book exposures	Of which: Securitisation exposures	Total	Own fund requirement weights	Countercyclical capital buffer rate
		010	020	030	040	050	060	070	080	090	100	110	120
		£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	Weighting	%
010	**Breakdown by country UK**	785.0	42,274.4	–	–	8.2	–	311.0	–	0.1	311.1	1.0	1%
020	**Total**	785.0	42,274.4	–	–	8.2	–	311.0	–	0.1	311.1	1.0	1%

Table 2: Amount of institution specific countercyclical capital buffer

Row		2019 Column	Restated 2018 Column
		010	010
010	**Total risk exposure amount**	**£5,283.6m**	£4,760.7m
020	**Institution specific countercyclical buffer rate**	**1%**	1%
030	**Institution specific countercyclical buffer requirement**	**£52.8m**	£47.6m

Appendix 6: Non-performing and forborne exposures

Gross carrying amount of forborne exposures and the related accumulated impairment, provisions, accumulated change in fair value due to credit risk, and collateral and financial guarantees received, according to the scope of regulatory consolidation in accordance with Chapter 2 of Title II of Part One of the CRR.

The Society's non-performing and forborne exposures are only associated to its Loans and advances. Overall movements year on year within all tables shown below reflect the growth of the book and low levels of arrears and impairment. These movements have been explained within section 5.

Template 1: Credit quality of forborne exposures

2019		**Gross carrying amount/nominal amount of exposures with forbearance measures**				**Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions**		**Collateral received and financial guarantees received on forborne exposures**	
			Non-performing forborne						
Row		**Performing forborne £m**	**£m**	**Of which defaulted £m**	**Of which impaired £m**	**On performing forborne exposures £m**	**On non-performing forborne exposures £m**	**£m**	**Of which collateral and financial guarantees received on non-performing exposures with forbearance measures £m**
1	**Loans and advances**	**4.9**	**3.4**	**0.3**	**2.3**	**–**	**–**	**8.3**	**3.4**
7	***Households***	**4.9**	**3.4**	**0.3**	**2.3**	**–**	**–**	**8.3**	**3.4**
9	**Loan commitments given**	**0.1**	**–**	**–**	**–**	**–**	**–**	**0.1**	**–**
10	***Total***	**5.0**	**3.4**	**0.3**	**2.3**	**–**	**–**	**8.4**	**3.4**

2018		Gross carrying amount/nominal amount of exposures with forbearance measures				Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions		Collateral received and financial guarantees received on forborne exposures	
			Non-performing forborne						
Row		Performing forborne £m	£m	Of which defaulted £m	Of which impaired £m	On performing forborne exposures £m	On non-performing forborne exposures £m	£m	Of which collateral and financial guarantees received on non-performing exposures with forbearance measures £m
1	Loans and advances	5.5	4.6	0.7	3.3	–	(0.1)	10.1	4.6
7	*Households*	5.5	4.6	0.7	3.3	–	(0.1)	10.1	4.6
9	Loan commitments given	–	0.1	–	0.1	–	–	0.1	0.1
10	*Total*	5.5	4.7	0.7	3.4	–	(0.1)	10.2	4.7

Template 3: Credit quality of performing and non-performing exposures by past due days

2019		**Gross carrying amount/nominal amount**											
		Performing exposures			**Non-performing exposures**								
Row		**£m**	**Not past due or past due ≤ 30 days £m**	**Past due > 30 days ≤ 90 days £m**	**£m**	**Unlikely to pay that are not past due or are past due ≤ 90 days £m**	**Past due > 90 days ≤ 180 days £m**	**Past due > 180 days ≤ 1 year £m**	**Past due > 1 year ≤ 2 years £m**	**Past due > 2 years ≤ 5 years £m**	**Past due > 5 years ≤ 7 years £m**	**Past due > 7 years £m**	**Of which defaulted £m**
1	**Loans and advances**	**41,971.4**	**41,877.2**	**94.2**	**197.6**	**130.6**	**41.2**	**18.1**	**5.6**	**2.1**	**–**	**–**	**34.5**
6	***Non-financial corporations***	**1.6**	**1.6**	**–**	**0.4**	**0.4**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
7	***Of which SMEs***	**1.6**	**1.6**	**–**	**0.4**	**0.4**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
8	***Households***	**41,969.8**	**41,875.6**	**94.2**	**197.2**	**130.3**	**41.2**	**18.1**	**5.6**	**2.1**	**–**	**–**	**34.5**
15	**Off-balance-sheet exposures**	**1,675.5**			**0.4**								**–**
21	***Households***	**1,675.5**			**0.4**								**–**
22	***Total***	**43,646.9**	**41,877.2**	**94.2**	**198.0**	**130.6**	**41.2**	**18.1**	**5.6**	**2.1**	**–**	**–**	**34.5**

