# Interim Financial Report

for the period ended 30 June 2017

COVENTRY
Building Society

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## IFRS RESULTS

This Interim Financial Report for the six months ended 30 June 2017 has been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority (FCA) and with International Accounting Standard (IAS) 34 Interim Financial Reporting as adopted by the European Union (EU). This Interim Financial Report should be read in conjunction with the Annual Report & Accounts for the year ended 31 December 2016, which have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU.

## FORWARD LOOKING STATEMENTS

Certain statements in this Interim Financial Report are forward looking. The Society, defined in this Interim Financial Report as Coventry Building Society and its subsidiary undertakings, believes that the expectations reflected in these forward looking statements are reasonable based on the information available at the time of the approval of this report. However, we can give no assurance that these expectations will prove to be an accurate reflection of actual results; because these statements involve risks and uncertainties, actual results may differ materially from those expressed or implied by these forward looking statements. We undertake no obligation to update any forward looking statements whether as a result of new information, future events or otherwise.

# INTERIM MANAGEMENT REPORT:
## CHIEF EXECUTIVE'S REVIEW

Coventry Building Society has continued to maintain its strong, consistent performance in the first half of 2017.

We are fundamentally a simple business, providing a safe home for savings and using these funds to provide low risk mortgages to UK borrowers. Our consistent and sustainable growth in both of these key markets shows that there remains healthy demand for straightforward good value products and high quality service.

- **A natural home for savings:** Savings balances have grown by 11% since June 2016 with balances increasing by £1.9 billion in the first half of the year, taking the Society's overall savings deposits to a record £29.9 billion. Savings growth has been more than seven times the rate of the market[1] as a whole for the five months to May 2017.
- **Giving value to members:** The average weighted savings rate paid to Coventry Building Society members of 1.54% was 0.89% higher than the market average (0.65%) over the first five months of the year[2].
- **Strong mortgage growth:** Gross lending was £4.4 billion and net lending £1.6 billion for the first half of 2017, with a market share of net lending for the five months to May 2017 of more than 10%[1]. Since June 2016, mortgage balances have grown by 10%.
- **Leading cost efficiency:** With a cost to mean asset ratio of 0.42%[3], the Coventry continues to report the lowest cost to mean asset ratio of any building society[4], underpinning the value given to members.
- **Low risk:** The Society's low risk lending approach protects individual members and the Society alike. Loans where arrears were greater than 2.5% of the balance were down to 0.15% (including possessions), around one sixth of the industry average of 0.93%[5].
- **Sustained profits:** Statutory profit before tax increased by 2% to £112.4 million (30 June 2016: £110.0 million).
- **Increased capital strength:** Common Equity Tier 1 (CET 1) ratio increased to 34.0% (30 June 2016: 30.4%) and remains the highest reported by any top 20 UK lender[6] whilst the Society's leverage ratio has been maintained at 4.1%, substantially above regulatory requirements.

We firmly believe that cash savings are an important component of the UK economy and seek to support savers. We are very proud of the significant growth in savings balances we achieved over the first half of 2017, against the background of a weaker savings market.

A large part of this growth is due to our clear commitment to protect savers from the effect of historically low rates. Our average weighted savings rate for the first five months of 2017 was 1.54%, more than double the market average of 0.65%[2] over the same period. In fact, this gap has widened since the end of 2016, further demonstrating our willingness to provide long-term value to members.

In particular, we actively and deliberately support cash ISAs, as we believe that they are best suited as the foundation of long-term savings plans for most people. Aided by best buy fixed rate and variable cash ISAs, we accounted for nearly two-thirds of ISA balance growth in the UK in the first five months of 2017[1].

Alongside pricing, our simple and open approach to savings has also been a key point of difference for the Society. For instance, in January we were the first major UK savings provider to allow individuals to compare our own savings products with competitors on our own website. Further endorsement of our approach came from consumer champion Fairer Finance, who placed us first in their rankings of savings providers in March 2017.

The mortgage market in the first half of 2017 has been markedly different from 12 months ago, when we saw significant volumes of property purchases in the buy to let sector ahead of changes to stamp duty. It has, though, continued to see a resurgence in remortgages as more homeowners and landlords seek to take advantage of current borrowing rates. Our strong product and service offering has allowed us to benefit from this shift, and as a result over the last year we have grown our mortgage balances by 10%. In the first five months of 2017 our mortgage balances grew over four times faster than the market growth rate, further increasing our share of the UK market[1].

At all times we remain a low-risk lender. In fact, we have seen the level of mortgages in arrears and credit losses continue to fall, testament to our conservative underwriting policies.

# INTERIM MANAGEMENT REPORT:
## CHIEF EXECUTIVE'S REVIEW

(continued)

A key factor in attracting and retaining customers is sustained, high quality service delivery. This has been evidenced not only in our own surveys, but also by organisations such as YouGov, whose customer satisfaction survey ranked us highest of any UK bank or building society[7]. Despite our growth, complaints from members about savings and mortgages fell further in the first half of 2017 and are among the lowest of any provider, based on the latest published Financial Conduct Authority statistics[8]. Furthermore, complaints referred to the Financial Ombudsman Service are overturned in only 6% of cases, compared to an industry average of 42%[9].

We believe that our approach is possible only through highly engaged employees who are wedded to our mission of Putting Members First. In 2017 the Society was announced as one of the 100 Best Companies to Work For in the UK, with 'Outstanding' employee engagement[10]. In the first half of 2017, employee engagement rose still further, with 92% of staff saying they are proud to work for the Coventry[11].

Each of these achievements is a result of a straightforward business model focused fully on Putting Members First. This is our consistent strategy. We continue to invest in our technology, propositions and people and are confident that our model will remain sustainable, regardless of changing political and economic conditions.

Signed on behalf of the Board by

Mark Parsons
Chief Executive
27 July 2017

1 Source: Bank of England – latest published data as at 31 May 2017.
2 The Society's average month end savings rate (Society mix of products) compared to the Bank of England weighted average rate for household interest-bearing deposits (market mix of products).
3 Administrative expenses, depreciation and amortisation/Average total assets.
4 Source: Building Societies Association: Annual Accounts Data 2017 and latest published data as at 27 July 2017.
5 Source: Prudential Regulation Authority – latest published data as at 31 March 2017.
6 Source: Council of Mortgage Lenders – 2016 top mortgage lenders (balance outstanding) – latest published CET 1 data as at 27 July 2017.
7 The YouGov BrandIndex Customer Satisfaction 'opinion only' measures perception for the 52 weeks to (24 July 2017). 'Opinion only' compares the number of satisfied versus dissatisfied former and current customers, and excludes those that don't give an opinion. The research is based on 1,177 customers from a Cards, Loans and Building Society study and 1,386 customers from a High Street Banks and Savings study with a nationally representative 18+ adult profile. It excludes brands with fewer than 100 responses.
8 Source: Financial Conduct Authority complaints data, latest published information, 1 July 2016 to 31 December 2016.
9 Source: Financial Ombudsman Service complaints data, latest published information, 1 July 2016 to 31 December 2016.
10 Source: Best Companies: The 100 Best Companies to work for in the mid-size category.
11 Source: Internal Employee Opinion Survey – May 2017.

# FINANCIAL REVIEW

## Summary

During the six months to 30 June 2017 the Society added £85.2 million (30 June 2016: £84.2 million) to its reserves to support future growth and maintained the leverage ratio[1] at 4.1%, whilst delivering growth in the mortgage book of £1.6 billion and maintaining a leading cost to mean asset ratio[2] of 0.42%.

