ANNUAL REPORT & ACCOUNTS

2013

the COVENTRY

TLC not PLC

CONTENTS

The term 'Society' is used in this Annual Report & Accounts (pages 2 to 85) to refer to the activities of the Society and its subsidiaries, except where the context indicates otherwise.

Chairman
Ian Pickering

Deputy Chairman and Senior Independent Director
Bridget Blow

Chief Executive
David Stewart

Executive directors
Feike Brouwers, Chief Risk Officer
Colin Franklin, Sales and Marketing Director
Peter Frost, Chief Operating Officer
John Lowe, Finance Director

Non-executive directors
Janet Ashdown
Peter Ayliffe
Roger Burnell
Ian Geden
Glyn Smith

Secretary
Thomas Crane

Senior Management
Julian Atkins
Rachel Haworth
Darin Landon
Siobhan Moynihan
Steve Oerton

Auditors
Ernst & Young LLP
1 More London Place
London SE1 2AF

Bankers
Bank of England
HSBC plc
The Royal Bank of Scotland plc

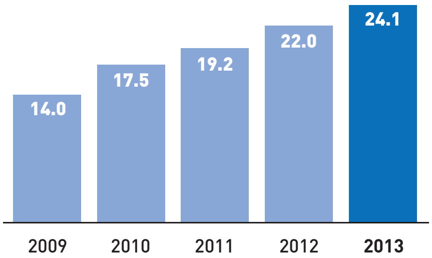
Principal Office
Economic House
PO Box 9
High Street
Coventry CV1 5QN

PERFORMANCE HIGHLIGHTS 2013

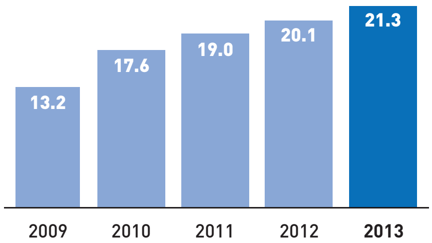
£144.7m	**Strong financial performance** Underlying profit increased by 62% over 2012.
£5.9bn	**Record mortgage lending** Representing 3.33% of all UK mortgage advances and around four times the Society's market share of gross lending at the start of the credit crisis in 2007. (Source: Bank of England)
19%	**Share of UK mortgage growth** Net mortgage lending was equivalent to 19% of all UK mortgage growth. (Source: Bank of England)
0.03%	**Very low impairments** Amongst the lowest impairments of any major mortgage lender. (Impairment losses on loans and advances to customers/Average loans and advances to customers)
£21.3bn	**Members' savings** Savings balances grew by over £1.2 billion, to a new record of £21.3 billion.
100 weeks	**Best buy ISAs** Coventry ISAs have been in the national best buy tables for 100 consecutive weeks.
2.50%	**The minimum rate on all existing variable cash ISAs** In April 2013 Coventry increased the rate it pays to existing easy access, variable rate cash ISA savers to 2.50%.
0.39%	**The most cost-efficient building society** Spending just 39p per £100 of assets, Coventry remains the UK's most cost-efficient building society. (Based on reported administrative expenses, depreciation and amortisation/Average total assets)
24.3%	**Strong and secure** Member reserves increased by £94.9 million, supporting the highest reported Core Tier 1 ratio of any top 10 building society at 24.3%.
Zero	**Sales incentives** No individual Coventry member of staff is incentivised to sell products.
Just 39	**FOS outcomes adjusted** Since 2009, when the Financial Ombudsman Service started to publish industry tables, it has asked for the outcome of referred Coventry customer complaints to be changed on just 39 occasions.
£2.3m	**Supporting the communities in which we work** Over 240 organisations supported by Society staff volunteers and fundraising in 2013, with total community investment rising to £2.3 million.

5 YEAR FINANCIAL SUMMARY

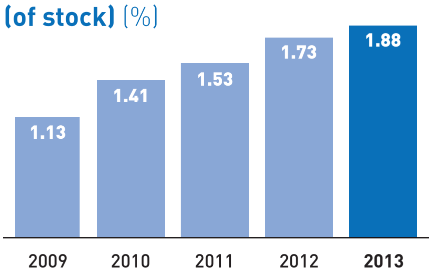
Mortgages (£bn)



Savings (£bn)

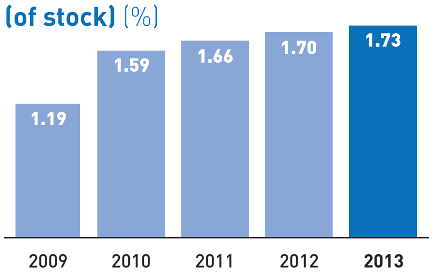


Mortgage market share* (of stock) (%)



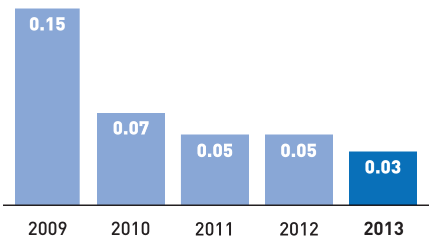
* Source: Bank of England

Savings market share* (of stock) (%)



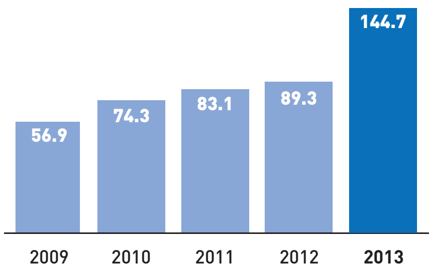
* Source: Bank of England

Impairment* (%)



* Impairment losses on loans and advances to customers/ Average loans and advances to customers

Underlying profit before tax* (£m)



* Underlying profit before tax excludes gains and losses from derivatives financial instruments (2009-2013), FSCS levies (2009-2013), Stroud & Swindon integration and merger related costs (2010-2011), gain on business combinations (2010) and gain on pension curtailment (2012)

CHAIRMAN'S STATEMENT

In future years, 2013 may come to be regarded as a turning point for the UK economy. Economic indicators started to improve and there were welcome signs that consistent and sustained growth was becoming a reality.

Of course, significant risks exist that may yet threaten this recovery. Initiatives to reduce the UK budget deficit and the continued weakness in European markets may restrict economic growth and the potential impact of reducing monetary support mechanisms, both in the UK and overseas, is difficult to predict.

In the housing market there were concerns from some quarters as the rate of house price inflation, albeit with some regional variation, began to make the news for the first time since the credit crisis began in 2007.

The influence of Government initiatives, easing the availability of funding for mortgages and supporting house purchases through its Help to Buy schemes, has clearly been a factor in growing activity levels.

It remains to be seen if the market will develop to the volumes seen prior to the credit crisis. Whilst activity is still below peak volumes there is an upward trend, with housing market transactions in 2013 exceeding one million for the first time since 2007.

Whilst borrowers have benefited from initiatives designed to encourage economic growth, savers have continued to bear the brunt of these exceptional market conditions. The Bank Base Rate remained at its historic low and the Government's Funding for Lending Scheme added downward pressure to a savings market that has often offered less than the prevailing rate of inflation.

In this context it is more important, and more challenging, that Coventry meets its responsibility to protect the interests of all its members - borrowers and savers. I believe we have achieved this.

In 2013, the Society took what we believe to be a unique decision amongst high street banks and building societies to raise the rate paid on its existing easy access, variable rate cash ISAs to a market-leading 2.50%.

The Society's commitment to its savings members is shown more generally by the fact that, at the end of 2013, 85% of its variable savings balances earned a rate of interest that was equal to or higher than the equivalent best buy from any major high street bank or building society[1].

The result was that the Society grew its savings balances in 2013, as it has done in every year since the onset of the credit crisis.

It is worth repeating that this growth took place despite the availability of cheaper funding through the Funding for Lending Scheme. The Society has made decisions, which I recognise may not transform the fortunes of individual members, but do reduce the Society's potential profitability and provide one clear example of the difference that a mutual business model can make.

Mortgage members have also benefited from the Society's activities in 2013. As has been the case throughout the credit crisis and economic recession, the Society has maintained its record of positive, high quality lending.

The key to Coventry's lending performance is sustainability. As the last few months of 2013 have illustrated, it does not take much for speculation of a housing bubble to take root. Mortgage lending in an environment of extremely low interest rates must be tempered with the responsibility to protect individuals, and the Society, from taking inappropriate risks.

This has always been a core value at Coventry. The consistent mortgage growth achieved over many years shows the Society's commitment to the market as a whole, and to people wishing to buy their own homes. The strong record of low arrears, repossessions and impairments shows the Society's commitment to lending responsibly, and reducing the risks implicit in taking on too much debt.

The result is sustainable growth. This achievement continues to be underpinned by a culture of strong cost control, which supports competitive pricing to members and equally importantly for a mutual building society,

1. As at 31 December 2013. Average deposit assumed as follows: Variable - £10,000 and ISAs £5,760. Excludes competitor products with restricted availability (e.g. existing customers only, Sharia accounts or reliant on maintaining or opening another product with the same provider) and Coventry Current/ MoneyManager and Offset accounts. Source: Moneyfacts data.

levels of profitability that provide capital to support growth whilst providing the best possible rates to members.

The Society's record of sustainable growth, responsible and high quality lending supported by secure funding, cost control and profitability is recognised by the credit ratings agencies that monitor the sector. Coventry has retained its 'A' rating from Fitch and Moody's throughout the credit crisis. In fact, the Society is the only major high street bank or building society not to have been downgraded by either of these agencies over the last four years.

Strong products and financial security may be key attributes for many of the Society's members, but meeting their service expectations is also important.

Coventry takes this responsibility equally seriously and invests in a number of methods of gauging and improving its performance. Member surveys show an extremely high level of satisfaction with, and indeed advocacy of, the Society. This is shown more tangibly by the relatively low levels of complaints about the Society.

This does not translate into complacency. The Society does make mistakes and although it has an excellent record in resolving these, they are a pointer to where, as an organisation, we need to improve.

The dangers of complacency and a lack of focus on the fundamentals, have been all too evident in the financial services sector in recent times. The failures of many organisations have shown that no one particular business model has a guarantee or right to success.

However, Coventry's success shows that the mutual business model can work. More than this, the ability of the organisation to achieve sustainable growth, whilst delivering fair conduct outcomes to its members, shows the value that the mutual business model can achieve.

That is why I am confident in saying that the Board and I remain unanimous in believing that Coventry should remain an independent building society. As I said last year, the Society will continue to develop in response to the changing environment and the needs and expectations of its members.

What we will not do is change the values that have helped it deliver a track record of outstanding performances throughout the credit crisis and subsequent economic downturn.

The Society has a long and proud heritage and many people have been responsible through its history for developing a modern financial services institution, with the values and principles that its founders would still recognise. Ensuring that we have the right people to maintain this development is one of the responsibilities of the Board, the importance of which has been thrown into stark relief in recent months.

I would at this point like to welcome three new members to the Society's Board. Peter Ayliffe, former Chief Executive Officer of Visa Europe and Board Director of Lloyds TSB, and Janet Ashdown, a former executive of BP, bring a wealth of experience to a strong and committed team of non-executive directors. Feike Brouwers has joined in the executive director role of Chief Risk Officer and brings considerable financial services experience gained in a number of senior positions within ING Group.

2014 will also see the succession of a new Chief Executive. I would like to thank David Stewart on behalf of the Board, staff and members for all he has achieved at the Society over the last eleven years. When he became Chief Executive, he said his aim was to ensure he left the Society in as strong a position as when he started. Despite the unprecedented conditions, he has done more than that. The Society is not only strong and secure, it has developed into a better organisation during his tenure. We wish him well for the future.

It only remains to thank every member of staff for their commitment and contribution to what has been another extremely successful year for the Society and its members.

Ian Pickering
Chairman
27 February 2014

CHIEF EXECUTIVE'S REVIEW

I am pleased once again to report a very strong performance by the Society. Our financial strength can clearly be seen in the consistency of this performance, but equally important is our commitment to protecting members' interests.

Since first joining the Society at the start of 2002, I have experienced market extremes from a housing boom to a global financial crisis. Throughout these extremes, Coventry Building Society has provided long-term value, a safe home for savings and has helped increasing numbers of members to buy their homes.

The consistency of this performance is probably its most remarkable attribute. In more benign conditions, the Society was judged by some to be overly cautious. I believe our actions are better described as prudent, a quality which has proved equally appropriate for the Society and its members in the more challenging times since the onset of the credit crisis.

As a mutual organisation, we are owned by our savers and borrowers and our responsibility is to put their interests first. I believe this lies at the heart of what the Society has achieved in delivering security, fairness and value for its members.

However, mutual ownership, whilst directing the Society's objectives, does not in itself ensure a successful performance. In 2013, as in previous years, the failings of financial services organisations were not defined by their structure, scale or ownership, but rather by the decisions they took.

Coventry's success is based on the values that govern our decisions and our ability to implement these decisions effectively. The simplicity of the business model requires close control over costs, risks and margin, and collectively this underpins the Society's financial strength and its ability to compete. Equally, our commitment to members extends to meeting their service expectations and here too the Society has proved a reliable and trusted organisation.

Mortgages

In 2012, Coventry was the UK's seventh largest lender for new lending, having entered the top 10 for the first time in 2008[1]. This year I expect us to also become one of the top 10 for outstanding balances.

The Society advanced £5.9 billion (2012: £5.1 billion), a record performance and one that continues a trend of growth which has resulted in around a four-fold increase in market share since the end of December 2006. The Society once again recorded positive net lending, with organic growth in mortgage balances of £2.1 billion, equivalent to 19% of all UK mortgage growth in the year[2].

It is of particular note that this has been achieved without recourse to higher risk lending. The Society's aim to protect its members' interests is based on the need to lend responsibly to individual borrowers and, by doing so, to protect the financial strength of the Society as a whole.

At a time of extremely low interest rates, the affordability of current lending must be judged by the likelihood of interest rate rises in the future. We must also take account of worsening economic conditions should the recent recovery not be sustained. The Society has taken great care to lend responsibly, and its success is clearly shown by levels of arrears, impairments and repossessions which are amongst the lowest in the industry. It will continue to follow this prudent approach in the future.

Retail savings

Sometimes the performance of building societies is judged solely by the volume of lending. However, our membership consists of savers as well as borrowers.

On average, we have nearly nine savings accounts for each mortgage. The credit crisis has shown beyond doubt that a building society has an equal and fundamental responsibility to protect the interests of its savers – keeping their deposits secure and offering them a fair return over the long-term.

Coventry has one of the strongest track records in the UK financial services sector of protecting savers from the impact of sustained low interest rates.

Over the last six years, the Society has paid the highest average savings rate[3] of any top 10 building society. In April 2013, we took what we believe to be a unique decision amongst high street banks and building societies to raise the rate paid on our existing easy access variable rate cash ISAs to a market leading 2.50%, and allowed all existing ISA holders with the

1. Source: Council of Mortgage Lenders.
2. Source: Bank of England.
3. Average rate estimate based upon interest payable on shares divided by average of opening and closing share balances, as disclosed in Annual Report & Accounts (2007 to 2012).

Society[4] to transfer in cash ISAs held with Coventry and other institutions. At 31 December 2013, no Coventry member earned less than 2.00% on any of their ISA savings against a market average variable cash ISA rate of 1.09%[2]. Indeed, of the Society's ISA balances, 98% earned equal to or more than 2.50% at 31 December 2013.

This encouraged more members to make use of their cash ISA allowance and resulted in the Society increasing its market share of UK cash ISA balances by 60%[2]. The Society's commitment to the ISA sector is also shown by the fact that its cash ISAs have been in the national press best buy tables for 100 consecutive weeks, whilst its Junior ISA has been a national press best buy every week since it was launched in April 2012[5]. In this context, Coventry has a strong case for being considered the UK's number one cash ISA provider, often the foundation of people's long-term savings.

The competitiveness of the Society's range of savings accounts, both ISA and non-ISA, was also shown by an increase in new account openings, up 30% on 2012.

This was supported by our continuing relationship with The Royal British Legion. The 2013 Poppy ISA proved to be the fastest selling Coventry product since records began[6], and we expect that the total donation raised through this innovative partnership since it began in 2008 will exceed £10 million in 2014 – a fitting achievement in the centenary year of the First World War.

We also raised over £200,000 for Cancer Research UK with our inaugural Race for Life Bond, maintaining our position as the leading provider of competitive charitable affinity accounts. We have been recently recognised in this regard through the award of Best Affinity Account Provider from Savings Champion.

2013 was also notable for the impact of the Funding for Lending Scheme, with many providers reducing savings rates significantly during the year. Where possible the Society took a different route, for example benefiting existing savers directly by increasing our easy access, variable rate cash ISA rate from 6 April 2013, and, where rates have been reduced, we have maintained the best buy status of many Society accounts.

The result, at the end of 2013, was that 85% of variable savings rate balances held at the Society were earning equal to or more than the equivalent best buy offered by any high street bank or building society[7].

The impact of these decisions was an increase in retail funding of £1.2 billion with overall balances reaching a record £21.3 billion. In an environment in which many savers saw a significant erosion in the value of their savings, with government funding available at far lower rates than in the retail market, this increase represents a significant commitment to the Society's savings members.

Strong and secure

It is equally important that the Society continues to retain sufficient profit to generate the capital needed to support growth and meet regulatory requirements. Notwithstanding the Society's extremely strong risk weighted capital ratios the introduction of additional requirements (discussed in detail on pages 24 to 27) requires the careful balancing of our commitment to savers against the level of profitability that is achieved.

Despite profits significantly increasing in 2013 this commitment to savers has moderated the Society's performance. Whilst the decision to do this is a clear indication that a mutual business model can balance these interests and deliver genuine benefits to its members, the ability to do it is dependent on the Society's control of costs, risks and net interest margin.

Coventry has been the most cost-efficient building society in the UK for some years, and in 2013 its cost to mean asset ratio of just 0.39% remained sector-leading by a significant factor.

I have already talked about the importance of lending responsibly and the resulting low levels of arrears and impairments. Impairment charges in 2013 totalled just £6.3 million, from a loan book in excess of £24.1 billion. Mortgage arrears remained significantly less than half the industry average[8].

4. At the close of business on 4 February 2013.
5. Best buy tables published in the national press.
6. Most accounts opened within the first 31 days.
7. As at 31 December 2013. Average deposit assumed as follows: Variable - £10,000 and ISAs £5,760. Excludes competitor products with restricted availability (e.g. existing customers only, Sharia accounts or reliant on maintaining or opening another product with the same provider) and Coventry Current/MoneyManager and Offset accounts. Source: Moneyfacts data.
8. As at 30 September 2013. Source: PRA.

CHIEF EXECUTIVE'S REVIEW

(continued)

The combined result was market leading savings rates[7], an increase in underlying profit before tax[9] of 62%, and the transfer of an additional £101.3 million to the Society's reserves.

Sustainable profits, low costs and impairments, and a sector-leading risk weighted capital ratio support the Society remaining 'A' rated by both Fitch and Moody's. This makes it one of the most highly rated banks or building societies in the UK and the only major high street bank or building society not to be downgraded in the last four years.

Putting Members First

The success of the Society's financial performance cannot be seen in isolation of the decisions taken to protect the interests of its members.

I believe what makes Coventry genuinely different from many of its competitors is its ability to deliver the right outcomes to its members whilst maintaining the financial strength of the organisation.

The mis-selling of Payment Protection Insurance (PPI) remains a constant reminder that profit should not be sought at the expense of customers. Coventry has been relatively unaffected by this scandal due to decisions regarding the product design and sales process.

Recent events have also drawn attention to continued poor sales practices at other financial institutions. Sales incentive schemes have frequently been cited as a major reason for customer detriment. By contrast Coventry's customer-facing staff do not have sales targets, let alone sales incentives. Indeed we largely moved away from even modest individual bonus arrangements as long ago as 2008.

This focus on doing the right things is supported by continued investment in listening to our members.

Our Coventry-based call centre has won awards at the European Call Centre & Customer Service Awards twice in the last four years, including Best Banking & Financial Services Contact Centre. Given this accolade, it is perhaps understandable that independently undertaken surveys placed it as the highest scoring financial services centre for customer satisfaction in two out of the last three years.

Customer advocacy scores, the degree to which a customer will recommend you to friends and family, amongst our branch network customers are exceptionally strong, averaging 86% in 2013.

This commitment to improving service is shown both by the low number of complaints received by the Society but equally our track record in resolving these in favour of our members. In the first half of 2013, only five complaints referred to and reviewed by the Financial Ombudsman Service were changed in favour of the complainant, a strong record that the Society expects to be reflected when industry-wide statistics for the second half of the year are published.

At its core, getting our service right depends on employing knowledgeable and motivated members of staff.

The Society works hard to recruit and retain individuals who understand and are keen to put into practice the values of the organisation. It is particularly encouraging that, in the annual employee opinion survey, staff expressed clear understanding of the Society's aims and values and were extremely supportive of them.

This extends not only to the Society's work on behalf of members, but also on behalf of the wider community.

I am pleased to report that we continue to increase the support we give local and national charities, both through our organisational expertise and the enthusiasm and skill of members of staff. Through a combination of fundraising, volunteering and affinity activities, the total community investment supported by the Society in 2013 was £2.3 million.

A key part of this activity has taken place at a local level with many successful community partnerships now established between branches, head office teams and community groups. Further support continues to be provided through the Coventry Building Society Charitable Foundation. In 2014, I expect total donations to the Foundation to reach £1 million since its inception in 1998.

9. Underlying profit before tax, equates to statutory profit before tax adjusted for a charge of £15.4 million (2012: £7.6 million) in respect of the Financial Services Compensation Scheme (FSCS) and a £2.8 million gain (2012: £0.1 million gain) on derivatives and hedge accounting.

Summary

I noted at the outset that in 2013 the Society has achieved another strong performance. This is particularly poignant as I conclude my eighth and final Chief Executive annual review.

The Society exists to serve the interests of its members. What makes Coventry genuinely different is that its performance has matched this commitment. In delivering competitive interest rates to savers and borrowers, and meeting their service expectations, it has also remained financially secure and grown stronger through a global credit crisis.

This has not been without challenge. Over the period of the financial crisis, the environment in which we operate has become more complex and, in some ways, more hostile. Notwithstanding recent improvements in economic data, it is clear to me that significant challenges remain.

However, at a time when many elements of the financial services sector continue to fall short of public expectations, Coventry Building Society has shown that focusing on the needs of its members and remaining a strong and profitable organisation are not mutually exclusive.

I hope that economic recovery is a reality. There can be no room for complacency. But should it stall, I am confident that the Society remains well placed to maintain its position as a trusted, successful and growing organisation, holding firm to its values of prudence and fairness.

David Stewart
Chief Executive
27 February 2014

OBJECTIVES, STRATEGY AND BUSINESS MODEL

Objectives

The Society's principal objective is to meet its current and future members' needs for residential mortgages and provide a trustworthy home for retail savings delivered in a fair manner. Growth will be delivered by providing long-term fairly priced products, making efficient use of resources and maintaining a resilient and sustainable business model.

Operating model

The Society generates long-term value by accepting deposits from savings members and providing secured mortgage lending on residential properties. The difference between the rates on mortgages and savings accounts provide the Society with a margin to cover its costs, impairment losses and taxation. The remaining retained earnings provide the Society with the capital to grow lending and protect existing members during periods of economic downturn.

As a mutual organisation, the Society does not have external shareholders or pay dividends, its customers have membership rights and are the 'owners' of the organisation. This creates clarity of purpose. The Society exists to serve its members and protect their interests, and strategic and operational decisions are taken with this responsibility in mind. Central to this is the provision of long-term sustainable value to members through competitively priced mortgage and savings products. The Society balances this with the requirement to protect members' interests by remaining financially strong and secure. As a result the Society aims to achieve sustainable levels of profitability rather than maximising profit to the detriment of its members.

Therefore, the Society can operate on lower levels of profit than would otherwise be the case enabling it to provide improved pricing for customers.

Market outlook

Future performance and growth of the Society may be impacted by:

- The performance of the UK economy and housing market.
- The availability and cost of retail savings and other funding.
- Regulatory and competitive impacts on the Society's ability to grow market share and earnings.

The performance of the UK economy has improved during 2013. The recovery has become more established and it appears likely that unemployment will continue to fall in the near term. The housing market has also recovered in 2013 with prices reaching pre-crisis highs in some regions, although significantly lower in real terms after adjusting for inflation. Government support for the market is likely to see some increase in supply of new housing and mortgage finance. However, the lag in increasing the availability of housing will potentially drive further house price inflation and a potential bubble in some areas, particularly if improvements in consumer confidence begin to lead sustainable increases in key economic indicators.

Growth in retail savings markets has been modest in 2013, constrained by negative growth in real terms earnings and low interest rates. Repayment of existing consumer debt, higher earnings growth and higher interest rates are likely to see a recovery in savings markets in the medium term. Wholesale market conditions are already improved albeit operating on lower levels of issuance than in recent years. The exit from extraordinary monetary and fiscal policy measures may lead to future disruption to both wholesale and savings markets, but if executed at the appropriate time and in an orderly fashion is likely to be positive to the Society's core retail savings markets.

Outside the growth in core markets, the Society's performance is primarily impacted by its regulators and the behaviour of competitors. The regulatory framework continues to evolve following the crisis and may have adverse consequences on the performance of the Society and other mutuals. In 2014 the Mortgage Market Review (MMR) will impact the way that mortgages are sold and underwritten, increasing costs and potentially disrupting the market. Non-risk based capital measures, in particular the leverage ratio (see pages 25 to 27) in the Basel III international framework have a particular impact on low risk mortgage lenders although the Society remains well placed to meet these new rules significantly in advance of the final implementation date.

Competitors continue to be more adversely impacted by the impairment of loans and payment of conduct redress from the mis-selling of financial products. The Society's low risk appetite, member focus and provision of financial products that offer long-term value for money has resulted in significantly lower provisions for these costs. A risk is that competitors, particularly the large banking groups, may disrupt our ability to grow market share through cross subsidising products from other parts of their businesses or develop economies of scale or other competitive advantage (including regulatory) that require building societies to adapt their business models or reduce rates of growth. The Society's focused business model and low cost base positions it well to deal with these threats.

Strategy

Against the market outlook the Society's strategy will continue to be as follows:

- The origination of low risk mortgage lending through intermediaries, branches and other direct channels. Growth in market share will be realised without taking on excessive levels of risk in order to protect existing members during periods of economic stress and to maintain the Society's ability to support future membership by remaining active in core markets in periods of economic downturn where possible.
- Flexible acquisition of retail funding by providing simple savings products offering long-term value for money through multiple direct channels to remain as the predominant funding source supported by access to wholesale funding markets.
- Efficient branches, call centre and back office operations with effective use of technology to allow customers to self service where they choose to do so and to maintain the Society's existing cost advantage over its peers.
- Strong ethical standards and conduct principles supporting 'Putting Members First'. This extends to how we recruit and reward staff and the design of products and services and consulting members about how we can better meet their financial services needs.

Overall the Society's rate of growth and pricing will remain flexible to respond to changes in the economic, regulatory and competitive environment to ensure performance is sustainable and balances the needs of the current and future membership.

Outcomes

In the context of the strategy noted above, the Board is pleased with the profit performance, cost-efficiency, market share and capital covered in this report, and also on customer experience and employee engagement covered in the Chief Executive's Review. These will continue to be the focus for the coming years.

BUSINESS REVIEW

(continued)

Performance against goals

Strategic goal	Key Performance Indicator	Performance in 2013
Growing the number of customers we serve.	Grow our share of the mortgage and savings markets, increasing the overall number of customers.	The Society's share of savings and mortgage stock increased in 2013, reflecting a trend that has seen it grow its share every year over the last seven years. The number of customers increased by over 90,000 during 2013, and the total number with either a savings or mortgage account now totals 1.7 million.
Competitively priced products offering long-term value.	Top quartile administered mortgage and savings rates[1].	85% of all variable savings balances[2] earned a rate of interest that is equal to or higher than the equivalent best buy available from any major high street bank or building society and our mortgage Standard Variable Rate[4] remains below the average rate applied by the peer group.
Strong risk adjusted capital ratios.	Have a top quartile Core Tier 1 capital ratio[1].	Highest reported Core Tier 1 capital ratio of any top 10 building society at 24.3%.
Sustainable levels profitability.	Maintain capital self-sufficiency to fund future growth.	The return on member reserves in 2013 was of ahead of the level of growth in mortgage assets.
Below median risk appetite.	Impairment charges in the lowest 25% of peer group average[1].	Latest impairment charge as a percentage of average total loans and advances to customers is lowest reported in peer group at just 0.03%.
Strong cost control.	Lowest reported cost to mean assets ratio[3] of our peer group[1].	At 0.39%, this measure is expected to remain comfortably the lowest of the peer group and around half of the total building society average[5].
High levels of customer satisfaction.	Low levels of complaints and high satisfaction scores in customer surveys.	Satisfaction scores for our branch network and telephone service are above 90% and the level of Financial Ombudsman complaints referred from Coventry customers was less than a third of our peer group[1].
Strong employee engagement scores.	Employee engagement scores above external high performance benchmarks.	The employee engagement score in the Society's 2013 staff opinion survey was 86% - 11% above the benchmark for UK financial services. The Society also continues to hold a Gold Award from Investors in People.
Community support.	To continue to make a tangible difference to local communities and national charities via fundraising and volunteering activities.	In 2013, the total investment in community activity, not including affinity products, increased by 32% to £460,000. This increased to £2.3 million when affinity accounts benefiting The Royal British Legion's Poppy Appeal and Cancer Research UK are included.

1. Unless otherwise stated, performance is measured against a peer group of the 10 largest building societies from last published annual results.
2. As at 31 December 2013. Average deposit assumed as follows: Variable - £10,000 and ISAs £5,760. Excludes competitor products with restricted availability (e.g. existing customers only, Sharia accounts or reliant on maintaining or opening another product with the same provider) and Coventry Current/MoneyManager and Offset accounts. Source: Moneyfacts data.
3. Administrative expenses, depreciation and amortisation/Average total assets.
4. Source: Moneyfacts data.
5. Source: Building Societies Association: Annual Accounts Data 2012.

These goals remain the strategic priorities for 2014 to 2018.

INCOME STATEMENT

Overview

Underlying profit before tax, equating to statutory profit before tax adjusted for a charge of £15.4 million in respect of the Financial Services Compensation Scheme (FSCS) and a £2.8 million gain on derivatives and hedge accounting, has increased by 62% to £144.7 million. Statutory profit before tax has increased by 45% to £132.1 million.

Whilst the Society does not aim to maximise profit, it is the key source of capital to protect members' interests and to enable growth. In this context both underlying and statutory profit measures show an extremely strong performance in 2013. This continues a track record of sustainable profitability that has seen the Society achieve appropriate levels of profits throughout the economic crisis.

Statutory and underlying profit are set out in the summarised income statement below:

Year to 31 December 2013	**Statutory profit £m**	**FSCS £m**	**Movements on derivatives and hedge accounting £m**	**Gain on pension curtailment £m**	**Underlying profit £m**
Net interest income	**253.1**	**-**	**-**	**-**	**253.1**
Other income	**9.3**	**-**	**-**	**-**	**9.3**
Gains on derivatives and hedge accounting	**2.8**	**-**	**(2.8)**	**-**	**-**
Total income	**265.2**	**-**	**(2.8)**	**-**	**262.4**
Administrative expenses, amortisation and depreciation	**(108.9)**	**-**	**-**	**-**	**(108.9)**
Impairment charges	**(6.3)**	**-**	**-**	**-**	**(6.3)**
Provisions	**(16.3)**	**15.4**	**-**	**-**	**(0.9)**
Charitable donation to Poppy Appeal	**(1.6)**	**-**	**-**	**-**	**(1.6)**
Profit before tax	**132.1**	**15.4**	**(2.8)**	**-**	**144.7**

Year to 31 December 2012	Statutory profit £m	FSCS £m	Movements on derivatives and hedge accounting £m	Gain on pension curtailment £m	Underlying profit £m
Net interest income	186.9	-	-	-	186.9
Other income	12.5	-	-	-	12.5
Gains on derivatives and hedge accounting	0.1	-	(0.1)	-	-
Total income	199.5	-	(0.1)	-	199.4
Administrative expenses, amortisation and depreciation	(98.6)	-	-	-	(98.6)
Impairment charges	(9.6)	-	-	-	(9.6)
Provisions	(7.6)	7.6	-	-	-
Charitable donation to Poppy Appeal	(1.9)	-	-	-	(1.9)
Operating profit before exceptional item	81.8	7.6	(0.1)	-	89.3
Gain on pension curtailment	9.3	-	-	(9.3)	-
Profit before tax	91.1	7.6	(0.1)	(9.3)	89.3

Net interest income

Net interest income at £253.1 million was £66.2 million higher than the previous year and was the primary driver in the increase in both underlying and statutory profit before and after tax.

	Year to 2013 £m	Year to 2012 £m
Net interest income	**253.1**	186.9
Average total assets	**27,594**	25,710
	%	%
Net interest margin	**0.92**	0.73

The Society's net interest margin has increased by 19 basis points to 0.92% in the year to 31 December 2013 compared with the previous year.

This is predominantly the result of changes in retail savings and wholesale funding markets led by the introduction of the Government's Funding for Lending Scheme (FLS) which has driven down the market price of both new lending and funding since its introduction. This is beneficial to margins given the shorter duration of liabilities relative to assets and the impact on the savings market has been marked with more significant reductions in the overall rates being offered to new and existing savers across the market.

Although the Society's net interest margin has benefited from FLS it has taken decisions to restrict the growth in its net interest margin, thereby delivering value to individual members through their product holdings. This has been achieved whilst continuing to offer extremely competitive mortgage products, including one of the lowest Standard Variable Mortgage rates within the Society's peer group. It has balanced this with the need to protect the overall financial strength of the organisation by increasing reserves through retained profits providing reassurance and security to all members.

In particular, the unique decision taken to raise the rate paid on cash ISA savings in April 2013 has returned significant value to the Society's ISA savers. The Junior ISA has been a best buy account since it was launched in April 2012[1], and where changes to savings accounts have been made, these have consistently reflected best buy pricing rather than average pricing. It is estimated that if variable rates at 31 December 2013 were aligned with best buy rates offered by any major UK bank or building society[2], interest payable to members would be £44 million gross less per year (based on interest rates, balances and the market as at 31 December 2013). This demonstrated the delivery of a key strategic goal.

Other income

Although the Society's other income of £9.3 million was in line with expectations it is lower than in 2012 (£12.5 million).

This decrease reflects a decision not to charge any fees for the provision of third party investment advice following implementation of the Retail Distribution Review. There was also a one-off gain of £0.8 million in 2012 on the disposal of property.

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

Derivatives and hedge accounting

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

1. Best buy tables published in the national press.
2. As at 31 December 2013. Average deposit assumed as follows: Variable - £10,000 and ISAs £5,760. Excludes competitor products with restricted availability (e.g. existing customers only, Sharia accounts or reliant on maintaining or opening another product with the same provider) and Coventry Current/MoneyManager and Offset accounts. Source: Moneyfacts data.