2018		Gross carrying amount/nominal amount											
		Performing exposures			Non-performing exposures								
Row		£m	Not past due or past due ≤ 30 days £m	Past due > 30 days ≤ 90 days £m	£m	Unlikely to pay that are not past due or are past due ≤ 90 days £m	Past due > 90 days ≤ 180 days £m	Past due > 180 days ≤ 1 year £m	Past due > 1 year ≤ 2 years £m	Past due > 2 years ≤ 5 years £m	Past due > 5 years ≤ 7 years £m	Past due > 7 years £m	Of which defaulted £m
1	Loans and advances	38,982.7	38,897.1	85.6	209.0	135.7	46.3	17.7	7.2	1.8	–	0.4	38.3
6	*Non-financial corporations*	1.8	1.8	–	0.4	0.4	–	–	–	–	–	–	–
7	*Of which SMEs*	1.8	1.8	–	0.4	0.4	–	–	–	–	–	–	–
8	*Households*	38,980.9	38,895.3	85.6	208.6	135.3	46.3	17.7	7.2	1.8	–	0.4	38.3
15	Off-balance-sheet exposures	1,737.2			0.4								–
21	*Households*	1,737.2			0.4								–
22	*Total*	40,719.9	38,897.1	85.6	209.4	135.7	46.3	17.7	7.2	1.8	–	0.4	38.3

Template 4: Performing and non-performing exposures and related provisions

2019		Gross carrying amount/nominal amount						Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions						Accumulated partial write-off	Collateral and financial guarantees received	
		Performing exposures			Non-performing exposures			Performing exposures – accumulated impairment and provisions			Non-performing exposures – accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions					
Row		£m	Of which stage 1 £m	Of which stage 2 £m	£m	Of which stage 2 £m	Of which stage 3 £m	£m	Of which stage 1 £m	Of which stage 2 £m	£m	Of which stage 2 £m	Of which stage 3 £m	£m	On performing exposures £m	On non-performing exposures £m
1	Loans and advances	41,971.4	40,892.9	1,078.5	197.6	0.1	197.3	(4.2)	(1.0)	(3.2)	(7.8)	–	(7.7)	–	41,854.9	191.7
6	*Non-financial corporations*	*1.6*	–	*1.6*	*0.4*	–	*0.4*	*(0.2)*	–	*(0.2)*	*(0.2)*	–	*(0.2)*	–	*1.4*	*0.2*
7	*Of which SMEs*	*1.6*	–	*1.6*	*0.4*	–	*0.4*	*(0.2)*	–	*(0.2)*	*(0.2)*	–	*(0.2)*	–	*1.4*	*0.2*
8	*Households*	*41,969.8*	*40,892.9*	*1,076.9*	*197.2*	0.1	*197.0*	(4.0)	*(1.0)*	*(3.0)*	*(7.6)*	–	*(7.5)*	–	*41,853.4*	*191.5*
15	Off-balance-sheet exposures	1,675.5	1,672.1	3.4	0.4	–	0.4	–	–	–	–	–	–		31.5	0.4
21	*Households*	*1,675.5*	*1,672.1*	*3.4*	*0.4*	–	*0.4*	–	–	–	–	–	–		*31.5*	*0.4*
22	Total	43,646.9	42,565.0	1,081.9	198.0	0.1	197.7	(4.3)	(1.0)	(3.2)	(7.8)	–	(7.7)	–	41,886.4	192.1