## Income Statement

**Net interest:** Net interest income for the period was £192.3 million (30 June 2016: £187.3 million). The Society's net interest margin has decreased by 7 basis points to 0.99% (30 June 2016: 1.06%), as increased competition for mortgage customers put pressure on new business margins, whilst the Society continued its commitment to paying market leading rates on a range of savings products.

**Other operating income:** Other income for the period was £5.1 million. This includes a £5.0 million gain following the sale of VocaLink Holdings Limited (VocaLink) to MasterCard, which was completed in April 2017 (30 June 2016: Other income of £5.6 million included £4.9 million gain on the sale of Visa Europe Limited to Visa Inc.).

**Management expenses:** Administrative expenses for the period were £72.6 million (30 June 2016: £66.5 million). The increase reflects the costs of servicing a larger membership, investing in future capability and implementing regulatory change. Depreciation and amortisation of property, plant and equipment and intangibles of £9.3 million (30 June 2016: £7.0 million) has increased due to investment to strengthen the resilience of our IT infrastructure during the period. The Society continues to focus on rigorous cost control with a cost to mean asset ratio[2] of 0.42%, remaining the lowest reported of all UK building societies[3] (30 June 2016: 0.42%).

**Impairment:** An impairment credit of £0.1 million was recognised during the period (30 June 2016: charge of £0.3 million) reflecting falling arrears levels and rising house prices. The business model continues to be focused on low risk lending and the average loan to value (simple average) of loans originated in the six months to 30 June 2017 is 56% (30 June 2016: 64%). During the period, arrears and possessions cases have continued to fall from the already low levels that were seen during 2016.

**Provisions for liabilities and charges:** The £3.5 million charge for the period is in respect of the Financial Services Compensation Scheme (FSCS) levy (£2.5 million) and Payment Protection Insurance (PPI) (£1.0 million) (30 June 2016: £7.6 million FSCS levy and £0.5 million PPI). The reduction in the FSCS charge reflects a substantial repayment of the loan from HM Treasury to the FSCS, which reduced the Society's charge. The charge for PPI reflects an increase in the number of claims received in the period and the impact of the finalised rules and guidance from the Financial Conduct Authority, in particular, claims relating to the *Plevin v Paragon Personal Finance Limited* ruling, and the deadline for PPI claims. Provisions for PPI claims continue to be materially lower for the Society than many other organisations.

**Charitable donation:** The Society donated £0.6 million to The Royal British Legion's Poppy Appeal during the period (30 June 2016: £0.7 million).

**Tax:** The corporation tax charge represented an effective rate of tax of 24.2% (30 June 2016: 23.5%).

## Balance Sheet

**Loans and advances to customers:** The Society's lending strategy is focused on high quality, low loan to value owner-occupier and buy to let loans within the prime residential market, distributed via mortgage intermediaries in addition to our own distribution channels. During the period, the Society advanced £4.4 billion of mortgages (30 June 2016: £4.8 billion), with net mortgage lending of £1.6 billion (30 June 2016: £2.0 billion). The overall simple average indexed loan to value of the mortgage book at 30 June 2017 reduced to 47% (31 December 2016: 48%), which reflects the low risk nature of the Society's lending activities.

**Liquidity:** On-balance sheet liquid assets have increased to £5.0 billion (31 December 2016: £4.8 billion), with additional high quality liquid assets held off-balance sheet. The Liquidity Coverage Ratio at 30 June 2017 was 173% (31 December 2016: 151%) and was significantly in excess of the regulatory minimum.

# FINANCIAL REVIEW
(continued)

**Retail savings:** The Society continues to be predominantly funded by retail savings, with balances of £29.9 billion at 30 June 2017 (31 December 2016: £28.1 billion) and growth of £1.9 billion during the first six months of the year. The Society has continued to pay market leading rates in the retail savings market with a strong focus on ISA products.

**Wholesale funding:** The Society uses wholesale funding to provide diversification by source and term, and also to provide value to members through lowering the overall cost of funding. During the period, wholesale funding[4] has remained at £7.7 billion (31 December 2016: £7.7 billion). The stability in wholesale funding overall reflects the utilisation of marketable securities in sale and repurchase agreements and the issuance of debt securities. During the period, the Society issued a €500 million covered bond and a £350 million medium-term note.

## Capital Ratios

The table below provides a summary of the Society's capital resources and CRD IV ratios on an end-point basis (i.e. assuming all CRD IV requirements were in force in full with no transitional provisions permitted).

| | **End-point 30 Jun 2017 £m** | End-point 30 Jun 2016 £m | End-point 31 Dec 2016 £m |
|---|---|---|---|
| **Capital resources:** | | | |
| Common Equity Tier 1 (CET 1) capital | **1,391.5** | 1,235.8 | 1,320.8 |
| Total Tier 1 capital | **1,788.4** | 1,632.7 | 1,717.7 |
| Total capital | **1,792.8** | 1,637.2 | 1,722.0 |
| **Risk weighted assets** | **4,096.6** | 4,069.2 | 4,099.3 |
| **CRD IV ratios:** | **%** | % | % |
| Common Equity Tier 1 (CET 1) ratio | **34.0** | 30.4 | 32.2 |
| Leverage ratio[1] | **4.1** | 4.0 | 4.1 |
| Leverage ratio (modified)[5] | **4.5** | n/a | 4.4 |

The Society is provided with Individual Capital Guidance (ICG) by the Prudential Regulatory Authority (PRA). Following a Supervisory Review process in the first half of 2016 the Society has been issued with an ICG of 12.8% which is the sum of its Pillar 1 and Pillar 2A requirements. With a CET 1 ratio of 34.0% the Society comfortably meets this requirement using CET 1 capital alone. The ratio has benefitted in the period from positive house price movements and continued low risk lending which have resulted in reduced risk weighted assets despite mortgage book growth.

On the 27 June 2017, the PRA proposed to increase the minimum leverage requirement to 3.25%. This follows the modification of the calculation of leverage exposure for the purpose of the UK leverage ratio framework to exclude central bank reserves. Under the modified basis of measurement the Society's leverage ratio would be 4.5% (31 December 2016: 4.4%).

The capital disclosures above are on a Group basis, including all subsidiary entities. For regulatory purposes the Group also reports on an Individual Consolidated basis, which only includes those subsidiaries meeting particular criteria contained within CRD IV. The Individual Consolidated CET 1 ratio on an end-point basis at 30 June 2017 is 0.8% higher than the Group ratio due to assets held by entities that sit outside of the Individual Consolidation, primarily those held by the Group's securitisation and covered bond entities.

1 The leverage ratio is calculated in accordance with the definitions of CRD IV as amended by the European Commission delegated regulation. The calculation reflects constraints on the inclusion of Additional Tier 1 capital, in accordance with the Financial Policy Committee's leverage ratio regime.
2 Administrative expenses, depreciation and amortisation/Average total assets.
3 Source: Building Societies Association: Annual Accounts Data 2017 and latest published data as at 27 July 2017.
4 Deposits from banks, Other deposits, Amounts owed to other customers and Debt securities in issue.
5 Leverage ratio modified under the UK regulatory regime by excluding central bank reserves from the calculation of leverage exposures.