Even though the Society uses derivatives exclusively for risk management purposes, income statement volatility arises due to accounting ineffectiveness of designated hedges or because hedge accounting is not achievable. Management believes that this volatility arises from application of the accounting rules rather than reflecting economic reality and consequently it is excluded from underlying performance.

During the year the Society has enhanced its valuation methodologies to align with evolving market conventions and details are included in note 25 to the accounts.

The £2.8 million fair value gain on derivatives and hedge accounting (2012: £0.1 million gain) is primarily in respect of cross currency swaps and reflects both a change in valuation methodology and subsequent cash flow hedge accounting ineffectiveness on derivatives.

Management expenses

Total expenses for 2013 were £108.9 million (2012: £98.6 million). The increase reflects the Society's continued growth, increasing regulation and focus on customer service.

There has been significant growth in staff costs in order to respond to new regulations, but also to improve the quality of service offered by our operational areas, particularly in customer facing areas including the contact centre and mortgage operations. Part of this has been in preparation for the forthcoming implementation of the MMR. Increased staff numbers has also required considerable investment to premises at the head office in Coventry where an additional 180 jobs have been created.

The Society has also invested in ensuring that its core IT, infrastructure and systems are robust and secure and are able to support increased functionality and methods of distribution, including developments in online services.

However, the Society's reputation for rigorous cost control is well founded. For over 10 years it has achieved the lowest reported cost to mean asset ratio of all UK building societies and will comfortably retain this position in 2013, despite a slight increase from 0.38% to 0.39%. The ability to grow the Society whilst retaining control of costs is central to the delivery of best value mortgage and savings products to members, and represents a significant competitive advantage.

Impairments

Impairment losses of £6.3 million were lower than in 2012 (£9.6 million). This equates to 3 basis points in the year and 6 basis points over 5 years.

The Society has an exemplary record on impairments reflecting the success of its low risk lending strategy which has always been a key element of its business model. Other than as a result of small books acquired as a result of the merger with Stroud & Swindon the Society has not undertaken commercial or second charge lending and exposure to unsecured lending is negligible with no new lending of this type since 2009. Underlying profit before impairment and tax is more than 23 times the impairment charge reflecting the ability to report strong profits even in the event of a further downturn.

Provisions for liabilities and charges

The £16.3 million provision for liabilities and charges (2012: £7.6 million) is made up of a £15.4 million charge in respect of the FSCS (2012: £7.6 million) and £0.9 million for Payment Protection Insurance (PPI).

The Society pays levies to the FSCS based on its share of protected deposits and further information is provided in note 1 to the accounts. FSCS levies are excluded from underlying profit.

The interpretation IFRIC 21 Levies was issued during the year, and provides guidance on accounting for liabilities in respect of government imposed levies. This has resulted in a change in the timing of recognition of the FSCS levy, and therefore the accounts have been restated to reflect the change. Further information is provided in note 1 to the accounts.

In contrast to the experience of many high street banks, PPI is not a material issue for the Society and in 2013 the Society experienced a reducing volume of PPI complaints. It is also noteworthy that on average 66% of monthly enquiries were from individuals who did not hold a PPI policy with the Society. This strong performance is a consequence of the design of the PPI product sold by the Society and the member focused sales process used. Notwithstanding the reduction in enquiries during the second half of 2013, the absolute level remains higher than in 2012 and an additional provision of £0.9 million was made during 2013.

Charitable donation to Poppy Appeal

The Society donated £1.6 million to The Royal British Legion's Poppy Appeal during the year (2012: £1.9 million). The contribution to this appeal since 2008 totals £9.1 million.

Gain on pension curtailment – 2012 exceptional item

On 31 December 2012, the Coventry Building Society defined benefit scheme was closed to future service accrual and a gain of £9.3 million was recognised in the 2012 income statement. This gain was excluded from underlying profit in the 2012 comparative year. The decision to close the final salary scheme was taken to manage risks to the Society rather than to enhance profitability. A new Group Personal Pension Plan was launched in 2013.

Taxation

The Society believes it should contribute its fair share of tax and in 2013 the tax charge arising on profits earned was £30.8 million (2012: £21.6 million). This represents an effective rate of tax of 23.3% (2012: 23.7%) which is broadly in line with the statutory corporate tax rate of 23.25% (2012: 24.5%).

BALANCE SHEET

Overview

Mortgage balances have grown by 9.5% from £22.0 billion to £24.1 billion in the year, funded by a mixture of retail savings, drawings from the FLS and long-term wholesale funding.

	2013 £m	2012 £m
Assets		
Loans and advances to customers	**24,117.1**	22,018.9
Liquidity	**3,887.4**	4,476.1
Other	**248.8**	438.8
Total assets	**28,253.3**	26,933.8
Liabilities		
Retail funding	**21,311.7**	20,110.5
Wholesale funding	**5,438.5**	5,050.1
Capital and reserves	**1,114.7**	1,032.0
Other	**388.4**	741.2
Total liabilities	**28,253.3**	26,933.8

Unencumbered FLS Treasury bills (off-balance sheet liquidity)*	**642.8**	99.8

*Market value

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

LOANS AND ADVANCES TO CUSTOMERS

The Society focuses on lending high quality, low loan to value mortgages for owner occupied and buy-to-let purposes, within the prime residential market.

These loans are primarily distributed through third-party intermediaries, with additional direct capacity through the Society's network of branches and contact centre advisors.

In 2013, the Society advanced £5.9 billion (2012: £5.1 billion) a record performance in terms of the value of advances made. This continues a trend of growth which has been maintained throughout the economic downturn and has resulted in around a four-fold increase in total UK market share of total UK gross advances from 0.85% at December 2006 to 3.33% at 31 December 2013[3]. The Society once again recorded positive net lending, with mortgage balances increasing as a result of organic growth by £2.1 billion (2012: £2.3 billion). This is equivalent to 19% of all UK mortgage growth in 2013 and a fifth (20%) of all UK mortgage growth over the last four years[4].

The growth in the mortgage book has been achieved whilst retaining the Society's focus on affordability and its low appetite for higher risk lending. The result is an overall indexed loan to value of the mortgage book at 31 December 2013 of 50.0% (simple average), a position that is consistent with previous years (2012: 52.1%).

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

As at 31 December 2013, 0.57% of mortgage balances were 2.5% or more in arrears (2012: 0.72%). At the time of the latest published data, arrears were 44% of the industry average[5]. This translates to extremely low levels of properties in possession. At the end of 2013, just 67 properties were in possession (2012: 71) from a total population in excess of 200,000 accounts.

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

Additional information and analysis of the mortgage book is set out in the Risk Management Report on pages 51 to 59.

LIQUIDITY AND FUNDING

Strategy

The Society has a strong and diversified funding base which continues to be predominantly funded by retail savings reflecting its long-term strategy and traditional building society model.

Retail funding consists of a mix of variable rate products, fixed rate bonds and ISAs. The Society has a strong record of attracting and retaining savings balances and has again this year organically grown its savings book.

Wholesale funding is used to provide diversification by source and term, and value to members through lowering the overall cost of funding. The Society continues to retain proven access to short and long-term wholesale funding markets, but no reliance is placed on wholesale funding. Bank of England programmes such as the FLS facility have been accessed to ensure that our members are not disadvantaged and to manage liquidity and funding risk.

3. Source: Council of Mortgage Lenders.
4. Source: Bank of England.
5. As at 30 September 2013. Source: PRA.

The Society's policy is to hold sufficient quality and quantity of liquidity to withstand the most severe but plausible combined market-wide and Society-specific stress that lasts for a three month period. In addition the Society is obliged to meet regulatory requirements set by the Prudential Regulation Authority (PRA).

Liquidity resources

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

Liquidity risk is managed through four different categories of resources reflecting different features and the time taken to convert the resource into cash. Separate limits are applied to each category. All liquidity is held for the principal purpose of meeting expected and unexpected cash flow requirements subject to the Society's defined tolerance. The amount of liquidity held in each category is managed with regard to the requirements derived from internal risk based measures, regulatory requirements, wholesale credit risk assessment, any encumbrance associated with the liquidity and the cost of holding such liquidity. The amount of the requirement is regularly updated and varies in line with business requirements, in particular with the timing of retail and wholesale bond maturities.

The Society's liquidity resources at 31 December 2013 are set out in the table below, split by the four key categories. This table is not a representation of the accounting balance sheet as it includes Treasury bills drawn under the FLS scheme which are not recognised on the balance sheet and excludes any encumbered assets such as cash held in the Society's covered bonds and RMBS programmes and balances posted with counterparties as collateral under interest rate swap agreements.

	Notes to the accounts[1]	**2013 £m**	2012 £m	**2013 Average[2] £m**
(i) Cash and balances with the Bank of England	14	**1,848.4**	1,714.7	**1,649.3**
(ii) UK Government Securities and multi-lateral development banks				
Securities - on-balance sheet[3]	16	**1,165.1**	1,173.7	**1,142.7**
Securities - FLS Treasury bills[3]	16	**642.8**	99.8	**305.7**
Total Liquid Assets Buffer (LAB)		**3,656.3**	2,988.2	**3,097.7**
(iii) Other Securities and bank deposits				
Securities - on-balance sheet[3]	16	**236.5**	452.8	**366.6**
Loans and advances to credit institutions	15	**-**	15.0	**9.0**
(iv) Bank of England approved mortgage portfolios, self-issued covered bonds and RMBS[4]	17	**4,959.2**	3,794.2	**3,085.7**
Total		**8,852.0**	7,250.2	**6,559.0**

1. Refer to notes to the accounts for reconciliation to on-balance sheet liquid assets.
2. Average of monthly values in the year.
3. Market value.
4. Nominal value of Notes and mortgage portfolio. Total amount of asset collateral is £5,078.5 million (see page 22).

- The first category consists of cash held at the Bank of England and in accounts with UK clearing banks. All of this is held in sterling, with the exception of £2.7 million which is held in euros.

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

- The third category consists of other liquid assets where the Society can be reasonably certain that they could be realised in a liquidity stress. This includes highly rated covered bonds, mortgage backed securities, bank debt (Medium Term Notes) and deposits. Prudent assumptions are made regarding the cash that could be generated from such assets in a liquidity stress and the time that this would take, having particular regard to the eligibility of the assets in Bank of England liquidity facilities. All covered bonds and mortgage backed securities are issued by UK entities and were rated Aaa on issue. Most of the liquidity is held in sterling with £26.7 million held in euros to part match a euro denominated wholesale debt issuance.

- The fourth category consists of approved portfolios of mortgage collateral that could be used to access Bank of England liquidity facilities and self-issued covered bonds and RMBS that could be used in Bank of England facilities or sold to and repurchased from third parties under sale and repurchase agreements.

The amount of liquidity resources held is also subject to regulatory requirements set by the PRA. At 31 December 2013, and throughout the year, the Society complied in full with the liquidity requirements that were in force. Further information on how the Society manages liquidity, and evaluates its liquidity requirements can be found in the Risk Management Report on pages 65 to 67.

The Capital Requirements Regulation and Capital Requirements Directive (CRD IV) (see page 24) contains new requirements on liquidity and stable funding based on the principles issued by the Basel Committee on Banking Supervision. This includes two new measures:

- Liquidity Coverage Ratio (LCR) - a new 30 day short-term liquidity measure. The LCR will become a requirement from January 2015 and the PRA has set a minimum requirement of 80% from 2015 rising thereafter to 100% from 1 January 2018. The calculation of the LCR is still subject to ongoing development so there remains uncertainty as to its final form. The Society monitors compliance against this measure and based on its current understanding at 31 December 2013, the Society's LCR was in excess of 100%.

- Net Stable Funding Ratio (NSFR) – a one year measure of stable funding. This is currently expected to be implemented from 2018. The Society continues to monitor its position relative to the anticipated requirement of the NSFR. Based on its current interpretation, the Society holds sufficient stable funding to meet the new requirement.

Liquid asset credit quality

Liquid assets on-balance sheet at 31 December 2013 were £3,887.4 million (2012: £4,476.1 million) and continue to be held primarily as deposits at central banks and government bonds.

The credit quality of liquid assets has been maintained with 97% of the portfolio rated Aaa-Aa3 (2012: 91%), with 2% rated A1-A3 (2012: 9%). The Society has no direct exposure to the peripheral Eurozone countries. As at 31 December 2013 no amounts in the liquid asset portfolio were either past due or impaired and as such no provision has been made.

Of the £3,887.4 million of liquid assets, £1,666.0 million (2012: £2,338.2 million) are held as Available-for-sale (AFS) and under IFRS are marked to market through other comprehensive income with fair value movements accumulated in reserves. The non-AFS assets are loans and advances to credit institutions or deposits with the Bank of England.

The fair value movement of AFS assets that are not impaired has no effect on the Society's regulatory capital as at 31 December 2013. This position changed under CRD IV which applies from 1 January 2014 and the AFS reserve is deducted in full where the reserve is in a negative position, as shown in the 'transitional' calculations quoted later in this report (see page 26).

As at 31 December 2013, the balance on the AFS reserve is £12.1 million negative net of tax (2012: £9.6 million negative net of tax).

Retail funding

Retail funding has increased by £1.2 billion with the year end balance of £21.3 billion (2012: £20.1 billion). As has been the case throughout the credit crisis, the Society has maintained a competitive stance in the retail savings markets and has chosen to increase retail funding, despite the availability of cheaper wholesale funding. This is a reflection of one of our core values that as a building society we exist not only to provide mortgages but also to offer our members an attractive rate of interest and a safe home for their savings.

The growth in retail funding in the year was driven by maintaining very competitive savings rates for both new and existing customers. The decision to increase the rate paid on existing easy access variable cash ISA savings in April 2013 is an obvious example, but also a number of other best buy savings products, ISA and non ISA, have been made available to attract new members including the popular Poppy Bond.

Wholesale funding

An analysis of the Society's wholesale funding is set out in the table below:

	Notes to the accounts	**2013 £m**	**2013 %**	2012 £m	2012 %
Deposits from banks, including sale and repurchase agreements	23	**1,032.6**	**19.0**	715.9	14.2
Other deposits and amounts owed to other customers		**341.1**	**6.3**	459.5	9.1
Debt securities in issue	24				
Certificates of Deposit		**13.8**	**0.3**	73.8	1.5
Medium Term Notes		**1,762.8**	**32.4**	1,260.4	25.0
Covered Bonds		**1,817.3**	**33.4**	1,805.3	35.7
Residential Mortgage Backed Securities		**470.9**	**8.6**	735.2	14.5
Total		**5,438.5**	**100.0**	5,050.1	100.0

In 2013 the Society raised €650 million of seven year funding from its medium term note programme and drew a further £1,250 million from the Bank of England's FLS.

The currency analysis of wholesale funding outstanding at the end of 2013 was:

	GBP £m	EUR £m	Total £m
Deposits from banks, including sale and repurchase agreements	**1,032.6**	**-**	**1,032.6**
Other deposits and amounts owed to other customers	**341.1**	**-**	**341.1**
Debt securities in issue			
Certificates of Deposit	**13.8**	**-**	**13.8**
Medium Term Notes	**776.6**	**986.2**	**1,762.8**
Covered Bonds	**1,273.2**	**544.1**	**1,817.3**
Residential Mortgage Backed Securities	**470.9**	**-**	**470.9**
Total as at 31 December 2013	**3,908.2**	**1,530.3**	**5,438.5**
Total as at 31 December 2012	4,033.4	1,016.7	5,050.1

All of the euro-denominated wholesale funding has been swapped back into sterling, except for £29.2 million which has been matched with euro-denominated liquidity.

In the next 12 months, the only significant maturity of long-term wholesale funding is €650 million of covered bonds in October 2014.

An expected maturity analysis for wholesale funding is shown below. This is based upon the earlier of the first call date or contractual maturity, where appropriate.

	2013 £m	2013 %	2012 £m	2012 %
Less than one year	**1,269.6**	**23.3**	1,290.0	25.5
One to two years	**523.4**	**9.6**	529.4	10.5
Two to five years	**2,359.5**	**43.4**	1,737.1	34.4
More than five years	**1,286.0**	**23.7**	1,493.6	29.6
Total	**5,438.5**	**100.0**	5,050.1	100.0

Asset encumbrance

Society assets can be used to support collateral requirements for secured funding, central bank operations or third party sale and repurchase transactions. An analysis of how the Society has used its balance sheet in this regard at 31 December 2013 is set out in the table below:

	Encumbered		Unencumbered		Total
	Pledged as collateral[1] £m	Other[2] £m	Available as collateral[3] £m	Other[4] £m	2013 £m
Cash and balances with the Bank of England	-	153.2	1,848.4	40.5	2,042.1
Loans and advances to credit institutions	84.2	95.1	-	-	179.3
Debt securities	244.4	20.0	1,401.6	-	1,666.0
Loans and advances to customers	5,323.4	-	5,078.5	13,715.2	24,117.1
Derivative financial instruments	-	-	-	191.2	191.2
Hedge accounting adjustments	-	-	-	(8.4)	(8.4)
Non-financial assets	-	-	-	66.0	66.0
Total	**5,652.0**	**268.3**	**8,328.5**	**14,004.5**	**28,253.3**
FLS Treasury bills	705.4	-	642.8	-	1,348.2
Total as at 31 December 2013	**6,357.4**	**268.3**	**8,971.3**	**14,004.5**	**29,601.5**
Total as at 31 December 2012	4,390.5	209.0	7,913.4	14,520.7	27,033.6

1. Assets that have been utilised to support interest rate swap collateralisation agreements, third party secured funding operations, central bank operations or third party sale and repurchase transactions and cannot be used for any other purpose.
2. Other encumbered assets are assets that cannot be utilised for secured funding due to legal or other reasons. This includes cash and assets supporting secured funding vehicles.
3. These assets are readily available as collateral to secure funding. Loans and advances to customers in this category comprise those that although technically encumbered are held in respect of retained self-issued notes in the Society's covered bond and securitisation programmes and Bank of England approved mortgage portfolios. The total of unencumbered available collateral is therefore referable to the total of on-balance sheet liquid resources in the table on page 18, the difference being £119.3 million of additional collateral.
4. Unencumbered other assets are therefore conservatively defined as not readily available for use as collateral. The loans and advances in this category include £6.7 billion which would be eligible for use to support future external or self-issuance under the Society's covered bond and securitisation programmes. A proportion of the remaining balance would also be suitable for such purpose subject to amending the programme structures.

External credit ratings

Short and long-term credit ratings as at 27 February 2014 are set out below. The Society is the only major high street bank or building society not to have been downgraded by any rating agency over the last four years.

	Long-term	Short-term	Subordinated	Date of last credit opinion
Moody's	A3	P-2	Baa1	Jan-14
Fitch	A	F1	N/a	Jan-14

The outlook for Moody's and Fitch is stable.

CAPITAL

Capital resources

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

The EU Capital Requirements Directive (Basel II) took effect from 1 January 2007. From 1 January 2008 the FSA granted the Society permission to use the Basel II Internal Ratings Based (IRB) approach to retail credit risk and capital management and this was extended by the PRA in July 2013 to include the mortgages transferred from the Stroud & Swindon Building Society in 2010. This allows the Society to calculate capital requirements for prime owner occupied and buy-to-let mortgage exposures (excluding the £0.5 billion mortgage book acquired from Bank of Ireland in 2012) using internally developed models that reflect the credit quality of the Society's mortgage book. This permission reflects the Society's detailed understanding of its customer base and credit risk profile. For other exposures and risk areas the Society follows the standardised approach which uses capital risk weighting percentages set by the PRA.

The table overleaf summarises the composition of regulatory capital for the Society as at 31 December 2013 and 31 December 2012. During the year £92.5 million was added to general reserves (2012: £65.5 million) driven by a strong profit after tax of £101.3 million (2012: £69.5 million). The Society regularly reviews the appropriateness of its capital structure.

At 31 December 2013, and throughout the year, the Society complied in full with the capital requirements that were in force. Further information on how the Society manages capital, and evaluates its capital requirement can be found in the Risk Management Report on pages 75 to 76.

Core Tier 1 ratio

The Society retains a strong capital position with a Core Tier 1 ratio of 24.3% (2012 restated: 23.6%).

	Notes	2013 £m	2012 £m
Tier 1			
General reserve		**914.6**	822.1
Pension fund surplus adjustment	1	**(5.1)**	(10.1)
Intangible assets	2	**(12.2)**	(9.2)
Deductions from Tier 1 capital	3	**(11.1)**	(9.6)
Core Tier 1 capital		**886.2**	793.2
Permanent Interest Bearing Shares	4	**160.0**	160.0
Total Tier 1 capital		**1,046.2**	953.2
Tier 2			
Collective provisions for impairment	5	**2.0**	0.4
Subordinated debt	6	**54.1**	55.5
Deductions from Tier 2 capital	3	**(11.1)**	(9.6)
Total Tier 2 capital		**45.0**	46.3
Total capital		**1,091.2**	999.5
IRB approach			
Credit risk – Retail exposures		**2,787.5**	2,034.0
Standardised approach			
Credit risk – Retail exposures		**387.4**	857.6
Credit risk – Liquidity book		**185.7**	201.2
Credit risk – Other		**42.0**	43.8
Operational risk		**250.8**	230.6
Risk weighted assets		**3,653.4**	3,367.2
Core Tier 1 ratio (%)		**24.3**	23.6

1. Pension fund surplus – note 21 to the accounts.
2. Intangible assets – note 19 to the accounts.
3. Under Basel II, a deduction is made for the excess of expected losses on loans and advances to customers, calculated on an IRB basis, over accounting provisions, and is allocated 50% to Tier 1 and 50% to Tier 2 capital.
4. Permanent Interest Bearing Shares - principal amount outstanding only, note 28 to the accounts.
5. Under Basel II, collective provisions for impairment relating to loans and advances to customers, calculated on a standardised basis, are included as Tier 2 capital.
6. Subordinated debt – principal amount outstanding only, and if in the last five years to maturity, the subordinated debt is amortised on a straight line basis, note 27 to the accounts.

Impact of the Capital Requirements Regulation and Capital Requirements Directive (Basel III)

The European Parliament and Council have approved new capital reforms, which implement Basel III in the EU. Some provisions of Basel III are implemented in the EU via a regulation in which case the provisions will apply directly to firms in the EU without further national discretion. In contrast some provisions of Basel III implemented via a directive require local regulator adoption and interpretation. Both the regulation (CRR) and directive (CRD) are referred to as CRD IV. The objective of the reform package is to improve the banking sector's ability to absorb shocks arising from financial and/or economic stress, thus reducing the risk of contagion from the financial sector into the wider economy. CRD IV legislation came into force on 1 January 2014. The key elements of CRD IV are as follows:

Quality of capital

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

CRD IV applies the principle that Tier 1 capital is available to absorb losses of the business on a 'going concern' basis. The Society's Permanent Interest Bearing Shares (PIBS) are not able to do this, and therefore will not be eligible as Tier 1 capital. These PIBS will be 'grandfathered' and recognised as additional Tier 1 capital on an amortising basis over 9 years from 1 January 2014, or to the call date if earlier. Of the Society's PIBS, £120 million will no longer be eligible as Tier 1 capital from their call date in June 2016.

CRD IV requires Tier 2 instruments to be free of any incentive to redeem. The Society's subordinated debt fails to meet this requirement and will be grandfathered as Tier 2 capital in the same way as the Society's PIBS.

Capital buffers
To promote the conservation of capital and the build up of adequate buffers that can be drawn down in periods of stress, CRD IV implements the use of common equity capital buffers; a capital conservation buffer of 2.5% of RWAs to be built up from 2016 to 2019; a systemic risk buffer applied to institutions judged to be systemically important; sectorial capital requirements (SCR); and a countercyclical capital buffer (CCB) of up to an additional 2.5% of RWAs. The Financial Policy Committee published a Policy Statement in January 2014 explaining the circumstances in which the SCR and CCB may be applied. The extent to which these will overlap with current capital planning buffers is not yet determined.

Counterparty credit risk and prudent valuation
A capital charge for credit valuation adjustment risk is required. The charge arises from the use of derivative instruments to manage interest rate and foreign exchange risk. The impact for the Society as at 31 December 2013 is immaterial, due to the vast majority of derivative instruments being collateralised. A further capital charge is made to cover any uncertainty of valuation where assets or derivative instruments held at 'fair value' are considered to be relatively illiquid. This charge is also minimal for the Society given the simple nature of the assets and instruments it uses and the fact that it does not trade in such assets or instruments.

Leverage
CRD IV introduces a non-risk based leverage ratio that is supplementary to the risk based capital requirements and is intended as a 'backstop' measure. The calculation determines a ratio based on the relationship between Tier 1 capital and total balance sheet exposures (see page 27). The leverage ratio does not distinguish between unsecured and secured loans or recognise the ratio of loan to collateral value of secured lending. Consequently the leverage ratio has the potential to act as a primary constraint on low risk mortgage lenders even, as is the case for the Society, where strong underlying collateral exists. The CRD IV requirement is for the minimum level of this ratio to be 3%. This measure does not come into effect until 2018. At 1 January 2014 the leverage ratio of the Society is 3.4% reflecting transitional provisions under CRD IV, and 3.0% on an end-point basis i.e. assuming no transitional provisions. This ratio is expected to improve further during 2014. In considering a target for this ratio the Society recognises the importance of continuing to originate high quality assets and the risk of targeting a higher ratio by originating higher yielding assets, or a lower growth strategy that could dilute operational efficiency. The Society will therefore operate at a leverage ratio that meets regulatory requirements with a buffer appropriate to the nature of its business model.

The Board's preferred measure is a risk weighted asset measure and this shows a Core Tier 1 ratio of 24.3%. Whilst no absolute target has been set for this measure, based on current methodology this ratio is expected to be maintained at, or close to current levels.

Whilst CRD IV was not in force during 2013, the Society has considered the impact of the introduction of these rules on future levels of capitalisation, including under stress testing within its capital plan. The directors consider that the Society will continue to remain adequately capitalised.

The table overleaf sets out estimated CRD IV ratios as at 31 December 2013, based upon the Society's current understanding of the regulations and reconciles the accounting capital to both transitional and full impact capital positions as if 2013 is 'year 1' of the transitional period. The table shows how these items are represented for regulatory purposes. The transitional measure is based on the PRA policy statement PS7/13 which has no transitional provisions for the deductions from capital. The actual capital ratios under CRD IV may differ as related technical standards are finalised and other guidance is issued by the relevant regulatory bodies.

	Notes	Current rules 31 Dec 2013 £m	Transitional rules 1 Jan 2014 £m	Post-transitional end-point 1 Jan 2014 £m
Common Equity Tier 1 capital: reserves				
General reserve		**914.6**	**914.6**	**914.6**
Accumulated other comprehensive income		**-**	**(19.6)**	**(19.6)**
Common Equity Tier 1 prior to regulatory adjustments		**914.6**	**895.0**	**895.0**
Common Equity Tier 1 regulatory adjustments				
Prudent additional valuation adjustment	1	**-**	**(4.5)**	**(4.5)**
Intangible assets		**(12.2)**	**(12.2)**	**(12.2)**
Deferred tax assets	2	**-**	**(1.4)**	**(1.4)**
Cash flow hedge reserve	3	**-**	**7.5**	**7.5**
Excess of expected loss over impairments	4	**(11.1)**	**(27.9)**	**(27.9)**
Pension fund surplus adjustment	5	**(5.1)**	**(4.1)**	**(4.1)**
Common Equity Tier 1 (CET 1) capital		**886.2**	**852.4**	**852.4**
Additional Tier 1 capital				
Permanent Interest Bearing Shares	6	**160.0**	**128.0**	**-**
Total Additional Tier 1 (AT1) capital		**160.0**	**128.0**	**-**
Total Tier 1 capital		**1,046.2**	**980.4**	**852.4**
Tier 2				
Collective provisions for impairment		**2.0**	**2.0**	**2.0**
Subordinated debt	6	**54.1**	**44.4**	**-**
Total Tier 2 prior to regulatory adjustments		**56.1**	**46.4**	**2.0**
Tier 2 regulatory adjustments				
Excess of expected loss over impairments	4	**(11.1)**	**-**	**-**
Total Tier 2 capital		**45.0**	**46.4**	**2.0**
Total capital		**1,091.2**	**1,026.8**	**854.4**
IRB approach				
Credit risk – Retail exposures		**2,787.5**	**2,787.5**	**2,787.5**
Standardised approach				
Credit risk – Retail exposures		**387.4**	**387.4**	**387.4**
Credit risk – Liquidity book		**185.7**	**185.7**	**185.7**
Credit risk – Other	7	**42.0**	**56.8**	**56.8**
Credit valuation adjustment risk	8	**-**	**82.0**	**82.0**
Operational risk		**250.8**	**250.8**	**250.8**
Risk-weighted assets		**3,653.4**	**3,750.2**	**3,750.2**
Total exposure for leverage ratio		**28,696.0**	**28,696.0**	**28,696.0**
Common Equity Tier 1 (as a percentage of risk weighted assets)		**24.3%**	**22.7%**	**22.7%**
Tier 1 (as a percentage of risk weighted assets)		**28.6%**	**26.1%**	**22.7%**
Total capital (as a percentage of risk weighted assets)		**29.9%**	**27.4%**	**22.8%**
Leverage ratio		**3.6%**	**3.4%**	**3.0%**

A reconciliation of total assets as disclosed in the balance sheet to the leverage ratio exposure is given in the following table:

	Notes	£m
Total balance sheet assets		**28,253.3**
Mortgage pipeline	9	**477.4**
Other committed facilities (undrawn lending)	9	**38.9**
Repurchase agreements		**8.9**
Netted derivative adjustment		**(32.4)**
Common Equity and Tier 1 deductions		**(50.1)**
Leverage ratio exposure		**28,696.0**

1. Under transitional and end-point calculations, an adjustment is required to move instruments shown at fair value from an accounting to a prudent valuation.
2. Under transitional and end-point calculations, an adjustment for deferred tax assets that rely on future profitability is required.
3. Under transitional and end-point calculations, the cash flow hedge reserve does not form part of regulatory capital.
4. Under transitional and end-point calculations, expected losses adjusted for provisions is deducted in full from Common Equity Tier 1 capital, and the adjustment for the tax effect is no longer applicable.
5. Under transitional and end-point calculations, an adjustment for the associated deferred tax liability is required.
6. Under transitional calculations, a deduction of 20% of the Society's Permanent Interest Bearing Shares and Subordinated debt is made. The end-point calculations result in full amortisation of both capital instruments to nil.
7. Deferred tax assets attract a risk weighting of 250% (when arising from temporary differences) where they are below a minimum level.
8. CRD IV requires the inclusion of a capital charge relating to credit valuation adjustment risk.
9. 50% weighting applied as per Basel III leverage ratio framework issued by the Basel Committee on Banking Supervision in January 2014.

CORPORATE RESPONSIBILITY, ENVIRONMENTAL AND EMPLOYEE FACTORS

Staff

The Society's success in 2013, and its ability to sustain this success over the long-term, continues to be underpinned by the commitment and professionalism of its staff.

As with all other objectives of the Society, the recruitment, management and development of its staff is driven by the commitment to 'Put Members First'.

This means that people are recruited not only on the basis of their skills and knowledge but also by demonstrating behaviours that support the delivery of good outcomes for the Society's members.

For all staff, 'Putting Members First' forms an essential part of performance management. The result is clarity of purpose and positive engagement with the Society's objectives.

This was independently confirmed by the most recent assessment by Investors in People. In awarding Coventry the highest 'Gold' status, Investors in People highlighted the degree to which staff recognise that decision-making at the Society is driven by the core principles of 'Putting Members First'.

This was reinforced in 2013 by the Employee Opinion Survey which achieved a response rate of 88%, well above the average achieved by other firms in the financial sector.

Three of the most positive responses concerned the Society's treatment of its members. 96% of staff said they believe the Society is committed to member satisfaction, 16% higher than the average for the industry. 95% of staff believe that the Society treats members fairly and 92% would recommend the Society's products and services, nearly 25% higher than the financial services average.

These results emphasise the benefits of an engaged and motivated workforce. Consistently doing the right thing for members creates credibility amongst staff who serve them on a daily basis, or support the underlying operations of the Society. This in turn increases engagement with the Society's objectives, and leads to a flexible and committed workforce.

This extends to providing personal and career development opportunities. The Society has grown significantly throughout the credit crisis, creating more jobs in Coventry – 180 in 2013 alone. In addition, many staff have taken the opportunities presented by this growth to develop skills and progress their career with the Society.

The directors recognise the importance of continuing to invest in the Society's staff. The strategy of 'Putting Members First' has helped deliver sustainable growth and security for members. It has also encouraged the engagement of staff. The result is that employee engagement, already higher than the sector average, continues to rise. In 2013, the Society's Employee Engagement Index rose to 86%, a level which is 11 percentage points higher than the financial services average. The outcome is a consistently high level of performance and, most importantly, outstanding levels of member satisfaction.

Community

The Society's community programmes encourage the high engagement of staff. These programmes focus on specific areas, including the development of financial literacy, helping young people in education develop the skills to gain work and supporting national and local charities.

The financial literacy activities supported by Society volunteers range from basic reading and numeracy programmes to sessions explaining savings, spending and budgets. Volunteers also work with schools to help students prepare for job applications and interviews. The Society provides internships and apprentice schemes to provide work experience opportunities.

The Society also works with other service providers to deliver financial literacy activities. An example is the long-running partnership with Coventry Citizens Advice Bureau through which the Society supports debt awareness and advice sessions for young and vulnerable adults.

A second area of focus is the Society's Community Partner programme. Members of staff adopt a local charity or community group and support it through fundraising and volunteering. In 2013, one head office partnership raised over £10,000 for a local hospice, and over 74 such partnerships are now in place across the Society. In addition to the funds raised directly, money raised by corporate events is made available via Community Partner Fund grants, and in 2013 over £14,000 was distributed to local charities through this route.

The Community Partner programme is an increasingly successful way of connecting the Society and its staff to local communities. The local element, often supported by personal experience of the work of these organisations, has increased fundraising and volunteering and community activity continues to be a source of motivation and engagement for Society staff.

The Society is also a leading provider of charitable affinity accounts. Its relationship with The Royal British Legion, which started in October 2008, continues to flourish with the active support of many Society members. In 2013, the Society donated £1.6 million to the Poppy Appeal as a result of its successful Poppy savings portfolio and an inaugural 'Race for Life Bond' led to a donation of over £200,000 for Cancer Research UK.

In 2013, the community investment supported by the Society, not including these affinity donations rose to £460,000, with the overall community investment exceeding £2.3 million.

Environment

The Society continues to reduce the environmental impact of its activities. In 2013, examples of this progress included a programme to install LED lighting across the branch network, reducing the amount of energy consumed.