2018		Gross carrying amount/nominal amount						Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions						Accumulated partial write-off	Collateral and financial guarantees received	
		Performing exposures			Non-performing exposures			Performing exposures – accumulated impairment and provisions			Non-performing exposures – accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions					
Row		£m	Of which stage 1 £m	Of which stage 2 £m	£m	Of which stage 2 £m	Of which stage 3 £m	£m	Of which stage 1 £m	Of which stage 2 £m	£m	Of which stage 2 £m	Of which stage 3 £m	£m	On performing exposures £m	On non-performing exposures £m
1	Loans and advances	38,982.7	37,853.3	1,129.5	209.0	0.1	208.6	(5.3)	(1.4)	(3.9)	(6.3)	–	(6.3)	–	38,851.9	200.7
6	*Non-financial corporations*	*1.8*	–	*1.8*	*0.4*	–	*0.4*	*(0.5)*	–	*(0.5)*	*(0.3)*	–	*(0.3)*	–	*1.3*	*0.2*
7	*Of which SMEs*	*1.8*	–	*1.8*	*0.4*	–	*0.4*	*(0.5)*	–	*(0.5)*	*(0.3)*	–	*(0.3)*	–	*1.3*	*0.2*
8	*Households*	*38,980.9*	*37,853.3*	*1,127.6*	*208.6*	*0.1*	*208.2*	(4.8)	*(1.4)*	*(3.4)*	*(6.0)*	–	*(6.0)*	–	*38,850.5*	*200.5*
15	Off-balance-sheet exposures	1,737.2	1,735.9	1.3	0.4	–	0.4	0.1	0.1	–	–	–	–		40.6	0.3
21	*Households*	*1,737.2*	*1,735.9*	*1.3*	*0.4*	–	*0.4*	*0.1*	*0.1*	–	–	–	–		*40.6*	*0.3*
22	Total	40,719.9	39,589.2	1,130.7	209.4	0.1	209.0	(5.3)	(1.5)	(3.9)	(6.3)	–	–	–	38,892.4	200.9

Template 9: Collateral obtained by taking possession and execution processes

		2019		2018	
		Collateral obtained by taking possession		Collateral obtained by taking possession	
		Value at initial recognition £m	**Accumulated negative changes £m**	Value at initial recognition £m	Accumulated negative changes £m
3	*Residential immovable property*	**5.60**	**0.40**	8.50	2.00
8	***Total***	**5.60**	**0.40**	8.50	2.00

Appendix 7: Abbreviated Liquidity Coverage Ratio (LCR) disclosures

This Appendix sets out abbreviated Liquidity Coverage Ratio (LCR) disclosures in the format prescribed in European Banking Authority Guidelines (EBA/GL/2017/01).

The LCR is 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. A binding minimum LCR of 100% applied to the Society from 1 January 2018.

These disclosures complement the disclosure of liquidity risk management under the CRR which are included in the Accounts Risk Management Report in the Liquidity and Funding risk section.

As prescribed by the EBA Guidelines:

- The Liquidity buffer represents the amount of the Society's liquidity resources for regulatory purposes. Substantially all of the Society's liquidity buffer is made of up balances with the Bank of England.
- The Total net cash outflow represents the total expected cash outflow on a stressed basis minus total expected contractual cash inflows for the subsequent 30 days.
- The values at each quarter end date are a simple average of month-end observations over the 12 months preceding the end of each quarter.

Liquidity Coverage Ratio (LCR) 2019

	12 month average			
	31-Mar-19	30-Jun-19	30-Sep-19	31-Dec-19
	£m	£m	£m	£m
Liquidity buffer	5,020.3	5,339.7	5,522.5	5,562.0
Total net cash outflow	2,519.1	2,453.2	2,591.9	2,640.6
Liquidity Coverage Ratio (LCR)	200%	218%	214%	212%

Throughout the year the Society has continued to meet all its internal and regulatory liquidity requirements.

Liquidity Coverage Ratio (LCR) 2018

	12 month average			
	31-Mar-18	30-Jun-18	30-Sep-18	31-Dec-18
	£m	£m	£m	£m
Liquidity buffer	5,097.1	5,056.3	5,192.7	5,244.4
Total net cash outflow	2,680.2	2,687.7	2,639.7	2,632.6
Liquidity Coverage Ratio (LCR)	192%	189%	198%	201%

Glossary

The following glossary defines terminology within the Pillar 3 disclosures to assist the reader and to facilitate comparison with publications by other institutions:

Accounts	The Society's Annual Report & Accounts
Additional Tier 1 (AT 1) capital	Capital that meets certain criteria set out in CRD IV. In particular, the criteria require that upon the occurrence of a trigger event, the AT 1 capital instrument converts to a form of Common Equity Tier 1 capital or the principal is written down on a permanent basis; or grandfathered instruments such as Permanent Interest Bearing Shares (PIBS).
Arrears	The financial value of unpaid obligations, which arise when contractual payments are not paid as they fall due.
Average loan to value	The average of individual loan to values (simple average). The average loan to value of the residential mortgage book, weighted by balance (balance weighted). For indexed loan to value – see 'Indexed loan to value'.
Basel III	The Basel Committee on Banking Supervision issued proposals for a strengthened capital regime in response to the financial crisis, which are referred to as Basel III. These standards were implemented in the European Union via CRD IV, which came into force on 1 January 2014.
Basel IV	The alternative industry name given to the Basel Committee's final implementation of its Basel III Banking Supervision reforms published in December 2017 addressing credit risk (standardised approach with floors, and IRB), operational risk, and the leverage ratio. They are applicable from January 2022 and are phased in over five years.
Buy to let mortgage	A mortgage secured on a residential property that is rented out to tenants.
Capital Conservation Buffer (CCoB)	A CRD IV risk adjusted capital requirement for all banks that can be used to absorb losses whilst avoiding breaching minimum capital requirements.
Capital requirements	Amount of capital required to be held by the Group to cover the risk of losses and to protect against excessive leverage. The level is set by regulators and the firm's own assessment of its risk profile.

Capital Requirements Regulation and Capital Requirements Directive IV (CRD IV)	CRD IV is the European Union legislation (part regulation and part directive) which came into force from 1 January 2014 to implement Basel III, revising the capital requirements framework and introducing liquidity requirements, which regulators use when supervising firms.
Capital Requirements Regulations (CRR) leverage ratio	A ratio defined by the Capital Requirement Regulations (CRR) which measures Tier 1 capital as a proportion of total CRR leverage ratio exposures. These exposures are the sum of the on-balance sheet exposures, adjusted for derivatives and securities financing transaction exposures, and off-balance sheet items.
Capital resources	Capital comprising the general reserve, fair value through other comprehensive income (FVOCI) reserve, Additional Tier 1 capital less all required regulatory adjustments.
Central clearing	The process by which parties to an OTC derivative contract replace this with a separate contract with a central counterparty, which takes over each party's positions under the original contract.
Collateral	Security pledged by the borrower to the lender in case of default
Common Equity Tier 1 (CET 1) capital	Common Equity Tier 1 capital comprises general reserves and the fair value through other comprehensive income (FVOCI) reserve, less regulatory deductions. Common Equity Tier 1 must absorb losses on a going concern basis.
Common Equity Tier 1 ratio	Common Equity Tier 1 capital as a percentage of risk weighted assets.
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 form of Common Equity Tier 1 (CET 1) capital. The Society's Perpetual Capital Securities (PCS) convert into CCDS at the rate of one CCDS for every £67 PCS held if the end-point CET 1 ratio, calculated on either an individual or consolidated basis, falls below 7%.
Countercyclical Buffer (CCyB)	A CRD IV risk adjusted capital requirement for all banks that is varied over the financial cycle to match the resilience of the banking system to the scale of risks faced.
Countercyclical Leverage Buffer (CCLB)	A leverage capital requirement under the UK leverage regime that is set at 35% of the corresponding risk adjusted Countercyclical Buffer (CCyB).
Counterparty credit risk	Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.

Covered bonds	Debt securities that are backed by both the resources of the issuer and 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 quality step	A credit quality assessment scale as set out in CRD IV.
Credit risk	The risk that borrowers or counterparties do not meet their financial obligations to the Society as they fall due. Within this class, the Society considers risks arising from retail credit risk and treasury credit risk to be individual Principal risk categories.
Credit risk mitigation	Techniques used to reduce the potential loss in the event that a customer (borrower or counterparty) becomes unable to meet its obligations. This may include the taking of financial or physical security, set off or netting.
Credit valuation adjustment	An adjustment to the valuation of financial instruments held at fair value to reflect the creditworthiness of the counterparty.
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	Liabilities of the Group that are transferable by external investors that operate within the global financial markets.
Default	Circumstances in which the probability of default is taken as 100% for the purposes of the calculation of regulatory capital and compliance with CRD IV. This is defined as when an account reaches a pre-defined past due status or where, on accounts that are up to date or in arrears by less than the pre-defined status, certain unlikeliness to pay indicators have been met. The unlikeliness to pay indicators are those that the Society has determined as having a higher propensity to eventually reaching the pre-define arrears status.
Deferred tax asset/(liability)	Corporation tax recoverable (or payable) in future periods as a result of the carry-forward of tax losses or unused tax credits, or from deductible (or taxable) temporary differences between the accounting value of assets and liabilities and the tax base of those assets and liabilities.
Derivative financial instrument	A contract or agreement which derives its value or cash flows from changes in an underlying index such as an interest rate, foreign exchange rate or market index. The most common type of derivative instruments are interest rate swaps.
EEA parent institution	A parent financial institution situated in a Member State of the European Economic Area which is not a subsidiary of another financial institution also situated in the EEA.