# PRINCIPAL RISKS AND UNCERTAINTIES

The Society's business model involves the taking of deposits from retail and wholesale investors and using these funds to provide mortgages for residential properties. Investors are rewarded in the form of fixed and variable rates of interest and borrowers pay fixed and variable rates of interest on their loans. Whilst influenced by market pricing the amount of interest charged to borrowers is correlated to the perceived riskiness of the loan. All residential lending currently undertaken is on a secured, first charge basis, with the residential property forming the underlying security. The difference between interest paid and interest received results in a margin from which the Society meets its overheads, impairment losses and taxation, and is the primary source of capital (by way of retained earnings) to support future growth and absorb losses, should they arise.

A description of the principal risks and uncertainties is given in this report to the extent they differ from those at 31 December 2016. The principal risks and uncertainties affecting the Society for the year ended 31 December 2016 were reported on pages 22 to 62 of the 2016 Annual Report & Accounts along with a number of emerging risks. Since the start of 2017 the Society has designated 'Model Risk' as a principal risk category reflecting the importance of models in business decision making, as illustrated by the implementation of the new accounting standard, IFRS 9 *Financial Instruments.*

Uncertainty continues surrounding Brexit and related events, including the UK General Election, which could impact the wider economy. This is reflected in the latest views of Monetary Policy Committee members where inflationary impacts from foreign exchange rate movements are leading some to call for rate increases, or reductions in other Bank stimulus.

The Society's UK focus and very limited foreign exchange and overseas treasury credit exposures means it is well placed to effectively manage any direct adverse implications from Brexit. For further details of these arrangements, see pages 38 to 40 of the 2016 Annual Report & Accounts.

Consequently, second order effects are the most likely source of any adverse impact from the Brexit process. Most notably if there is a sustained fall in house prices, losses may increase in the event of default, or borrowers may experience payment difficulties as a result of increases in unemployment or rises in the cost of living or base rates. In line with most commentators, we expect Bank of England Base Rate rises to be relatively modest and to be extended over a number of years. The Society's prudent lending policy and low risk mortgage book insulates it from these potential challenges.

Tax changes introduced for buy to let landlords in 2016 have reduced the overall demand for buy to let borrowing to purchase new rental properties. However, the buy to let remortgage market remains robust, and the Society continues to lend strongly into this sector. It remains committed to supporting the buy to let market whilst maintaining strong underwriting standards and will continue to evolve its lending policy in response to any future political and regulatory change.

There are continued potential regulatory pressures in meeting the minimum requirements for own funds and eligible liabilities (MREL), risk weighted capital floors, and IFRS 9. Whilst these can disproportionately impact lower risk lenders such as the Society, our strong business fundamentals mean we fully expect to be able to accommodate these changes.

Fines and regulatory action against financial firms have been common place over recent years. Although the Society has not been subject to any such censure, reflecting its commitment to delivering good customer outcomes, the adverse publicity associated with some of our competitors continues to impact the reputation of the whole of the financial services sector. Along with the rest of the payments industry, the Society is working to support open banking and changes to the UK payment environment. Regulatory obligations continue to emerge which require interpretation, thus narrowing implementation windows. The Board therefore remains conscious of the conduct risks that have the potential to impact the Society, and continues to take the necessary steps to mitigate such risks.

As explained in the 2016 Annual Report & Accounts, the Society is aware of increasing threats across the cyber security landscape, in particular the recent prevalence of Ransomware. Whilst the Society has taken the necessary steps to protect against the recent global attacks, it recognises the need to remain vigilant as attacks of this nature increase in both frequency and sophistication.

# CONDENSED CONSOLIDATED INCOME STATEMENT

## FOR THE PERIOD ENDED 30 JUNE 2017

| | Notes | **Period to 30 Jun 2017 (Unaudited) £m** | Period to 30 Jun 2016 (Unaudited) £m | Year ended 31 Dec 2016 (Audited) £m |
|---|---|---|---|---|
| Interest receivable and similar income | 3 | **430.5** | 461.9 | 907.3 |
| Interest payable and similar charges | 4 | **(238.2)** | (274.6) | (522.3) |
| Net interest income | | **192.3** | 187.3 | 385.0 |
| Fees and commissions receivable | | **4.7** | 5.7 | 13.3 |
| Fees and commissions payable | | **(4.9)** | (4.4) | (8.9) |
| Other operating income | 5 | **5.1** | 5.6 | 6.1 |
| Net gains/(losses) from derivative financial instruments | | **1.1** | (1.6) | (1.0) |
| Total income | | **198.3** | 192.6 | 394.5 |
| Administrative expenses | 6 | **(72.6)** | (66.5) | (134.5) |
| Amortisation of intangible assets | | **(6.0)** | (4.2) | (9.1) |
| Depreciation of property, plant and equipment | | **(3.3)** | (2.8) | (5.9) |
| Impairment credit/(charge) on loans and advances to customers | 7 | **0.1** | (0.3) | 1.5 |
| Provisions for liabilities and charges | 8 | **(3.5)** | (8.1) | (6.1) |
| Charitable donation to Poppy Appeal | | **(0.6)** | (0.7) | (1.3) |
| **Profit before tax** | | **112.4** | 110.0 | 239.1 |
| Taxation | | **(27.2)** | (25.8) | (56.7) |
| **Profit for the financial period** | | **85.2** | 84.2 | 182.4 |

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

# CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

## FOR THE PERIOD ENDED 30 JUNE 2017

| | Notes | | | |
|---|---|---|---|---|
| **Profit for the financial period** | | **85.2** | 84.2 | 182.4 |
| **Other comprehensive income** | | | | |
| Items that will not be transferred to the Income Statement: | | | | |
| Remeasurement of defined benefit plan | | **-** | - | (13.7) |
| Taxation | | **-** | - | 3.8 |
| Effect of change in corporation tax rate | | **-** | - | (0.3) |
| Items that may be transferred to the Income Statement: | | | | |
| Available-for-sale investments: | | | | |
| Fair value movements taken to reserves | | **(9.8)** | 49.5 | 33.5 |
| Amount transferred to Income Statement | 14 | **9.2** | (54.3) | (26.7) |
| Taxation | | **0.1** | 0.4 | (2.8) |
| Effect of change in corporation tax rate | | **-** | - | 0.2 |
| Cash flow hedges: | | | | |
| Fair value movements taken to reserves | | **29.9** | 185.6 | 213.6 |
| Amount transferred to Income Statement | | **(49.7)** | (150.2) | (198.2) |
| Taxation | | **5.4** | (9.4) | (4.3) |
| Effect of change in corporation tax rate | | **(0.2)** | 0.6 | 0.7 |
| **Other comprehensive (expense)/income for the period, net of tax** | | **(15.1)** | 22.2 | 5.8 |
| **Total comprehensive income for the period, net of tax** | | **70.1** | 106.4 | 188.2 |

The notes on pages 11 to 21 form part of this Interim Financial Report.

# CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

## AS AT 30 JUNE 2017

| | Notes | **30 Jun 2017 (Unaudited) £m** | 30 Jun 2016 (Unaudited) £m | 31 Dec 2016 (Audited) £m |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and balances with the Bank of England | | **3,773.3** | 2,854.7 | 3,260.0 |
| Loans and advances to credit institutions | | **194.6** | 276.1 | 213.5 |
| Debt securities | | **1,001.2** | 1,453.2 | 1,354.3 |
| Loans and advances to customers | 9 | **34,527.6** | 31,446.3 | 32,881.6 |
| Hedge accounting adjustment | | **63.5** | 260.2 | 144.5 |
| Derivative financial instruments | | **343.1** | 349.4 | 354.2 |
| Investment in equity shares | | **2.2** | 5.8 | 5.9 |
| Intangible assets | | **37.5** | 19.6 | 32.5 |
| Property, plant and equipment | | **34.7** | 32.0 | 35.7 |
| Investment properties | | **0.1** | 0.9 | 0.2 |
| Pension benefit surplus | | **3.3** | 15.2 | 2.5 |
| Deferred tax assets | | **1.9** | 2.1 | 1.9 |
| Prepayments and accrued income | | **11.9** | 9.0 | 9.1 |
| **Total assets** | | **39,994.9** | 36,724.5 | 38,295.9 |
| | | | | |
| **Liabilities** | | | | |
| Shares | | **29,935.7** | 26,927.6 | 28,054.3 |
| Deposits from banks | | **1,851.3** | 2,265.4 | 2,937.5 |
| Other deposits | | **6.0** | 6.0 | 7.0 |
| Amounts owed to other customers | | **903.8** | 781.3 | 819.4 |
| Debt securities in issue | 10 | **4,904.0** | 4,111.8 | 3,978.1 |
| Hedge accounting adjustment | | **111.0** | 220.0 | 158.7 |
| Derivative financial instruments | | **256.0** | 489.4 | 366.7 |
| Current tax liabilities | | **22.7** | 22.3 | 25.1 |
| Deferred tax liabilities | | **9.5** | 18.6 | 13.7 |
| Accruals and deferred income | | **26.3** | 22.8 | 28.5 |
| Other liabilities | | **8.7** | 9.3 | 11.0 |
| Provisions for liabilities and charges | 8 | **10.7** | 16.6 | 7.5 |
| Subordinated liabilities | 11 | **25.5** | 43.1 | 25.5 |
| Subscribed capital | 12 | **41.6** | 41.6 | 41.6 |
| **Total liabilities** | | **38,112.8** | 34,975.8 | 36,474.6 |
| | | | | |
| **Equity** | | | | |
| General reserve | | **1,452.0** | 1,297.3 | 1,376.1 |
| Other equity instruments | 13 | **396.9** | 396.9 | 396.9 |
| Available-for-sale reserve | 14 | **6.2** | (1.9) | 6.7 |
| Cash flow hedge reserve | | **27.0** | 56.4 | 41.6 |
| **Total members' interests and equity** | | **1,882.1** | 1,748.7 | 1,821.3 |
| **Total members' interests, liabilities and equity** | | **39,994.9** | 36,724.5 | 38,295.9 |

The notes on pages 11 to 21 form part of this Interim Financial Report.

# CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN MEMBERS' INTERESTS AND EQUITY

FOR THE PERIOD ENDED 30 JUNE 2017

| | Notes | General reserve £m | Other equity instruments £m | Available-for-sale reserve £m | Cash flow hedge reserve £m | Total £m |
|---|---|---|---|---|---|---|
| **As at 1 January 2017 (Audited)** | | **1,376.1** | **396.9** | **6.7** | **41.6** | **1,821.3** |
| Profit for the financial period | | **85.2** | - | **-** | **-** | **85.2** |
| Net movement in Available-for-sale reserve | | **-** | - | **(0.5)** | **-** | **(0.5)** |
| Net movement in Cash flow hedge reserve | | **-** | - | **-** | **(14.6)** | **(14.6)** |
| **Total comprehensive income** | | **85.2** | - | **(0.5)** | **(14.6)** | **70.1** |
| Distribution to Additional Tier 1 capital holders* | 13 | **(9.3)** | - | **-** | **-** | **(9.3)** |
| **As at 30 June 2017 (Unaudited)** | | **1,452.0** | **396.9** | **6.2** | **27.0** | **1,882.1** |

| | Notes | General reserve £m | Other equity instruments £m | Available-for-sale reserve £m | Cash flow hedge reserve £m | Total £m |
|---|---|---|---|---|---|---|
| As at 1 January 2016 (Audited) | | 1,222.3 | 396.9 | 2.5 | 29.8 | 1,651.5 |
| Profit for the financial period | | 84.2 | - | - | - | 84.2 |
| Net movement in Available-for-sale reserve | | - | - | (4.4) | - | (4.4) |
| Net movement in Cash flow hedge reserve | | - | - | - | 26.6 | 26.6 |
| Total comprehensive income | | 84.2 | - | (4.4) | 26.6 | 106.4 |
| Distribution to Additional Tier 1 capital holders* | 13 | (9.2) | - | - | - | (9.2) |
| As at 30 June 2016 (Unaudited) | | 1,297.3 | 396.9 | (1.9) | 56.4 | 1,748.7 |

| | Notes | General reserve £m | Other equity instruments £m | Available-for-sale reserve £m | Cash flow hedge reserve £m | Total £m |
|---|---|---|---|---|---|---|
| As at 1 January 2016 (Audited) | | 1,222.3 | 396.9 | 2.5 | 29.8 | 1,651.5 |
| Profit for the financial year | | 182.4 | - | - | - | 182.4 |
| Net remeasurement of defined benefit plan | | (10.2) | - | - | - | (10.2) |
| Net movement in Available-for-sale reserve | | - | - | 4.2 | - | 4.2 |
| Net movement in Cash flow hedge reserve | | - | - | - | 11.8 | 11.8 |
| Total comprehensive income | | 172.2 | - | 4.2 | 11.8 | 188.2 |
| Distribution to Additional Tier 1 capital holders* | 13 | (18.4) | - | - | - | (18.4) |
| As at 31 December 2016 (Audited) | | 1,376.1 | 396.9 | 6.7 | 41.6 | 1,821.3 |

* The distribution to Additional Tier 1 capital holders is shown net of an associated tax credit of £3.5 million (30 June 2016: £3.6 million, 31 December 2016: £7.2 million).

The notes on pages 11 to 21 form part of this Interim Financial Report.

# CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

## FOR THE PERIOD ENDED 30 JUNE 2017

| | **Period to 30 Jun 2017 (Unaudited) £m** | Period to 30 Jun 2016 (Unaudited) £m | Year ended 31 Dec 2016 (Audited) £m |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| **Profit before tax** | **112.4** | 110.0 | 239.1 |
| Adjustments for: | | | |
| Impairment provisions and other provisions | **3.4** | 8.4 | 4.6 |
| Depreciation and amortisation | **9.3** | 7.0 | 15.0 |
| Interest on subordinated liabilities and subscribed capital | **3.3** | 7.7 | 11.7 |
| Changes to fair value adjustment of hedged risk | **(71.9)** | (137.6) | (208.0) |
| Other non-cash movements | **(42.1)** | (59.2) | 13.2 |
| **Non-cash items included in profit before tax** | **(98.0)** | (173.7) | (163.5) |
| Loans and advances to credit institutions | **67.1** | (13.4) | 15.0 |
| Loans and advances to customers | **(1,646.0)** | (2,035.6) | (3,469.3) |
| Prepayments, accrued income and other assets | **(3.6)** | (4.0) | (16.3) |
| **Changes in operating assets** | **(1,582.5)** | (2,053.0) | (3,470.6) |
| Shares | **1,947.2** | 1,620.8 | 2,696.7 |
| Deposits and other borrowings | **(1,002.0)** | 433.5 | 1,144.4 |
| Debt securities in issue | **165.4** | 177.6 | 268.7 |
| Accruals, deferred income and other liabilities | **(4.8)** | (7.8) | (7.5) |
| **Changes in operating liabilities** | **1,105.8** | 2,224.1 | 4,102.3 |
| Interest paid on subordinated liabilities and subscribed capital | **(3.3)** | (7.7) | (12.4) |
| Taxation | **(25.0)** | (18.2) | (41.7) |
| **Net cash flows from operating activities** | **(490.6)** | 81.5 | 653.2 |
| **Cash flows from investing activities** | | | |
| Purchase of investment securities | **(18.4)** | (92.8) | (143.6) |
| Sale and maturity of investment securities and equities | **333.5** | 238.5 | 372.1 |
| Proceeds from sale of properties | **0.1** | 2.4 | 3.5 |
| Repurchase of subordinated liabilities and subscribed capital | **-** | (134.8) | (152.7) |
| Purchase of property, plant and equipment and intangible assets | **(13.6)** | (10.4) | (34.6) |
| **Net cash flows from investing activities** | **301.6** | 2.9 | 44.7 |
| **Cash flows from financing activities** | | | |
| Distributions paid to Additional Tier 1 capital holders | **(12.8)** | (12.8) | (25.6) |
| Repurchase and repayment of debt securities | **(19.8)** | (52.8) | (282.3) |
| Issue of debt securities | **783.1** | 275.0 | 275.0 |
| **Net cash flows from financing activities** | **750.5** | 209.4 | (32.9) |
| **Net increase in cash** | **561.5** | 293.8 | 665.0 |
| Cash and cash equivalents at start of period | **3,207.5** | 2,542.5 | 2,542.5 |
| **Cash and cash equivalents at end of period** | **3,769.0** | 2,836.3 | 3,207.5 |
| **Cash and cash equivalents:** | | | |
| Cash and balances with the Bank of England[1] | **3,719.0** | 2,806.3 | 3,207.5 |
| Loans and advances to credit institutions | **50.0** | 30.0 | - |
| | **3,769.0** | 2,836.3 | 3,207.5 |

1. Excludes £54.3 million mandatory reserve with the Bank of England (30 June 2016: £48.4 million, 31 December 2016: £52.5 million).

The notes on pages 11 to 21 form part of this Interim Financial Report.

# NOTES TO THE INTERIM FINANCIAL REPORT

## 1. Reporting Period

These results have been prepared as at 30 June 2017 and show the financial performance for the period from, and including, 1 January 2017 to this date.

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

### Basis of preparation

These condensed consolidated financial statements for the six months ended 30 June 2017 have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority (FCA) and with IAS 34 Interim Financial Reporting as adopted by the EU. The Interim Financial Report does not include all the information and disclosures required in the annual financial statements, and should be read in conjunction with the Annual Report & Accounts for the year ended 31 December 2016, which have been prepared in accordance with IFRSs as adopted by the EU.

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

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

### Changes in accounting policy

The accounting policies adopted by the Group in the preparation of its 2017 Interim Financial Report are consistent with those disclosed in the Annual Report & Accounts for the year ended 31 December 2016. There have been no new or amended standards or interpretations which have had a significant impact on the preparation of the 2017 Interim Financial Report.

There are a number of standards, relevant to the Group's future reporting, which were not effective as at 30 June 2017 and have therefore not been applied in preparing the Interim Financial Report. Of these, the most significant is IFRS 9 *Financial Instruments*, which will lead to substantial changes in the accounting for financial instruments.

Pages 107 and 108 of the Annual Report & Accounts for the year ended 31 December 2016 provides information on the impact of transition to IFRS 9, in addition to other reporting standards which are relevant to the Group's future reporting which have not been applied at 30 June 2017.

Progression of the IFRS 9 implementation programme is in line with plans. The expected credit loss model builds are now complete and robust testing of models and modelled outputs has commenced. The required changes to systems and business processes continue to be developed and approaches to incorporating alternative economic scenarios are to be finalised.

The financial impact of adopting IFRS 9 will be quantified and disclosed in the financial statements for the year ended 31 December 2017, but at this stage, the Group expects this to be modest given the underlying quality of the mortgage book.

## Going concern and long-term viability statement

Details of the Group's objectives, policies and processes for managing its exposure to credit, market, liquidity and funding, conduct, operational and business risks are contained in the Risk Management Report of the 2016 Annual Report & Accounts. The directors also include a statement on long-term viability on page 62 of the 2016 Annual Report & Accounts. The current assessment has been over the period to 31 December 2021, in line with the Society's Strategic Plan and capital and liquidity stress testing process. An update on new principal risks and uncertainties has been provided on page 6 and does not identify any material changes to the Society's risk profile.

Taking the Society's objectives, policies and processes into account alongside the current economic and regulatory environment, the directors confirm they are satisfied the Group has adequate resources to continue in business for the foreseeable future and that the long-term viability statement in the 2016 Annual Report remains appropriate. Accordingly, it is appropriate to adopt the going concern basis in preparing this Interim Financial Report.

## Significant accounting judgement and estimates

The preparation of financial statements requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from these estimates. Those items where management is required to make critical accounting estimates (as noted below) remain unchanged from the year ended 31 December 2016 and details are provided on page 115 of the 2016 Annual Report & Accounts.

| Areas of significant judgement and estimation |
|---|
| Mortgage Effective Interest Rate |
| Fair value adjustments in respect of acquired assets |
| Impairment provisions on loans and advances to customers |
| Hedge accounting and valuation of Level 3 derivatives |

## 3. Interest receivable and similar income

| | **Period to 30 Jun 2017 (Unaudited) £m** | Period to 30 Jun 2016 (Unaudited) £m | Year ended 31 Dec 2016 (Audited) £m |
|---|---|---|---|
| On loans fully secured on residential property | **465.2** | 485.5 | 972.4 |
| On other loans | **0.9** | 1.1 | 2.2 |
| Interest and other income on debt securities | **16.5** | 18.4 | 36.8 |
| Interest and other income on other liquid assets | **4.0** | 6.3 | 10.0 |
| Net expense on financial instruments hedging assets | **(57.4)** | (51.0) | (113.0) |
| Foreign currency gains/(losses) | **1.3** | 1.6 | (1.1) |
| **Total** | **430.5** | 461.9 | 907.3 |

## 4. Interest payable and similar charges

| | **Period to 30 Jun 2017 (Unaudited) £m** | Period to 30 Jun 2016 (Unaudited) £m | Year ended 31 Dec 2016 (Audited) £m |
|---|---|---|---|
| Bank and customer | | | |
| Subordinated liabilities | **0.9** | 1.7 | 3.9 |
| Other | **8.7** | 11.3 | 21.2 |
| Debt securities in issue | **60.7** | 61.1 | 122.7 |
| Other borrowed funds | | | |
| On shares held by individuals | **203.1** | 229.8 | 444.1 |
| On other shares | **-** | - | 0.1 |
| On subscribed capital | **2.4** | 6.0 | 8.5 |
| Net income on financial instruments hedging liabilities | **(38.7)** | (37.2) | (76.8) |
| Foreign currency losses/(gains) | **1.1** | 1.9 | (1.4) |
| **Total** | **238.2** | 274.6 | 522.3 |

## 5. Other operating income

Other operating income of £5.1 million includes £5.0 million relating to the gain on completion of the sale of the Society's equity investment in VocaLink Holdings Limited (VocaLink) to MasterCard. The Society has received upfront cash proceeds in exchange for 90% of its VocaLink shares, and put and call options over the remaining 10% of VocaLink shares exist with maturity dates in 2020 and 2022. Future deferred cash consideration, which is contingent on certain performance thresholds being met, has been ascribed a zero value in calculating the gain on sale.