The Society continues to explain the benefits of online communications and account servicing to members as a means of reducing paper consumption and costs. As a result, an increasing number of members have chosen to receive the Annual General Meeting voting pack via email.

This example shows that environmental initiatives may benefit members directly through the delivery of online services as well as lowering organisational costs. Such developments will continue to be encouraged by the Society as a means of maintaining an organisation which prioritises its environmental responsibilities.

Awards

In 2013, the Society's strong performance was once again reflected by a number of independently assessed industry awards, including 'Your Mortgage - Best Building Society'.

As in previous years many awards related to the aspects of the Society's activities which are most valued by its members - the products and services offered by the Society.

It is particularly noteworthy that these include awards for the strength of the Society's ISA proposition. Coventry was named 'Most Trusted Cash ISA Provider' in the 2013 Moneywise Customer Service Awards, and Moneywise also named the Society the 'Best Junior ISA Provider' – an accolade endorsed by Moneynet in naming Coventry the 'Best Junior Cash ISA Provider' in its 2013 awards. It was also recognised by Savings Champion for its work with Cancer Research UK and the Poppy Appeal, winning 'Best Affinity Account Provider'.

Overall, consumer champion Which? recommended the Society for both its savings and mortgage products, whilst Your Mortgage also identified the Society as the 'Best Regional Mortgage Lender' (organisations with fewer than 100 branches).

The Society's focus on providing the best possible service was not only shown by its own extremely strong advocacy scores but also by its Coventry-based contact centre being named 'Winner - Best Banking & Financial Services Contact Centre' in The European Call Centre and Customer Service Awards 2013.

DIRECTORS' REPORT ON CORPORATE GOVERNANCE

PUTTING MEMBERS FIRST

The Board places the highest priority on effective corporate governance as part of its commitment to put members first in everything the Society does. The Board is accountable to the Society's members (being the majority of its customers) for the operation of the Society and the Board encourages feedback from them on all aspects of the Society's activities.

This report explains how the Board applies the principles of the UK Corporate Governance Code (the Code) and the Building Societies Association Guidance for Building Societies on the Code. The Board has considered the requirements of the Code and will continue to comply in a manner which is proportionate to the Society's size and scale. Where the provisions of the Code have not been adopted an explanation is provided below.

THE ROLE OF THE BOARD

The Board of Directors is responsible for the overall direction and management of all affairs and business of the Society and its subsidiaries. The Board has a general duty to ensure that the Society operates within its Rules, and all applicable laws, rules and guidance issued by relevant regulatory authorities.

In particular it is responsible for:

- Setting the culture and values of the Society.
- Challenging and approving the long-term strategy of the Society and its subsidiary companies and reviewing the Corporate Plan and annual budget.
- Determining and reviewing the Society's risk appetite and the major risks faced by the Society.
- Monitoring the performance of the Society and holding the Chief Executive and the Executive team to account on behalf of the members of the Society.
- Approving the Society's Remuneration Policy Statement and the remuneration for directors and certain other members of senior management.
- Communications with stakeholders by approving the annual financial statements and communications with members through the Annual General Meeting.

THE BOARD OF DIRECTORS

The Society's Rules detail the appointment process for directors and require that the Board comprises between six and twelve directors. The Board currently comprises a Chairman, six independent non-executive directors and five executive directors. The Board has determined that its current composition is appropriate.

The roles of the Chairman and Chief Executive are held by different people and are distinct in their purpose. The Chairman is responsible for leading the Board and ensuring that it acts effectively. The Chief Executive has overall responsibility for managing the Society and for implementing the strategies and policies agreed by the Board.

The role of the Senior Independent Director is to provide support to the Chairman in his role of leading and managing the Board, ensure the views of members and other key stakeholders are conveyed and in conjunction with the other directors, evaluate the performance of the Chairman and lead succession planning for the Chairman.

The following persons served as directors of the Society during the year: Janet Ashdown (since 18 September 2013), Peter Ayliffe (since 1 May 2013), Bridget Blow, Feike Brouwers (since 24 April 2013), Roger Burnell, Colin Franklin, Peter Frost, Ian Geden, John Lowe, Ian Pickering, Fiona Smith, Glyn Smith and David Stewart. Fiona Smith retired as a director on 25 April 2013.

Letters of appointment for the non-executive directors are available from the Secretary on request.

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

THE DIRECTORS AND SECRETARY

Ian Pickering, Chairman (58)

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

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

Bridget Blow, Deputy Chairman and Senior Independent Director (64)

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

Bridget was a non-executive director of the Bank of England between 2000 and 2005 and chairman of Trustmarque Group until June 2013.

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

Janet Ashdown, Non-executive Director (54)

Janet joined the Board as a non-executive director in September 2013. She is a member of the Remuneration Committee and the Board Risk Committee.

Janet worked for BP for 30 years until 2010, with experience in the UK and overseas. Her last role in BP was as head of BP's UK retail and commercial fuel marketing and supply business. She also spent over 10 years in BP's oil global trading business as a trader and trading manager. On leaving BP Janet became chief executive of Harvest Energy, a UK-based oil distribution and marketing business.

She has served as a non-executive director of SIG plc (a member of the FTSE 250) since July 2011 and on leaving Harvest Energy took up an appointment as a non-executive director at Essar Oil (UK) Ltd in July 2013.

Peter Ayliffe, Non-executive Director (60)

Peter joined the Board as a non-executive director in May 2013. He is a member of the Board Audit Committee and the Nominations and Governance Committee.

Peter is currently chairman of Monitise plc and president of the Chartered Management Institute (CMI) and has been on the boards of Investors In People (UK), Visa International and Visa Europe. He was president and chief executive officer of Visa Europe from March 2006 to September 2013. Prior to joining Visa Europe, Peter spent over 30 years in retail banking and was for the last two of those years a main board director at Lloyds TSB with responsibility for the UK retail bank.

Roger Burnell, Non-executive Director (63)
Roger Burnell joined the Board as a non-executive director in 2008 and is a Chartered Accountant with over 25 years' senior executive experience. He worked as finance director and managing director of several businesses within the Thomson Travel Group before becoming group chief operating officer in 1998.

Since retiring from his executive roles Roger has continued to work at board level through a number of non-executive directorships, including previously as chairman of International Life Leisure Group, chairman of The First Resort and chairman of HomeForm Group. Roger has recently retired as senior independent director of Thomas Cook Group plc.

Roger chairs the Board Risk Committee and is a member of the Board Audit Committee.

Ian Geden, Non-executive Director (60)
Ian Geden joined the Board as a non-executive director in 2008. He has a first class honours degree in horticulture from the University of Worcester and is a member of the Board Risk Committee, the Nominations and Governance Committee and the Remuneration Committee.

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

Glyn Smith, Non-executive Director (61)
Glyn Smith joined the Board as a non-executive director in 2010. He has over 30 years' experience in the financial services sector, most notably as a senior executive at Barclays Bank PLC and as finance director of Portman Building Society. He was previously a non-executive director at Stroud & Swindon Building Society.

Glyn is a graduate of Cambridge University, a Chartered Accountant and member of the examinations team for the Institute of Chartered Accountants in England and Wales. Since 2003, he has worked at board level through a number of non-executive directorships, including Domestic & General Group PLC, Covent Garden Market Authority and two Primary Care Trusts.

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

David Stewart, Chief Executive, Executive Director (48)
David Stewart is a graduate of Warwick University and qualified as a Chartered Accountant with KPMG. In 2002 he joined the Board as Finance Director, before assuming Board responsibility for the Sales and Marketing functions in 2004. He was appointed Chief Executive of the Society in 2006.

Prior to joining the Society, David gained financial services experience at DBS Management plc where he was group finance director and then group chief executive. David serves on the council of the Building Societies Association and is a member of both the chairman's and executive committees of the Council of Mortgage Lenders.

David chairs the Non-Executive Directors Remuneration Committee.

John Lowe, Finance Director, Executive Director (41)

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

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

Feike Brouwers, Chief Risk Officer, Executive Director (46)

Feike was appointed as Chief Risk Officer on 1 April 2013 and as an executive director with effect from 24 April 2013.

Feike has extensive experience of the financial services industry. He trained as a certified public accountant in the Netherlands. Following several years with Price Waterhouse he joined ING Group in 1997 where he spent more than four years as group financial controller and head of strategy and business development at the ING Direct headquarters in Amsterdam. After a short period as chief financial officer of ING Direct France in Paris he became chief financial officer at ING Direct UK in October 2007 until the ING Direct business was sold to Barclays in March 2013.

Colin Franklin, Sales and Marketing Director, Executive Director (58)

Colin joined the Society over 35 years ago and has held line management responsibility for a number of areas including the branch network, operations and sales.

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

Peter Frost, Chief Operating Officer, Executive Director (48)

Peter Frost joined the Board in November 2012 as the Society's Chief Operating Officer and has responsibility for all aspects of the Society's IT, Change and Operations functions.

A graduate of Liverpool University, Peter has over 20 years' experience in financial services. Prior to joining the Society, Peter worked at Barclays where he was operations director for the UK retail bank. Before this he had a number of positions at Woolwich Building Society and Woolwich plc. Peter has also held a number of non-executive directorships including roles at Vaultex and iPSL.

Thomas Crane, Secretary (41)

Thomas Crane is a qualified solicitor. He was appointed as Secretary to the Society on 22 November 2013 following more than eight years in financial services. He started his career at Theodore Goddard in London in 1998 and has subsequently undertaken a number of different roles before joining the Society.

In his capacity as the Society's General Counsel, Thomas is the principal legal advisor to the Board. In addition to his role as a member of the senior executive team he serves as Secretary to the Board and all its Committees.

DIRECTORS' REPORT ON CORPORATE GOVERNANCE

(continued)

HOW THE BOARD FULFILS ITS ROLE

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

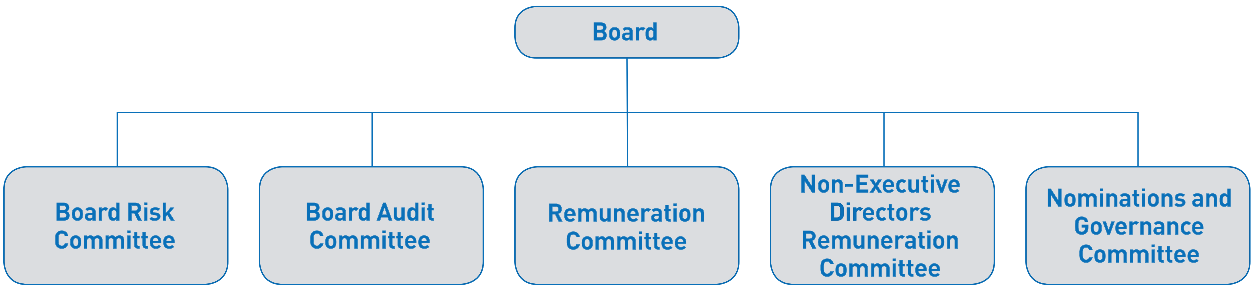
The Board applies principles of good governance by adopting the following procedures:

- The Board meets monthly (except August). The non-executive directors meet, without executive directors present, at least once a year as required by the Code but in practice meet more frequently.
- The Board holds an annual strategy review away day outside the formal meeting cycle, which gives the non-executive directors an opportunity to develop and challenge proposals on strategy.
- The Chairman sets the tone of the Board meetings to ensure, amongst other things, that there is a culture of openness and constructive challenge from both non-executive and executive directors. This is assessed through the annual Board effectiveness review process.
- Directors receive accurate, timely and clear information and it is the responsibility of the Chairman to ensure that this information is considered by the Board.
- The size and composition of the Board and the senior management team is kept under review to ensure that there is adequate succession planning for executive and non-executive directors and that the Board has the appropriate skills and experience for the direction of the Society's activities. See pages 36 to 37 relating to the Nominations and Governance Committee.
- All directors have access to the advice and services of the Secretary, whose appointment is a matter for the Board. The Secretary is responsible for ensuring compliance with Board procedures and advising the Board, through the Chairman, on governance related matters.
- All directors have access to independent professional advice at the Society's expense in order to fulfil their responsibilities as directors.

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

BOARD COMMITTEES

The Board has established a number of Committees:



Summaries of each committee's remit and activities during the year are set out opposite. The terms of reference of each committee are available on the Society's website (thecoventry.co.uk/corporategovernance) and from the Secretary on request.

Board Risk Committee

The Board Risk Committee meets monthly except in August and the members of the Committee are:

Roger Burnell (chairs the Committee)
Janet Ashdown
Ian Geden
Glyn Smith

The Board Risk Committee is the senior risk committee in the Society. It has delegated authority from the Board and assists the Board in fulfilling its responsibilities for risk management across the Society. The Committee's remit includes the following:

- Overseeing, and advising the Board on, current and potential risk exposures to the Society, including determination of risk appetite, risk limits and tolerances across the full range of risks to which the Society may be exposed.
- Satisfying itself on the design and completeness of the Society's internal control and assurance framework relative to the risks that it faces including culture, policy, processes, structure and systems.
- Seeking assurance that the Society has an effective risk governance structure which envelops all risk areas with appropriate reporting regimes.
- Reviewing major initiatives, such as acquisitions or change projects, and seeking assurance that appropriate due diligence has been carried out and that any associated movement in risks to which the Society may be exposed remains within its risk appetite.
- Reviewing the Society's capital and liquidity adequacy assessments and reverse stress testing analysis.

Minutes of Committee meetings are submitted to the Board following each meeting. In addition, the Committee Chairman reports verbally to the Board after each meeting of the Committee.

In 2013 the Committee considered reports relating to each of the principal risks and uncertainties, which are set out in the Risk Management Report (pages 44 to 76). At each meeting it considered a detailed consolidated risk report.

Other matters considered by the Committee during the year included:

- Stress testing scenarios and adequacy assessment of capital (ICAAP) and liquidity (ILAA).
- Independent health and safety review.
- Independent review of the Society's IT systems.
- Contingency funding plan and business continuity arrangements.
- Risk of supplier failure.
- Reserves duration.
- Forbearance strategy.

In December 2013, the terms of reference of the Board Risk Committee were revised by the Board, following a review by the Committee, to provide that it would be comprised solely of non-executive directors. Janet Ashdown joined the Committee and David Stewart, John Lowe, Feike Brouwers and Peter Frost (all executive directors) left the Committee as a result of that change, but will continue to attend meetings of the Committee in their capacity as Chief Executive, Finance Director, Chief Risk Officer and Chief Operating Officer. Fiona Smith was a member of the Committee until April 2013 when she left the Society, Ian Geden was appointed as a member of the Committee in May 2013 and Feike Brouwers was a member from April to December 2013.

Board Audit Committee

Details of the Board Audit Committee are contained in the Board Audit Committee Report on pages 40 to 43.

Remuneration Committee

The Remuneration Committee consists of non-executive directors only. The members of the Committee are:

Bridget Blow (chairs the Committee)
Janet Ashdown
Ian Geden
Ian Pickering

The Remuneration Committee has delegated authority from the Board to:

- Review and approve the Society's Remuneration Policy Statement.

- Approve the remuneration of the executive directors and, in consultation with the Chief Executive, senior management.
- Oversee the remuneration of all other Code Staff.
- Approve all performance-related pay schemes together with relevant targets.
- Review the remuneration of the Chairman for recommendation to and approval by the Board.
- Review and approve the Directors' Remuneration Report on pages 77 to 82.

No director takes part in the discussion of his or her own remuneration.

The Committee met six times during the year to consider matters within its remit. The outcomes of the Committee's work are set out in the Directors' Remuneration Report at pages 77 to 82.

Fiona Smith was a member of the Committee until April 2013 when she left the Society. Janet Ashdown was appointed as a member of the Committee in September 2013.

During the year, the Committee reviewed its own terms of reference and concluded that they were still appropriate.

Non-Executive Directors Remuneration Committee

The members of the Committee are:

David Stewart (chairs the Committee)
John Lowe
Ian Pickering

The Committee is responsible for reviewing and recommending to the Board for approval the remuneration of the non-executive directors, other than the Chairman.

Non-executive directors do not participate in the Society's performance related bonus scheme.

The Committee met twice during the year. Among its activities in 2013, the Committee reviewed the non-executive directors' remuneration. It also reviewed its terms of reference and concluded that they were still appropriate.

Nominations and Governance Committee

The members of the Committee are:

Ian Pickering (chairs the Committee)
Bridget Blow
Peter Ayliffe
Ian Geden

The Committee is responsible for reviewing and making recommendations to the Board on matters relating to the structure, size and composition of the Board (including Board succession planning, the appointment of new directors, the re-appointment of retiring directors, the appointment of non-executive and executive directors to Committees of the Board) and certain aspects of senior management appointments. When vacancies on the Board are being filled, the Committee considers the skills, knowledge, experience and diversity (including gender) of existing members of the Board in order to consider the capabilities needed on each occasion.

As part of its terms of reference, the Committee reviews diversity on the Board. It also decides on a target for female representation on the Board and a policy as to how to reach that target in accordance with Article 88 of the CRD IV. The Society has set a target of 25% female directors by December 2017. The current percentage is 17%. In order to reach the target the Society has a development programme that includes a Leadership Academy and mentoring programmes designed to develop a more diverse talent pool from within the Society for senior positions. It also works with a recruitment agency experienced and successful in the identification of female executives with the potential to be effective Board members.

The Nominations and Governance Committee considers that the directors currently comply with Article 91 of CRD IV, that will become effective in July 2014, since all directors are able to commit sufficient time to perform their duties at the Society and none of the directors have more than the maximum number of directorships when taking into account the provisions relating to group directorships and non-commercial organisations.

The Committee met eight times during the year. Among its activities in 2013 were:

- It oversaw the recruitment process for two non-executive director vacancies and recommended the appointment of Janet Ashdown and Peter Ayliffe. In both cases a commitment to mutuality and a connection to the Society's heartland were among the key requirements for the role. The non-executive director positions were advertised in national newspapers and an external recruitment agency was instructed in respect of the recruitment of Janet Ashdown. Through the 2013 Annual General Meeting (AGM) process the Society issued a standing invitation to members to apply for the position of non-executive director. A number of applications, including from members, were received and considered. A thorough interview and assessment process was carried out for shortlisted candidates.
- It made recommendations to the Board for new members of the Board Risk Committee and the Remuneration Committee and for the appointment of the Secretary when required.
- It considered proposals for ongoing Board development; review of the effectiveness of the Board and associated effectiveness reviews; and non-executive director succession planning.
- It considered the implications of CRD IV relating to the governance of the Society and reviewed the Board governance manual.

In December 2013, the terms of reference of the Nominations and Governance Committee were revised by the Board, following a review by the Committee, to provide that it would oversee directors' conflicts of interest. They were also changed to provide that the Committee would be comprised solely of non-executive directors. Peter Ayliffe and Ian Geden joined the Committee with effect from 1 January 2014 and David Stewart ceased to be a member while continuing to attend Committee meetings as appropriate.

APPOINTMENTS TO THE BOARD

The Board has considered the provisions of the Code relating to re-election of directors, and has decided that it is the best interests of members to submit the entire Board for annual re-election by the members. It is anticipated that this will begin from the 2015 AGM.

In accordance with Rule 25 of the Society's Rules, all directors are subject to election by members at the AGM following their appointment or, where applicable, at the next following AGM. In addition, all directors must receive approval from the regulators as an approved person in order to fulfil their controlled function as a director. The Board has decided unanimously to recommend Janet Ashdown and Peter Ayliffe, who both joined the Board during the year as non-executive directors, and Feike Brouwers, who joined the Society on 1 April 2013 as Chief Risk Officer and the Board later that month, for election as directors by the members at the 2014 AGM.

Under Rule 26 of the Society's Rules, directors have to submit themselves for re-election at least once every three years. The directors retiring by rotation in 2014 are Ian Geden, John Lowe and Glyn Smith. The Board has unanimously decided to recommend them for re-election by the members at this year's AGM.

Following the announcement at the 2013 AGM by David Stewart of his intention to step down from his role, the Board established a Chief Executive Nominations Committee comprised of the Chairman, the Deputy Chairman and Ian Geden to lead the campaign to recruit a successor. Odgers Berndtson, a specialist recruitment consultancy, have been retained to assist with the process.

ONGOING BOARD DEVELOPMENT

Non-executive directors complete a tailored induction programme that covers the Society's business and regulatory environment, including meetings with senior management and branch visits. Non-executive directors update their skills, knowledge and familiarity with the Society through presentations by senior managers and by attending relevant bespoke internal and external courses. Ongoing training and development needs are reviewed by the Nominations and Governance Committee.

DIRECTORS' REPORT ON CORPORATE GOVERNANCE

(continued)

BOARD AND BOARD COMMITTEE ATTENDANCE 2013

Name	Title	Number of Board Meetings – 14	Number of Board Audit Committee Meetings – 7	Number of Board Risk Committee Meetings – 11	Number of Remuneration Committee Meetings – 6	Number of NED Remuneration Committee Meetings – 2	Number of Nominations & Governance Committee Meetings – 8
Ian Pickering	Chairman	14			6	2	8
Bridget Blow	Deputy Chairman	14	7		6		8
Janet Ashdown[1]	Non-executive director	4			4		
Peter Ayliffe[2]	Non-executive director	9	4				
Feike Brouwers[3]	Chief Risk Officer	9		8			
Roger Burnell	Non-executive director	13	7	11			
Colin Franklin	Sales and Marketing Director	14					
Peter Frost[4]	Chief Operating Officer	14		10			
Ian Geden[5]	Non-executive director	14	3	7	6		
John Lowe	Finance Director	14		11		2	
Fiona Smith[6]	Non-executive director	5		3			
Glyn Smith	Non-executive director	14	7	11			
David Stewart	Chief Executive	13		11		2	8

1. Appointed to the Board in September 2013; maximum number of meetings is 5. Appointed to the Remuneration Committee in September 2013; maximum number of meetings is 4.
2. Appointed to the Board in May 2013; maximum number of meetings is 9. Appointed to the Board Audit Committee in May 2013; maximum number of meetings is 4.
3. Appointed to the Board in April 2013; maximum number of meetings is 9. Appointed to the Board Risk Committee in April 2013; maximum number of meetings is 8.
4. Appointed to the Board Risk Committee in January 2013; maximum number of meetings is 10.
5. Stepped down from the Board Audit Committee in May 2013; maximum number of meetings is 3. Appointed to the Board Risk Committee in May 2013; maximum number of meetings is 7.
6. Retired from the Board and Board Risk Committee in April 2013. Maximum number of meetings is 5 and 4 respectively.

REVIEW OF BOARD EFFECTIVENESS

The performance of the directors is appraised by the Chairman. The Chairman's performance review is led by the Senior Independent Director taking into account the views of the rest of the Board.

Each Board committee reviews its own effectiveness by means of a self-assessment questionnaire and the committee Chairman reports the outcome of the review to the Board.

The Board also periodically reviews its own performance and that of its committees. The Board carried out a review of its own and its committees' effectiveness and concluded that all operated effectively.

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

RELATIONS WITH MEMBERS

The members' views are communicated to the Board through a Members' Council that meets quarterly, online member surveys and member roadshows. These are events held around the UK, which enable members to meet and discuss Society matters with staff at all levels of experience from the local branch to members of the Board.

Non-executive directors also engage with the Society's members through attending the AGM. The Chairmen of the Audit, Remuneration and Nominations and Governance Committees are all available to answer questions at the AGM.

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

INTERNAL CONTROLS AND RISK MANAGEMENT

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

Responsibility for implementing sound and effective systems of risk management and internal control has been delegated by the Board to senior management.

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

- Regular reports to the Board, through the Board Audit Committee, from the Internal Audit function in respect of its independent audits of risk management processes and the effectiveness of internal controls across the Society. The Head of Internal Audit has direct access to the Board Audit Committee Chairman.
- Regular reports to the Board, through the Board Risk Committee, from the risk function on the principal operational, credit, market and business risks facing the Society and the strength of the controls in place to mitigate such risks. The Chief Risk Officer has direct access to the Board Risk Committee Chairman.
- Regular reports to the Board, through the Board Risk Committee, from the compliance function on the strength of the controls in place to mitigate against conduct risk.
- Regular reports and presentations to the Board by the various Board committee Chairmen.
- Reports presented by the Chief Risk Officer at each Board meeting.
- Stress testing various aspects of the Society's models and approval of the Individual Liquidity Adequacy Assessment (ILAA) and Individual Capital Adequacy Assessment Process (ICAAP).

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

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

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

The Board is satisfied that during 2013 the Society maintained an adequate system of risk management arrangements taking into account its profile and strategy together with an adequate system of internal control that met the requirements of the Code.

BOARD AUDIT COMMITTEE REPORT

BOARD AUDIT COMMITTEE

The Board Audit Committee consists of non-executive directors only. The members of the Committee are:

Glyn Smith (chairs the Committee)
Peter Ayliffe
Bridget Blow
Roger Burnell

Glyn Smith, who chairs the Committee, has recent and relevant financial experience and is a Chartered Accountant. During the year, Roger Burnell joined the Committee in January 2013, Peter Ayliffe joined in July 2013 and Ian Geden stepped down in May 2013.

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

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

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

- Monitoring the integrity of the interim and annual financial statements and formal announcements relating to financial performance, focusing particularly on significant financial reporting judgements and ensuring the overall statements are fair, balanced and understandable.
- Reviewing the adequacy of systems of internal control and risk management processes.
- Approving the annual internal audit plan.
- Reviewing the effectiveness of the Internal Audit function. The Committee is responsible for approving the appointment and removal of the Head of Internal Audit.
- Monitoring the effectiveness of the external audit process and making recommendations to the Board on the appointment, re-appointment and remuneration of the external auditors.
- Ensuring that an appropriate relationship between the Society and the external auditors is maintained, including reviewing non-audit services which can be provided and fees.

In 2013, the Committee met seven times. It focused on the following matters:

The Society's risk management framework and systems of internal control

In addition to reports from the Society's internal and external auditors, the Committee considered a comprehensive report from the Chief Risk Officer on the overall effectiveness of the Society's risk management framework. The Committee also considered an annual report on the Society's whistle-blowing process and reviewed the whistle-blowing policy.

Preparation of financial statements and key areas of judgement

When assessing both the interim and full year 2013 accounts, the Committee considered a paper from the Finance Director to support the preparation of the accounts on a going concern basis (see Directors' Report, page 85 for further details). Regular updates on financial reporting developments were also presented to enable the Committee to provide effective oversight on the reporting and disclosures within the Society's Annual Report & Accounts. In particular, following consideration of these updates, the Committee agreed to the prior year adjustments for changes in accounting policies set out in note 1 to the Annual Report & Accounts and the inclusion of relevant Financial Stability Board's Enhanced Disclosure Task Force disclosures. The Committee also agreed to the reorganisation of narrative content, simplification of the income statement and the removal of non-essential disclosures better to support the fair, balanced and understandable criteria required by the Code. The Interim and Annual Report & Accounts were scrutinised by the members of the Committee, all of whom have extensive commercial experience and two of whom are Chartered Accountants.

The Committee considered in detail areas of the accounts subject to management judgement and received a report from the Finance Director for each key area setting out the approach adopted, methodology, key assumptions and comparison with prior year in order to assess the consistency of approach. The areas reviewed included:

Effective Interest Rate (EIR) methodology
The Society recognises interest income using a rate of return that reflects a constant level of interest over the expected behavioural life of the mortgage loan. This methodology recognises the impact of different interest rates charged over the life of the loan, for example an initial fixed interest rate for a period followed by the Society's Standard Variable Rate, and generally gives rise to an asset in the balance sheet in the early life of a loan that is subsequently amortised. The EIR rate is most sensitive to behavioural life assumptions and the level of prepayment that may occur. The Committee reviewed the impact on the EIR asset of higher levels of prepayment than currently being experienced and concluded that the basis of calculation and value of the asset was appropriate and based on assumptions consistent with previous years.

Impairments and forbearance
The Committee reviewed in detail the level of provision within the accounts and the range of impairment triggers considered by management. The Committee also considered a comprehensive paper setting out the basis of calculation of individual and collective provisions, management overlays and details of the forbearance measures utilised by the Society and the approach used to calculate the likelihood and level of any future losses on such accounts. Noting the limited use of forbearance, the subsequent performance of assets subject to such measures and the general high quality of the mortgage assets, the Committee was satisfied with the adequacy of the provisions recorded within the balance sheet.

Fair valuations for acquired assets
The Society acquired mortgage assets and retail savings through the merger with Stroud & Swindon Building Society and mortgage assets as a result of a loan book (£0.5 billion) purchased from Bank of Ireland. These items were initially recognised at fair value with subsequent recognition at amortised cost using EIR methodology. Fair value techniques were used based on observable market data where available, and the Society's internal models used for similar asset classes. The key fair value adjustments recognised were in respect of anticipated credit losses and interest shortfall, where the yield was lower than corresponding levels in the market. The Committee considered the performance of the assets and the level of fair value adjustments that had been amortised through the income statement. Noting the consistent performance of the assets, the Committee was satisfied that amortisation in the current period was in line with previous projections. The Committee also considered the impact of the adjustments on the income statement and whether year on year there was a significant variation that required additional disclosure. It was concluded that this was not the case and that the Committee was satisfied with the disclosures prepared by management.

Hedge accounting and valuation methodology
The Committee reviewed a report setting out the Society's approach to valuing derivatives including counterparty and own credit adjustments and the application of hedge accounting. This included reviewing the different types of hedging adopted by the Society and key sources of ineffectiveness. In addition, the report detailed the approach to valuing the assets designated as Available-for-sale and considered the requirement for any additional valuation adjustments on these assets and the derivatives in order to calculate Common Equity Tier 1 under the CRD IV requirements.

Calculation of the defined benefit pension plan position
The Society has a defined benefit pension plan which was closed to new entrants in December 2001 and was closed to future service accrual on 31 December 2012. The Committee reviewed the methodologies and the acceptable ranges from which assumptions had been selected in calculating the latest estimate of the scheme's assets and liabilities. This review was supported by a benchmarking report provided by the Society's advisors. Noting that the assumptions adopted by management were consistent with this report, a view confirmed by the external auditors, the Committee was satisfied with the position reported within the accounts.

All of the reports presented to the Committee by management were subject to scrutiny by the external auditors. Note 2 to the accounts summarises material judgements and critical accounting estimates made in applying accounting policies, and the sensitivity of reported performance to these judgements and estimates is then set out in subsequent relevant notes.

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

The Committee considered reports at each meeting from the Head of Internal Audit in order to review progress against the annual Audit Plan, including monitoring the management response and completion of actions arising from that function's reviews as well as the adequacy of resources. The Committee reviewed the guidance on 'Effective Internal Audit in the Financial Services Sector', issued in July 2013 by the Committee on Internal Audit Guidance for Financial Services. A gap analysis against the guidance was presented to the Committee as part of a broader review of the development of the Internal Audit function and the Committee approved an action plan to address the areas identified for development. An annual review of the effectiveness of the Internal Audit function was undertaken through seeking the views of the Committee and senior management, assessed against the International Standards for the Professional Practice of Internal Auditing and against the Internal Audit function's terms of reference. The Committee concluded that the Internal Audit function was effective.

The external auditors – effectiveness, tendering and feedback on activities

The Committee received regular reports from the external auditors, including matters highlighted from their audit work at the Society and other matters of general interest impacting the sector.

At its meeting in February 2014, the Committee considered feedback on the performance of the external auditors. The feedback was facilitated by the Internal Audit function and involved key stakeholders across the Board, Committee members and Society management. The Committee was satisfied with the performance of the external auditors.

In 2013, the Society tendered its external audit relationship in line with best practice including the Financial Reporting Council document 'Audit Tenders: notes on best practice' published subsequently. The previous tender exercise had last taken place in 2007. Three tenders were sought, including one from the Society's current auditors Ernst & Young. Barton, Mayhew & Co., a predecessor firm of Ernst & Young, were first appointed to audit the Coventry Permanent Economic Building Society's 1930 accounts. Following a comprehensive tender process, the Committee concluded that Ernst & Young remained the best candidate for external auditors for the Society and the Committee has recommended to the Board and to the members via a Resolution at the 2014 AGM that Ernst & Young be reappointed.

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

The Committee regularly reviews and monitors the Society's relationship with the external auditors to ensure that auditor independence and objectivity is maintained at all times, taking into consideration relevant UK professional and regulatory requirements. The Committee has developed a policy and framework which defines unacceptable non-audit assignments, pre-approval of acceptable non-audit assignments and procedures for approval of other acceptable non-audit assignments. At no time do the external auditors audit their own work, make management decisions for the Society, create a conflict of interest or find themselves in the role of advocate for the Society. The Committee keeps non-audit engagements under review and receives regular reports from the external audit partner confirming that adequate safeguards remain in place.

Furthermore, the Society's policy and framework requires that the external auditors should not be appointed if the threat to their objectivity is other than clearly insignificant, unless appropriate safeguards can be applied to eliminate or reduce such threat to an acceptable level.

During 2013 the Society engaged the external audit firm to provide certain non-audit services. These engagements included regulatory, accounting and taxation advice; all such engagements complied with the policy set out above and the Committee received regular updates on the nature and cost of the engagements.

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

The Society also commissioned services from a number of other major accountancy firms during the year.

The effectiveness of the Committee

The Committee undertook a self-assessment exercise during 2013 to monitor its effectiveness. The review involved Committee members, the Head of Internal Audit and others who attended meetings regularly. The review concluded that the Committee had operated effectively during the year with no additional action needed to improve its effectiveness.

During the year, the Committee reviewed its own terms of reference. Following this the Board revised them to reflect the Committee's role in reviewing financial announcements.

CONTROLLING AND MANAGING RISK

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

The Society continues to aim to improve the quality and transparency of its disclosures to ensure they are as clear and informative as possible. In particular, this year the Society has developed further its disclosures in line with the principles and the recommendations from the Financial Stability Board's Enhanced Disclosure Task Force.

Risk governance and control

Risk categorisation

The risks of the organisation are managed on a group basis to include the Society and its subsidiaries. The term 'Society' is therefore used in this report to include the activities of the Society and its subsidiaries.

Risks generally crystallise as an impact to cashflow or capital of an organisation in the form of a loss event. However the Society's Board recognises the importance of reputation and considers this carefully when considering its risk profile.