Encumbered assets	Assets used to secure liabilities or otherwise pledged. This excludes loans and advances to customers that, although technically encumbered, are held in respect of undrawn self-issued notes under the Group's covered bond and securitisation programmes.
End-point	Full implementation of regulation (for example, CRD IV) with no transitional provisions.
Enterprise Risk Management Framework (ERMF)	A Board approved framework which provides the context, guidance and principles needed for cohesive risk management activity across the Society and its subsidiaries.
European Banking Authority (EBA)	An independent European Union authority which works to ensure effective and consistent financial regulation and supervision across the European banking sector.
Expected credit loss (ECL)	The present value of all cash shortfalls over the expected life of the financial instrument. The term is used for the accounting for impairment provisions under the new IFRS 9 standard.
ECL – 12 month	Cash shortfalls resulting from default events that are possible in the next 12 months weighted by the probability of that default occurring.
ECL - lifetime	Cash shortfalls resulting from default events that are possible over the remaining expected life of the loan, weighted by the probability of that default occurring.
Expected loss	A calculation under the IRB approach to estimate the potential losses on current exposures due to expected defaults over a 12 month time period.
Exposure	The quantified potential for loss that might occur as a result of a risk occurring.
Exposure at Default (EAD)	A parameter used in IRB approaches and under IFRS 9 to estimate the amount outstanding at the time of default.
External Credit Assessment Institution (ECAI)	An ECAI (e.g. Moody's, Standard and Poor's and Fitch) is an institution that assigns credit ratings to issuers of certain types of debt obligations as well as the debt instruments themselves.
Fair value	The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date.

Fair value through other comprehensive income (FVOCI) reserve	Financial assets held at fair value on the Balance Sheet with changes on the fair value recognised through other comprehensive income.
Financial Conduct Authority (FCA)	A statutory body responsible for the conduct of business regulation and supervision of UK financial institutions in the UK.
Financial Policy Committee (FPC)	A committee based at the Bank of England, charged with identifying, monitoring and taking action to reduce or remove systemic risks with a view to protect and enhance the resilience of the UK financial system. It is also responsible for supporting the economic policy of the UK Government.
Fitch	A credit rating agency which provides credit ratings and research covering financial institutions and governments and their debt instruments and securities.
Forbearance	Forbearance takes place when a concession, which can be temporary or permanent, is made on the contractual terms of a loan in response to the borrower's financial difficulties.
General reserve	The general reserve is the accumulation of historical and current year profits and includes remeasurements of the defined benefit pension plan and distributions to holders of Perpetual Capital Securities (net of tax).
Gilts Government investment securities (gilts)	The name given to long-term fixed income debt securities (bonds) issued by the UK Government.
IFRS/IAS	International Financial Reporting Standards/ International Accounting Standards. A set of international accounting standards stating how particular types of transactions and other disclosures should be reported in financial statements.
Impaired loans	Impaired loans are defined as those which are defaulted loans in IFRS 9 stage 3.
Impairment provision	Expected Credit Losses (ECL) held under IFRS 9 – see ECL glossary definition.
Indexed loan to value	Loan to value calculated on the basis of the latest property valuation being adjusted by the relevant House Price Index movement since that date.
Interest rate swap	A contract under which two counterparties agree to exchange periodic interest payments based on a predetermined notional principal amount.