In 2016, other operating income of £5.6 million included £4.9 million relating to the gain on sale of Visa Europe Limited (Visa Europe) to Visa Inc..

# NOTES TO THE INTERIM FINANCIAL REPORT
(continued)

## 6. Administrative expenses

| | **Period to 30 Jun 2017 (Unaudited) £m** | Period to 30 Jun 2016 (Unaudited) £m | Year ended 31 Dec 2016 (Audited) £m |
|---|---|---|---|
| Employee costs | | | |
| Wages and salaries | **34.7** | 31.8 | 67.6 |
| Social security costs | **3.4** | 3.1 | 6.9 |
| Pension costs | | | |
| Defined benefit plan | **-** | (0.3) | (0.6) |
| Defined contribution plan | **2.5** | 2.3 | 4.6 |
| | **40.6** | 36.9 | 78.5 |
| Other expenses | **32.0** | 29.6 | 56.0 |
| **Total** | **72.6** | 66.5 | 134.5 |

## 7. Impairment provisions on loans and advances to customers

Impairment provisions have been deducted from the appropriate asset values in the Condensed Consolidated Statement of Financial Position.

| | **Period to 30 Jun 2017 (Unaudited) £m** | Period to 30 Jun 2016 (Unaudited) £m | Year ended 31 Dec 2016 (Audited) £m |
|---|---|---|---|
| Impairment (credit)/charge for the period | **(0.1)** | 0.3 | (1.5) |
| | | | |
| Impairment provision at the end of the period: | | | |
| Residential mortgages | **13.1** | 15.7 | 13.4 |
| Other loans | **5.1** | 5.2 | 5.1 |
| **Total** | **18.2** | 20.9 | 18.5 |

The incurred loss element of the fair value adjustments arising from the merger with Stroud & Swindon Building Society of £4.1 million has been included within the closing provision in the table above (30 June 2016: £4.0 million, 31 December 2016: £4.1 million).

Further information on loans and advances to customers is presented in note 9.

## 8. Provisions for liabilities and charges

| | **Period to 30 Jun 2017 (Unaudited) £m** | Period to 30 Jun 2016 (Unaudited) £m | Year ended 31 Dec 2016 (Audited) £m |
|---|---|---|---|
| At 1 January | **7.5** | 8.8 | 8.8 |
| Charge for the period | **3.5** | 8.1 | 6.1 |
| Provision utilised | **(0.3)** | (0.3) | (7.4) |
| **Total** | **10.7** | 16.6 | 7.5 |

As at 30 June 2017, a provision of £6.9 million (30 June 2016: £14.6 million, 31 December 2016: £4.4 million) was held for amounts payable to the Financial Services Compensation Scheme (FSCS). During the period, a further provision was made in respect of the FSCS totalling £2.5 million (30 June 2016: £7.6 million, 31 December 2016: £4.3 million).

Included also are other provisions totalling £3.8 million (30 June 2016: £2.0 million, 31 December 2016: £3.1 million) made in respect of circumstances that may give rise to various customer claims. During the period, the Group raised a further £1.0 million provision (30 June 2016: £0.5 million, 31 December 2016: £1.8 million) for Payment Protection Insurance (PPI) redress to customers, reflecting an increase in the number of claims received in the period and the impact of the finalised rules and guidance from the Financial Conduct Authority, in particular, claims relating to the Plevin v Paragon Personal Finance Limited ruling, and the deadline for PPI claims.

## 9. Loans and advances to customers

| | **Period to 30 Jun 2017 (Unaudited) £m** | Period to 30 Jun 2016 (Unaudited) £m | Year ended 31 Dec 2016 (Audited) £m |
|---|---|---|---|
| **Residential mortgages** | | | |
| Owner-occupier mortgages | **21,173.1** | 19,002.9 | 20,089.4 |
| Buy to let mortgages | **13,005.1** | 12,043.2 | 12,416.7 |
| Near-prime mortgages[1] | **82.1** | 91.7 | 87.5 |
| Self-certification mortgages[1] | **234.5** | 269.2 | 252.0 |
| **Other loans** | | | |
| Commercial mortgages[2] | **2.3** | 3.3 | 2.8 |
| Unsecured loans[2] | **30.5** | 36.0 | 33.2 |
| **Total** | **34,527.6** | 31,446.3 | 32,881.6 |

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

## 10. Debt securities in issue

As at 30 June 2017, the Group had a total of £4,904.0 million debt securities in issue (30 June 2016: £4,111.8 million, 31 December 2016: £3,978.1 million).

In January 2017, the Society issued a €500 million 7 year fixed rate covered bond in addition to a £350 million medium-term note in May 2017.

## 11. Subordinated liabilities

| | **Period to 30 Jun 2017 (Unaudited) £m** | Period to 30 Jun 2016 (Unaudited) £m | Year ended 31 Dec 2016 (Audited) £m |
|---|---|---|---|
| Fixed rate subordinated notes 2016 - 12.25% | **-** | 7.5 | - |
| Fixed rate subordinated notes 2021 - 6.12% | **-** | 10.1 | - |
| Fixed rate subordinated notes 2026 - 6.327% | **10.2** | 10.2 | 10.2 |
| Fixed rate subordinated notes 2032 - 7.54% | **15.3** | 15.3 | 15.3 |
| **Total** | **25.5** | 43.1 | 25.5 |

All subordinated liabilities are denominated in sterling. The notes are repayable in the years stated, or earlier in accordance with their terms at the option of the Society, with the prior consent of the Prudential Regulation Authority (PRA). The subordinated notes rank equally with each other and behind all other creditors of the Society and the claims of Shareholding Members (other than holders of Permanent Interest Bearing Shares (PIBS) and Perpetual Capital Securities (PCS)) as to principal and interest.

During 2016 the Society, with the consent of the PRA, repurchased all £10.1 million of the Fixed rate subordinated notes 2021 – 6.12% and all £7.1 million of the Fixed rate subordinated notes 2016 – 12.25%.

## 12. Subscribed capital

| | Call date | **Period to 30 Jun 2017 (Unaudited) £m** | Period to 30 Jun 2016 (Unaudited) £m | Year ended 31 Dec 2016 (Audited) £m |
|---|---|---|---|---|
| Permanent Interest Bearing Shares 1992 - 12.125% | n/a | **41.6** | 41.6 | 41.6 |
| **Total** | | **41.6** | 41.6 | 41.6 |

Interest is paid in arrears on £40 million PIBS at the rate of 12.125% per annum in half-yearly instalments. The PIBS are repayable only in the event of a winding up of the Society or otherwise with the prior consent of the PRA. PIBS rank equally with PCS. They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than holders of PCS) as to principal and interest. The holders of PIBS are not entitled to any share in any final surplus upon a winding up or final dissolution of the Society.

## 13. Other equity instruments

In June 2014, the Society issued £400 million (£396.9 million net of issuance costs and associated tax) of new Perpetual Capital Securities (PCS), which qualify as Additional Tier 1 capital in the Society. These instruments rank equally with each other and PIBS. They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than PIBS) as to principal and interest. The holders of PCS are not entitled to any share in any final surplus upon a winding up or final dissolution of the Society.