The risks to the Society are defined across five broad categories detailed below:

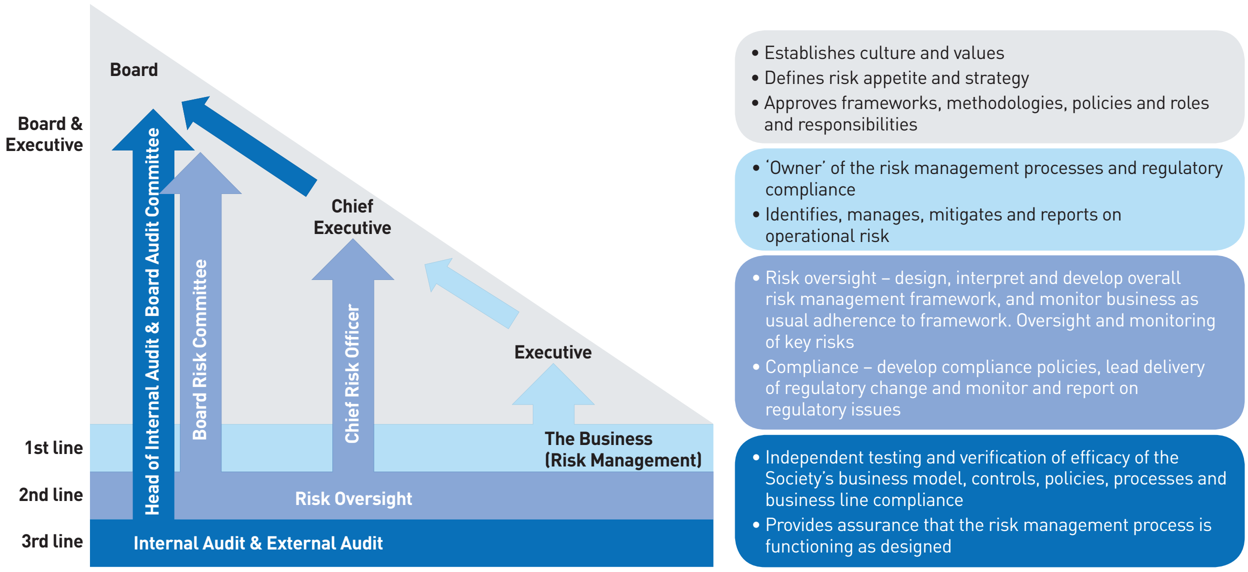
Risk category	**Brief definition**
Credit risk	Credit risk is the risk that borrowers or counterparties do not meet their financial obligations to the Society as they fall due.
Market risk	Market risk is the risk that the value of income derived from the Society's assets and liabilities may change adversely as a result of changes in interest rates or foreign exchange rates.
Liquidity & funding risk	Liquidity risk is the risk the Society has insufficient funds to meet its obligations as and when they fall due. Funding risk is the inability to access funding markets or to only do so at excessive cost and/or liquidity risk.
Operational risk	Operational risk is the risk of loss arising from inadequate internal processes, systems, people, or from external events. Operational risk includes conduct risk.
Business risk	Business risk is the risk arising from changes to the business model and also the risk of the business model or strategy proving inappropriate due to macroeconomic, geopolitical, regulatory or other factors.

It is the primary purpose of capital to absorb losses from the above risk categories and therefore capital is considered within this report.

Three lines of defence

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

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



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

RISK GOVERNANCE STRUCTURE

Board

Chair: Chairman

Sets the culture and values of the Society.

Challenges and approves the long-term strategy of the Society.

Determines and reviews the Society's risk appetite and the major risks faced by the Society.

Approves Internal Capital Adequacy Assessment Process (ICAAP), Individual Liquidity Adequacy Assessment (ILAA), Corporate Plan, Risk Appetite, Recovery and Resolution Plan and stress testing.

Chief Executive

Board Risk Committee (BRC)

Chair: Non-executive director

Oversees and reviews the key risks to which the Society is exposed; including determination of risk appetite, risk limits and tolerances across the full range of risks to which the Society may be exposed.

Satisfies itself on the design and completeness of the Society's internal control and assurance framework relative to the risk profile seeking assurance that the Society has an effective risk governance structure.

Risk Management Committee (RMC)

Chair: Chief Risk Officer

Ensures that risk is being identified and managed efficiently across the Society.

Ensures that the Society's Risk Management Framework remains effective.

Ensures the robustness of the overall stress testing and scenario analysis programme for risks faced by the Society.

Board Audit Committee (BAC)

Chair: Non-executive director

Reviews the adequacy of internal control and risk management processes.

Monitors the integrity of financial statements.

Internal Audit

Provides assurance that the risk management processes and controls are effective.

External Audit

Independently examines and expresses an opinion on the financial statements.

Asset and Liability Committee (ALCO)

Chair: Finance Director

Oversees the asset and liability risks faced by the Society, specifically market risk, wholesale credit risk and liquidity risk.

Retail Credit Risk Committee (RCRC)

Chair: Chief Risk Officer

Monitors the management of retail credit risk across the Society and the performance of the mortgage books to ensure compliance with limits approved by the Board.

Operational Risk Committee (ORC)

Chair: Chief Operating Officer

Monitors operational risk, business continuity, compliance and financial crime policy, and security risk in the Society.

Conduct Risk Committee (CRC)*

Chair: Chief Executive

Oversees and monitors the Society's delivery of good customer outcomes consistent with the conduct risk appetite statement approved by the Board.

Models and Ratings Committee

Chair: Non-executive director

Monitors the Society's use of its IRB system and reviews compliance with rules surrounding regulatory capital requirements e.g. with CRD IV.

* Committee formed with effect from 1 January 2014

Risk strategy

Risk appetite

The Society has an umbrella risk appetite statement to be a 'below median risk lender'. This over-arching statement provides a check and balance against underlying appetite statements and limits for the previously categorised risks.

For each of the key risks, appetite is set either qualitatively or through limits. The Society's overall risk appetite is to be able to withstand a severe but plausible stress and still report an accounting profit. The Society will tend to operate with a lower level of risk than its stated appetite or boundary condition, if it is possible to do so and still meet its Corporate Plan targets.

The Society's performance against limits, which together with the qualitative aspects create the articulation of the Board's risk appetite, are reviewed monthly as part of a consolidated risk report by both the Risk Management Committee (RMC) and BRC.

Risk culture

The Society operates a very simple business model and there is a high level of engagement between individual business functions and between staff at all levels of the organisation. A key element of the Society's risk culture is a genuine emphasis on putting members first and this is supported by the absence of sales incentives for any staff. In addition, the business model and strategy does not depend on fee or commission income earned from cross-selling additional products to new or existing members.

Stress testing and planning

The Society uses stress testing as a key risk management tool to gain a better understanding of its risk profile and its resilience to internal and external shocks. In addition, stress testing provides a key input to the Society's capital and liquidity assessments and related tests of risk management and measurement assumptions.

The stress testing that the Society undertakes is designed to:

- Confirm the Society has sufficient capital and liquid resources.
- Ensure the Society remains within its risk appetite.
- Ensure the alignment between the Society's risk management framework and senior management decision making.
- Provide sufficiently severe and forward looking scenarios.

ICAAP

The ICAAP (Internal Capital Adequacy Assessment Process) is the Society's evaluation of its capital position and requirements, assessed under the CRD IV framework. The ICAAP provides details of the current approaches used to manage risk across the Society. As part of that assessment the ICAAP has to assess capital requirements both against its current position and during severe but plausible stresses.

The Society bases its capital requirements on a stressed scenario specified by the regulator overlaid with further adverse second order effects. In addition a range of other more severe stresses are considered. For example, the Society stresses its capital requirements to include scenarios in which the worst house price deflation ever observed is compounded by the worst arrears observed to date. The stresses also reflect both low rate and high rate Bank Base Rate scenarios.

ILAA

The ILAA (Individual Liquidity Adequacy Assessment) is the Society's documentation of its liquidity position and requirements, assessed against regulatory requirements and risk tolerance. An integral component of the approach to liquidity risk management is stress testing; some of which is mechanical using the very detailed rules and guidance issued within Prudential regulations and contained within regulatory returns. In addition to the regulatory prescribed stress testing the Society undertakes its own stress tests and sets limits on these which tend to be more onerous than those of the regulator. The Society stress tests and the regulatory returns are completed weekly, alongside a monthly operational stress and six monthly alternative stress tests.

Reverse stress testing
The Reverse Stress Testing (RST) informs, enhances and integrates with the Society's existing stress testing framework by considering extreme events that could 'break' the Society. As such it complements the existing ICAAP and ILAA processes, helping to improve risk identification and risk management more generally.

The application of RST follows two basic approaches: a qualitative approach which begins with executive workshops to provide an opportunity to explore the threats and issues which may sit outside routine risk reporting. The threats identified are amalgamated with risks identified in a parallel process incorporating operational risks. The combined threats and risks are then explored to see what additional events would be required to 'break' the Society and determine the feasibility of all these events occurring together. This qualitative approach is supplemented with a quantitative assessment of the risks which explores the level of capital or liquidity failure needed to 'break' the Society. A key outcome from the process is to consider whether any of the scenarios considered are sufficiently plausible to necessitate a change to the Society's strategy.

The analysis is formally undertaken every 12 months and reviewed and approved by the Board although the scenarios are considered more frequently.

TOP AND EMERGING RISKS

The principal risks and uncertainties affecting the Society reported at the 2012 year end and also within the 2013 interim results continue to apply to the Society as at 31 December 2013, and there have been no material changes to the Society's approach to risk management during the year.

Although the global economic environment remains weak, there have been continued signs of improvements to the UK housing market and economy as a whole. While this makes the key themes of the risk environment consistent with those assessed in 2012, it also brings a potential new threat from the risk of the UK housing market over-heating. The Society's view is that the economic recovery appears to be on track but that it is still fragile.

In addition the Society is cognisant of the continued fall out from various banking scandals and the heightened risk from cyber attack which is starting to get increasing external focus, albeit this has long been a risk the Society has taken robust steps to mitigate. These risks and uncertainties and how the Society is managing them are summarised below:

A continued but fragile economic recovery
The UK economy now appears to be one of the strongest western economies with welcome signs that the housing market and wider economy are starting to recover. While the UK economy is growing faster than previously anticipated, it still sits at a subdued level compared to where it stood prior to the credit crisis. Since the Bank of England issued forward guidance during 2013 there has been much debate about the timing of the first Bank Base Rate movement. Latest guidance suggests that any rate movement is unlikely for at least the remainder of 2014.

In its assessment of the economic environment, the Society has always taken a prudent approach to anticipated interest rate rises. Even against a prolonged projected flat Bank Base Rate environment, the Society continues to generate strong profits with no diminution of capital. The Society is conscious of the inherent risks to mortgage members currently enjoying relatively low rates who could suffer from a rate 'shock' in the event that Bank Base Rate begins to rise. To this end, the Society only lends to those members who it believes can afford repayments even at higher rates and adopts a supportive approach to those few that do experience difficulties. The Society also continues to ensure that it has a significant proportion of administered rate savings and mortgages on its balance sheet giving it greater flexibility than many of its peers to manage these risks. Limits are in place and are reviewed monthly to ensure that this flexibility is retained. The ability to administer such a large proportion of both the mortgage and savings book also provides management with a number of credible options in the event of an upward or downward movement in Bank Base Rate. The fact that the Society's Standard Variable Rate remains at the lower end of its peer group, better positions the Society's members for any such rate rises.

The US budgetary issues in Q4 2013 and wider concerns about the impact of the withdrawal of monetary stimulus on emerging economies has also highlighted that economies around the world are still very fragile and that it would not take much to reverse the improvements seen to date. While the Society is well protected from the direct impacts from such global stresses the impacts on the UK economy would affect the Society. The Eurozone threat attracts far less media attention than it did in 2012 since which time the Society has continued to reduce its limited exposure to this region. However, unemployment across the Eurozone remains high and there is real risk of further bail-outs in 2014, all of which means that the threat from a Eurozone crisis has not ended, but that the Society has taken all reasonable measures to mitigate the risk.

The Society has minimal redenomination risk with all euro denominated exposures held with UK counterparties. There is no direct credit risk from any individual Eurozone sovereign as the Society does not hold any sovereign securities other than those of the UK, and the Society continues to take a very cautious view towards exposure to European counterparts. The Society's analysis of counterparty risk extends to the risk from bail-in as well as to credit default events.

Over-heating of the UK housing market

The recovery in the UK economy is tempered by fears that the comparatively cheap funding available to lenders via the Government-backed schemes to support homebuyers (e.g. Help to Buy), could lead to another housing bubble.

Moreover, the Government's desire for more lending to reach households could create credit risks for lenders that undertake lending at higher loan to values. The Society's cautious approach to higher loan to value lending is a fundamental part of its business model and evidenced through the low level of impairment losses reported and low indexed loan to value of the mortgage book which stands at just 50% (simple average).

Banking sector operational events

The operational events which characterised 2012 for a number of the larger UK banks continued in 2013 with LIBOR and EURIBOR fixing leading to record fines, a spate of resignations and continued low levels of trust in the banking sector by consumers. The more recent announcements indicate that some banks may have been involved in the manipulation of foreign exchange rates and further fines and reputational damage might be expected. Alongside this, the spectre of the credit crisis and legal action taken by the large US mortgage providers Freddie Mac and Fannie Mae over the sale of mortgage backed securities have seen a number of global banks hit by fines amounting to billions of dollars.

With regard to the highest profile events, the Society is not a market maker and therefore has no means or incentive to modify market rates such as LIBOR and it does not therefore have exposure to the reputational risk impacts seen in some of the UK banks. The risks arising from mergers and acquisitions, which have also highlighted the fragility of some UK firms, have been shown to be well managed by the Society as illustrated by previous successful integrations and are not a key feature of the business model.

The Society is similarly cognisant of the significant negative publicity surrounding the Co-operative Bank p.l.c. and the inferences applied in the press to the mutual sector. However, the Society has consistently shown that mutuals with a simple low risk member-focused business model can still thrive in the current economic environment.

The damage associated with a loss of consumer trust is exemplified by the high level of complaints amongst many financial services providers for specific issues, including mis-selling, or poor service. PPI continues to be a notable feature with increasing provision set aside for customer redress. In total some £20 billion of provisions have now been reported across the industry and the Financial Ombudsman continues to highlight poor treatment of complainants.

In contrast, the Society continues to have an excellent track record of reporting low numbers of complaints and resolving those complaints it does receive to the satisfaction of the members concerned. This is the case with complaints reported to both the regulator and the Financial Ombudsman Service. Complaints will remain an important measure of the Society's performance in managing conduct risk as well as customer satisfaction.

Cyber threats
Due in no small part to technological evolution and increased media coverage, the risks associated with cyber-attack have risen in prominence across the globe; and nowhere more so than in financial services where businesses and individuals are reliant on the services provided by the large clearing banks.

Criminals are increasingly targeting elderly or otherwise vulnerable customers, with the industry seeing a significant increase in low-tech crimes of deception, where consumers are distracted or duped into parting with cards, PINs and other personal information, including passwords.

Financial institutions have made substantial investment in technological solutions to combat the more sophisticated high-tech financial crime threats that are faced. This has led to a significant fall in losses associated with most fraud types since their peak in 2008, including a recently reported decline in remote banking fraud.

The Society is determined to ensure that its defences remain as robust as possible, implementing industry leading practices, including (but not limited to) those promoted via the GCHQ 10 Steps to Cyber Security and the 20 Critical Controls endorsed by the Centre for the Protection of National Infrastructure (CPNI), and adopting a 'defence in depth' approach to control mechanisms.

Regulatory reforms
The ambitious agenda of regulatory reform continues with the CRD IV package, being released in final form in June 2013. A substantial part of the legislation came into force on 1 January 2014.

The CRD IV package introduces a number of measures, such as the leverage ratio, which must be calibrated at European level. To inform this process, firms must report their leverage ratio under the new supervisory Common Reporting (COREP) framework. The European Banking Authority (EBA) is expected to review the data and determine a leverage ratio methodology and binding minimum level for introduction on 1 January 2018.

In the interim, the Prudential Regulation Authority (PRA) has imposed on the eight major UK banks and building societies a 3% minimum leverage requirement. This is based on a Basel III end-point calculation and uses Tier 1 as the capital measure. In addition, HM Treasury (HMT) asked the Financial Policy Committee (FPC) to review whether it required additional powers over the leverage ratio. HMT noted the importance of applying the international standard in line with the final Basel definition and calibration but was open to a recommendation that the FPC may need the power to implement a leverage ratio ahead of the international timetable, or to set a higher baseline ratio.

The leverage ratio is a non-risk based measure that is designed to act as a supplement to the risk based capital requirements. It is intended as a backstop measure. The leverage calculation determines a ratio based on the relationship between Tier 1 capital and total balance sheet exposures (see page 27). The leverage ratio does not distinguish between unsecured and secured loans or recognise the ratio of loan to collateral value of secured lending. Consequently, the leverage ratio has the potential to act as a primary constraint on low risk mortgage lenders even, as is the case for the Society, where strong underlying collateral exists.

The transition from the current capital adequacy regime to the CRD IV package has been assessed through regular monitoring of the EBA's technical standards with the successful implementation monitored through a Society based project run in partnership between the business areas impacted, and the Society's Risk and Compliance teams.

The Society ensures that its focus on regulatory matters is appropriately split between prudential and conduct matters, thus aligning with the 'twin peaks' supervision structure which came into force on 1 April 2013.

A key focus of the conduct team is the regulatory reforms relating to the mortgage market (Mortgage Market Review – 'MMR'), which has the potential to significantly alter the manner in which lenders and intermediaries interact with their customers. However, the Society's preparations are advanced and it believes it is well placed to meet the full regulatory timescale for MMR and does not believe that the reforms will have an adverse impact on its business model or strategy.

CREDIT RISK

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

Maximum exposure to credit risk (Audited)

The following table presents the Society's maximum exposure to credit risk of on-balance sheet and off-balance sheet financial exposures before taking into account collateral held or other credit enhancement and after allowing for impairment where appropriate. The maximum exposure to loss for off-balance sheet financial exposures is considered to be their contractual nominal amounts.

	On-balance sheet carrying value 2013 £m	**Off-balance sheet exposures[1] 2013 £m**	**Maximum credit risk exposure 2013 £m**	On-balance sheet carrying value 2012 £m	Off-balance sheet exposures[1] 2012 £m	Maximum credit risk exposure 2012 £m
Cash and balances with the Bank of England	**2,042.1**	**-**	**2,042.1**	1,814.2	-	1,814.2
Loans and advances to credit institutions	**179.3**	**-**	**179.3**	323.7	-	323.7
Debt securities	**1,666.0**	**1,348.2**	**3,014.2**	2,338.2	99.8	2,438.0
Loans and advances to customers	**24,117.1**	**1,032.6**	**25,149.7**	22,018.9	890.1	22,909.0
Hedge accounting adjustments	**(8.4)**	**-**	**(8.4)**	86.8	-	86.8
Derivative financial instruments	**191.2**	**-**	**191.2**	279.6	-	279.6
Total	**28,187.3**	**2,380.8**	**30,568.1**	26,861.4	989.9	27,851.3

1. Off balance sheet exposures comprise of loan commitments and off-balance sheet treasury bills relating to FLS.

RETAIL CREDIT RISK

Retail credit risk profile

The nature of the Society's lending has remained focused on low risk residential mortgage business, including buy-to-let. Limited non-traditional lending in the form of near-prime mortgages and self-certification was discontinued in 2008 and 2009 respectively and these portfolios are reducing over time. Commercial loans in the Stroud & Swindon portfolio were added to the Society's assets upon merger of the two Societies in 2010. These balances also continue to reduce over time, with no new lending activity being undertaken in this portfolio. There has been no new unsecured lending since 2009.

The Society acquired around £1.9 billion of mortgages on its merger with the Stroud & Swindon Building Society in 2010 and a further £0.5 billion through the acquisition of a Bank of Ireland portfolio in 2012. The performance of both of these books has been strong with only £4.2 million written off on the Stroud & Swindon mortgages to date, and only three Bank of Ireland mortgages more than three months in arrears. Loans and advances to customers, gross of impairment provisions, are shown below:

Loans and advances to customers (Audited)	**2013 £m**	**2013 %**	2012 £m	2012 %
Residential mortgages: owner-occupier	**15,161.1**	**62.8**	14,185.2	64.3
Residential mortgages: buy-to-let	**8,419.8**	**34.9**	7,174.9	32.6
Total traditional residential mortgages	**23,580.9**	**97.7**	21,360.1	96.9
Residential near-prime mortgages	**116.0**	**0.5**	142.7	0.6
Residential self-certification mortgages	**382.6**	**1.6**	474.9	2.2
Commercial mortgages[1]	**8.3**	**-**	10.1	-
Total non-traditional mortgages	**506.9**	**2.1**	627.7	2.8
Unsecured personal loans[1]	**56.7**	**0.2**	58.7	0.3
Total gross balance	**24,144.5**	**100.0**	22,046.5	100.0

1. Legacy books of unsecured personal loans and commercial mortgages exist. The credit risks from these are immaterial and are not considered further within the report.

Owner-occupier
Residential mortgages: owner-occupier includes £330.0 million (1.4% of total gross balances) (2012: £341.5 million and 1.5%) 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 manages this risk by granting loans at a relativity low loan to value, subject to the age of the borrower, and through the use of statistical modelling to stress potential exposures within acceptable prudent limits. The Society has not offered these mortgages since 2009.

Buy-to-let
The Society undertakes low risk, low loan to value business, and the amount of equity each borrower consequently retains within the property means that even in the event of default, credit losses are low.

Along with assessing rental income and stipulating conservative minima that are acceptable, which helps protect the mortgage repayments independently of the borrower's circumstances, the Society also limits the number of properties it will consider in lending to individual landlords. Additionally, the Society considers the value of the property on the basis of whether it can be resold into the owner-occupier market. This therefore gives recourse to two markets (buy-to-let and owner-occupier) in the event that the property was to move into Society ownership. For these reasons the risks from the Society's buy-to-let portfolio are in many respects comparable to standard owner-occupier mortgages.

Geographic concentration (Audited)
The residential mortgage portfolio is well diversified and reflects the national coverage of the Society's lending operations. The geographical split of residential mortgages by balance, gross of impairment provisions is shown below:

Region	**2013 %**	2012 %
East of England	**12.4**	12.1
London	**14.2**	13.1
Midlands	**16.0**	17.0
North East	**9.1**	9.2
North West	**8.6**	8.7
Scotland & Northern Ireland	**4.6**	4.6
South Central	**12.6**	12.7
South East	**10.6**	10.3
South West & Wales	**11.9**	12.3
Total	**100.0**	100.0

Loan to value
The Society's low risk approach to lending is reflected in the loan to value profile of the residential mortgage book. The estimated value of the residential mortgage portfolio is updated on a quarterly basis using the Nationwide regional house price index.

The residential mortgage book as at 31 December 2013 is analysed opposite, together with an analysis of gross new lending in the year. The following tables are by number of accounts unless stated otherwise:

Book analysis (Audited)	2013 %	2012 %
Indexed loan to value:		
< 50%	**45.0**	43.3
50% to 65%	**26.6**	22.3
65% to 75%	**13.7**	14.5
75% to 85%	**9.1**	10.8
85% to 95%	**4.1**	5.5
> 95%	**1.5**	3.6
Total	**100.0**	100.0
Average indexed loan to value of stock (simple average)	**50.0**	52.1
Average indexed loan to value of stock (balance weighted)	**57.7**	60.9

New business profile (Gross lending)[1] (Audited)	2013 %	2012 %
Owner-occupier purchase	**36.7**	32.0
Owner-occupier remortgages	**24.0**	23.9
Buy-to-let	**39.3**	44.1
Total	**100.0**	100.0
Average loan to value (simple average)	**63.6**	60.6
Average loan to value (balance weighted)	**66.5**	64.1

1. New business and average loan to value of new business excludes further advances (2013: £141.7 million, 2012: £129.0 million).

Retail credit risk management – residential mortgages

The Society operates a simple business model, focusing on its principal objective, to meet its current and future members' needs for residential mortgages. Credit risk for the Society is therefore most likely to present itself in the potential inability of borrowers to repay their mortgage.

Exposure to this risk is monitored and managed by a specialist department that reports to the Chief Risk Officer, and is overseen by the Retail Credit Risk Committee (RCRC). RCRC's activities and decisions are overseen by RMC and BRC.

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

With respect to controlling the quality and mix of new lending and ensuring that it is within limits and the risk appetite set by the Board, the Society operates a combination of statistical modelling (credit scoring) and assessment of applications against lending policy criteria which are embedded as rules within the Society's automated decision system. This system uses information from the statistical modelling and assessment against policy rules to provide consistent lending decisions, and helps determine when manual intervention is required by skilled underwriters.

There is also a comprehensive quality assurance programme to monitor the quality of lending decisions and adherence to lending policy.

The Society's retail mortgage lending is only secured against properties in the UK. The Society's natural concentration in the UK market could then be exacerbated by over exposure to one geographical location or counterparty, or reliance on particular product types within the portfolio. The Society manages this risk by monitoring the geographical distribution of lending, the distribution of gross lending by channel of acquisition and by setting new lending risk limits in specific segments of the mortgage market.

Regular stress testing is undertaken on the mortgage book which seeks to establish the extent to which losses may emerge under a range of macro-economic and specific stress scenarios and to ensure that the Society continues to remain within its retail credit risk appetite. These stress tests primarily consider the impact of economic events on the probability of default and on house price movements.

RCRC monitors arrears and the policy and strategy for managing members in payment difficulties. A specialist team works with borrowers in financial hardship or difficulty to resolve matters and each case is reviewed on its own merit. The overarching aim is to collect arrears and to regularise payments, using possession as a last resort or where it is the only credible option. Reasonable and realistic arrangements will be accepted, based on what the customer can afford, provided in the longer term there is a high degree of confidence the debt will reduce. Additional information on the extent and use of forbearance is set out later in this section.

Repossession of a property is only sought where all reasonable efforts to regularise matters have failed or the mortgage is unsustainable in the longer term. Regular reviews of the Society's arrears management function and processes are independently undertaken to ensure that borrowers are being treated fairly, appropriately and sympathetically and in line with established policies and procedures and regulatory guidance.

Identifying impaired loans (Audited)

Loans are categorised by arrears status in line with industry practice and are identified as being either not past due and not impaired, if up-to-date at the balance sheet date, past due up to three months but not impaired, or impaired if more than three months in arrears or in possession.

In terms of impaired mortgages, the Society's performance is compared with figures published by the Council of Mortgage Lenders (CML). From these figures it can be seen that the performance of the Society has remained strong, with arrears reducing over the year, and favourable to the industry.

The Society's number of customers in arrears as a percentage of loans and advances to customers compared to the CML data is shown below:

	2013		2012	
	Society	**CML[1]**	Society	CML[1]
(Audited)	**%**	**%**	%	%
Greater than three months	**0.90**	**1.68**	1.08	1.91
Greater than six months	**0.41**	**0.91**	0.51	1.05
Greater than one year	**0.12**	**0.37**	0.14	0.43
In possession	**0.03**	**0.08**	0.03	0.10

1. Council of Mortgage Lenders' data as at 31 December 2013 (31 December 2012).

An analysis of past due and impaired loans by loan to value is shown below:

As at 31 December 2013 (Audited)

Indexed Loan to value:	Not impaired: Not past due £m	Not impaired: Past due up to three months £m	Impaired: Past due over three to six months £m	Impaired: Past due over six months or in litigation £m	Impaired: In possession £m	Impairment provision £m	Total £m
< 50%	7,297.0	135.1	17.2	15.2	0.2	(2.2)	**7,462.5**
50% to 65%	7,712.5	189.4	26.3	17.8	-	(4.0)	**7,942.0**
65% to 75%	4,113.8	136.6	21.1	21.0	0.2	(3.5)	**4,289.2**
75% to 85%	2,620.5	113.0	22.2	18.9	0.3	(3.0)	**2,771.9**
85% to 95%	1,016.7	134.4	20.1	19.8	0.7	(4.0)	**1,187.7**
> 95%	338.7	31.0	16.8	21.7	9.6	(9.6)	**408.2**
Unsecured	51.7	4.0	0.6	0.4	-	(1.1)	**55.6**
Total	**23,150.9**	**743.5**	**124.3**	**114.8**	**11.0**	**(27.4)**	**24,117.1**

As at 31 December 2012 (Audited)

Indexed Loan to value:	Not impaired: Not past due £m	Not impaired: Past due up to three months £m	Impaired: Past due over three to six months £m	Impaired: Past due over six months or in litigation £m	Impaired: In possession £m	Impairment provision £m	Total £m
< 50%	5,980.0	101.8	14.6	13.8	0.2	(0.9)	6,109.5
50% to 65%	5,936.0	149.6	19.5	17.4	-	(2.1)	6,120.4
65% to 75%	3,949.6	148.1	25.0	15.1	0.2	(2.7)	4,135.3
75% to 85%	2,981.8	183.0	24.7	21.8	0.2	(3.9)	3,207.6
85% to 95%	1,333.8	84.3	23.1	24.8	0.1	(4.3)	1,461.8
> 95%	792.8	62.2	34.0	40.2	10.1	(12.1)	927.2
Unsecured	53.2	4.2	0.7	0.6	-	(1.6)	57.1
Total	21,027.2	733.2	141.6	133.7	10.8	(27.6)	22,018.9

The Society held properties valued at £9.1 million (2012: £8.4 million) pending their sale against balances of £8.2 million (net of provisions) (2012: £7.5 million). Shortfalls between expected sale proceeds (less anticipated costs) and the balance outstanding are fully provided.

The table below provides further information regarding the impaired status of retail mortgages and loans. Balances are shown gross of impairment provisions.

As at 31 December 2013 (Audited)	**Not impaired**		**Impaired**				
	Not past due £m	**Past due up to three months £m**	**Past due over three to six months £m**	**Past due over six months or in litigation £m**	**In possession £m**	**Impairment provision £m**	**Total £m**
Traditional residential mortgages							
Owner-occupier	14,505.6	490.9	89.2	69.5	5.9	(11.9)	**15,149.2**
Buy-to-let	8,201.3	187.4	12.3	15.9	2.9	(9.4)	**8,410.4**
Non-traditional mortgages							
Residential near-prime	62.0	25.7	10.8	16.7	0.8	(1.9)	**114.1**
Residential self-certified	322.9	34.6	11.4	12.3	1.4	(2.1)	**380.5**
Commercial lending	7.4	0.9	-	-	-	(1.0)	**7.3**
Unsecured	51.7	4.0	0.6	0.4	-	(1.1)	**55.6**
Total	**23,150.9**	**743.5**	**124.3**	**114.8**	**11.0**	**(27.4)**	**24,117.1**

As at 31 December 2012 (Audited)	Not impaired		Impaired				
	Not past due £m	Past due up to three months £m	Past due over three to six months £m	Past due over six months or in litigation £m	In possession £m	Impairment provision £m	Total £m
Traditional residential mortgages							
Owner-occupier	13,597.8	412.8	87.8	80.7	6.1	(11.6)	14,173.6
Buy-to-let	6,892.2	243.9	18.6	17.5	2.7	(8.8)	7,166.1
Non-traditional mortgages							
Residential near-prime	74.7	29.2	18.7	19.7	0.4	(2.8)	139.9
Residential self-certified	400.1	42.3	15.8	15.1	1.6	(2.6)	472.3
Commercial lending	9.2	0.8	-	0.1	-	(0.2)	9.9
Unsecured	53.2	4.2	0.7	0.6	-	(1.6)	57.1
Total	21,027.2	733.2	141.6	133.7	10.8	(27.6)	22,018.9

Movement in impaired loans

The table below reconciles the movements in impaired loans in the year.

As at 31 December 2013 (Audited)	**Traditional residential mortgages**		**Non-traditional mortgages**				
	Owner-occupier £m	**Buy-to-let £m**	**Residential near-prime £m**	**Residential self-certified £m**	**Commercial lending £m**	**Unsecured £m**	**Total £m**
Impaired at 1 January 2013	174.6	38.8	38.8	32.5	0.1	1.3	**286.1**
Classified as impaired during the year	141.6	39.7	21.8	32.8	0.2	1.7	**237.8**
Transferred from impaired to unimpaired	(135.6)	(42.3)	(26.4)	(32.5)	(0.3)	(0.6)	**(237.7)**
Amounts written off	(4.3)	(1.5)	(0.3)	(0.7)	-	(1.3)	**(8.1)**
Charged to impaired loans	3.0	1.1	0.6	0.4	-	-	**5.1**
Repayments and other movements	(14.7)	(4.7)	(6.2)	(7.4)	-	(0.1)	**(33.1)**
Impaired at 31 December 2013	**164.6**	**31.1**	**28.3**	**25.1**	**-**	**1.0**	**250.1**

Loan balances are shown gross of provisions. The balances are of impaired loans at the start and end of the year. Amounts written off reflect losses on loans sold from possession where the balances on these loans were in excess of the sale proceeds. Repayments and other movements include disposals (where the balances of loans sold from possession were in excess of sale proceeds) repayments (from customers reducing the outstanding balances) and transfers between categories. Amounts charged to impaired loans includes interest accrued and charges.

The movement in impairment provisions on loans and advances to customers is further detailed in note 12 to the accounts.

Extent and use of forbearance (Unaudited)

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

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

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

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

With regard to cases that are not past due, forbearance may be granted to members as a means of helping them overcome temporary financial difficulties. The vast majority of cases of this type are payment holidays granted by the Collections department. Payment holidays are a contractual feature on most of the mortgage products offered by the Society, but where a customer requests a payment holiday and it has been determined that financial difficulties are the reason for the request, the action is recorded as being a forbearance measure.

In rare cases, the Society may also capitalise arrears and schedule repayment of the balance over the remaining term of the loan when the period of financial difficulty has ended, provided that the customer has made at least six consecutive monthly payments and payments will be sustainable over the remaining life of the mortgage. Capitalisation will only be allowed once on each loan. In 2013 the Society capitalised arrears on 13 accounts (2012: 12) in total, of which 10 are currently performing and up to date (2012: 10).

The Society no longer lends on an interest-only basis for owner-occupier mortgages, and the option to transfer members on to temporary interest-only payments has been curtailed accordingly and is only used in very rare situations. During 2013 only four mortgages were put on to a temporary interest-only basis (2012: 37) of which three are currently performing and up to date (2012: 35).

	2013 No of accounts	2013 Carrying value £m	2012 No of accounts	2012 Carrying value £m
Forbearance: Accounts past due				
Arrangements	**2,789**	**323.4**	3,099	360.9
Concessions	**208**	**22.2**	242	28.7
Term extensions[1]	**41**	**4.6**	122	12.4
Capitalisation of arrears[1]	**3**	**0.4**	2	0.3
Temporary transfer to interest-only[1,2]	**1**	**0.1**	2	0.2
Forbearance indicators: Accounts not past due				
Payment holidays granted by Collections department[1]	**1,605**	**197.5**	1,213	137.1
Term extensions[1]	**61**	**7.0**	50	5.2
Capitalisation of arrears[1]	**10**	**1.1**	10	1.2
Temporary transfer to interest-only[1,2]	**3**	**0.3**	35	4.7

1. Granted in the last 12 months.
2. The option to transfer members on to temporary interest-only payments is only used in very rare situations.

The Society holds £9.9 million provision (2012: £11.8 million) in total for all cases in these forbearance categories. The provision balance has fallen despite the overall increase in the number of cases since last year because of the reduction in the number of accounts with forbearance indicators that are also past due and have a greater propensity to default.