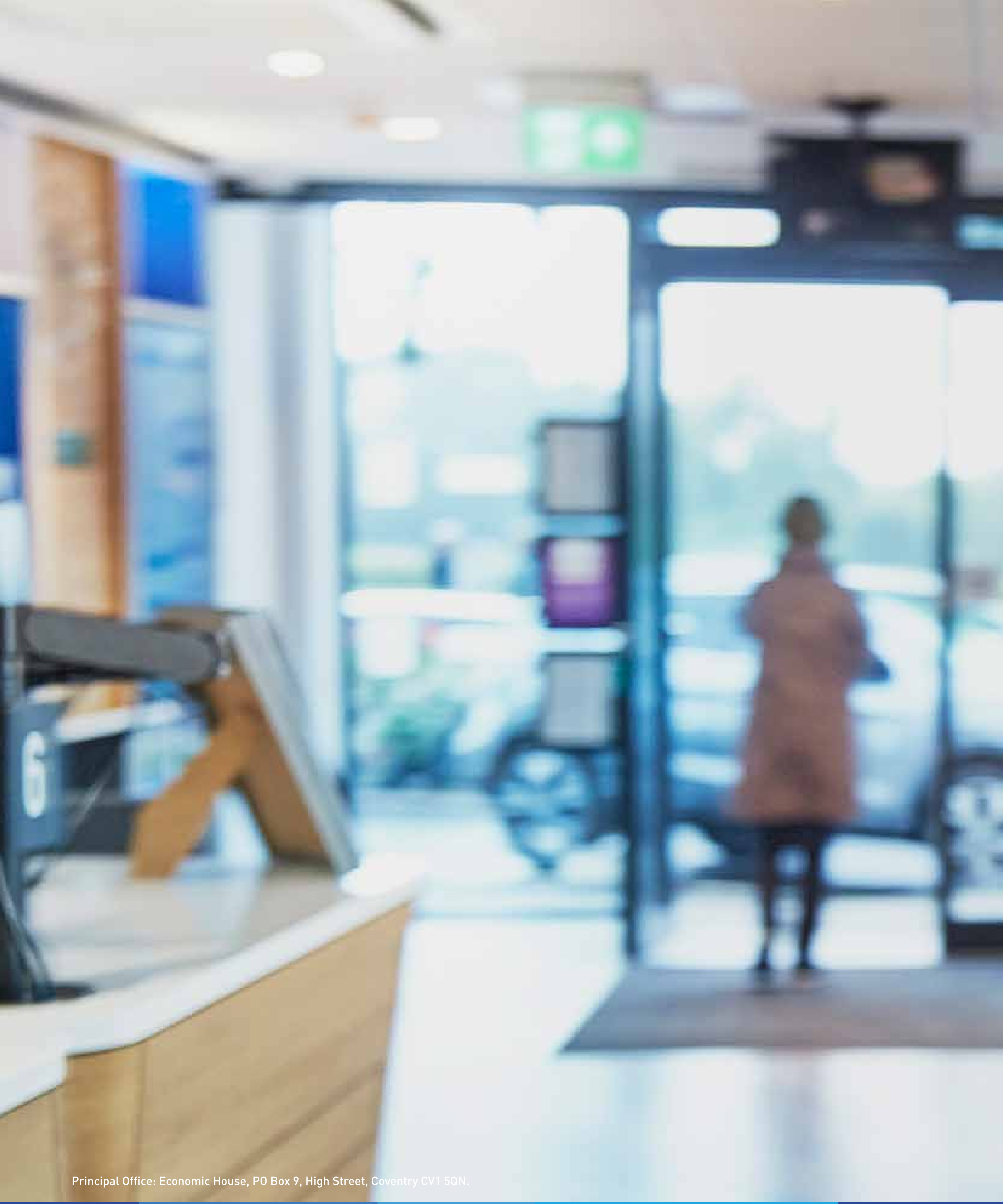
Internal Capital Adequacy Assessment Process (ICAAP)	The Society's own assessment of the amount of capital that it needs to hold to support all relevant current and future risks. This assessment includes determination of a number of capital buffers to be held in case of potential future economic stress, and provides confirmation that the Society has appropriate processes in place to ensure compliance with regulatory requirements.
Internal Liquidity Adequacy Assessment Process (ILAAP)	The Society's own assessment of the liquidity resources that are required 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.
Internal Ratings-Based (IRB) approach	An advanced approach to measuring capital requirements in respect of credit risk under Pillar 1. The IRB approach may only be used with permission from the PRA.
ISDA	International Swaps and Derivatives Association is the global trade association for over-the-counter (OTC) derivatives and providers of the industry-standard documentation for derivative transactions.
Leverage ratio	A calculation brought in as part of CRD IV which measures the relationship between eligible Tier 1 capital and exposures to on and off-balance sheet items. There are two bases of calculation – see Capital Requirements Regulations (CRR) leverage ratio and UK leverage ratio.
Liquidity Coverage Ratio (LCR)	A measure brought in as part of CRD IV 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	The amount of mortgage loan as a percentage of the value of the property.
Loss Given Default (LGD)	A parameter used under IRB approaches and IFRS 9 to estimate the difference between exposure at default (EAD) and the net amount of the expected recovery expressed as a percentage of EAD.
Member	A person who holds a share in the Society or has a mortgage loan with the Society.
Minimum requirement for own funds and eligible liabilities (MREL)	A requirement under the Bank Recovery and Resolution Directive (BRRD) which requires deposit takers to hold minimum levels of capital plus debt eligible for bail-in.
Moody's	Moody's Investor Services is a credit rating agency which provides credit ratings and research covering financial institutions and governments and their debt instruments and securities.
Mortgage backed securities	Asset backed securities that represent interests in a group of mortgages which give the investor the right to cash received from future mortgage payments of both principal and interest.