The PCS pay a fully discretionary, non-cumulative fixed coupon at an initial rate of 6.375% per annum. The rate will reset on 1 November 2019 and every five years thereafter to the five year mid swap rate plus 4.113%. Coupons are paid semi-annually in May and November.

A coupon payment of £12.8 million, covering the period 1 November 2016 to 30 April 2017 was approved and recognised (net of tax) in the Statement of Changes in Members' Interests and Equity in the period ended 30 June 2017 (30 June 2016: coupon payment of £12.8 million, covering the period from 1 November 2015 to 30 April 2016).

The instruments have no maturity date. They are repayable at the option of the Society in November 2019 or on every fifth anniversary thereafter, but only with the prior consent of the PRA. If the end-point Common Equity Tier 1 ratio for the Group, on either an individual consolidated or a consolidated basis, falls below 7% they convert to Core Capital Deferred Shares (CCDS) at the rate of one CCDS for every £67 held.

The returns paid to investors on these securities are treated as an appropriation of profit after tax, reflecting their categorisation as equity instruments, and hence are not reflected within the Income Statement, but instead are distributed directly from the general reserve.

## 14. Available-for-sale reserve

Amounts within the Available-for-sale reserve are transferred to the Income Statement upon the disposal of the related debt securities or equity investments, and where a hedging relationship exists between the debt securities and a derivative instrument.

During the period, a £9.2 million loss was transferred to the income statement, this is summarised in the table below:

| | **Period to 30 Jun 2017 (Unaudited) £m** | Period to 30 Jun 2016 (Unaudited) £m | Year ended 31 Dec 2016 (Audited) £m |
|---|---|---|---|
| Items recognised transferred to the Income Statement | | | |
| Interest receivable and similar income[1] | **1.3** | - | - |
| Other operating income[2] | **5.0** | 4.9 | 4.9 |
| Net losses from derivative financial instruments[3] | **(15.5)** | 49.4 | 21.8 |
| **Total** | **(9.2)** | 54.3 | 26.7 |

1. Transfer to the Income Statement relates to the disposal of Available-for-sale debt securities.
2. Transfer to the Income Statement relates to the disposal of Available-for-sale equity instruments.
3. Transfer to the Income Statement offsets the effects of changes in the fair value of derivatives hedging Available-for-sale debt securities.

## 15. Financial instruments – classification and fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants assuming the most advantageous market to which the Group has access at the reporting date.

The Group measures fair value using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

Level 1: quoted prices (unadjusted) in active markets for identical instruments.
Level 2: valuation techniques for which all significant inputs are based on observable market data.
Level 3: valuation techniques for which significant inputs are not based on observable market data.

When applicable, the Group measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions take place with sufficient frequency and volume to provide pricing information on an ongoing basis. For all other financial instruments the Group determines fair values using other valuation techniques.

**Fair value of assets held at amortised cost**

The following table summarises the fair value of the Group's financial assets and liabilities measured at amortised cost on the face of the Group's Statement of Financial Position:

| | **Carrying amount 30 Jun 2017 (Unaudited) £m** | **Fair value 30 Jun 2017 (Unaudited) £m** | Carrying amount 30 Jun 2016 (Unaudited) £m | Fair value 30 Jun 2016 (Unaudited) £m | Carrying amount 31 Dec 2016 (Audited) £m | Fair value 31 Dec 2016 (Audited) £m |
|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | |
| Cash and balances with the Bank of England | **3,773.3** | **3,773.3** | 2,854.7 | 2,854.7 | 3,260.0 | 3,260.0 |
| Loans and advances to credit institutions | **194.6** | **194.6** | 276.1 | 276.1 | 213.5 | 213.5 |
| Loans and advances to customers | **34,527.6** | **34,443.9** | 31,446.3 | 31,325.2 | 32,881.6 | 32,751.5 |
| **Financial liabilities** | | | | | | |
| Shares | **29,935.7** | **30,193.8** | 26,927.6 | 27,136.2 | 28,054.3 | 28,257.3 |
| Deposits from banks | **1,851.3** | **1,851.3** | 2,265.4 | 2,267.9 | 2,937.5 | 2,936.4 |
| Other deposits | **6.0** | **6.0** | 6.0 | 5.9 | 7.0 | 7.0 |
| Amounts owed to other customers | **903.8** | **903.3** | 781.3 | 780.9 | 819.4 | 818.0 |
| Debt securities in issue | **4,904.0** | **5,065.8** | 4,111.8 | 4,344.5 | 3,978.1 | 4,187.6 |
| Subordinated liabilities | **25.5** | **28.9** | 43.1 | 47.5 | 25.5 | 29.2 |
| Subscribed capital | **41.6** | **82.5** | 41.6 | 78.4 | 41.6 | 79.4 |

*Loans and advances to customers*

The fair value of loans and advances to customers is assessed as the value of the expected future cash flows. Future cash flows are projected using contractual interest payments, contractual repayments and the expected prepayment behaviour of borrowers. Conservative assumptions are applied regarding expected levels of customer prepayments and the risk of defaults.

The resulting estimated future cash flows are discounted at current market rates to determine a fair value. These fair values have been adjusted where necessary to reflect any observable market conditions at the time of valuation.

## 15. Financial instruments – classification and fair value measurement continued

*Customer shares and deposits*
Shares and deposits from customers are valued in accordance with the cash flows projected from the contractual terms of the deposits. The fair value of shares and deposits that are available on demand approximates to the carrying value. The fair value of fixed term or restricted access deposits is determined from the estimated projected cash flows from those deposits discounted at the current market rates for those types of deposit.

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

**Fair value of assets held at fair value, and classification within the fair value hierarchy**
The following table summarises the fair value hierarchy of the Group's financial assets and liabilities measured at fair value on the face of the Group's Statement of Financial Position:

| **30 June 2017 (Unaudited)** | **Level 1 £m** | **Level 2 £m** | **Level 3 £m** | **Total fair value £m** |
|---|---|---|---|---|
| Derivative financial instruments - assets | **-** | **343.1** | **-** | **343.1** |
| Debt securities | **993.9** | **-** | **7.3** | **1,001.2** |
| Investment in equity shares | **-** | **-** | **2.2** | **2.2** |
| Derivative financial instruments - liabilities | **-** | **(192.5)** | **(63.5)** | **(256.0)** |
| **Total** | **993.9** | **150.6** | **(54.0)** | **1,090.5** |
| 30 June 2016 (Unaudited) | | | | |
| Derivative financial instruments - assets | - | 349.4 | - | 349.4 |
| Debt securities | 1,444.2 | 3.0 | 6.0 | 1,453.2 |
| Investment in equity shares | - | - | 5.8 | 5.8 |
| Derivative financial instruments - liabilities | - | (410.9) | (78.5) | (489.4) |
| Total | 1,444.2 | (58.5) | (66.7) | 1,319.0 |
| 31 December 2016 (Audited) | | | | |
| Derivative financial instruments - assets | - | 354.2 | - | 354.2 |
| Debt securities | 1,344.7 | 3.6 | 6.0 | 1,354.3 |
| Investment in equity shares | - | - | 5.9 | 5.9 |
| Derivative financial instruments - liabilities | - | (298.1) | (68.6) | (366.7) |
| Total | 1,344.7 | 59.7 | (56.7) | 1,347.7 |

*Level 1 - Debt securities*
Market prices have been used to determine the fair value of listed debt securities.