With regard to the increase in payment holidays granted by the Collections department, in 2013 a new automated process was introduced whereby an increased number of requests were referred to the department to determine if there was any indication of financial difficulty. This increase therefore reflects a more robust process for identifying cases for treatment within the appropriate business area, and does not in itself represent an increase in forbearance.

Whilst accounts not past due are not considered to be individually impaired it is recognised that collectively impairment exists. Provisions have therefore been raised against accounts subject to a forbearance measure (see note 12). In addition the Society has identified the following situations as indicating potential impairment amongst members whose mortgages are nonetheless not past due.

- Accounts where direct debits had been cancelled or returned but payment was subsequently made.
- Payments were being made by the Department for Work and Pensions.
- The Society has paid ground rent on behalf of members living in leasehold properties.

Members whose mortgage accounts display these potential impairment indicators have a higher than expected propensity to go into arrears, but the increased propensity is not so high as to consider these loans as being impaired.

The analysis of these potential impairment indicators assesses the performance of any mortgage that has had one of these situations arise in the previous 12 months. As at 31 December 2013 there were 3,661 members with such potential impairment indicators, to the value of £365.4 million (1.5% of the mortgage book). A collective provision of £0.5 million is being held, which reflects the low probabilities of default (since 31 December 2012, only 45 cases in these categories had gone into arrears by six or more months) and high collateral values (the average simple loan to value is 50.4 % and less than 4% are above 95% loan to value) of these cases.

Outlook

There have been stronger signs of recovery in the UK economy also reflected in the housing market but fears the economy remains fragile and various Government schemes could lead to another housing bubble.

The Society continues to focus its lending on low loan to value business to protect the Society from loss and assesses affordability under a higher interest rate environment to protect the borrower. However even modest interest rate rises could have significant impacts on some households as a result of both the historically low rate environment and the record period over which those rates have remained unchanged. As the economy improves the likelihood of a Bank Base Rate rise increases and it is likely that over the period of the Society's corporate planning process (five years) rates will rise. While the Society anticipates that any rate rise will be gradual, it undertakes stress testing against, and is prepared for, much more rapid rises.

TREASURY CREDIT RISK

Management of treasury credit risk

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

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

Derivatives are only executed with organisations that have been subject to review by the Treasury Credit Committee and the vast majority include collateral agreements primarily reducing the risk to the extent valuations may move within a week. The Society has no exposure to emerging markets, hedge funds, non-UK RMBS or credit default swaps and 99.9% of exposures have an investment grade rating.

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

Treasury liquid assets profile (Audited)

The Society's treasury assets comprise cash and balances with the Bank of England, loans and advances to credit institutions, debt securities, and Treasury bills drawn under the FLS.

Analysis of the Society's treasury assets by credit rating is set out below:

2013 (Audited)	Exposure value by Moody's rating Aaa-Aa3 £m	A1-A3 £m	Baa1-Baa3 £m	Unrated[1] £m	Total £m
Central banks and sovereigns	**4,537.1**	**-**	**-**	**-**	**4,537.1**
Multilateral development banks (supranational bonds)	**95.7**	**-**	**-**	**-**	**95.7**
Financial institutions	**323.6**	**90.7**	**4.1**	**1.6**	**420.0**
Mortgage-backed securities	**177.9**	**4.9**	**-**	**-**	**182.8**
Total	**5,134.3**	**95.6**	**4.1**	**1.6**	**5,235.6**

2012 (Audited)	Exposure value by Moody's rating Aaa-Aa3 £m	A1-A3 £m	Baa1-Baa3 £m	Unrated[1] £m	Total £m
Central banks and sovereigns	3,416.5	-	-	-	3,416.5
Multilateral development banks (supranational bonds)	217.2	-	-	-	217.2
Financial institutions	320.1	396.3	4.9	16.7	738.0
Mortgage-backed securities	198.9	5.3	-	-	204.2
Total	4,152.7	401.6	4.9	16.7	4,575.9

1. Unrated institutions comprise smaller building societies and local authorities.

The following section summarises the Society's exposure to institutions split by geographic domicile.

2013 (Audited)	Liquid assets					Of which, debt securities		
	Sovereign £m	Supranational £m	Financial institutions £m	Mortgage backed securities £m	Total liquid assets £m	Amortised cost £m	Market value movement £m	Fair value £m
United Kingdom	4,537.1	-	310.6	182.8	**5,030.5**	2,874.2	35.3	**2,909.5**
Denmark	-	-	2.4[2]	-	**2.4**	-	-	**-**
Germany	-	-	2.3[2]	-	**2.3**	-	-	**-**
Netherlands	-	-	9.0	-	**9.0**	9.0	-	**9.0**
Switzerland	-	-	0.6[2]	-	**0.6**	-	-	**-**
Supranational[1]	-	95.7	-	-	**95.7**	95.5	0.2	**95.7**
Australia	-	-	65.1	-	**65.1**	-	-	**-**
Canada	-	-	30.0	-	**30.0**	-	-	**-**
Total	**4,537.1**	**95.7**	**420.0**	**182.8**	**5,235.6**	**2,978.7**	**35.5**	**3,014.2**

2012 (Audited)	Liquid assets					Of which, debt securities		
	Sovereign £m	Supranational £m	Financial institutions £m	Mortgage backed securities £m	Total liquid assets £m	Amortised cost £m	Market value movement £m	Fair value £m
United Kingdom	3,416.5	-	469.3	204.2	4,090.0	1,913.5	170.3	2,083.8
Belgium	-	-	54.7[3]	-	54.7	55.1	(0.4)	54.7
Denmark	-	-	4.9[2]	-	4.9	-	-	-
France	-	-	16.4[2]	-	16.4	-	-	-
Germany	-	-	55.7[2]	-	55.7	53.3	-	53.3
Netherlands	-	-	109.0	-	109.0	28.0	-	28.0
Switzerland	-	-	2.4[2]	-	2.4	-	-	-
Supranational[1]	-	217.2	-	-	217.2	209.1	8.1	217.2
Australia	-	-	25.6[2]	-	25.6	1.0	-	1.0
Total	3,416.5	217.2	738.0	204.2	4,575.9	2,260.0	178.0	2,438.0

1. Supranational relates to amounts held with the European Investment Bank, which is guaranteed by a number of European Sovereigns.
2. Collateral accounts in relation to derivative liabilities, except for £53.3 million and £25.1 million in 2012, held in Germany and Australia respectively.
3. Invested with financial institutions, which are guaranteed by Sovereigns (Belgium and France).

Credit risk mitigation

Debt securities are generally unsecured with the exception of securitisation and covered bond positions which are secured by pools of financial assets.

The Society has entered into International Swaps and Derivatives Association (ISDA) master netting agreements for all of its derivatives (other than derivatives held by the Coventry Building Society Covered Bonds LLP), whereby outstanding transactions with the same counterparty can be settled net following a default or other predetermined event. Credit Support Annexes (CSAs) are executed in conjunction with these ISDA master agreements which typically provide for the exchange of collateral on a weekly basis to mitigate net mark to market credit exposure.

The Coventry Building Society Covered Bonds LLP does not enter into a master netting agreement due to the structure of the transaction but a CSA has been entered into which provides for full collateralisation when the counterparty bank credit rating falls below a certain threshold. Substantially all of the net derivative credit exposure in the table below relates to this arrangement. The counterparty has a credit rating of Aa3.

Counterparty credit risk - derivative financial instruments (Audited)

Counterparty credit risk includes the risk of default of a counterparty to such a derivative instrument. All counterparties are subject to credit assessments. All of the Society's derivatives are over-the-counter (OTC).

The balance sheet exposure values of derivative instruments are given in the following table:

(Audited)	**2013 Exposure value £m**	2012 Exposure value £m
Gross positive fair value of contracts	**191.2**	279.6
Netting benefits	**(102.8)**	(166.7)
Net credit exposure	**88.4**	112.9
Collateral held	**(46.4)**	(1.2)
Net derivative credit exposure	**42.0**	111.7

As at 31 December 2013, all counterparties with whom the Society has a net derivative credit exposure have a Moody's credit rating of A3 or above. The net 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.

Impairment provisions: Available-for-sale assets

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

When a decline in the fair value of an AFS financial asset has been recognised directly in equity reserves and there is objective evidence that the asset is impaired, the cumulative loss recognised in equity reserves is removed and recognised in the income statement. In assessing impairment, the Society considers the credit ratings of the counterparties, current market valuations (such as negative fair value adjustment) as well as the extent to which coupon payments have been made on a timely basis. As at 31 December 2013 no amounts in the treasury portfolio were either past due or impaired, and as such no provision had been made.

Outlook

The financial markets have been undergoing a prolonged period of market stress since the onset of the credit crunch. Europe, and the Eurozone in particular has been hard hit by this stress, with a number of European states requiring bail-outs in order to continue to meet their obligations.

The European Central Bank launched its Outright Monetary Transactions scheme in September 2012, which ensures a market exists for the debt of bailed-out countries. This calmed the markets and, alongside other central bank actions, has contributed to lower credit spreads and eased refinancing conditions for both banks and sovereigns. However many parts of Europe continue to face the challenge of high unemployment, high and rising public sector debt burdens, and an indebted private sector, leaving the economic recovery fragile and susceptible to shocks.

An additional uncertainty exists over the central bank programmes in place. Having successfully supported liquidity in the markets, central banks now need to look at how best to unwind the support given, without also undoing the positive effects these programmes have had.

The ongoing uncertainties support the Society's consistently cautious approach to credit risk in its treasury operations.

MARKET RISK

Management of market risk

Market risk is the risk that the value of income derived from the Society's assets and liabilities may change adversely as a result of changes in interest rates, or foreign exchange rates.

The Society's policy is to manage its exposure to these risks within prudent limits. It does this through a combination of matching assets and liabilities with offsetting interest rate or exchange rate characteristics and by the use of derivative financial instruments such as interest rate swaps, interest rate options and cross currency interest rate swaps.

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

Control of market risk exposure is overseen by ALCO, which reports to RMC and BRC. The accounting policy for derivatives and hedge accounting is described in the Accounting Policies in note 1.

The most significant elements of market risk for the Society are interest rate risk and foreign currency each of which is described below.

Interest rate risk (Audited)

Interest rate risk arises from the different interest rate characteristics of the Society's mortgages and savings products and from other financial instruments. The Society is subject to the risk that changes in interest rates will cause material variations in earnings because of different interest rates charged for the mortgages and paid for the funding that comprise the bulk of the balance sheet.

For example, where the Society has issued fixed rate mortgages, the risk is that a general increase in interest rates would leave the Society facing higher interest expense, but without a compensating increase in interest income. Where the opportunity exists, the Society will offset assets and liabilities with similar interest profiles. Alternatively the Society may take out an interest rate swap with a counterparty bank under which the Society's fixed rate income is exchanged for one based on a variable rate which would be expected to follow the general pattern of interest rate movements and thereby reduce the Society's exposure. This risk increases with the duration of the asset and is particularly relevant for equity release mortgages (£330.0 million) held by the Society, however as at 31 December 2013 approximately £150 million of this balance was hedged. Similarly, in cases of issuing fixed rate savings products, the Society may take out an interest rate swap under which it receives a fixed rate of interest and pays a variable rate.

The Society also continues to ensure that it has a significant proportion of administered rate savings and mortgages on its balance sheet, giving it flexibility to manage a prolonged low interest rate environment, or the impacts from a Bank Base Rate rise.

The Society has a series of Board approved limits that ensure the impact of a change in general interest rates has limited effects on both the net interest income generated and present value (PV) of its balance sheet repricing gaps. In addition, the Society forecasts monthly the impact of movements in the Bank Base Rate on the Society's net interest income to ensure any potential adverse impact can be anticipated. This information is reported to ALCO, RMC and BRC every month.

The following tables show the impact of a 200bps parallel shock to interest rates on the value of the assets and liabilities (PV200) and net interest income (100bps) throughout the reporting period:

Shock applied	**+200bps 31 Dec 2013 £m**	-200bps 31 Dec 2012 £m
PV200 results	**(5.4)**	(4.5)

	+100bps 2013 £m	**-100bps 2013 £m**	+100bps 2012 £m	-100bps 2012 £m
Impact on profit and loss	**13.1**	**(7.6)**	19.2	(10.1)

The PV200 measures the impact of a rate change on the value of the assets and liabilities and incorporates a Board approved duration for the investment of reserves. The impact on profit and loss reflects the changes in interest income on the assets and liabilities and the expected consequential effects that would occur, such as changes in customer behaviour, over the accounting period following a rate shock. In a low interest rate environment, interest rates are floored at zero. The reported sensitivity will vary over time due to strategic changes to the balance sheet mix and general market conditions and should not be considered predictive of future sensitivity.

In line with the Society's policy to manage interest risk management within prudent limits, the balance sheet is positioned to be relatively insensitive to adverse interest rate movements.

Basis risk

Variable rate instruments may also cause interest rate risk where the underlying basis of the rate differs from the prevailing variable rate of the balance sheet.

The risk is driven from market influences on the different basis which may not operate in an equal manner, creating uneven changes in the rates (e.g. Bank Base Rate, LIBOR and SONIA). This risk is characterised as basis risk and is subject to limits, regularly monitored, stress tested, and reported monthly to ALCO, RMC and BRC.

The risk is measured by applying a basis spread shock to the financial forecasts which includes behavioural assumptions and current business plans but excludes the impact of any consequential response, and assessing the impact of that shock on the prevailing net interest income.

The Board has defined limits for the level of reduction in net interest income each quarter that arises from the basis shock applied. These limits are reviewed monthly by ALCO, RMC and BRC to ensure compliance.

Swap spread risk
In order to diversify its liquidity holdings the Society holds a part of its liquidity portfolio in gilts, which have associated derivatives (swaps) in order to hedge the interest rate risk. The hedging undertaken to mitigate interest rate movements (which follow the swap curve), will provide some protection against offsetting movements in the value of the gilts (which follow the government securities curve). However, the credit element of gilt value movements arising from perceptions of Sovereign quality, remain unprotected and it is this which creates 'swap spread risk'. This risk only crystallises if the gilts are sold, generally they are held to term as part of the Society's liquidity resources; however under CRD IV the net difference is deducted from capital as part of the Available-for-sale reserve. Swap spread risk is monitored through a Board limit.

Product option risk
Prepayment risk is a category of product option risk, sometimes referred to as a behavioural risk, which arises from product features available to the Society's members.

Members have the option, albeit sometimes with penalties, to redeem their mortgage loan (prepayment) or withdraw their savings (access) at their discretion, representing prepayment or repayment risk to the Society.

These risks are managed through a combination of the following:

- Redemption charges on mortgage products and repayment charges on savings products to reflect the risk.
- Offering products whose behaviour may be more predictable under the anticipated future interest rate outcomes.
- Monitoring past trends and stress testing future forecasts.
- Matching hedging to the expected attrition profile of the product.
- Balance tracking hedges for equity release mortgages.

Product option risk also includes pipeline risk, the risk that between the point of application for a product and completion, customers choose not to take the product potentially during a period in which interest rate expectations may have moved. This could leave the Society with an imbalance of funding or hedging that is no longer at prevailing interest rates.

The risk is managed by only allocating specific tranches to individual products and undertaking hedging activity whilst applications are received. The risk is further mitigated by keeping the pipeline small compared to the overall balance sheet and through close monitoring during early product stages.

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

The Society has a very low risk appetite for foreign currency risk and manages this through the use of currency swaps and foreign currency forward contracts. The Society has also in the past, offset foreign currency liabilities with foreign currency assets.

After taking into account the effects of cross currency swaps, the Society has no material net exposure to foreign exchange risk fluctuations or changes in foreign currency interest rates. Foreign currency repricing risk is assessed as the effect of a 3% parallel rate shift on repricing mismatches within any foreign currency and the results are set out opposite. ALCO sets limits on the level of exposure by currency which are monitored daily.

	31 Dec 2013 £m	31 Dec 2012 £m
Foreign currency repricing	**0.08**	0.20

Redenomination risk
Redenomination risk is the risk that in the event that the euro ceases to be traded or a particular country leaves the euro, previously matched foreign exchange positions, designated in euros, become unmatched when these are exchanged for an alternative currency (valued against a local currency equivalent). The Society has minimal redenomination risk, as all euro denominated asset exposures are held with UK institutions.

Outlook

Despite market movements in swap and LIBOR rates, the Society anticipates low Bank Base Rates to dominate the market outlook during 2014.

Over the past year the Society continued to reduce its non-UK exposure, and continues with its policy of hedging all foreign exchange positions. While there is still the possibility of a Eurozone crisis, the Society has very limited foreign exchange or redenomination risk.

LIQUIDITY AND FUNDING RISK

The Society's liquidity and funding strategy together with details of its year end liquidity resources, liquid asset credit quality, retail and wholesale funding, asset encumbrance and external credit ratings are included in the Business Review on pages 17 to 22.

Management of liquidity and funding risk

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

Funding risk is the inability to access funding markets or to only do so at excessive cost and/or liquidity risk. Funding risk is managed by ensuring that reliance on any single funding provider is minimised. This is principally achieved by limiting wholesale funding to a level lower than that imposed by both the Building Societies Act and by the PRA. Diversifying the source of retail deposits is achieved by having a broad customer base spread throughout the UK. The Society is predominantly funded through retail deposits reflecting the long-term strategy. Wholesale funding is used to provide diversification and lower the overall cost of funding. Funding is managed centrally enabling it to be used to fund assets throughout the Society.

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

The Society's appetite for liquidity risk is set out in the Liquidity Risk Tolerance Statement which has been approved by the Board following a recommendation from BRC. The tolerance statement is kept under regular review and revised in line with changes to the risk environment and regulatory context. The Tolerance Statement was last revised in September 2013 and is set with reference to the ability to meet all cash requirements throughout a prolonged combination stress as detailed later in this section.

Liquidity adequacy

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

The ILAA considers a range of time horizons, in particular intra-day, one day, two weeks, three months and five years. The ILAA is compliant with Chapter 12 of the Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU) introduced by the FSA in 2010. The main 'combination stress' assessed in the ILAA estimates the impact from a two week Society specific stress combined with a three month market-wide stress.

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

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

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

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

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

The ILAA is reviewed by the PRA through their Supervisory Liquidity Review Process (SLRP), an in-depth periodic review and assessment of a firm's quantitative and qualitative liquidity risk management processes and operations. Following the SLRP, the PRA provides 'Individual Liquidity Guidance' (ILG), which sets out the amount and composition of eligible liquidity that the PRA requires the Society to hold. This measure uses a three month time period and assesses similar liquidity requirements. The Society is required to meet a set percentage of the calculated liquidity requirement through eligible Liquid Asset Buffer (LAB) assets (the first and second categories of liquidity set out on page 18). Following the initial expansion of eligible liquidity to include pre-positioned mortgage assets and self issued covered bonds, the PRA has extended the amount of off-balance sheet collateral that can be used to meet the ILG assessment. The original intention was that the requirement would increase to 100% over time. However, this has now been suspended pending the replacement of the ILG regime with the CRD IV equivalent, the Liquidity Coverage Ratio, which is based on a one month time period.

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

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

A Recovery and Resolution Plan is in place which sets out a range of options available to the Society in the event of a severe liquidity or capital stress. As part of this Recovery and Resolution Plan, there are a number of contingent funding options designed to deal with a liquidity or funding stress, which are evaluated on a regular basis through the Society's periodic realisation programme, and through an annual full scale exercise.

Outlook

The availability of funding through central bank schemes (such as FLS) has led to a more benign funding environment for solvent UK banks and building societies. However, a material deterioration in markets could threaten this outlook.

The Society remains well placed to withstand any deterioration in markets. The Society has an extremely strong track record of being able to access the retail funding markets before and since 2007 and is confident it could replace wholesale funding, including FLS with retail funding. The Society's credit ratings of A/F-1 from Fitch and A3/P-2 from Moody's remain strong and stable relative to other banks and building societies, supported by the quality of the loan portfolio, diversified funding, low cost base and stable earnings.

CRD IV was published in June 2013. Among other items CRD IV introduces the Liquidity Coverage Ratio in January 2015 as a replacement to the ILG set out above. The PRA has announced that the LCR will apply at 80% from 2015, increasing to 100% over a three year period. In August 2013, following a speech by Bank of England Governor Mark Carney, the PRA announced that it would be more flexible in its approach to liquidity for major UK banks and building societies which either meet or have plans that will enable them to meet the 7% CET1.

Maturity profile of financial assets and liabilities

The table overleaf analyses the carrying value of financial assets and financial liabilities into relevant maturity groupings based on the remaining period to the contractual maturity date. In practice, customer deposits will be repaid later than on the earliest date on which repayment can be required. Likewise, in practice, customer assets may be repaid ahead of their contractual maturity. As such, the Society uses past performance of each asset and liability class along with management judgement to forecast likely cash flow requirements.

At 31 December 2013 (Audited)	Repayable on demand £m	Up to 3 months £m	3–12 months £m	1–5 years £m	More than 5 years £m	Total £m
Assets						
Cash and balances with the Bank of England	2,042.1	-	-	-	-	2,042.1
Loans and advances to credit institutions	84.2	70.0	25.1	-	-	179.3
Debt securities	-	62.1	42.5	352.6	1,208.8	1,666.0
Loans and advances to customers	30.6	499.0	1,410.1	6,609.8	15,567.6	24,117.1
Derivative financial instruments	-	-	1.6	137.4	52.2	191.2
Other financial assets	-	0.6	5.6	(23.2)	8.6	(8.4)
Total financial assets	**2,156.9**	**631.7**	**1,484.9**	**7,076.6**	**16,837.2**	**28,187.3**
Liabilities						
Shares	17,940.1	-	1,470.7	1,900.9	-	21,311.7
Sale and repurchase agreements[1]	-	249.5	1.4	697.8	-	948.7
Deposits from banks - other	16.6	67.3	-	-	-	83.9
Other deposits	-	4.0	-	-	-	4.0
Amounts owed to other customers	17.9	308.8	6.4	4.0	-	337.1
Secured debt securities in issue - RMBS and covered bonds	-	2.5	568.3	1,247.5	469.9	2,288.2
Senior unsecured debt funding	-	13.9	12.9	463.8	1,286.0	1,776.6
Derivative financial instruments	-	0.6	35.1	29.4	148.5	213.6
Other financial liabilities	-	-	1.2	44.3	44.0	89.5
Subordinated liabilities	-	0.8	0.6	22.0	34.8	58.2
Subscribed capital	-	1.6	0.1	120.0	39.8	161.5
Total financial liabilities	**17,974.6**	**649.0**	**2,096.7**	**4,529.7**	**2,023.0**	**27,273.0**
Net liquidity gap	**(15,817.7)**	**(17.3)**	**(611.8)**	**2,546.9**	**14,814.2**	**914.3**

1. Included in Deposits from banks on the statement of financial position.

At 31 December 2012 (Audited)	Repayable on demand £m	Up to 3 months £m	3–12 months £m	1–5 years £m	More than 5 years £m	Total £m
Assets						
Cash and balances with the Bank of England	1,814.2	-	-	-	-	1,814.2
Loans and advances to credit institutions	203.6	95.1	25.0	-	-	323.7
Debt securities	-	201.1	82.1	434.5	1,620.5	2,338.2
Loans and advances to customers	19.3	465.0	1,298.4	6,121.8	14,114.4	22,018.9
Derivative financial instruments	-	0.1	3.6	54.6	221.3	279.6
Other financial assets	-	2.1	8.1	56.9	19.7	86.8
Total financial assets	2,037.1	763.4	1,417.2	6,667.8	15,975.9	26,861.4
Liabilities						
Shares	16,603.0	7.5	2,285.6	1,214.4	-	20,110.5
Sale and repurchase agreements[1]	1.2	676.3	-	-	-	677.5
Deposits from banks - other	1.2	37.2	-	-	-	38.4
Other deposits	-	6.5	3.0	-	-	9.5
Amounts owed to other customers	19.5	317.6	111.9	1.0	-	450.0
Secured debt securities in issue - RMBS and covered bonds	-	2.7	26.3	1,027.8	1,483.7	2,540.5
Senior unsecured debt funding	-	44.6	39.6	501.7	748.3	1,334.2
Derivative financial instruments	-	2.5	8.9	110.1	289.7	411.2
Other financial liabilities	-	-	2.6	28.4	209.4	240.4
Subordinated liabilities	-	0.8	0.6	6.8	49.9	58.1
Subscribed capital	-	1.6	0.1	120.0	39.7	161.4
Total financial liabilities	16,624.9	1,097.3	2,478.6	3,010.2	2,820.7	26,031.7
Net liquidity gap	(14,587.8)	(333.9)	(1,061.4)	3,657.6	13,155.2	829.7

1. Included in Deposits from banks on the statement of financial position.

The following is an analysis of gross contractual cash flows payable under financial liabilities:

At 31 December 2013 (Audited)	**Up to 3 months £m**	**3–12 months £m**	**1–5 years £m**	**More than 5 years £m**	**Total £m**
Liabilities					
Shares	**17,925.4**	**1,516.5**	**1,965.5**	**-**	**21,407.4**
Deposits, amounts owed to other customers and debt securities	**719.9**	**763.5**	**3,133.2**	**1,614.4**	**6,231.0**
Other liabilities and adjustments	**76.6**	**106.3**	**180.7**	**49.7**	**413.3**
Subordinated liabilities	**0.9**	**3.3**	**44.9**	**37.1**	**86.2**
Subscribed capital	**2.4**	**9.7**	**150.4**	**40.0**	**202.5**
Total liabilities	**18,725.2**	**2,399.3**	**5,474.7**	**1,741.2**	**28,340.4**
Undrawn loan facilities	**97.7**	**-**	**-**	**-**	**97.7**
Leasing commitments	**0.8**	**2.3**	**9.0**	**7.3**	**19.4**

At 31 December 2012 (Audited)	Up to 3 months £m	3–12 months £m	1–5 years £m	More than 5 years £m	Total £m
Liabilities					
Shares	16,582.0	2,366.3	1,245.5	-	20,193.8
Deposits, amounts owed to other customers and debt securities	1,154.2	358.5	2,557.9	1,694.2	5,764.8
Other liabilities and adjustments	116.3	97.3	367.1	173.3	754.0
Subordinated liabilities	0.9	3.4	47.4	38.8	90.5
Subscribed capital	2.4	9.7	157.7	40.0	209.8
Total liabilities	17,855.8	2,835.2	4,375.6	1,946.3	27,012.9
Undrawn loan facilities	110.5	-	-	-	110.5
Leasing commitments	0.8	2.4	9.6	9.1	21.9

These results do not directly align to those presented for the balance sheet as they include interest relating to future periods. The tables above exclude cash flows beyond five years (other than the repayment of principal) that relate to subscribed capital.

OPERATIONAL RISK

Overview

Operational risk is the risk of loss arising from inadequate internal processes, people and systems or from external events impacting these. During the year, conduct risk was managed as part of the overall operational risk management framework but from early 2014 it will be managed by a dedicated Conduct Risk Committee to provide oversight of conduct risk matters and developments.

Operational risks are managed as an integral part of the Society's operations. Management has a responsibility to understand how operational risk impacts the area of the business for which it is responsible, and for putting in place controls or mitigating activities, overseen and challenged by the Operational Risk team which acts as the second line of defence. Key operational risk activities are detailed below:

Risk category	Brief definition
Business continuity	The risk to the Society arising from its incapacity to continue its business operations in the event of significant operational disruption or arising from loss or damage to physical assets or staff from a natural disaster or other events.
Change	The risk to the Society arising from the failure to successfully manage key projects.
Conduct	The risk to the Society arising from a loss or a failure to deliver fair customer outcomes.
Financial reporting	The risk to the Society as a result of a loss or a failure arising from the operational risks associated with the publication of financial statements, adherence to accounting standards, compliance with tax laws and codes, maintenance of the general ledger and publication of documentation for funding programmes.
Financial crime	The risk of loss to the Society arising from a failure to prevent fraud.
Information management and security	The risk of loss arising from its failure to ensure the security, accuracy and completeness of data and information.
Model	The risk of loss arising from the inaccurate implementation and/or use of models and model outputs.

Risk category	Brief definition
People	The risk of loss arising from the inability to recruit, develop or retain the appropriate people resources.
Premises and physical security	The risk arising from injury or loss as a consequence of a failure to ensure that premises and physical assets are fully compliant with regulations, effectively maintained, secured and protected.
Technology	The risk of damage to the Society as a result of the failure of its technology assets.

In addition to the direct loss attributable to these risk categories, the reputational impact of such an event may damage the business franchise leading to secondary impacts.

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

Management of operational risk

Business continuity

The Society has developed Business Continuity Plans to manage situations in which buildings, systems or key staff are unavailable, for example in the event of a flu pandemic or the loss of utilities. The Society's Business Continuity Plan is approved annually and regularly tested and overseen by the Business Continuity Committee which reports into Operational Risk Committee (ORC).

Change

Change programmes are carefully managed to ensure that they are achievable and can be managed to agreed timescales with limited reliance on external support. The Society has undertaken significant investment in its change resources and has a strong track record of successful delivery. All key projects have a dedicated steering committee chaired by an executive director which reports regularly to the Board.

The risks arising from mergers and acquisitions, which have highlighted the fragility of some firms, have been shown to be well managed by the Society as illustrated by previous successful integrations and these transactions are not a key feature of the business model.

Conduct

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

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

Conduct risk was overseen by ORC and reported to RMC and BRC. From early 2014, the Society is implementing a dedicated Conduct Risk Committee to provide oversight of conduct risk matters and developments.

Financial reporting

Increased reporting requirements and disclosures highlights the need for robust systems and controls in the preparation of these documents. The Society undertakes a number of reviews provided by its Internal Audit function and by external auditors as part of its ongoing assurance to assess the accuracy of its published material. Development of accounting standards and areas of reporting subject to judgement are regularly reviewed by the BAC.

Financial crime
Financial crime is managed by the Society's experienced Financial Crime team which is part of the Risk Management function, reporting directly to the Chief Risk Officer and overseen by the Society's ORC. This reflects the Society's focus on Financial Crime as a separate discipline with dedicated expertise to respond professionally to the evolving and substantial threat to the security and the safe operation of all financial institutions. Given the rapidly growing developments in technology, cybercrime and social media, the Society pays close attention to the source, likelihood and impact of financial crime generally and the various ways in which this could manifest itself.

Following substantial investments by financial institutions in technological solutions to combat the more sophisticated financial crime threats, recent years have seen an increasing trend of deception crimes targeting the customer directly. The Society is firmly committed to developing its defences further to protect those who are most likely to be vulnerable to financial abuse. As such, the Society continues to increase investment in resourcing its Financial Crime team and its monitoring and control systems to prevent increasingly sophisticated criminal attacks.

Information management and security
The Society recognises the importance of information management and security for the protection of the Society and its members and regularly commissions attack and penetration tests by a number of different third parties as part of validating the strength of its defences.

The Society is determined to ensure that its defences remain as robust as possible, implementing industry leading practices, and has adopted a defence in depth approach to its control mechanisms. In this rapidly changing world, the Society remains vigilant and will continue to evaluate and enhance its controls to ensure that appropriate protection is provided. This includes the continual measurement against industry best practices and use of tools and practices aligned to the environment in which it operates, and to its low risk appetite.

To demonstrate its stance in addressing the Information Security challenge, and to bolster its knowledge, skills and capabilities, the Society has employed a Chief Information Security Officer to be the advocate for information security standards.

Model risk
Models are employed in two key aspects of Society activity, in the assessment of net interest income, and in the determination of retail credit risk. Modified assumptions and detailed outputs from the model used to determine net interest income are reviewed monthly by Finance, Risk and Treasury functions. The Society's Models and Ratings Committee meets six times a year to review the retail credit risk models and is chaired by a non-executive member of the Board. The credit risk models are also subject to independent external scrutiny. Locally built models are required to comply with the Society's policy on end-user computing.

People
The Society manages its people risk by having rigorous recruitment selection processes, providing an induction program before new staff commence work, and providing courses and other opportunities for staff to develop their skills and experience throughout their time with the Society. The Society benchmarks its reward strategy against others in the financial services sector, and offers a range of support services under the Society's Wellbeing Programme and Policy. More generally, procedures and policies are designed to minimise employee dissatisfaction with the objective of attracting and retaining high performing staff. The Society periodically undertakes a survey of staff satisfaction and engagement with the Society's values and responds positively to any issues revealed.

Premises and physical security
The Society has a duty of care to its staff, members and visitors whilst present on Society premises. The Society has in place comprehensive health and safety policies and a compliance regime which includes internal and

external inspection. This work is overseen by the Health & Safety and Security Committees, which are both chaired by executive directors and report to RMC and the Board each month.

Technology

The Society recognises the risks associated with not keeping pace with technology and invests significant resources in ensuring the robustness of its systems and controls and ongoing monitoring. Key to establishing a low risk environment is the maintenance of a single core system. During 2013 the Society appointed a specialist third party to undertake an independent review of its IT resources. This confirmed the resilience of the Society's system and strength of its people resources. Progress on implementing recommendations made is being overseen by the Board.

To the extent that the above risks arise from the actions of third parties, the Society continues to enhance its management of third party relationships through the appointment of a procurement and supply specialist.

Operational risk outlook

Conduct risk is a key area of focus within the financial services sector and via its impact on customers an area of focus within the consumer press.

The MMR published by the Financial Conduct Authority (FCA) requires all mortgage lenders to enhance responsible lending controls for mortgages by 26 April 2014, to ensure that the mortgages are affordable and thus minimise the risk of detrimental outcomes for members. While responsible lending is already central to the Society's lending policy, MMR will require changes to be made to our systems and processes ahead of the regulatory deadline.

In addition the FCA published a guidance note during 2013 regarding the potential risks facing interest-only borrowers in being able to repay the mortgage sum borrowed at the end of their mortgage. The Society has long maintained a programme of regularly issuing reminders to customers of the nature of interest-only lending and in 2013 has strengthened this by establishing a team to support borrowers determine what action they might need to take now to ensure they will be able to repay the capital at the end of the mortgage term.

The Board expects further conduct redress provisions to be established across the financial services sector in response to consumer complaints and the work of the FCA. The most notable recent example is PPI and in total conduct redress provisions across the sector have now exceeded £20 billion. The Society's focused business model, absence of sales incentives and simple product base inherently position it as a low risk financial institution.

It is expected that the PRA will continue to focus on two areas: systems' resilience and cyber security. The Society maintains a fundamentally straight forward infrastructure, and actively seeks to maintain this. Cyber security is a key focus of the Society, with significant resources deployed to minimise loss.

BUSINESS RISK

The Society defines business risk as the risk arising from changes to its business model and also the risk of the business model or strategy proving inappropriate due to macroeconomic, geopolitical, regulatory or other factors. Some of the risks are discussed elsewhere in this report and the risks are controlled through the Society's continual assessment of its policies (including risk appetite and limits) and strategy (through the Corporate Plan) which are regularly reviewed by the Board. Performance against the Corporate Plan is assessed via defined checkpoints that are reviewed quarterly by the Board.