Near-prime	Loans to borrowers with marginally weakened credit histories such that their credit risk is greater than 'prime' customers, but is not considered heavily adverse.
Netting	The ability to reduce credit risk exposures through entering into ISDA master netting agreements (whereby outstanding transactions with the same party can be settled net following a default or other predetermined event) and the receipt of financial collateral.
Output floor	A future requirement of Basel IV that sets a floor on the determination of risk weights. The floor will be a proportion of the standardised approach and will be phased in for firms using IRB models.
Over-the-counter (OTC)	Contracts that are traded (and privately negotiated) directly between two parties without going through an exchange or other intermediary. They offer flexibility because, unlike standardised exchange-traded products, they can be tailored to fit specific needs.
Owner-occupier mortgage	A mortgage on residential property that is to be occupied by the borrower.
Past due	A financial asset such as a loan is past due when the counterparty has failed to make a payment when contractually due.
Permanent Interest Bearing Shares (PIBS)	Unsecured, perpetual deferred shares of the Society offering a fixed coupon. PIBS rank equally with each other and Perpetual Capital Securities. They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than Perpetual Capital Securities) as to principal and interest. Under Basel III PIBS are included as Tier 1 under transitional rules only.
Perpetual Capital Securities (PCS)	Securities that pay a non-cumulative coupon at the discretion of the Society. They rank equally with each other and Permanent Interest Bearing Shares (also AT 1 capital) but behind all other creditors of the Society, including subordinated liabilities and the claims of Shareholding Members (other than Permanent Interest Bearing Shares), as to principal and interest.
Pillar 1	The part of the Basel Framework which sets out the regulatory minimum capital requirements for credit, market and operational risk.
Pillar 2	The part of the Basel Framework which sets out the processes by which financial institutions review their overall capital adequacy. Supervisors then evaluate how well financial institutions are assessing their risks and take appropriate actions in response to the assessments. This includes all risks (including Pillar 1 risks) – TCR (see below) is an outcome of Pillar 2.
Pillar 3	The part of the Basel Framework which sets out the disclosure requirements for firms to publish details of their risks, capital and risk management. The aims are greater transparency and strengthening market discipline.

Point in Time (PiT)	A modelling approach which assesses the credit risk of an exposure at a single point in time.
PRA Buffer	A buffer to ensure that banks that are more at risk of loss than the system in aggregate have additional capital buffers to reflect that risk.
Principal risk	Principal risk is a class of significant inherent risk which could materially compromise the Society's ability to grow and provide attractive products to savings and borrowing members.
Probability of Default (PD)	An estimate of the probability that a borrower will default on their credit obligations over a fixed time period. With respect to impairment provisions under IFRS 9, 12 month ECLs use 12 month PDs, whilst a lifetime ECL uses the estimated PD over the remaining contractual life of the loan. With respect to IRB, PD is the probability of a loan defaulting in the next 12 months calculated as an average over an economic cycle.
Prudential Regulation Authority (PRA)	The statutory body responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms. The PRA is a subsidiary of the Bank of England.
Residential Mortgage Backed Securities (RMBS)	Securities issued with interest and principal backed by that it represent interests in a group of residential mortgages which give the investor the right to cash received from future mortgage payments of both principal and interest.
Residual maturity	The remaining period to the contractual maturity date of a financial asset or financial liability.
Resolution Authority	In the UK, the Resolution Authority is the Bank of England who is responsible for taking charge, recapitalising and restructuring a firm; on account of the firms realised or expected failure.
Reverse stress test	Regulatory stress test that requires a firm to assess scenarios and circumstances that would render its business model unviable, thereby identifying potential business vulnerabilities.
Risk appetite	The articulation of the level of risk that the Society is willing to accept in order to safeguard the interests of the Society's members, whilst also achieving business objectives.
Risk weighted assets (RWAs)	The value of assets, after adjustment to reflect the degree of risk they represent in accordance with the relevant capital 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 structured entity which then issues securities (RMBS) backed by the assets. The Group has used residential mortgages as the loan pool for securitisation purposes.