*Level 2 - Derivatives*
Derivative products valued using a valuation technique with observable market inputs are interest rate swaps and cross currency swaps. The valuation techniques applied are swap models using present value calculations. The models incorporate various assumptions including interest rate curves and foreign exchange spot and forward rates.

## 15. Financial instruments – classification and fair value measurement continued

*Level 2 - Debt securities*

Debt securities for which no market price or executable bid is available at the period end date are valued by one of two methods. Where there are recent market prices or executable bids for the security, these are used as the basis for establishing a period end price for valuation purposes. Otherwise, a security is priced based on its relative value to comparable bonds.

*Level 3 - Debt securities*

The item included within Level 3 is a mortgage backed security. This is valued using the same valuation technique as Level 2 debt securities, namely by establishing a price based on its relative value to comparable bonds. The unobservable inputs relate to estimates of the likely timing of repayments and hence the weighted average life of the security. A change in price of ten basis points, which can be taken to represent the impact of repayment commencing (if positive) or being set back further (if negative), would change the value of the security by £0.8 million.

*Level 3 - Investment in equity shares*

Level 3 investment in equity shares represent the Group's holding in Visa Inc. preference shares and VocaLink Holdings Limited shares. These shares are valued based on future cash consideration which the Group expects to receive on sale of these instruments, or the underlying market value. Contingent, performance based, deferred consideration has been assigned a value of nil.

A discount is applied to the valuation of the holding in Visa Inc. to reflect marketability and other risks in relation to the instrument. A change in the discount of 10% would result in a change in the carrying value of the investment of £0.2 million.

*Level 3 - Derivatives*

The items included within Level 3 are balance tracking swaps which have remained in place during the period. These are valued using the same valuation technique as Level 2 derivatives, namely present value calculations based on market interest rates curves. The unobservable inputs relate to the projection of the swap notional amount, which changes over time to match the balance of the underlying mortgage portfolio. Projected mortgage prepayment amounts are used in the modelling of the mortgage portfolio profile. A change of 10% in the prepayment rates used results in a £0.6 million change in the value of the swaps. As changes in the projection of interest and prepayment rates of the underlying mortgage portfolio impact the swap and hedged item equally, the net Income Statement and Statement of Financial Position impact would be negligible.

## 15. Financial instruments – classification and fair value measurement continued

The following table analyses movements in the Level 3 portfolio:

| | Total £m |
|---|---|
| As at 1 January 2016 (Audited) | (45.2) |
| Items recognised in the Income Statement | |
| Interest receivable and similar income | 0.1 |
| Interest payable and similar expense | (6.3) |
| Net unrealised gains on derivatives and hedge accounting | (13.1) |
| Available-for-sale reserve fair value movement | 0.9 |
| Settlements | 1.3 |
| Transfers into Level 3 portfolio | 5.6 |
| As at 31 December 2016 (Audited) | **(56.7)** |
| Items recognised in the Income Statement | |
| Interest payable and similar expense | **(3.2)** |
| Net unrealised losses on derivatives and hedge accounting | **5.1** |
| Fair value movement taken to members' interests and equity | **2.7** |
| Settlements | **(1.9)** |
| Transfers into Level 3 portfolio | **-** |
| **As at 30 June 2017 (Unaudited)** | **(54.0)** |

Transfers only occur when either it becomes possible to value a financial instrument using a method that is higher up the valuation hierarchy or it is no longer possible to value it using the current method and therefore it is valued using a method lower down the hierarchy.

In the six months to 30 June 2017, two debt securities valued at £3.5 million were transferred from Level 2 to Level 1. During 2016, two investments in equity shares valued at £5.6 million were transferred to Level 3. One of these (£4.5 million as at 31 December 2016) had previously been held at cost, as fair value could not be reliably measured. The second transfer related to the Group's holding in Visa Inc. preference shares which were received following the sale of Visa Europe to Visa Inc..

# RESPONSIBILITY STATEMENT

The directors confirm that this Interim Financial Report has been prepared in accordance with IAS 34 as adopted by the EU. The Interim Management Report includes a fair review of the important events that have occurred during the first six months of the financial year and their impact on the Interim Financial Statements, as required by the Disclosure and Transparency Rules (DTR 4.2.7). The principal risks and uncertainties continue to be those reported within the Risk Management Report starting on page 22 of the 2016 Annual Report & Accounts as amended by those detailed on page 6 of this Interim Financial Report.

A full list of the Board of directors can be found in the 2016 Annual Report & Accounts. Subsequent to the publication of those Accounts, on 27 April 2017, John Lowe and Janet Ashdown retired from the Board, and Michele Faull and Andy Deeks were appointed to the Board. Michele Faull is Chief Financial Officer of the Society and was previously Group Risk Director at Nationwide Building Society until December 2016. Prior to that Michele served as Director for Financial Reporting & Tax at Nationwide Building Society. Andy Deeks is the Product, Marketing and Strategy Director for the Society, having worked for the Society for ten years in addition to several years' experience as a management consultant, working across many UK retail banks, building societies and insurers.

Signed on behalf of the Board by

Mark Parsons
Chief Executive
27 July 2017

Michele Faull
Chief Financial Officer

# INDEPENDENT REVIEW REPORT

## Independent review report to Coventry Building Society

**Introduction**

We have been engaged by the Society to review the condensed set of financial statements in the Interim Financial Report for the six months ended 30 June 2017 which comprises the Condensed Consolidated Income Statement, Condensed Consolidated Statement of Comprehensive Income, Condensed Consolidated Statement of Financial Position, Condensed Consolidated Statement of Changes in Members' Interests and Equity, Condensed Consolidated Statement of Cash Flows and the related explanatory notes 1 to 15. We have read the other information contained in the Interim Financial Report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Society in accordance with guidance contained in International Standard on Review Engagements 2410 (UK and Ireland) 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society, for our work, for this report, or for the conclusions we have formed.

**Directors' Responsibilities**

The Interim Financial Report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the Interim Financial Report in accordance with the Disclosure Guidance and Transparency Rules of the United Kingdom's Financial Conduct Authority.

As disclosed in note 2 the annual financial statements of the Society are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this Interim Financial Report has been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union.

**Our Responsibility**

Our responsibility is to express to the Society a conclusion on the condensed set of financial statements in the Interim Financial Report based on our review.

**Scope of Review**

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

**Conclusion**

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the Interim Financial Report for the six months ended 30 June 2017 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure Guidance and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Ernst & Young LLP
Leeds
27 July 2017

# OTHER INFORMATION

The Interim Financial Report information set out in this document is unaudited and does not constitute accounts within the meaning of section 73 of the Building Societies Act 1986.

The financial information for the year ended 31 December 2016 has been extracted from the Annual Report & Accounts for that year. The Annual Report & Accounts for the year ended 31 December 2016 have been filed with the Financial Conduct Authority (formerly the Financial Services Authority). The Auditors' report on these Annual Report & Accounts was unqualified.

A copy of the Interim Financial Report is placed on the website of Coventry Building Society, at thecoventry.co.uk/interim2017. The directors are responsible for the maintenance and integrity of the information on the Society's website. Information published on the internet is accessible in many countries with different legal requirements. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

COVENTRY
Building Society

Coventry Building Society.
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