Regulatory risk

The financial services industry is undergoing transformational reforms. The general objective of regulatory bodies is to improve consumer protection and promote more stable and transparent financial markets.

This exposes financial institutions to regulatory risk. The Society defines this as the risk that a change in law or regulation will adversely impact the Society's economic prospects and may lead to regulatory non-compliance. It includes the risk that complex regulation will prove overly burdensome and impede the ability of a low risk lender to compete successfully.

The Society's simple business model and members first principles mitigate some of these risks and the Society's compliance function supports business line management in ensuring appropriate policies are in place and providing challenge where necessary. The function is organised to recognise the different objectives of the Society's regulators. Compliance Policy & Change focuses on retail conduct, consumer and product regulation. Balance Sheet Risk concentrates on prudential and wholesale conduct regulation. Both units review government and regulatory proposals for reform, and engage with the Society's trade associations on initiatives that impact the building society sector as a whole. The compliance function also supports business change projects that have a regulatory dimension.

The complexity and burden of regulation is increasingly difficult to manage but the investment in second line functions, and recruitment of a permanent Chief Risk Officer has helped to relieve some of the pressure from operational focused functions. Increasing capital requirements and in particular the focus on non-risk based measures pose challenges to low risk business models particularly mutual lenders who have less established routes to raise new capital from external sources than publicly quoted companies.

The Society maintains an open and co-operative relationship with its regulators.

Reputational risk

Reputational risk is the risk of loss arising from the degradation of the Society's reputation even if events which create the reputational impact do not have a direct financial consequence.

It is clear from 2013 that in periods of stress the media attention and reputational impact of operational events or corporate failings is heightened. The Society recognises this and invests significant resources in ensuring the robustness of its systems and controls, governance, product set, and ongoing monitoring. Key to establishing a low risk environment is a focus on member outcomes, simple low risk product offerings and the maintenance of a single core system.

Pension obligation risk

The Society is the sponsor of a defined benefit pension scheme. As the sponsor, the Society is exposed to adverse movements in the actuarial valuation of the scheme. Following the closure of the fund to new entrants at the end of 2001, the Society closed the fund to future service accrual in 2013. Further contributions are to be provided by the Society to the fund in accordance with the schedule of contributions agreed with the trustees of the fund and are subject to future scheme valuations.

To mitigate pension risk, the trustees of the fund review regular reports prepared by the fund's independent actuaries and investment consultants to assess risks and take appropriate actions which may, for example, include adjusting the investment strategy, hedging inflation risks and/or hedging interest rate risks (see further details in note 21).

Outlook

Business risks have generally increased over the period due to the level of regulatory change and recent events at the Co-operative Bank p.l.c.

The implementation of CRD IV has presented a departure from previous regulation as elements of the applicable text is taken directly from European regulation, rather than through the interpretation of European directives. Alongside CRD IV, new regulatory initiatives including the MMR, European Market Infrastructure Regulation, and Recovery & Resolution Plans have greatly increased the burden placed upon financial institutions and their compliance teams. This has therefore increased the regulatory risk facing the Society. Much of the positive press around building societies, built up over many decades and which largely survived intact through the credit crisis, has been severely tarnished by association, through the events at the Co-operative Bank p.l.c. The Society recognises the impact that this could have had on its own brand. However, the Society continues to maintain its core mutual values offering good quality products through a simple business model and providing strong support for local and national community and charity work. This track record has been maintained for many years.

Closing the Society's defined benefit pension fund to new accruals has helped mitigate a number of the risks that would remain for an open fund and notwithstanding the impact of low gilt yields on the calculation of the scheme's liabilities, the scheme remains in an IAS 19 (see note 21) surplus position.

CAPITAL

Details of the Society's capital resources and impact of Basel III are set out in the Business Review on pages 23 to 27.

Capital management

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

- Credit risk from mortgages and other retail lending.
- Credit risk from treasury assets and derivatives.
- Concentration risk (which can exacerbate credit exposures).
- Interest rate risk.
- Liquidity risk.
- Operational risk.
- Pension obligation risk.

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

This initial level of capital allocation is based on a 'point in time' assessment. A further capital allocation is made (Pillar 2B) which is a 'capital planning buffer' giving assurance that the Society can meet capital requirements under stressed conditions. The calculation of the capital planning buffer is a forward looking projection and examines the Society's business plans in detail, subjecting them to economic and operational stresses over a five year planning horizon.

The severity and duration of the stress scenarios used is determined by reference to the 'anchor stress scenarios' published by the PRA. In addition the Society incorporates additional second order stresses to make the capital stress even greater than that prescribed by the regulator.

These additional stresses include:

- A compression of the spread between mortgage rates and Bank Base Rate when interest rates rise significantly from their current level.
- Increased retail funding costs arising from stresses driven by the end of all FLS funding.
- The impact of a two notch rating downgrade on the Society, on top of the economic stresses.

This stress testing enables the Society to estimate the magnitude of losses that may be incurred, determine the impact of these losses on the stock of capital available to the Society, and compare this with the additional capital requirements that may be needed in a stressed environment.

The impact of the stress testing is compared with the ability of the Society to react to stressed conditions by modifying its business plans. The Society retains the ability to control the rate of asset growth and therefore has the flexibility necessary to react to stressed conditions by reducing the overall capital requirement, and so maintain adequate capitalisation. Furthermore, the Society maintains a significant proportion of the mortgages and retail savings on the balance sheet at administered interest rates. This provides the Society with the option of realigning the interest margin if necessary in order to maintain an adequate level of capital generation.

The capital planning buffer is set having regard to both the impact of the stress tests and the ability of the Society to undertake a credible scale of management action in response to the stress scenarios. The ICAAP is used by the PRA in its Supervisory Review and Evaluation Process (SREP) through which it sets the Society's capital requirements, expressed as Individual Capital Guidance (ICG). The PRA adds a capital planning buffer to the ICG to ensure that the requirements may be met throughout the planning horizon.

The ICAAP is reviewed by BRC before submission to the Board for formal approval as part of the corporate planning process. The Society's Internal Audit function reviews the accuracy and consistency of the financial information included within the ICAAP document. Capital levels for the Society are reported to and monitored by the Board on a monthly basis. The Society continues to be strongly capitalised and maintains its capital substantially above current regulatory requirements. The Society's Core Tier 1 ratio is the highest reported by any top 10 building society and the Board believes this reflects the low risk profile of the Society's assets. Consequently it is anticipated the Society's level of regulatory surplus will tend to be driven by non risk based measures such as the CRD IV leverage ratio.

Significant events and environment

CRD IV was implemented in January 2014, although some of the changes arising from the regulation do not come into force until 2018. The regulation is implemented as stated whereas the directive requires local regulator (i.e. PRA) interpretation. As the local regulator, the PRA has consulted on its interpretation of the CRD IV text, and issued policy statement 7/13 in December 2013. However there are a number of aspects which will continue to require PRA interpretation and which will evolve over the coming years, in particular reform to the Pillar 2 framework. Additional aspects of CRD IV include changes to Board Governance and the use of Additional Valuation Adjustments (AVAs) as a means of ensuring that capital reflects prudent valuation of assets.

In November 2013 the market saw the first issuance of a building society compliant CET1 instrument. The Society continues to monitor the development of eligible capital instruments that are available to mutuals but there is no reliance placed on an external issuance to meet minimum CRD IV requirements.

Outlook

In addition to the release of further technical standards on CRD IV and further consultation on Pillar 2 buffers, 2014 is anticipated to bring the final publication of the Recovery & Resolution directive which will set standards on the minimum requirements for own funds (capital) and eligible liabilities – collectively known as MREL. This new standard could see the expanded issuance of lower forms of capital which might not meet the capital requirements of CRD IV but could contribute to the MREL target. The directive also requires a resolution fund to be established within the next 10 years. These funds would be available to provide temporary support to institutions under resolution, but will require prefunding.

The Financial Policy Committee of the Bank of England has responsibility for setting certain of the capital buffers, and capital policy could be subject to further development in 2014 as part of the review it has commissioned on the leverage ratio.

DIRECTORS' REMUNERATION REPORT

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

REMUNERATION DISCLOSURE REQUIREMENTS

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

The Society is subject to the FCA's Remuneration Code, and the additional requirements regarding remuneration disclosure, in compliance with CRD III and IV.

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

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

SOCIETY REMUNERATION POLICY - PRINCIPLES

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

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

REMUNERATION COMMITTEE

The Remuneration Committee has taken account of industry best practice as advised by the FCA and reviewed the remuneration policies of the Society's peer group and other businesses of a similar size and complexity.

Independent consultants have been commissioned to review the Society's remuneration for senior managers, and for executive and non-executive directors, including the Chairman. The Remuneration Committee is also able to access independent third party pay data from consultants Towers Watson; Deloitte LLP has provided advice on matters relating to the remuneration of both executive and non-executive directors and other senior management. The remit and the composition of the Remuneration Committee are detailed on pages 35 to 36 of the Directors' Report on Corporate Governance.

DIRECTORS' REMUNERATION REPORT

(continued)

POLICY FOR EXECUTIVE DIRECTORS

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

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

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

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

Whilst the Remuneration Committee accepts that best practice requires that a significant proportion of remuneration should be paid by way of variable, performance related pay, it is alert to the risk of excessive payments and therefore it sets the potential for variable remuneration at levels broadly in line with our peer group of major building societies and significantly lower than other financial institutions.

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

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

In 2012 Deloitte LLP conducted an independent review of the remuneration of the executive directors. Deloitte's review encompassed the Society's comparator group and businesses of a similar size and complexity in the FTSE 250. In April 2013 the Remuneration Committee reviewed executive pay taking into account Deloitte's findings. Deloitte LLP conducted a similar exercise in 2013 and found that for most roles pay remains below median of comparator groups.

The FCA Remuneration Code requires that at least 50% of any variable remuneration for Directors and other Code Staff where variable pay could exceed 33% of total remuneration is paid in an equivalent share-like instrument and retained for a further period of at least six months. A retention instrument has been agreed with the PRA to meet this requirement. Variable remuneration, including any retained element, can also be withdrawn or reduced at the discretion of the Remuneration Committee if it emerges that the original assessment of performance was subsequently proved to be inaccurate or in the event of poor individual performance or due to a failure of risk management.

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

The principal elements of the Society's remuneration packages are described in the following sections:

a) Base salary

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

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

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

b) Annual performance related incentive pay scheme

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

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

- Member satisfaction, including number and resolution of complaints.
- Member engagement.
- Market share.
- Risk and compliance.
- Operational performance.
- Competitiveness of rates paid to members.
- Staff engagement.
- Community activity.

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

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

For directors and Code Staff whose variable pay is more than 33% of total pay, 50% of the payment is paid in the form of an equivalent share-like instrument and retained for a period of six months. This applies to the five executive directors and four senior managers of the Society.

c) Long Term Incentive Plan

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

The LTIP rewards sustained performance and the achievement of challenging financial targets over a three year performance cycle. In 2013, an LTIP grant was made, whereby participants are eligible to receive an award based on the performance of the Society over the three year period from 2013-2015. An on-target performance would provide a 10% of salary payment for executive directors and a 5% of salary payment for other senior management, with a current maximum of 40% (executive directors) or 20% (senior management) for substantial over-performance over the period.

There are currently five executive directors and four senior managers who have been awarded grants under the Society's LTIP scheme.

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

- Member satisfaction.
- Member engagement.
- Regulatory record.
- Market share.
- Risk management factors.
- Overall financial performance of the Society relative to the performance of other building societies and in light of the market conditions prevailing during the performance period.
- Individual performance and conduct.
- Any other factors the Remuneration Committee feels are relevant.

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

50% of the vesting LTIP award is paid in the form of an equivalent 'share-like instrument' and retained for a period of six months.

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

d) Pension arrangements

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

In 2013 the final salary scheme was closed to future service accrual. This took effect on 31 March 2013 for the majority of staff other than those whose notice period extended beyond this date. At the same time the Society's funded defined contribution pension scheme (Stakeholder Scheme) was also closed. These have been replaced by a new Group Personal Pension (GPP) scheme which is offered to all staff and is pensions auto-enrolment compliant. Executive directors, executives and senior management have been transferred to the GPP on the same terms as other members affected by the closure of the scheme.

No special arrangements have been put in place for the executive directors or senior management and consequently the Finance Director and Chief Operating Officer, who were members of the Society's Stakeholder Scheme, transferred to the Group Personal Pension scheme on 1 April 2013. The Chief Risk Officer joined the GPP scheme on 1 April and was not a member of the previous pension arrangement.

David Stewart left the final salary scheme immediately before being appointed Chief Executive in July 2006, and joined the defined contribution scheme. On 31 March 2013 he ceased to be a member of the Society's pension arrangements.

The Sales and Marketing Director, whose long service at the Society pre-dates January 2002 by a number of years, continued as a member of the Society's contributory final salary pension scheme up to 31 December 2013.

e) Other benefits

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

CHANGE OF CHIEF EXECUTIVE

At the Society's Annual General Meeting on 25 April 2013, David Stewart announced his decision to resign his position as Chief Executive. To ensure a smooth transition in the leadership of the Society, he agreed to extend his notice period to 30 September 2014. Under the terms of an agreement entered into between Mr Stewart and the Society he will continue to accrue normal contractual pay and benefits up to the end of his notice period. Satisfactory progress is being made in identifying a successor to Mr Stewart.

Full details of all executive directors' emoluments for 2013 are shown in note 11 to the accounts.

NON-EXECUTIVE DIRECTORS

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

A Non-Executive Directors Remuneration Committee, comprising the Chairman, Chief Executive and Finance Director, reviews the fees of the non-executive directors annually in light of their responsibilities and comparative information from other building societies and financial institutions. The fees set in 2013 reflected the findings of the work undertaken in 2012 which reviewed fees paid by the Coventry's peer group of building societies and FTSE 250 companies of a similar size to the Coventry. Recommendations for the remuneration of the Chairman are made by the Remuneration Committee and approved by the full Board without the participation of the Chairman. Full details of the Committee are detailed on pages 35 to 36 of the Directors' Report on Corporate Governance.

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

Full details of all non-executive directors' emoluments for 2013 are shown in note 11 to the accounts.

DIRECTORS' SERVICE CONTRACTS

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

AGGREGATE REMUNERATION DATA

The Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU) requires the Society to disclose aggregate remuneration data for all staff and separately for all Code Staff. The total fixed pay paid to all employees in 2013 was £55.3 million and variable pay was £6.2 million. The remuneration relevant to Code Staff, comprising senior management and other material risk takers was as follows for 2013 and 2012:

	Aggregate remuneration data for Jan-Dec 2013			Aggregate remuneration data for Jan-Dec 2012		
	Number of Staff	**Fixed pay[3] £m**	**Variable pay[4] £m**	Number of Staff	Fixed pay[3] £m	Variable pay[4] £m
Senior managers[1]	**20**	**2.7**	**0.8**	20	2.7	0.5
Other material risk takers[2]	**14**	**1.2**	**0.1**	13	1.1	0.1
Total	**34**	**3.9**	**0.9**	33	3.8	0.6

1. Non-executive directors, executive directors and senior managers. Non-executive directors' fees are included under fixed pay; no variable pay is awarded to non-executive directors.
2. Other Code Staff to cover those whose actions have a material impact on the risk profile of the Society.
3. Fixed pay includes basic pay, allowances and employer pension contributions.
4. Variable pay includes the annual performance related bonus (£0.3 million) for 2013 (paid March 2014) (2012: £0.3 million paid March 2013) and the LTIP 2013-2015 payment granted (not paid) in 2013 (£0.6 million) (2012: LTIP 2012-2014 payment granted (not paid) in 2012, £0.3 million). The LTIP payment included above is the maximum possible under the scheme (40% executive directors and 20% senior managers of salary as at the Grant Date); the actual payment will be subject to the performance criteria outlined on pages 79 and 80.

DIRECTORS' REMUNERATION REPORT

(continued)

2013 ANNUAL PERFORMANCE BONUS – SUMMARY OF PERFORMANCE

The Society has performed strongly in 2013, exceeding key performance targets. Details of this performance are set out in the Chairman's Statement (pages 4 to 5), Chief Executive's Review (pages 6 to 9), and Business Review (pages 10 to 27) with highlights also included on page 2.

This outstanding performance gave rise to a calculated bonus for all 1,956 eligible members of staff equivalent to 14% of base salary. The bonus percentage payable to each of the executive directors is the same as all other eligible staff.

2011-2013 LONG TERM INCENTIVE PLAN – SUMMARY OF PERFORMANCE

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

Further information in respect of this performance is provided in the Chairman's Statement (pages 4 to 5), Chief Executive's Review (pages 6 to 9), and Business Review (pages 10 to 27) with highlights also included on page 2.

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

Taking into account both overall performance and that against the specific 2011 LTIP targets, the Remuneration Committee approved a payment for each participant equivalent to 40% of base salary for executive directors and 20% of base salary for senior management. Base salary is set as the salary for each participant at the date of the original 2011 grant. No targets were adjusted from those originally set when the grant was made in 2011.

On behalf of the Board

Bridget Blow
Chairman of the Remuneration Committee
27 February 2014

DIRECTORS' REPORT

The directors have pleasure in presenting their Annual Report & Accounts for the year ended 31 December 2013.

BUSINESS OBJECTIVES

The Society's principal objective is to meet its current and future members' needs for residential mortgages and provide a trustworthy home for retail savings delivered in a fair manner. Growth will be delivered by providing long-term fairly priced products making efficient use of resources and maintaining a resilient and sustainable business model.

BUSINESS REVIEW, FUTURE DEVELOPMENTS AND KEY PERFORMANCE INDICATORS

The Group's business and future plans are reviewed in the Chairman's Statement (pages 4 to 5), the Chief Executive's Review (pages 6 to 9) and the Business Review (pages 10 to 27). The Group's principal key performance indicators are reviewed in the Business Review.

PROFIT AND CAPITAL

Profit before tax for the year ended 31 December was £132.1 million (2012: £91.1 million). The profit after tax transferred to the general reserve was £101.3 million (2012: £69.5 million).

Total Group reserves at 31 December 2013 were £895.0 million (2012: £812.5 million). Further details on the movements of reserves are given in the Group Statement of Changes in Members' Interests.

Gross capital at 31 December 2013 was £1,114.7 million (2012: £1,032.0 million) including £58.2 million (2012: £58.1 million) of subordinated debt and £161.5 million (2012: £161.4 million) of subscribed capital. The ratio of gross capital as a percentage of savings and borrowings at 31 December was 4.17% (2012: 4.10%) and the free capital ratio was 4.05% (2012: 3.97%). The Annual Business Statement gives an explanation of these ratios (see pages 138 and 139).

MORTGAGE ARREARS

At 31 December 2013, there were 332 mortgage accounts 12 months or more in arrears (including those in possession) (2012: 366). The balance on these accounts totalled £44.1 million (2012: £46.4 million) and the value of these arrears was £4.1 million (2012: £5.2 million) or 0.02% (2012: 0.02%) of total mortgage balances. The mortgage arrears methodology is based on the Council of Mortgage Lenders' definition, which calculates months in arrears by dividing the arrears balance outstanding by the latest contractual payment.

CHARITABLE AND POLITICAL DONATIONS

The Society provided for donations of £1.9 million (2012: £2.0 million) to charitable organisations during the year. This included a provision for £1.6 million (2012: £1.9 million) to The Royal British Legion's Poppy Appeal, £200,000 to Cancer Research UK following the launch of the Society's inaugural Race for Life Bond, and £102,000 (2012: £60,000) to the Coventry Building Society Charitable Foundation.

No contributions were made for political purposes. Time allowed for employees to carry out civic duties and political activity can amount to a donation. The Society supports a very small number of employees in this way.

CREDITOR PAYMENT POLICY

The Society's policy is to agree the terms of payment at the start of trading with the supplier and to pay in accordance with its contractual and other legal obligations. The Society's creditor days were 11 days at 31 December 2013 (2012: 6 days).

RISK MANAGEMENT

As a result of its normal business activities, the Group is exposed to a variety or risks including credit, market, liquidity and funding, operational, business and capital risk. The Group seeks to manage all the risks that arise from its activities and has established a number of committees and policies to do so. Details of these are set out in the Risk Management Report (pages 44 to 76), and the Directors' Report on Corporate Governance (pages 30 to 39).

In addition to these risks the Group is exposed to the effects of the economic cycle, particularly in relation to the UK residential housing market and the competitive nature of the UK personal financial services market. These are discussed in the Chairman's Statement, Chief Executive's Review and Business Review.

EMPLOYEES

The Society recognises that its goal to 'Put Members First' is best achieved through a knowledgeable and motivated workforce.

This underpins all aspects of the Society's approach to its staff. People are recruited on the basis of their attitude and behaviours as well as skills and knowledge, and the values of 'Putting Members First' are built-in to the way the Society recruits, develops, communicates with and manages its staff.

The Society has invested significantly in developing its staff, and has a framework of training initiatives that provide career advancement and personal development opportunities at all levels of the organisation. It is committed to equal opportunities and encouraging diversity and has policies in place to support the aspirations of applicants and members of staff, regardless of creed, marital status, age, and physical and mental disability. Should employees become disabled, the Society's policy is to continue their employment where possible with appropriate training and redeployment.

The Society recognises the importance of effective internal communications and operates a number of channels to inform and engage with staff. A well-used intranet and established briefing channels are supported by events and focus groups whilst regular surveys provide additional opportunities to voice opinions and identify areas for improvement. The Society has positive relations with its union, and has worked closely with it on key projects affecting staff.

In 2012 the Society was one of the first financial services organisations to be awarded Gold status by Investors in People. This independent assessment highlighted the importance the Society attaches to positive employee relations and the success that it is achieving in this regard.

DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE PREPARATION OF THE ANNUAL REPORT & ACCOUNTS

The following statement, which should be read in conjunction with the statement of the auditors' responsibilities on page 86, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Accounts, the Directors' Remuneration Report and the Notes to the Accounts, the Annual Business Statement and this Report.

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

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

The Group and Society Annual Accounts are required by law and IFRS as adopted by the EU to present fairly the financial position and the performance of the Group and the Society. The Building Societies Act 1986 provides in relation to such Annual Accounts, that references in the relevant part of that Act to Annual Accounts giving a true and fair view, are references to their achieving a fair presentation. The Act also requires the Annual Accounts to provide details of directors' emoluments in accordance with Part VIII of the Act and regulations made thereunder.

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

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

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

DIRECTORS' RESPONSIBILITIES IN RESPECT OF ACCOUNTING RECORDS AND INTERNAL CONTROL

The directors are responsible for ensuring that the Group:

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

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

The directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Group's auditors are unaware, and each director has taken all the steps that they ought to have taken as directors to make themselves aware of any relevant information and to establish that the Group's auditors are aware of that information.

DIRECTORS' STATEMENT PURSUANT TO THE DISCLOSURE AND TRANSPARENCY RULES

As required by the Disclosure and Transparency Rules of the Financial Conduct Authority the directors have included a management report containing a fair review of the business and a description of the principal risks and uncertainties facing the Group. This information is contained principally in the Business Review and Risk Management Report.

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

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

DIRECTORS' STATEMENT PURSUANT TO THE UK CORPORATE GOVERNANCE CODE

As required by the UK Corporate Governance Code, the directors confirm their opinion that the Annual Report & Accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for members to assess the performance, strategy and business model of the Society.

DIRECTORS' RESPONSIBILITIES IN RESPECT OF GOING CONCERN

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

The Society meets its day-to-day liquidity requirements through managing both its retail and wholesale funding sources and is required to maintain a sufficient buffer over minimum regulatory capital requirements in order to continue to be authorised to carry on its business.

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

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

DIRECTORS

The directors who served during the year are set out in the Directors' Report on Corporate Governance (pages 30 to 39).

THE AUDITORS

A resolution to re-appoint Ernst & Young LLP as auditors of the Society will be proposed at the AGM.

On behalf of the Board

Ian Pickering
Chairman
27 February 2014

INDEPENDENT AUDITORS' REPORT
TO THE MEMBERS OF COVENTRY BUILDING SOCIETY

We have audited the Group and Society financial statements of Coventry Building Society for the year ended 31 December 2013 which comprise the Group and Society Income Statements, the Group and Society Statements of Comprehensive Income, the Group and Society Statements of Financial Position, the Group and Society Statements of Changes in Members' Interests, the Group and Society Statements of Cash Flows and the related notes 1 to 35. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 84, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the Group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view, in accordance with IFRSs, as adopted by the European Union, of the state of the Group's and the Society's affairs as at 31 December 2013 and of the Group's and the Society's income and expenditure for the year then ended; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Our assessment of risks of material misstatement

We identified the following risks of material misstatement that had the greatest effect on the overall audit strategy, the allocation of resources in the audit, and directing the efforts of the engagement team:

- The appropriateness of effective interest rate and fair value adjustments where significant inputs are unobservable and judgemental, including the risk of management override of internal control.
- The valuation of financial instruments in hedge accounting relationships and the accuracy of associated hedge accounting adjustments.
- The measurement of impairments of loans and advances to customers.

Our application of materiality

We apply the concept of materiality both in planning and performing the audit and in evaluating the effect of identified and unadjusted misstatements (if any) on the financial statements and in forming our opinion.

When establishing our overall audit strategy, we determined materiality for the Group to be £8.4 million, which is approximately 1% of Members Interests. This provided a basis for determining the nature, timing and extent of risk assessment procedures, identifying and assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that overall performance materiality (i.e. our tolerance for misstatement in an individual account or balance) for the Group should be 50% of materiality, namely £4.2 million. Our objective in adopting this approach was to ensure that total uncorrected and undetected audit differences in the financial statements did not exceed our materiality level.

We have reported to the Board Audit Committee all identified audit differences in excess of £0.4 million, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

An overview of the scope of our audit

Our Group audit scope included all of the Society's subsidiaries.

Our primary responses to the risks identified above were as follows:

- For unobservable inputs to fair value adjustments and recognition of interest income using the effective interest method of accounting, we compared estimates and assumptions within management's models to actual performance and external data sources. We also challenged unusual adjustments made by management and performed analytical procedures to address the risk of fraud arising from management override of internal controls.
- We carried out tests of controls and performed independent valuation testing for samples of financial instruments and related hedge accounting entries, and assessed compliance of hedge accounting procedures with IFRS.
- We tested the accuracy and completeness of data used within impairment models described in note 1 to the financial statements through reconciliation to source systems and independent testing of internal controls, and challenged management's judgements including specific key assumptions to model inputs and cash flow forecasts such as for loss given default, prepayment rates and forecast house price movements.

Opinion on other matters prescribed by the Building Societies Act 1986

In our opinion:

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

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the ISAs (UK and Ireland), we are required to report to you if, in our opinion, information in the annual report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
- is otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the annual report is fair, balanced and understandable and whether the annual report appropriately discloses those matters that we communicated to the audit committee which we consider should have been disclosed.

Under the Building Societies Act 1986 we are required to report to you if, in our opinion:

- proper accounting records have not been kept by the Society; or
- the Society's financial statements are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit.

Peter Wallace (Senior statutory auditor)
for and on behalf of Ernst & Young LLP,
Statutory Auditor
London
27 February 2014

INCOME STATEMENTS

for the year ended 31 December 2013

	Notes	Group 2013 £m	*Group 2012 £m	Society 2013 £m	*Society 2012 £m
Interest receivable and similar income	3	**854.5**	846.5	**790.2**	773.3
Interest payable and similar charges	4	**(601.4)**	(659.6)	**(624.5)**	(634.8)
Net interest income		**253.1**	186.9	**165.7**	138.5
Fees and commissions receivable	5	**12.1**	14.6	**10.7**	13.4
Fees and commissions payable	6	**(3.3)**	(3.6)	**(3.2)**	(3.5)
Other operating income	7	**0.5**	1.5	**0.3**	10.7
Net gains from derivative financial instruments	8	**2.8**	0.1	**3.5**	2.8
Total income		**265.2**	199.5	**177.0**	161.9
Administrative expenses	9	**(98.2)**	(89.0)	**(91.8)**	(84.2)
Amortisation of intangible assets	19	**(4.7)**	(3.8)	**(4.7)**	(3.8)
Depreciation of tangible fixed assets	20	**(6.0)**	(5.8)	**(5.9)**	(5.8)
Impairment losses on loans and advances to customers	12	**(6.3)**	(9.6)	**(2.9)**	(6.1)
Provisions for liabilities and charges	26	**(16.3)**	(7.6)	**(16.3)**	(7.6)
Charitable donation to Poppy Appeal		**(1.6)**	(1.9)	**(1.6)**	(1.9)
Operating profit before exceptional item		**132.1**	81.8	**53.8**	52.5
Gain on pension curtailment	21	**-**	9.3	**-**	9.3
Profit before tax		**132.1**	91.1	**53.8**	61.8
Taxation	13	**(30.8)**	(21.6)	**(12.2)**	(10.9)
Profit for the financial year		**101.3**	69.5	**41.6**	50.9

* Comparatives have been restated. Refer to note 1 for further details.

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

STATEMENTS OF COMPREHENSIVE INCOME

for the year ended 31 December 2013

	Notes	Group 2013 £m	*Group 2012 £m	Society 2013 £m	*Society 2012 £m
Profit for the financial year		**101.3**	69.5	**41.6**	50.9
Other comprehensive income					
Items that will not be transferred to the income statement:					
Remeasurement of defined benefit plan	21	**(10.8)**	(5.0)	**(10.8)**	(5.0)
Taxation	13	**2.0**	1.0	**2.0**	1.0
Items that may subsequently be transferred to the income statement:					
Available-for-sale investments:					
Fair value movements taken to reserves		**(138.0)**	34.5	**(138.0)**	34.5
Amount transferred to income statement	29	**134.8**	(41.2)	**134.8**	(41.2)
Taxation	13	**0.7**	0.8	**0.7**	0.8
Cash flow hedges:					
Fair value movements taken to reserves		**(33.9)**	-	**(17.3)**	-
Amount transferred to income statement		**24.4**	-	**9.1**	-
Taxation	13	**2.0**	-	**1.7**	-
Other comprehensive income for the year, net of tax		**(18.8)**	(9.9)	**(17.8)**	(9.9)
Total comprehensive income for the year, net of tax		**82.5**	59.6	**23.8**	41.0

* Comparatives have been restated. Refer to note 1 for further details.

The accounting policies and notes on pages 93 to 137 form part of these accounts.

GROUP STATEMENT OF FINANCIAL POSITION

as at 31 December 2013

	Notes	2013 £m	*2012 £m
Assets			
Cash and balances with the Bank of England	14	**2,042.1**	1,814.2
Loans and advances to credit institutions	15	**179.3**	323.7
Debt securities	16	**1,666.0**	2,338.2
		3,887.4	4,476.1
Loans and advances to customers	17	**24,117.1**	22,018.9
Hedge accounting adjustment		**(8.4)**	86.8
Derivative financial instruments	25	**191.2**	279.6
Intangible assets	19	**12.2**	9.2
Property, plant and equipment	20	**29.4**	30.5
Investment properties	20	**5.3**	5.4
Pension benefit surplus	21	**5.1**	10.1
Deferred tax assets	22	**8.3**	9.1
Prepayments and accrued income		**5.7**	8.1
Total assets		**28,253.3**	26,933.8
Liabilities			
Shares		**21,311.7**	20,110.5
Deposits from banks	23	**1,032.6**	715.9
Other deposits		**4.0**	9.5
Amounts owed to other customers		**337.1**	450.0
Debt securities in issue	24	**4,064.8**	3,874.7
Hedge accounting adjustment		**89.5**	240.4
Derivative financial instruments	25	**213.6**	411.2
Current tax liabilities		**16.1**	3.8
Deferred tax liabilities	22	**2.0**	6.9
Accruals and deferred income		**35.6**	48.0
Other liabilities		**21.7**	21.7
Provisions for liabilities and charges	26	**9.9**	9.2
Subordinated liabilities	27	**58.2**	58.1
Subscribed capital	28	**161.5**	161.4
Total liabilities		**27,358.3**	26,121.3
Equity			
General reserve		**914.6**	822.1
Available-for-sale reserve	29	**(12.1)**	(9.6)
Cash flow hedge reserve		**(7.5)**	-
Total liabilities and equity		**28,253.3**	26,933.8

* Comparatives have been restated. Refer to note 1 for further details.

The notes on pages 93 to 137 form part of these accounts.

Approved by the Board of directors on 27 February 2014.

Ian Pickering	David Stewart	John Lowe
Chairman	Chief Executive	Finance Director

SOCIETY STATEMENT OF FINANCIAL POSITION

as at 31 December 2013

	Notes	31 Dec 2013 £m	*31 Dec 2012 £m	*1 Jan 2012 £m
Assets				
Cash and balances with the Bank of England	14	**1,883.7**	1,730.3	1,600.1
Loans and advances to credit institutions	15	**86.7**	220.3	319.3
Debt securities	16	**1,646.0**	2,313.2	2,846.3
Other liquid assets		**-**	-	0.5
		3,616.4	4,263.8	4,766.2
Assets held for resale		**-**	-	2.5
Loans and advances to customers	17	**16,195.2**	14,937.1	14,023.0
Hedge accounting adjustment		**(8.4)**	86.8	68.7
Derivative financial instruments	25	**129.5**	177.8	169.4
Investments in subsidiary undertakings	18	**7,852.3**	6,838.5	5,283.3
Intangible assets	19	**12.2**	9.2	9.5
Property, plant and equipment	20	**29.4**	30.5	32.8
Investment properties	20	**0.3**	0.3	0.6
Pension benefit surplus	21	**5.1**	10.1	3.9
Deferred tax assets	22	**5.6**	5.7	6.7
Prepayments and accrued income		**5.0**	7.1	6.8
Total assets		**27,842.6**	26,366.9	24,373.4
Liabilities				
Shares		**21,311.7**	20,110.5	18,964.1
Deposits from banks	23	**1,032.6**	715.9	510.9
Other deposits		**4.0**	9.5	23.0
Amounts owed to other customers		**337.1**	450.0	549.3
Debt securities in issue	24	**3,593.9**	3,139.5	2,863.8
Hedge accounting adjustment		**51.3**	160.6	148.4
Derivative financial instruments	25	**185.4**	374.4	299.8
Current tax liabilities		**7.9**	2.0	1.6
Deferred tax liabilities	22	**2.0**	6.9	5.6
Accruals and deferred income		**14.3**	14.6	13.2
Other liabilities		**272.6**	377.9	19.8
Provisions for liabilities and charges	26	**9.9**	9.2	9.0
Subordinated liabilities	27	**58.2**	58.1	68.2
Subscribed capital	28	**161.5**	161.4	161.3
Total liabilities		**27,042.4**	25,590.5	23,638.0
Equity				
General reserve		**818.8**	786.0	739.1
Available-for-sale reserve	29	**(12.1)**	(9.6)	(3.7)
Cash flow hedge reserve		**(6.5)**	-	-
Total liabilities and equity		**27,842.6**	26,366.9	24,373.4

* Comparatives have been restated. Refer to note 1 for further details.