Self-certified mortgage	An owner-occupier mortgage where the lending decision with respect to affordability has been based solely on the borrower's declaration of their income.
Significant increase in credit risk	A significant increase in credit risk on a financial asset is judged to have occurred when an assessment, using quantitative and qualitative factors, identifies at a reporting date that the credit risk has increased significantly since the asset was originally recognised.
Sovereign exposure	Exposures to governments and on account of cash balances and deposits with central banks.
Stage 1	Stage 1 assets are assets which have not experienced a significant increase in credit risk since the asset was originally recognised on the Balance Sheet. 12 month ECLs are recognised as the impairment provision for all financial assets on initial recognition. Interest revenue is the EIR on the gross carrying amount.
Stage 2	Stage 2 assets have experienced a significant increase in credit risk since initial recognition. Lifetime ECL is recognised as an impairment provision. Interest revenue is EIR on the gross carrying amount.
Stage 3	Stage 3 assets are identified as in default and considered credit impaired. Lifetime ECL is also recognised as an impairment provision. Interest revenue is the EIR on the net carrying amount.
Standardised approach	The basic method used to calculate capital requirements for credit and operational risk. In this approach the risk weighting used in the capital calculation is determined by specified percentages.
Stress testing	Testing undertaken to provide an understanding of the Society's resilience to internal and external shocks.
Structured entity	An entity in which voting or similar rights are not the dominant factor in deciding control. Structured entities are consolidated when the substance of the relationship indicates control.
Subordinated liabilities	A form of Tier 2 capital that is unsecured. Subordinated notes rank equally with each other and behind all other creditors of the Society and the claims of Shareholding Members (other than holders of Permanent Interest Bearing Shares and Perpetual Capital Securities) as to principal and interest. Under Basel III are included as Tier 2 under transitional rules only.
Subscribed capital	See Permanent Interest Bearing Shares.
Supervisory Review and Evaluation Process (SREP)	The PRA assessment of a firm's own capital assessment (ICA) under Pillar 2.

Supplementary Leverage Ratio Buffer (SLRB)	Applied to systemically important banks and building societies. As a guiding principle, the FPC sets the buffer at 35% of the risk weighted Systemic Risk Buffer.
Systemic Risk Buffer (SRB)	Buffer set for ring-fenced banks and large building societies to reduce their probability of failure or distress commensurately with the greater cost their failure or distress would have for the UK economy.
Term Funding Scheme	The Term Funding Scheme (TFS) is a tool of the Monetary Policy Committee designed to reinforce the transmission of Bank of England Base Rate cuts to those interest rates actually faced by households and businesses by providing term funding to banks and building societies at rates close to Bank of England Base Rate.
Tier 1 capital	A component of regulatory capital comprising Common Equity Tier 1 and Additional Tier 1 capital.
Tier 2 capital	A component of regulatory capital comprising qualifying subordinated debt and eligible collective impairment allowances.
Total Capital Requirement (TCR)	The minimum amount of capital the Society should hold as set by the PRA under Pillar 1 and Pillar 2A and informed by the Internal Capital Adequacy Assessment Process (ICAAP).
Trading book	A regulatory classification consisting of positions in financial instruments or commodities held by a bank with an intention to trade. The Society does not have a trading book.
The Standardised Approach: operational risk	The standardised approach to operational risk, calculated using three year historical net income multiplied by a percentage factor depending on the underlying business being considered.
UK Finance	A trade association that incorporates residential mortgage lending.
UK leverage ratio	A ratio prescribed by the PRA based on the CRR leverage ratio but modified to restrict the amount of AT1 capital that can be included in Tier 1 capital and to exclude eligible central bank holdings from leverage ratio exposures.
Unencumbered assets	Assets readily available as collateral to secure funding. This includes loans and advances to customers that, although technically encumbered, are held in respect of undrawn self-issued notes under the Group’s covered bond and securitisation programmes and are therefore readily available as collateral to secure funding or to pledge as collateral against margin calls.
Wrong way risk	Defined by the PRA as a situation where there is an adverse correlation between the counterparty’s probability of default and the mark-to market value of the underlying transaction.



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COVENTRY
Building Society