The notes on pages 93 to 137 form part of these accounts.

Approved by the Board of directors on 27 February 2014.

Ian Pickering — Chairman
David Stewart — Chief Executive
John Lowe — Finance Director

STATEMENTS OF CHANGES IN MEMBERS' INTERESTS

for the year ended 31 December 2013

Group	Notes	*General reserve £m	Available-for-sale reserve £m	Cash flow hedge reserve £m	*Total £m
As at 1 January 2013		**822.1**	**(9.6)**	**-**	**812.5**
Profit for the financial year		**101.3**	**-**	**-**	**101.3**
Remeasurement of defined benefit plan (net of tax)	13,21	**(8.8)**	**-**	**-**	**(8.8)**
Net movement in Available-for-sale reserve (net of tax)		**-**	**(2.5)**	**-**	**(2.5)**
Net movement in Cash flow hedge reserve (net of tax)		**-**	**-**	**(7.5)**	**(7.5)**
As at 31 December 2013		**914.6**	**(12.1)**	**(7.5)**	**895.0**
As at 1 January 2012 (as previously reported)		747.9	(3.7)	-	744.2
Changes in accounting policy		8.7	-	-	8.7
As at 1 January 2012 (as restated)		756.6	(3.7)	-	752.9
Profit for the financial year (as restated)		69.5	-	-	69.5
Remeasurement of defined benefit plan (net of tax)	13,21	(4.0)	-	-	(4.0)
Net movement in Available-for-sale reserve (net of tax)		-	(5.9)	-	(5.9)
As at 31 December 2012 (as restated)		822.1	(9.6)	-	812.5

* Comparatives have been restated. Refer to note 1 for further details.

Society	Notes	*General reserve £m	Available-for-sale reserve £m	Cash flow hedge reserve £m	*Total £m
As at 1 January 2013		**786.0**	**(9.6)**	**-**	**776.4**
Profit for the financial year		**41.6**	**-**	**-**	**41.6**
Remeasurement of defined benefit plan (net of tax)	13,21	**(8.8)**	**-**	**-**	**(8.8)**
Net movement in Available-for-sale reserve (net of tax)		**-**	**(2.5)**	**-**	**(2.5)**
Net movement in Cash flow hedge reserve		**-**	**-**	**(6.5)**	**(6.5)**
As at 31 December 2013		**818.8**	**(12.1)**	**(6.5)**	**800.2**
As at 1 January 2012 (as previously reported)		730.4	(3.7)	-	726.7
Changes in accounting policy		8.7	-	-	8.7
As at 1 January 2012 (as restated)		739.1	(3.7)	-	735.4
Profit for the financial year (as restated)		50.9	-	-	50.9
Remeasurement of defined benefit plan (net of tax)	13,21	(4.0)	-	-	(4.0)
Net movement in Available-for-sale reserve (net of tax)		-	(5.9)	-	(5.9)
As at 31 December 2012 (as restated)		786.0	(9.6)	-	776.4

* Comparatives have been restated. Refer to note 1 for further details.

The notes on pages 93 to 137 form part of these accounts.

STATEMENTS OF CASH FLOWS

for the year ended 31 December 2013

	Notes	Group 2013 £m	*Group 2012 £m	Society 2013 £m	*Society 2012 £m
Cash flows from operating activities					
Profit before tax		**132.1**	91.1	**53.8**	61.8
Adjustments for:					
Impairment provisions and other provisions	12,26	**22.6**	17.2	**19.2**	13.7
Depreciation and amortisation		**10.7**	9.6	**10.6**	9.6
Interest on subordinated liabilities and subscribed capital		**16.4**	16.8	**16.4**	16.8
Changes to fair value adjustment of hedged risk		**(39.6)**	34.9	**(28.2)**	19.1
Other non-cash movements		**(9.9)**	(8.5)	**(10.9)**	(10.1)
Non-cash items included in profit before tax		**0.2**	70.0	**7.1**	49.1
Loans to credit institutions and other liquid assets		**111.5**	(243.7)	**98.7**	(208.3)
Loans and advances to customers		**(2,106.1)**	(2,788.5)	**(1,261.0)**	(920.2)
Prepayments, accrued income and other assets		**(14.6)**	(9.5)	**(14.9)**	(8.9)
Changes in operating assets		**(2,009.2)**	(3,041.7)	**(1,177.2)**	(1,137.4)
Shares		**1,222.9**	1,148.2	**1,222.9**	1,148.2
Deposits and other borrowings		**197.4**	93.0	**197.4**	93.0
Debt securities in issue		**(90.3)**	(126.1)	**(90.5)**	(124.3)
Accruals and deferred income and other liabilities		**(28.0)**	26.4	**(4.1)**	3.5
Changes in operating liabilities		**1,302.0**	1,141.5	**1,325.7**	1,120.4
Interest paid on subordinated liabilities and subscribed capital		**(16.4)**	(16.8)	**(16.4)**	(16.8)
Taxation		**(17.9)**	(14.4)	**(18.1)**	(14.4)
Net cash flows from operating activities		**(609.2)**	(1,770.3)	**174.9**	62.7
Cash flows from investing activities					
Purchase of investment securities		**(573.3)**	(3,104.3)	**(553.3)**	(3,104.3)
Sale and maturity of investment securities		**1,110.5**	3,645.6	**1,085.5**	3,670.6
Sale of properties		**-**	3.6	**-**	3.6
Purchase of property, plant and equipment and intangible assets		**(12.8)**	(7.2)	**(12.8)**	(7.2)
Net cash flows from investing activities		**524.4**	537.7	**519.4**	562.7
Cash flows from financing activities					
Loans to connected undertakings		**-**	-	**(1,119.5)**	(1,198.6)
Repurchase of subordinated liabilities		**-**	(10.0)	**-**	(10.0)
Repurchase and repayment of debt securities		**(263.9)**	(564.6)	**-**	(500.0)
Issue of debt securities		**543.7**	1,705.6	**543.7**	905.6
Net cash flows from financing activities		**279.8**	1,131.0	**(575.8)**	(803.0)
Net increase/(decrease) in cash		**195.0**	(101.6)	**118.5**	(177.6)
Cash and cash equivalents at start of year		**1,876.6**	1,978.2	**1,724.7**	1,902.3
Cash and cash equivalents at end of year		**2,071.6**	1,876.6	**1,843.2**	1,724.7
Cash and cash equivalents:					
Cash and balances with central banks	14	**2,001.6**	1,793.6	**1,843.2**	1,709.7
Loans and advances to credit institutions		**70.0**	83.0	**-**	15.0
		2,071.6	1,876.6	**1,843.2**	1,724.7

* Comparatives have been restated. Refer to note 1 for further details.

The notes on pages 93 to 137 form part of these accounts.

NOTES TO THE ACCOUNTS

1. ACCOUNTING POLICIES

BASIS OF PREPARATION

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

The accounts have been prepared on an historical cost basis, as modified by the revaluation of Available-for-sale debt securities and certain financial instruments which are measured at fair value. As stated in the Directors' Report, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the accounts. A summary of the Group's accounting policies is set out below.

BASIS OF CONSOLIDATION

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

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

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

CHANGES IN ACCOUNTING POLICY

The following standards and interpretations, relevant to the Group have been adopted with effect from 1 January 2013. The Society has also used cash flow hedge accounting for the first time during the year and has simplified the format of the income statement (see below).

Pronouncement	Nature of change
IFRS 13 *Fair Value measurement*	IFRS 13 has replaced guidance on fair value measurement in previous IFRS accounting publications with a single standard. The standard provides guidance on the calculation of the fair value of financial and non-financial assets and liabilities and additionally requires enhanced disclosure regarding information on valuation techniques, inputs used in measuring fair value and significant details of the fair value hierarchy. The IFRS 13 disclosures are in note 32.
IAS 1 *Presentation of Financial Statements (Amendments)*	The amendment requires changes to the presentation of the statement of comprehensive income, requiring items that could be reclassified to profit and loss at a future point in time to be presented separately from items that will never be reclassified.
IAS 19 *Employee Benefits (Amendments)*	The amendments update the recognition, presentation and disclosure of retirement benefit plans, including the elimination of the 'corridor approach', as well as the replacement of the expected return on plan assets and interest cost with a single measurement of income (or expense). This amendment is required to be applied retrospectively. The Group has never adopted the corridor approach and in 2012 the expected return on plan assets was equal to the discount factor used in the scheme liabilities. Accordingly there is no impact on the Group's results from adopting these amendments.
IFRS 7 *Financial Instruments: Disclosures –Offsetting Financial Assets and Financial Liabilities Amendment)*	The amendments require disclosure of the effect or potential effect of netting arrangements on the Group's financial position including financial instruments that are subject to an enforceable master netting arrangement or similar agreement. This disclosure is given in note 33.

1. ACCOUNTING POLICIES (continued)

Hedge accounting – cash flow hedge accounting
During the year, the Group designated existing cross currency swaps as cash flow hedges of the impact of changes in euro-sterling exchange rates on its euro denominated covered bond. This was the first time the Group has used cash flow hedge accounting and the Group's hedging accounting policy note has been updated accordingly.

Simplification of income statement format
The format of the income statement has been simplified for the current and comparative year by removing a number of sub-totals and also by no longer classifying the recurring FSCS provision charges as exceptional. The format changes themselves do not impact profit before tax for either the Group or Society.

PRIOR YEAR ADJUSTMENT

IFRC 21 Levies
This interpretation provides guidance on accounting for the liability to pay a government imposed levy and has resulted in a change in the timing of recognition of Financial Services Compensation Scheme (FSCS) levies that impact both the Society and the Group.

The Society has an obligation to contribute to the FSCS to enable the scheme to meet interest, capital and administrative costs of safeguarding the protected deposits of savers in failed financial institutions. The FSCS scheme year runs from 1 April to 31 March and levies are based on the deposit taker's share of protected deposits at the preceding 31 December.

In previous years, the Group has recognised an FSCS provision under IAS 37 on the basis that the obliging event was being a deposit taker on the preceding 31 December to the following FSCS scheme year so that in its 2012 financial statements an estimated provision was recognised in respect of the 2013/14 FSCS levy. IFRIC 21 has clarified that the obliging event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy and this is the case even if the levy is calculated by reference to revenue generated in a previous period. Given that the FSCS can only raise a levy within its scheme year, under IFRIC 21 the Group should no longer recognise its FSCS provision in the preceding year to the FSCS scheme year but in the scheme year itself. Therefore, the 2013/14 FSCS levy should be recognised in the Group's 2013 financial statements.

IFRIC 21 is applicable for annual periods beginning on or after 1 January 2014 with early adoption permitted and the Group has elected to adopt in its 2013 financial statements. The change has been applied retrospectively and comparatives restated accordingly. A summary of the line item restatement for the Group for the 2012 comparative year is provided below. The IFRIC 21 adjustments of the Society are identical in nature and value. As the change has not had a material effect at the beginning of the preceding period a Group statement of financial position as at 1 January 2012 has not been disclosed.

Group Income Statement for the year ended 31 December 2012	Notes	Previously published £m	Amounts transferred to 2013 £m	Amounts transferred from 2011 £m	Restated £m
Provision for liabilities and charges	26	(10.2)	13.9	(11.3)	(7.6)
Profit before tax		88.5	13.9	(11.3)	91.1
Taxation	13	(21.0)	(3.2)	2.6	(21.6)
Profit for the financial year		67.5	10.7	(8.7)	69.5

Group Statement of Comprehensive Income for the year ended 31 December 2012	Previously published £m	IFRIC 21 adjustment £m	Restated £m
Profit for the financial year	67.5	2.0	69.5
Total comprehensive income for the year, net of tax	57.6	2.0	59.6

Group Statement of Financial Position as at 31 December 2012	Notes	Previously published £m	IFRIC 21 adjustment £m	Restated £m
Deferred tax liabilities	22	3.7	3.2	6.9
Provisions for liabilities and charges	26	23.1	(13.9)	9.2
Total liabilities		26,132.0	(10.7)	26,121.3
General reserve		811.4	10.7	822.1
Total liabilities and equity		26,933.8	-	26,933.8

Group Statement of Cash Flows for the year ended 31 December 2012	Previously published £m	IFRIC 21 adjustment £m	Restated £m
Profit before tax	88.5	2.6	91.1
Impairment provisions and other provisions	9.6	7.6	17.2
Other non-cash movements	1.7	(10.2)	(8.5)
Non-cash items included within profit before tax	72.6	(2.6)	70.0

Financial arrangements between the Society and its subsidiaries

There has been a change in accounting policy that impacts on the Society only and not on the consolidated Group in respect of the financing arrangements between the Society and its subsidiary Coventry Building Society Covered Bonds LLP (LLP).

The Society issues covered bonds to both itself and external counterparties and then lends the proceeds on back to back terms to the LLP. An additional sum is provided as a capital contribution. The LLP then uses all of these funds to purchase a beneficial interest in mortgages from the Society. As a consequence of the recognition requirement of IAS 39 Financial Instruments: Recognition and Measurement, the mortgages remain on the Society's statement of financial position and the receipt of proceeds from the LLP is recorded as a loan from the LLP.

Previously the loans to the LLP and the consideration for the beneficial interest were recognised as an asset and a liability, in addition to the asset recognised for the mortgages and the liability recognised for the bonds issued to external counterparties. This had the effect of grossing up both the Society's statement of financial position and its interest income and expense. Under the new policy, the loans to the LLP and the consideration for the beneficial interest are not recognised separately as an additional asset and liability. This ensures that the statement of financial position and income statement of the Society do not present two assets (and associated interest income) and two liabilities (and associated interest expense) for the same underlying cash flows. The directors believe that the new policy better reflects the substance of the arrangement.

In addition to this change in accounting policy, the Society's 2012 interest payable has also been decreased by £6.3 million to revise the allocation of the beneficial interest in the Leofric securitisation vehicle between the Society and its subsidiary Godiva Mortgages Limited. There is no impact on the consolidated Group results.

The change has been applied retrospectively and comparatives restated accordingly. There is no impact on the Group and Society statements of comprehensive income and statement of changes in members' interests from this policy change. A summary of the restatement of other line items for the 2012 comparative year end is provided below. This restatement also includes the Society only IFRIC 21 restatement noted above where applicable. As the change has a material effect in the Society's statement of financial position at the beginning of the preceding period an additional statement as at 1 January 2012 is included on page 90.

Society Income Statement for the year ended 31 December 2012	Notes	Previously published £m	IFRIC 21 adjustment £m	Financial arrangements adjustment £m	Restated £m
Interest receivable and similar income	3	900.9	-	(127.6)	773.3
Interest payable and similar charges	4	(768.7)	-	133.9	(634.8)
Net interest income		132.2	-	6.3	138.5
Provisions for liabilities and charges	26	(10.2)	2.6	-	(7.6)
Profit before tax		52.9	2.6	6.3	61.8
Taxation	13	(8.8)	(0.6)	(1.5)	(10.9)
Profit for the financial year		44.1	2.0	4.8	50.9

NOTES TO THE ACCOUNTS

(continued)

1. ACCOUNTING POLICIES (continued)

Society Statement of Financial Position	Notes	Previously published 1 Jan 2012 £m	*Adjustments 1 Jan 2012 £m	Restated 1 Jan 2012 £m	Previously published 31 Dec 2012 £m	*Adjustments 31 Dec 2012 £m	Restated 31 Dec 2012 £m
Investments in subsidiary undertakings	18	9,758.0	(4,474.7)	5,283.3	11,178.9	(4,340.4)	6,838.5
Total assets		28,848.1	(4,474.7)	24,373.4	30,707.3	(4,340.4)	26,366.9
Current tax liabilities		1.6	-	1.6	0.5	1.5	2.0
Deferred tax liabilities		3.0	2.6	5.6	3.7	3.2	6.9
Other liabilities		4,494.5	(4,474.7)	19.8	4,724.6	(4,346.7)	377.9
Provisions for liabilities and charges	26	20.3	(11.3)	9.0	23.1	(13.9)	9.2
Total liabilities		28,121.4	(4,483.4)	23,638.0	29,946.4	(4,355.9)	25,590.5
General reserves		730.4	8.7	739.1	770.5	15.5	786.0
Total liabilities and equity		28,848.1	(4,474.7)	24,373.4	30,707.3	(4,340.4)	26,366.9

*Adjustments presented are in respect of the financing arrangements between the Society and its subsidiaries, and also in respect of IFRIC 21.

Society Statement of Cash Flows for the year ended 31 December 2012	Previously published 31 Dec £m	IFRIC 21 adjustment 31 Dec £m	Financial arrangements adjustment 31 Dec £m	Restated 31 Dec £m
Profit before tax	52.9	2.6	6.3	61.8
Impairment provisions and other provisions	6.1	7.6	-	13.7
Other non-cash movements	0.1	(10.2)	-	(10.1)
Non-cash items included in profit before tax	51.7	(2.6)	-	49.1
Net cash flows from operating activities	56.4	-	6.3	62.7
Loans from connected undertakings	(1,192.3)	-	(6.3)	(1,198.6)
Net cash flows from financing activities	(796.7)	-	(6.3)	(803.0)

FUTURE ACCOUNTING DEVELOPMENTS

The following standards and interpretations, relevant to the Group, were not effective as at 31 December 2013 and have not been applied in preparing these financial statements. The anticipated impact of these standards and interpretations are listed below:

Pronouncement	Nature of change	Periods beginning on or after
IFRS 10,11, 12 and amendments to IAS 27 and 28	A package of five new and revised standards addressing the accounting for consolidation, involvements in joint ventures and disclosure of involvements with other entities. With the exception of additional disclosure requirements, the new and revised standards will not have a significant impact for the Group.	1 January 2014
IAS 32 *Offsetting Financial Assets and Financial Liabilities*	Clarifies existing offsetting criteria. The amendment is not expected to have a significant impact for the Group.	1 January 2014
IFRS 9 *Financial Instruments: Classification and measurement*	IFRS 9 is the new standard to replace IAS 39. As currently issued, IFRS 9 addresses the classification and measurement of financial assets and liabilities and general hedge accounting. Later phases will address impairment and macro hedge accounting.	To be determined
IFRS 9 *Financial Instruments (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39)*	Whilst, a number of significant proposals have yet to be finalised, as currently issued, there is little anticipated impact to the Society. The mandatory effective date for IFRS 9 is still yet to be determined.	

SECURITISATION AND COVERED BOND TRANSACTIONS

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

The transfers of the mortgage loans to the SPEs are not treated as sales by the Society. The Society continues to recognise the mortgage loans on its own statement of financial position after the transfer because it retains the risks and rewards of the mortgage loans through the receipt of substantially all of the profits of the SPEs. For securitisations, in the accounts of the Society, the proceeds received from the transfer are accounted for as a deemed loan repayable to the SPEs disclosed within other liabilities on the statement of financial position. For covered bonds, the position is as set out earlier under the heading 'Prior year adjustment – Financial arrangements between the Society and its subsidiaries'.

The Group has also entered into issuances of debt to be used as collateral for central government schemes or sale and repurchase agreements and similar transactions. Some or all of the issuances of debt may be retained by the Society (self-issued debt). Investments in self-issued debt and the equivalent deemed loan, together with the related income, expenditure and cash flows are not recognised in the Society's financial statements. This avoids the 'grossing up' of the financial statements that would otherwise arise.

To manage interest rate risk, the Society enters into derivative transactions with the SPEs, receiving a rate of interest based on the securitised mortgages and paying a rate inherent in the debt issuances. In accordance with IAS 39, these internal derivatives are treated as part of the deemed loan and not separately measured at fair value because the relevant mortgage loans are not derecognised. Cash flows arising from these internal derivatives are accounted for on an accruals basis. All other derivatives relating to securitisations are treated as explained in the derivatives and hedging accounting policy (see page 101).

FUNDING FOR LENDING SCHEME (FLS)

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

INTEREST RECEIVABLE AND INTEREST PAYABLE

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

In calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees received and paid and costs borne that are an integral part of the effective interest rate and all other premiums above or below market rates.

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

FEES AND COMMISSIONS

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

TAXATION INCLUDING DEFERRED TAX

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

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

1. ACCOUNTING POLICIES (continued)

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

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

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

EXCEPTIONAL ITEMS

Exceptional items are items of income and expenditure that are disclosed separately on the basis that they are material, either by their nature or their size, to the understanding of the Group's financial performance. An operating profit before exceptional items sub-total is included to provide clear and useful information on the trends in the components of profit.

In prior years, the FSCS provision charge has been treated as an exceptional item but given its recurring nature this is no longer the case and the comparative income statement has been amended accordingly. In 2012, exceptional items included a gain on pension curtailment resulting from the closure of the Coventry Building Society Superannuation Fund to future service accrual (see note 21). This is a non-recurring item.

SEGMENTAL REPORTING

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

FINANCIAL ASSETS

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

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

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

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

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

Fair value through profit or loss
All derivatives are carried at fair value.

For those derivatives in fair value hedge accounting relationships and for any derivatives not in a hedge accounting relationship, gains and losses arising from changes in the fair values are recognised in the income statement. The impact of hedging on the measurement of financial assets and liabilities is detailed in the derivatives and hedge accounting policy note (page 101).

For derivatives in cash flow hedge accounting relationships, the gains and losses arising from changes in fair value are initially recognised in other comprehensive income as set out in the hedge accounting policy note for cash flow hedges on page 101.

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

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

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

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

Purchases and sales of financial assets are accounted for at the trade date. Financial assets are derecognised when the rights to receive cash flows have expired or where substantially all the risks and rewards of ownership have been transferred.

IMPAIRMENT OF LOANS AND ADVANCES TO CUSTOMERS

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

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

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

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

- All properties being used as security are valued at the outset of the loan and, if a further advance is made during the lifetime of the loan, at the time of the further advance.

1. ACCOUNTING POLICIES (continued)

- Once the value of the property has been established, the Nationwide regional house price index is used to provide an updated estimate of the property's value, on a quarterly basis.
- Assumptions are continuously updated to reflect the time taken to sell a repossessed property and the likely discount to the latest property valuation. Typically, the forced sale discount averages 26% of the property value.
- No assumptions are made as to the future value of properties beyond the estimation of a discount for the forced sale that results from a repossession of a mortgaged property.

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

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

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

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

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

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

Write-off policy and recognition of post-loss recoveries
When a loan is not collectable, it is written off against the related provision for loan impairment (see note 12). Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recorded in the income statement.

SALE AND REPURCHASE AGREEMENTS

Securities sold subject to a commitment to repurchase them are retained on the statement of financial position when substantially all the risks and rewards of ownership remain within the Group. The counterparty liability is included separately on the statement of financial position, as appropriate. The difference between the sale and repurchase price is accrued over the life of the agreements using the effective interest rate method.

DERIVATIVE FINANCIAL INSTRUMENTS

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

All derivative financial instruments are carried at fair value. Derivatives are principally valued by discounting cash flows using yield curves that are based on observable market data or are based on valuations obtained from counterparties. For collateralised positions the Group uses discount curves based on overnight indexed swap (OIS) rates and for non-collateralised positions the Group uses discount curves based on term LIBOR rates. In measuring fair value, separate adjustments are made for counterparty or own credit risk to the extent not already included in the valuation.

The use of OIS rates to discount collateralised positions and the inclusion of counterparty or own credit risk in assessing fair value is a change from the prior year to align with evolving market conventions and is detailed further in note 25. Similarly, the rates used to discount cross currency swaps hedging non-sterling wholesale funding have been adjusted to incorporate the effect of changes in cross currency spreads.

HEDGE ACCOUNTING

All derivatives entered into by the Group are for the purpose of providing an economic hedge and where the criteria set out in IAS 39 are met the Group uses hedge accounting and designates the hedging derivative as either hedging fair value or cash flow risks.

Fair value hedges
Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement under net gain from derivative financial instruments in the period in which the movement occurs together with the change in fair value of the hedged asset or liability that are attributable to the hedged risk. This also applies if the hedged item is classified as an Available-for-sale financial asset.

Cash flow hedges
Changes in the effective part of any gain or loss on the derivative financial instrument hedging the variability in cash flows of a recognised asset or liability are recognised directly through other comprehensive income in the cash flow hedge reserve and reclassified to the income statement under net gains from derivative financial instrument in the periods in which the hedged item affects profit or loss. Any ineffective portion of the gain or loss on the hedging instrument is recognised in the income statement immediately.

The Group used cash flow hedging for the first time during the year in order to better reflect the economic nature of the arrangement.

LEASES AND CONTRACT PURCHASE AGREEMENTS

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

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

1. ACCOUNTING POLICIES (continued)

INTANGIBLE ASSETS

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

INVESTMENT PROPERTIES AND PROPERTY, PLANT AND EQUIPMENT

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

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

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

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

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

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

EMPLOYEE BENEFITS

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

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

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

Pension costs for service in the period are assessed in accordance with advice from a qualified actuary and are recognised in the income statement. Following the closure of the defined benefit pension scheme to future accrual, service costs incurred relate to the notice periods given to the scheme's members. Gains or losses arising from the remeasurement of the defined benefit plan are recognised in full in the year they occur in the statement of comprehensive income.

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

Other long-term employee benefits
The cost of bonuses payable 12 months or more after the end of the financial year in which they are earned is recognised in the year in which the employees render the related service and when there is an obligation to pay a bonus under the terms of the scheme.

FINANCIAL LIABILITIES

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

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

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

Fair value through profit or loss
All derivatives are carried at fair value.

For those derivatives in fair value hedge accounting relationships and for any derivatives not in a hedge accounting relationship, gains and losses arising from changes in the fair values are recognised in the income statement. The impact of hedging on the measurement of financial assets and liabilities is detailed in the derivatives and hedge accounting policy note (page 101).

For derivatives in cash flow hedge accounting relationships, the gains and losses arising from changes in fair value are initially recognised in other comprehensive income as set out in the hedge accounting policy note for cash flow hedges on page 101.

PROVISIONS AND CONTINGENT LIABILITIES

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

Contingent liabilities are potential obligations from past events which shall be confirmed by future events. Contingent liabilities are not recognised within the statement of financial position.

FOREIGN CURRENCY TRANSLATION

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

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

CASH AND CASH EQUIVALENTS

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

IFRS DISCLOSURE

For ease of reference, certain audited IFRS disclosures, which in previous years have been reported in the notes to the accounts, are included within the Risk Report as follows:

- Credit risk (pages 51 to 62);
- Market risk (pages 62 to 65); and
- Funding and liquidity risk (pages 65 to 70).

A maturity analysis for all assets and liabilities is presented in the table on pages 68 to 69.

These disclosures, where marked as 'Audited', are covered by the Independent Auditors' Report on pages 86 and 87.

2. JUDGEMENT IN APPLYING ACCOUNTING POLICIES AND CRITICAL ACCOUNTING ESTIMATES

The Group has to make judgements in applying its accounting policies which affect the amounts recognised in the accounts. In addition, estimates and assumptions are made that could affect the reported amounts of assets and liabilities within the following financial year. The most significant areas where judgement and estimates are disclosed is in the following notes:

Area of significant judgement and estimate	Note
Mortgage effective interest rate	3
Fair value adjustments in respect of acquired assets	3
Impairment provisions on loans and advances to customers	12
Pension scheme	21
Valuation of derivatives	25

3. INTEREST RECEIVABLE AND SIMILAR INCOME

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	*Society 2012 £m
On loans fully secured on residential property	**865.0**	813.3	**525.3**	512.4
On other loans				
Connected undertakings	**-**	-	**277.9**	249.8
Other	**3.3**	3.7	**2.1**	2.3
	868.3	817.0	**805.3**	764.5
Interest and other income on debt securities	**56.5**	94.2	**56.0**	74.3
Interest and other income on other liquid assets	**8.7**	7.3	**7.9**	6.5
Net expense on financial instruments hedging assets	**(79.0)**	(72.0)	**(79.0)**	(72.0)
Total	**854.5**	846.5	**790.2**	773.3

* Comparatives have been restated. Refer to note 1 for further details.

Included within interest receivable and similar income is interest accrued of £7.1 million (2012: £8.6 million) for the Group and £4.6 million (2012: £5.3 million) for the Society on impaired financial assets.

3. INTEREST RECEIVABLE AND SIMILAR INCOME (continued)

Critical accounting estimates and judgements

The Group recognises interest on loans and advances to customers on the basis of their effective interest rate. This is a constant rate that averages out the effect of incentives and fees across the expected life of the loan account. A critical assumption in the calculation is the expected life, as this determines the assumed period over which customers may be paying various differentiated interest rates. The calculation of the effective interest rate uses assumptions on expected life that are based on the experience of similar products. These assumptions are monitored to ensure their ongoing appropriateness. Changes in the amortised cost balance arising from actual product life experience differing from the assumed life, are periodically calculated and an adjustment made to the loan balance, with a corresponding adjustment to interest receivable and similar income. An increase in projected redemption rates of 1% over the next 12 months would result in a decrease in loans and advances to customers of £4.2 million with a corresponding reduction to income in the income statement. Within the calculations, provision has been made for the uncertainty of the estimates in order to reduce the risk of overstatement of interest income.

Where assets are acquired as a result of merger or via the purchase of mortgage portfolios, management is required to estimate the expected life and associated cash flows of the assets and amortise the fair value adjustments over this period. Similarly, management is required to estimate a suitable period to amortise the impact of any transactions where the transaction price differed from fair value. If different assumptions were made then the impact of these adjustments would be recognised over longer or shorter periods. The impact of increasing the length of these assumptions by one year would have reduced profits by £4.9 million.

4. INTEREST PAYABLE AND SIMILAR CHARGES

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	*Society 2012 £m
Bank and customer				
Subordinated liabilities	**4.2**	4.6	**4.2**	4.6
Other	**11.5**	7.3	**11.5**	7.2
Debt securities in issue	**138.1**	148.4	**134.8**	99.2
Other borrowed funds				
On shares held by individuals	**497.8**	552.0	**497.8**	552.0
On other shares	**0.1**	0.1	**0.1**	0.1
On subscribed capital	**12.2**	12.2	**12.2**	12.2
On loans from connected undertakings	**-**	-	**7.0**	7.7
Net income on financial instruments hedging liabilities	**(62.5)**	(65.0)	**(43.1)**	(48.2)
Total	**601.4**	659.6	**624.5**	634.8

* Comparatives have been restated. Refer to note 1 for further details.

5. FEES AND COMMISSIONS RECEIVABLE

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
Mortgage related fees	**4.1**	4.0	**2.7**	2.8
General insurance commissions	**5.8**	6.4	**5.8**	6.4
Other fees and commissions	**2.2**	4.2	**2.2**	4.2
Total	**12.1**	14.6	**10.7**	13.4

6. FEES AND COMMISSIONS PAYABLE

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Banking fees	**2.3**	2.5	**2.2**	2.4
Funding related fees	**0.1**	0.2	**0.1**	0.2
Other fees and commissions	**0.9**	0.9	**0.9**	0.9
Total	**3.3**	3.6	**3.2**	3.5

7. OTHER OPERATING INCOME

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Rents receivable	**0.5**	0.5	**0.3**	0.3
Other	**-**	1.0	**-**	10.4
Total	**0.5**	1.5	**0.3**	10.7

In 2012 the Society recognised dividend income of £9.4 million from its subsidiaries (see note 35) and £0.8 million relating to profits from the disposals of a non-current asset held for sale and an investment property held by the Society.

8. NET GAINS FROM DERIVATIVE FINANCIAL INSTRUMENTS

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Gains/(losses) on derivatives designated as fair value hedges	**86.9**	(2.6)	**129.2**	(26.6)
Movement in fair value of hedged items attributable to hedged risk	**(82.8)**	3.0	**(124.3)**	29.7
	4.1	0.4	**4.9**	3.1
Derivatives designated as cash flow hedges	**(1.2)**	-	**0.1**	-
Losses on other derivatives	**(0.1)**	(0.3)	**(1.5)**	(0.3)
Total	**2.8**	0.1	**3.5**	2.8

The Group £2.8 million gain is primarily in respect of cross currency swaps and reflects both the change in valuation methodology (see note 25) and subsequent cash flow hedge accounting for these derivatives.

9. ADMINISTRATIVE EXPENSES

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Employee costs				
Wages and salaries	**51.7**	46.7	**51.7**	46.7
Social security costs	**5.2**	4.7	**5.2**	4.7
Pension costs				
Defined benefit plan (note 21)	**0.4**	2.1	**0.4**	2.1
Defined contribution plan	**2.8**	1.1	**2.8**	1.1
	60.1	54.6	**60.1**	54.6
Other expenses	**38.1**	34.4	**31.7**	29.6
Total	**98.2**	89.0	**91.8**	84.2

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

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Audit of the annual accounts	**0.2**	0.2	**0.2**	0.2
Audit related assurance services – subsidiary audits	**0.1**	0.1	**0.1**	0.1
Other assurance services	**-**	0.1	**-**	0.1
Total	**0.3**	0.4	**0.3**	0.4

The Group's policy in relation to the use of its auditors on non-audit engagements sets out the nature of services they are generally precluded from performing. Further details on the Society's policy is included within the Board Audit Committee Report on pages 42 to 43. All non-audit engagements provided by the Group's auditors, are subject to pre-approval by either the Board Audit Committee or the Finance Director (on a delegated basis from the Board Audit Committee), depending upon the nature of the non-audit engagement.

10. STAFF NUMBERS

Group and Society	**2013 Full-time**	**2013 Part-time**	2012 Full-time	2012 Part-time
The average number of persons employed during the year (including executive directors) was:				
Head office and administrative centres	**1,019**	**287**	892	277
Branches	**377**	**242**	391	228
Total	**1,396**	**529**	1,283	505

NOTES TO THE ACCOUNTS

(continued)

11. DIRECTORS' EMOLUMENTS

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

	Salary £000	Annual bonus[1] £000	Long Term Incentive Plan[2,3] £000	Pension contributions[4] £000	Increase in accrued pension £000	Taxable benefit £000	Total £000
Executive directors:							
2013							
David Stewart	**420**	**60**	**128**	**-**	**1**	**124**[5]	**733**
John Lowe	**279**	**40**	**74**	**28**	**-**	**13**	**434**
Colin Franklin	**156**	**22**	**55**	**51**	**12**	**16**	**312**
Peter Frost	**224**	**32**	**-**	**22**	**-**	**24**	**302**
Feike Brouwers (appointed 24.04.2013)	**171**	**26**	**33**	**17**	**-**	**36**	**283**
Total	**1,250**	**180**	**290**	**118**	**13**	**213**	**2,064**
2012							
David Stewart	377	47	124	33	1	79	661
John Lowe	250	31	72	24	-	12	389
Colin Franklin	143	16	53	34	4	16	266
Peter Frost (appointed 01.11.2012)	37	4	-	4	-	4	49
Total	807	98	249	95	5	111	1,365

No director has received payments in excess of €1,000,000 during 2013 or 2012.

1.The performance of the Society during 2013 gave rise to a payment for all 1,956 eligible members of Coventry staff (2012: 1,794), including executive directors, equivalent to 14% (2012: 12%) of basic salary. For payments awarded to executive directors for 2013, 50% of the Annual Bonus will be paid in March 2014, and the balance in the form of an equivalent share-like instrument retained for a further period of six months and subject to performance adjustment during the retention period.
2.Payments made under the Long Term Incentive Plan (LTIP) are in relation to the performance of the three financial years 2011, 2012 and 2013. The Remuneration Committee approved a payment of 40% (2012: 38.9%) of base salary at the date of the Deed of Grant to participants in the scheme at that date, reflecting the Group's performance over this period. For payments awarded to executive directors for 2013, 50% of the LTIP will be paid in March 2014, and the balance in the form of an equivalent share-like instrument retained for a further period of six months and subject to performance adjustment during the retention period.
3.Feike Brouwers was granted an award in relation to the 2011 and 2012 LTIPs on a pro rata basis to meet the value of existing incentives foregone when he left his previous employment. The Remuneration Committee is satisfied that the value of incentives granted is not greater than those relinquished.
4.John Lowe, Feike Brouwers and Peter Frost are active members of the Group's defined contribution pension scheme. David Stewart ceased to be a member of the Society's pension arrangement on 31 March 2013.
5.David Stewart left the Society's defined benefit scheme in 2006. Taxable benefits include payments equivalent to 25% of base salary in respect of the value of benefits foregone.

DEFINED BENEFIT SCHEME

Pension benefits earned by directors	**Director's contribution 2013 £000**	**Accrued pension per annum at 31.12.2013 £000**	Director's contribution 2012 £000	Accrued pension per annum at 31.12.2012 £000
David Stewart[1]	**-**	**43**	-	42
Colin Franklin[2]	**12**	**71**	11	59

1. David Stewart is a deferred member of the Group's contributory final salary pension scheme, having left the final salary pension scheme immediately before being appointed Chief Executive in July 2006.
2. Colin Franklin left the scheme and became a deferred member on 31 December 2013 following the scheme closure to future service accrual.

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

11. DIRECTORS' EMOLUMENTS (continued)

	Basic Fees		Committee Fees		Total Fees	
	2013 £000	2012 £000	**2013 £000**	2012 £000	**2013 £000**	2012 £000
Non-executive directors:						
Ian Pickering (Appointed as Chairman, 01.01.2013)	**130**	41	**-**	21	**130**	62
David Harding (Chairman, retired 31.12.2012)	**-**	100	**-**	-	**-**	100
Janet Ashdown (appointed 18.09.2013)	**13**	-	**-**	-	**13**	-
Peter Ayliffe (appointed 01.05.2013)	**29**	-	**-**	-	**29**	-
Bridget Blow (Deputy Chairman, Senior Independent Director and Chairman of the Remuneration Committee)	**44**	41	**16**	12	**60**	53
Roger Burnell (Chairman of the Board Risk Committee)	**44**	41	**12**	-	**56**	41
Ian Geden	**44**	41	**-**	-	**44**	41
Fiona Smith (retired 25.04.2013)	**14**	41	**-**	-	**14**	41
Glyn Smith (Chairman of the Board Audit Committee and Models and Ratings Committee)	**44**	41	**18**	12	**62**	53
Total	**362**	346	**46**	45	**408**	391

No pension contributions were made for non-executive directors.

Non-executive directors fees are made up of a basic fee, £44,000 per annum (£40,774 per annum up to 31 December 2012) plus a Committee Chair fee as follows:

Role	**Per annum Up to 31 December 2013 £000**	Per annum Up to 31 December 2012 £000
Deputy Chair	**6**	6
Remuneration Committee Chair	**10**	6
Board Audit Committee Chair	**12**	12
Board Risk Committee Chair	**12**	12
Models and Ratings Committee Chair	**6**	6
Senior Independent Director (if different from Deputy Chair)	**6**	6

For further information on the dates of appointments and retirements of the non-executive directors and the Society's committees, please see the Directors' report on Corporate Governance on pages 30 to 39.

12. IMPAIRMENT PROVISIONS ON LOANS AND ADVANCES TO CUSTOMERS

Impairment provisions have been deducted from the appropriate asset values on the statement of financial position. In addition, the incurred loss element of the fair value adjustments arising from the merger with the Stroud & Swindon Building Society, have been included within the table below:

Group	Loans fully secured on residential property 2013 £m	Other loans 2013 £m	Total 2013 £m	Loans fully secured on residential property 2012 £m	Other loans 2012 £m	Total 2012 £m
At 1 January						
Individual impairment	**18.8**	**1.4**	**20.2**	17.6	0.8	18.4
Collective impairment	**7.0**	**0.4**	**7.4**	7.2	0.4	7.6
	25.8	**1.8**	**27.6**	24.8	1.2	26.0
Charge for the year						
Individual impairment	**4.4**	**0.4**	**4.8**	7.6	2.2	9.8
Collective impairment	**1.6**	**(0.1)**	**1.5**	(0.2)	-	(0.2)
	6.0	**0.3**	**6.3**	7.4	2.2	9.6
Charge covered by fair value adjustment*	**0.8**	**0.8**	**1.6**	1.7	0.2	1.9
Amounts written off	**(7.3)**	**(0.8)**	**(8.1)**	(8.1)	(1.8)	(9.9)
At 31 December						
Individual impairment	**16.2**	**1.3**	**17.5**	18.8	1.4	20.2
Collective impairment	**9.1**	**0.8**	**9.9**	7.0	0.4	7.4
Total	**25.3**	**2.1**	**27.4**	25.8	1.8	27.6

Society	Loans fully secured on residential property 2013 £m	Other loans 2013 £m	Total 2013 £m	Loans fully secured on residential property 2012 £m	Other loans 2012 £m	Total 2012 £m
At 1 January						
Individual impairment	**10.5**	**1.0**	**11.5**	10.3	0.7	11.0
Collective impairment	**3.5**	**0.3**	**3.8**	3.8	0.2	4.0
	14.0	**1.3**	**15.3**	14.1	0.9	15.0
Charge for the year						
Individual impairment	**2.8**	**0.2**	**3.0**	4.9	1.3	6.2
Collective impairment	**-**	**(0.1)**	**(0.1)**	(0.2)	0.1	(0.1)
	2.8	**0.1**	**2.9**	4.7	1.4	6.1
Charge covered by fair value adjustment*	**-**	**-**	**-**	0.7	-	0.7
Amounts written off	**(4.2)**	**(0.7)**	**(4.9)**	(5.5)	(1.0)	(6.5)
At 31 December						
Individual impairment	**9.2**	**0.5**	**9.7**	10.5	1.0	11.5
Collective impairment	**3.4**	**0.2**	**3.6**	3.5	0.3	3.8
Total	**12.6**	**0.7**	**13.3**	14.0	1.3	15.3

* Utilisation of fair value adjustment arising from the merger with Stroud & Swindon Building Society in 2010.

12. IMPAIRMENT PROVISIONS ON LOANS AND ADVANCES TO CUSTOMERS (continued)

When arriving at the impairment provision, the Group has considered accounts with forbearance and other potential impairment indicators. See pages 57 and 58 for further details.

Critical accounting estimates and judgements

In accordance with the accounting policy described in note 1, impairment is measured as the difference between an asset's carrying amount and the present value of management's estimate of discounted future cash flows. Key assumptions include the probability of any account going into default, the probability of defaulting accounts progressing to possession and the eventual loss incurred in the event of forced sale or write off. These assumptions are based on observable historical data and updated as management considers appropriate to reflect current conditions.

If house prices were to fall 10%, the impact on the impairment provision would be an increase of £4.3 million.

13. TAXATION

	Group 2013 £m	*Group 2012 £m	**Society 2013 £m**	*Society 2012 £m
Current tax				
UK corporation tax at 23.25% (2012: 24.5%)	**32.5**	15.5	**14.9**	10.3
UK corporation tax - adjustment in respect of prior years	**(0.3)**	(0.7)	**(0.3)**	(1.7)
Total current tax	**32.2**	14.8	**14.6**	8.6
Deferred tax				
Current year	**1.6**	6.5	**0.6**	1.8
Adjustment in respect of prior years	**0.2**	(0.3)	**0.2**	(0.1)
Change in accounting policy – FSCS	**(3.2)**	0.6	**(3.2)**	0.6
Total deferred tax	**(1.4)**	6.8	**(2.4)**	2.3
Total	**30.8**	21.6	**12.2**	10.9

* Comparatives have been restated. Refer to note 1 for further details.

The effective tax rate for the year is 23.3% (2012: 23.7%) for the Group and 22.7% (2012: 17.6%) for the Society. The actual tax charge for the period differs from the UK standard corporation tax rate of 23.25% (2012: 24.5%). The differences are explained below:

	Group 2013 £m	*Group 2012 £m	**Society 2013 £m**	*Society 2012 £m
Profit before tax (PBT)	**132.1**	91.1	**53.8**	61.8
Tax at UK standard rate of corporation tax on PBT of 23.25% (2012: 24.5%)	**30.7**	22.3	**12.5**	15.1
Adjustments in respect of prior years	**(0.1)**	(1.0)	**(0.1)**	(1.8)
Gain on liquidation of Group entities	**-**	-	**-**	(2.3)
Effect of rate change	**0.1**	0.3	**(0.4)**	(0.1)
Expenses not deductible for tax purposes	**0.1**	-	**0.2**	-
Total	**30.8**	21.6	**12.2**	10.9

* Comparatives have been restated. Refer to note 1 for further details.

13. TAXATION (continued)

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

Statement of comprehensive income	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Tax credit on remeasurement of defined benefit pension plan	**(2.0)**	(1.0)	**(2.0)**	(1.0)
Tax credit on Available-for-sale movements	**(0.7)**	(0.8)	**(0.7)**	(0.8)
Tax credit on cash flow hedges	**(2.0)**	-	**(1.7)**	-
Total	**(4.7)**	(1.8)	**(4.4)**	(1.8)

Further information relating to deferred tax is presented in note 22.

14. CASH AND BALANCES WITH THE BANK OF ENGLAND

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Cash and balances with the Bank of England other than mandatory reserve deposits	**2,001.6**	1,793.6	**1,843.2**	1,709.7
Mandatory reserve with the Bank of England	**40.5**	20.6	**40.5**	20.6
Total	**2,042.1**	1,814.2	**1,883.7**	1,730.3

The £1,848.4 million (2012: £1,714.7 million) cash and balances with the Bank of England included in the Group liquidity resources table on page 18 excludes the £40.5 million (2012: £20.6 million) mandatory reserve with the Bank of England and £153.2 million (2012: £78.9 million) of cash held in the Group's covered bond and RMBS programmes as neither of these are available for use in the Group's day-to-day operations.

15. LOANS AND ADVANCES TO CREDIT INSTITUTIONS

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Loans and advances to credit institutions have remaining maturities as follows:				
Accrued interest	**0.1**	0.1	**-**	-
Repayable on demand	**84.2**	203.6	**86.7**	205.3
Other loans and advances by residual maturity repayable				
In not more than three months	**70.0**	95.0	**-**	15.0
In more than three months but not more than one year	**25.0**	25.0	**-**	-
Total	**179.3**	323.7	**86.7**	220.3

The £nil (2012: £15.0 million) loans and advances to credit institutions included in the Group liquidity resources table on page 18 excludes £84.2 million held in collateral accounts with counterparties relating to interest rate swap agreements and sale and repurchase transactions (2012: £203.6 million) and £95.1 million held in the Group's covered bond and RMBS programmes (2012: £105.1 million) as neither of these are available for use in the Group's day-to-day activities.

16. DEBT SECURITIES

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
Available-for-sale:				
UK Government investment securities	**1,333.8**	1,597.7	**1,313.8**	1,597.7
Analysis of transferable debt securities				
Listed	**332.2**	589.4	**332.2**	564.4
Unlisted	**-**	151.1	**-**	151.1
Total	**1,666.0**	2,338.2	**1,646.0**	2,313.2

Movements during the year are analysed below:				
At 1 January	**2,338.2**	2,846.3	**2,313.2**	2,846.3
Additions	**573.3**	3,104.3	**553.3**	3,104.3
Maturities and disposals	**(1,110.5)**	(3,645.6)	**(1,085.5)**	(3,670.6)
Gains from changes in fair value	**(135.0)**	33.2	**(135.0)**	33.2
At 31 December	**1,666.0**	2,338.2	**1,646.0**	2,313.2

A maturity analysis of the Group debt securities is included in the table on page 68. The Society's debt securities are not materially different.

Pledged assets ('Encumbrance') – Sale and repurchase transactions of debt securities

As part of its liquidity management, the Group enters into sale and repurchase agreements, whereby the Group sells but agrees to repurchase assets at a future date, typically up to three months. Both UK Government investment securities and listed transferable debt securities include items which have been sold under sale and repurchase agreements. These assets have not been derecognised, as the Group has retained substantially all the risks and rewards of ownership. The Group is unable to use, sell or pledge the transferred assets for the duration of the transaction and remains exposed to any associated interest rate risk and credit risk of the assets. Proceeds of these sale and repurchase agreements are included within deposits from banks (see note 23).

	Pledged 2013 £m	**Proceeds 2013 £m**	Pledged 2012 £m	Proceeds 2012 £m
Available-for-sale:				
UK Government investment securities	**244.4**	**248.6**	591.1	596.2
Transferable debt securities	**-**	**-**	95.6	80.1
Total	**244.4**	**248.6**	686.7	676.3

The £1,401.6 million (2012: £1,626.5 million) of on-balance sheet debt securities included in the Group liquidity resources table on page 18 excludes £244.4 million of pledged assets (2012: £686.7 million) and £20.0 million in the Group's covered bond and RMBS programmes (2012: £25.0 million) as neither of these are available for use in the Group's day-to-day activities.

Although not included on the statement of financial position, the Group also received FLS Treasury bills with a market value of £1,348.2 million. Subsequently, Treasury bills with a market value of £705.4 million were pledged as part of a sale and repurchase agreement for proceeds of £700.1 million included in deposits from banks (see note 23).

Again, although not included on the statement of financial position, the Group has received UK Government investment securities with a market value of £34.0 million deposited by counterparties under interest rate swap agreements (see note 33).

17. LOANS AND ADVANCES TO CUSTOMERS

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
Residential				
Owner-occupier mortgages	**15,149.2**	14,173.6	**14,230.8**	12,995.5
Buy-to-let mortgages	**8,410.4**	7,166.1	**1,733.0**	1,691.0
Near-prime mortgages	**114.1**	139.9	**7.3**	7.6
Self-certification mortgages	**380.5**	472.3	**184.5**	203.2
Other				
Commercial mortgages	**7.3**	9.9	**1.3**	1.5
Unsecured personal loans	**55.6**	57.1	**38.3**	38.3
Total	**24,117.1**	22,018.9	**16,195.2**	14,937.1

Maturity analysis

The remaining maturity of loans and advances to customers at the statement of financial position date is as follows:

	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
In not more than one year	**1,941.9**	1,784.9	**1,300.7**	1,228.3
In more than one year	**22,202.6**	20,261.6	**14,907.8**	13,724.1
	24,144.5	22,046.5	**16,208.5**	14,952.4
Impairment provision (note 12)	**(27.4)**	(27.6)	**(13.3)**	(15.3)
Total	**24,117.1**	22,018.9	**16,195.2**	14,937.1

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

Pledged assets – Loans and advances to customers

Certain loans and advances to customers have been pledged to the Group's asset backed funding programmes or utilised as whole mortgage loan pools with the Bank of England. The programmes have enabled the Group to obtain secured funding.

Loans and advances to customers pledged to support the programmes and FLS and the nominal value of the notes in issue are as follows:

		Notes in issue			
2013	**Mortgages pledged £m**	**Held by third parties £m**	**Held by the Group drawn £m**	**Held by the Group undrawn £m**	**Total £m**
Loans and advances to customers					
Covered bond programme	**4,320.1**	**1,817.3**	**1,400.0**	**-**	**3,217.3**
Securitisation programme – Leofric No.1 plc	**694.1**	**470.9**	**-**	**78.7**	**549.6**
Securitisation programme – Mercia No.1 plc	**1,535.0**	**-**	**-**	**1,436.4**	**1,436.4**
Whole mortgage loan pools	**3,852.7**	**-**	**408.6**	**3,444.1**	**3,852.7**
Total	**10,401.9**	**2,288.2**	**1,808.6**	**4,959.2**	**9,056.0**

17. LOANS AND ADVANCES TO CUSTOMERS (continued)

2012	Mortgages pledged £m	Notes in issue: Held by third parties £m	Notes in issue: Held by the Group drawn £m	Notes in issue: Held by the Group undrawn £m	Total £m
Loans and advances to customers					
Covered bond programme	4,397.2	1,805.3	-	1,400.0	3,205.3
Securitisation programme – Leofric No.1 plc	1,015.7	735.2	-	122.7	857.9
Securitisation programme – Mercia No.1 plc	1,571.3	-	-	1,436.4	1,436.4
Whole mortgage loan pools	988.4	-	153.3	835.1	988.4
Total	7,972.6	2,540.5	153.3	3,794.2	6,488.0

Mortgages pledged are not derecognised from the Group or Society statements of financial position as the Group has retained substantially all the risk and rewards of ownership. No gain or loss has been recognised on pledging the mortgages to the programmes.

The whole mortgage loan pools are pre-positioned at the Bank of England. Pools are pledged to the Bank of England when drawings are made directly against the eligible collateral, for example under FLS, subject to a 'haircut' as defined by the Bank of England. Therefore, balances shown in the table above under 'Notes in issue' are the outstanding balances of the mortgages.

Notes in issue and held by third parties are included within debt securities in issue (note 24).

Notes in issue, held by the Group and drawn include debt securities issued by the covered bond programme to the Society and whole mortgage loans pledged as collateral.

Notes in issue held by the Group and undrawn are other debt securities issued by the programmes to the Society, and mortgage loan pools that have been pre-positioned at the Bank of England, but not utilised. These are held to provide collateral for potential future use in sale and repurchase agreements or central bank operations.

Notes in issue and held by the Group are not recognised on the Group or Society statements of financial position, thus preventing inappropriate grossing up of the Group and Society statements of financial position.

Covered Bonds

The Group established Coventry Building Society Covered Bonds LLP (LLP) in July 2008, initially in order to provide security for issues of self-issued covered bonds and subsequently for external issuances. As at 31 December 2013 and 2012, the Society had in issue £2,650.0 million and €650.0 million of covered bonds.

Securitisation – Leofric No.1 plc

Leofric No.1 plc (Leofric) was incorporated in November 2011. In May 2012, Leofric issued £933.5 million of listed debt securities secured against certain loans of the Society and its subsidiary Godiva Mortgages Limited, of which £133.5 million was retained by the Group. Under the terms of the Securitisation programme, the nominal amount of the debt securities is paid down to match the payment profile of the mortgages pledged to the programme. As at 31 December 2013, the nominal value of listed debt securities in issue had fallen to £550.1 million of which £78.7 million was held by the Group.

Securitisation – Mercia No.1 plc

Mercia No.1 plc (Mercia) was incorporated in October 2012 and in December 2012 Mercia issued £1,436.4 million of listed debt securities all of which were retained by the Group. As at the 31 December 2013, listed debt securities totalled £1,436.4 million.

17. LOANS AND ADVANCES TO CUSTOMERS (continued)

The fair value of assets that have been pledged and their associated liabilities where recourse is limited to the underlying asset are presented in the table below:

	Fair value assets pledged 2013 £m	**Fair value liabilities 2013 £m**	**Fair value net position 2013 £m**	Fair value assets pledged 2012 £m	Fair value liabilities 2012 £m	Fair value net position 2012 £m
Securitisation programme – Leofric No.1 plc	**694.1**	**560.3**	**133.8**	1,015.4	886.8	128.6

The above table excludes the Mercia securitisation programme as all the notes issued were retained by the Society.

18. INVESTMENTS IN SUBSIDIARY UNDERTAKINGS

	Shares £m	***Loans £m**	***Total £m**
At 1 January 2013	**8.0**	**6,830.5**	**6,838.5**
Additions	**-**	**1,013.8**	**1,013.8**
At 31 December 2013	**8.0**	**7,844.3**	**7,852.3**

* Comparatives have been restated. Refer to note 1 for further details.

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

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

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

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

19. INTANGIBLE ASSETS

Group and Society	Software expenditure 2013 £m	Other intangible assets 2013 £m	Total 2013 £m	Software expenditure 2012 £m	Other intangible assets 2012 £m	Total 2012 £m
Cost						
At 1 January	**13.4**	**-**	**13.4**	12.7	3.0	15.7
Additions	**7.7**	**-**	**7.7**	3.5	-	3.5
Retirements	**(3.0)**	**-**	**(3.0)**	(2.8)	(3.0)	(5.8)
At 31 December	**18.1**	**-**	**18.1**	13.4	-	13.4
Amortisation						
At 1 January	**4.2**	**-**	**4.2**	3.2	3.0	6.2
Charge for the year	**4.7**	**-**	**4.7**	3.8	-	3.8
Amortisation on retirements	**(3.0)**	**-**	**(3.0)**	(2.8)	(3.0)	(5.8)
At 31 December	**5.9**	**-**	**5.9**	4.2	-	4.2
Net book value at 31 December	**12.2**	**-**	**12.2**	9.2	-	9.2

At 1 January 2012, £0.5 million of software expenditure that was fully written down at that date was held outside the Society. Given materiality a separate Society only analysis has not been provided as for 2013 Group and Society are identical and for 2012 the only difference would be an increase to both cost and amortisation by £0.5 million.

20. PROPERTY, PLANT AND EQUIPMENT

	Land and buildings				
Group and Society	**Freehold £m**	**Long leasehold £m**	**Short leasehold £m**	**Equipment, fixtures, fittings and vehicles £m**	**Total £m**
Cost					
At 1 January 2013	**9.3**	**3.9**	**3.4**	**48.1**	**64.7**
Additions	**-**	**-**	**-**	**5.1**	**5.1**
Disposals	**-**	**-**	**-**	**(2.7)**	**(2.7)**
At 31 December 2013	**9.3**	**3.9**	**3.4**	**50.5**	**67.1**
Depreciation					
At 1 January 2013	**1.4**	**0.7**	**2.3**	**29.8**	**34.2**
Charge for the year	**0.1**	**-**	**-**	**5.8**	**5.9**
Depreciation on disposals	**-**	**-**	**-**	**(2.4)**	**(2.4)**
At 31 December 2013	**1.5**	**0.7**	**2.3**	**33.2**	**37.7**
Net book value at 31 December 2013	**7.8**	**3.2**	**1.1**	**17.3**	**29.4**

Disposals relate to assets that were retired during the year.

20. PROPERTY, PLANT AND EQUIPMENT (continued)

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

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

Group and Society	**2013 £m**	2012 £m
Net book value	**1.5**	1.5
Accumulated depreciation	**0.8**	0.6

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

Group and Society	**2013 £m**	2012 £m
At 31 December	**11.6**	11.6

Investment properties

As at 31 December 2013 the Group held investment properties with a cost of £5.6 million and accumulated depreciation of £0.3 million after depreciation charged during the year of £0.1 million (Group 2012: cost £5.6 million, accumulated depreciation £0.2 million, depreciation charge £nil). The Society held investment properties with a cost of £0.4 million and accumulated depreciation of £0.1 million, after depreciation charged during the year of £nil (Society 2012: cost £0.4 million, accumulated depreciation £0.1 million, depreciation charged of £nil).

21. PENSION SCHEME

The Society operates a funded defined benefit and a defined contribution pension scheme.

The Coventry defined benefit scheme (the 'Fund') is administered by a separate trust that is legally separated from the Society. The Fund has been closed to new members since December 2001 and provides benefits based on final pensionable salary but was closed to future service accrual from 31 December 2012. The trustees of the Fund are required to act in the best interest of the plan's beneficiaries. The appointment of the trustees is determined by the plan's trust documentation. It is policy that one third of all trustees should be nominated by the members of the pension fund. As at 31 December 2011, the date of the last full actuarial valuation, 1,867 employees, ex employees and executive directors were members of the Fund.

The Fund is subject to the funding legislation outlined in the Pensions Act 2004 which came into force on 30 December 2005. This, together with documents issued by the Pensions Regulator, and Guidance Notes adopted by the Financial Reporting Council, set out the framework for funding defined benefit occupational pension plans in the UK.

The Fund typically exposes the Society to actuarial risks such as investment risk, interest rate risk, mortality risk and longevity risk. A decrease in corporate bond yields, a rise in inflation or an increase in life expectancy would result in an increase to plan liabilities. This would detrimentally impact the statement of financial position and may give rise to increased charges in future periods. This effect would be partially offset by an increase in the value of the plan's bond and liability matching holdings. Additionally, caps on inflationary increases are in place to protect the plan against extreme inflation.

The Liability Matching Funds (LMFs) are leveraged pooled funds that are used to help manage interest rate and inflation risk. The investment policy of the LMFs can be summarised as follows:

- Each LMF relates to a single named benchmark gilt – the Fund holds units in the 2022, 2027, 2032, 2040, 2050 and 2062 index-linked gilt LMFs.
- The LMFs will principally hold a combination of gilt repos, gilt total return swaps and physical gilts.
- The leverage of each fund will vary with changes in interest rates and inflation. The Fund Manager will follow a recapitalisation process if the leverage in any individual LMF reaches a heightened level and follow a re-leveraging process if the leverage in any individual LMF decreases to a depressed level.
- The Fund Manager aims to limit the exposure to each counterparty to 30% of each LMF's overall exposure.
- The Fund will retain the coupon payments and will use them for leverage management rather than being re-invested in the benchmark gilt. Full proceeds will be distributed upon maturity of the benchmark gilt.

For the purposes of IAS 19 Employee Benefits the actuarial valuation as at 31 December 2011, which was carried out by a qualified independent actuary, has been updated on an approximate basis to 31 December 2013. There have been no changes in the valuation methodology adopted for this period's disclosures compared to the previous period's disclosures.

IAS 19 allows the Society to recognise a surplus as an asset, reflecting the Society's ability to recover a surplus either through reduced contributions in the future or through refunds from the Fund after the last benefit has been paid.

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

I. an investment return pre-retirement of 2.15% (2012: 0.5%) per annum in excess of projected pre-retirement benefit increase; and
II. an investment return post-retirement of 1.15% (2012: 1.5%) per annum in excess of guaranteed pension increases in respect of pensionable service accrued prior to 6 April 2006 and 2.05% (2012: 2.3%) per annum in excess of guaranteed pension increases in respect of pensionable service accrued after 6 April 2006.

21. PENSION SCHEME (continued)

A full actuarial valuation was carried out as at 31 December 2011 in accordance with the scheme funding requirements of the Pensions Act 2004 and the funding of the scheme is agreed between the Society and the trustees in line with those requirements. This actuarial valuation showed a deficit of £21.9 million. The Society has agreed with the trustees that it will aim to eliminate the deficit over a period of five years and four months from 1 April 2013 by the payment of annual contributions of £1.4 million in respect of the deficit plus a one-off contribution of £4.4 million which was paid in March 2013. In addition and in accordance with the actuarial valuation, the Society has agreed with the trustees that it will pay 36.6% of pensionable earnings in respect of accruing benefits and will meet expenses of the plan and levies to the Pension Protection Fund. In 2013 the Society contributed 36.6% (2012: 24.5%) of members' pensionable salaries during the notice period following the decision to close the scheme to future service accrual. The best estimate of contributions to be paid by the Society to the plan in 2014 is £1.4 million.

The present value of plan liabilities is measured by discounting the best estimate of future cash flows to be paid out by the plan using the projected unit credit method. The value calculated in this way is then deducted from the fair value of plan assets and the net surplus is presented in the statement of financial position as shown below:

Group and Society	**2013 £m**	2012 £m
Present value of funded obligation	**(157.7)**	(147.9)
Fair value of plan assets	**162.8**	158.0
Funded status/Pension benefit surplus	**5.1**	10.1

	2013			2012		
	Present value of obligation £m	**Fair value of plan assets £m**	**Total £m**	Present value of obligation £m	Fair value of plan assets £m	Total £m
As at 1 January	**(147.9)**	**158.0**	**10.1**	(142.9)	146.8	3.9
Included within administrative expenses:						
Current service cost	**(0.8)**	**-**	**(0.8)**	(2.3)	-	(2.3)
Interest (expense)/income	**(6.5)**	**6.9**	**0.4**	(6.8)	7.0	0.2
Gain on curtailment*	**-**	**-**	**-**	9.7	-	9.7
	(7.3)	**6.9**	**(0.4)**	0.6	7.0	7.6
Included within other comprehensive income:						
Remeasurements:						
Return on plan assets (excluding amounts in the income statement)	**-**	**(3.5)**	**(3.5)**	-	4.4	4.4
Losses from changes in financial assumptions	**(7.3)**	**-**	**(7.3)**	(9.4)	-	(9.4)
	(7.3)	**(3.5)**	**(10.8)**	(9.4)	4.4	(5.0)
Other contributions and payments:						
Employer contributions	**-**	**6.2**	**6.2**	-	3.6	3.6
Employee contributions	**(0.2)**	**0.2**	**-**	(0.7)	0.7	-
Benefit payments	**5.0**	**(5.0)**	**-**	4.5	(4.5)	-
	4.8	**1.4**	**6.2**	3.8	(0.2)	3.6
As at 31 December	**(157.7)**	**162.8**	**5.1**	(147.9)	158.0	10.1

*A curtailment gain of £9.3 million (net of costs) was recognised in 2012 as an exceptional gain following the closure of the Fund to future service accrual.

21. PENSION SCHEME (continued)

The major categories of plan assets are:	**Plan assets at 31.12.2013 £m**	Plan assets at 31.12.2012 £m
Quoted		
UK Equities	**-**	9.3
Overseas Equities	**-**	17.1
Corporate bonds and liability matching	**99.1**	51.2
Government bonds	**-**	36.7
Diversified growth funds	**27.4**	20.3
Cash	**0.9**	1.2
Unquoted		
Corporate bonds and liability matching	**20.9**	16.6
Property	**14.5**	5.6
Total	**162.8**	158.0

At 31 December 2013, the Coventry Building Society Superannuation Fund held assets totalling £0.7 million invested in Coventry Building Society Permanent Interest Bearing Shares (PIBS) (2012: £0.5 million).

The principal actuarial assumptions used are as follows:

Weighted average assumptions used to determine benefit obligation at	**31.12.2013 %**	31.12.2012 %
Discount rate	**4.55**	4.4
Rate of pensionable salary increase	**2.4**	3.9
Rates of inflation (Retail Price Index)	**3.4**	2.9
Rates of inflation (Consumer Price Index)	**2.4**	2.15

Weighted average assumptions used to determine net pension cost for the year ended	**31.12.2013 %**	31.12.2012 %
Discount rate	**4.4**	4.8
Rate of pensionable salary increase	**3.9**	4.0
Rates of inflation (Retail Price Index)	**2.9**	3.0
Rates of inflation (Consumer Price Index)	**2.15**	2.0

Weighted average life expectancy for mortality tables used to determine benefit obligation at	**31.12.2013**		31.12.2012	
	Male	**Female**	Male	Female
Member age 60 (current life expectancy)	**26.8**	**29.2**	26.8	29.4
Member age 45 (life expectancy at age 60)	**28.3**	**30.7**	28.3	31.0

The assumptions on mortality are determined by the actuarial tables known as S1PXA with CMI 2013 projections with a 1.25% p.a. long-term improvement rate (2012: S1PXA with CMI 2011 projections with a 1.25% p.a. long-term improvement rate).

21. PENSION SCHEME (continued)

The Group has to make assumptions on the discount rate, inflation and life expectancy when valuing the pension fund surplus and changes in these assumptions could affect the reported surplus. The sensitivity of the defined benefit obligation to changes in the weighted principal assumptions is:

Impact on present value of obligation:	**Change in assumption**	**Increase in assumption %**	**Decrease in assumption %**
Discount rate	0.25%	- 4.6	+ 4.9
Rates of inflation (Retail Price Index and Consumer Price Index)	0.25%	+ 4.2	- 3.9
Life expectancy	1 year	+ 2.2	- 2.2

The average duration of the defined benefit obligation at the period ending 31 December 2013 is 20 years.

22. DEFERRED TAX

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

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
Deferred tax assets				
Provisions	**0.4**	0.5	**0.4**	0.5
IFRS transitional fair value adjustments	**0.6**	0.9	**0.5**	0.6
Excess of depreciation over capital allowances	**1.3**	0.9	**1.2**	0.8
Transfer of engagements - fair value adjustments	**4.0**	6.8	**1.8**	3.8
Cash flow hedges	**2.0**	-	**1.7**	-
Total	**8.3**	9.1	**5.6**	5.7
Deferred tax liabilities				
IFRS transitional fair value adjustments	**0.7**	1.0	**0.7**	1.0
Defined benefit pension plan surplus	**1.0**	2.3	**1.0**	2.3
Transfer of engagements - fair value adjustments	**0.3**	0.4	**0.3**	0.4
Change in accounting policy	**-**	3.2	**-**	3.2
Total	**2.0**	6.9	**2.0**	6.9

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

The headline rate of UK corporation tax reduced from 24% to 23% on 1 April 2013, and through the enactment of Finance Act 2013 will reduce further to 21% from 1 April 2014 and 20% from 1 April 2015.

Under IAS 12 deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the statement of financial position date.

Accordingly, as the future reductions of the corporation tax rate to 21% and 20% were enacted on 17 July 2013, the deferred tax balances at 31 December 2013 have been reflected at the tax rates they are expected to be realised or settled.

23. DEPOSITS FROM BANKS

A maturity analysis for the Group's deposits from banks is included in the table on page 68. The Group and Society balances are identical.

As at the 31 December 2013, deposits from banks include £948.7 million (2012: £676.3 million) in respect of sale and repurchase agreements, of which £700.1 million (2012: £nil) relates to off-balance sheet Treasury bills. The carrying value of assets of £244.4 million (2012: £686.7 million) sold under sale and repurchase agreements is included within debt securities (see note 16). The Group held £nil (2012: £1.2 million) of collateral deposited by counterparties under sale and repurchase agreements.

As at 31 December 2013, £16.6 million (2012: £1.2 million) was held by the Group as amounts deposited by counterparties under interest rate swap collateralisation agreements.

24. DEBT SECURITIES IN ISSUE

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
Certificates of Deposit	**13.8**	73.8	**13.8**	73.8
Medium Term Notes	**1,762.8**	1,260.4	**1,762.8**	1,260.4
Covered Bonds	**1,817.3**	1,805.3	**1,817.3**	1,805.3
Residential Mortgage Backed Securities	**470.9**	735.2	**-**	-
Total	**4,064.8**	3,874.7	**3,593.9**	3,139.5

Debt securities in issue are repayable from the statement of financial position date in the ordinary course of business as follows:

Accrued interest	**42.7**	42.0	**41.6**	40.4
Other debt securities in issue with residual maturity repayable:				
In not more than one year	**554.9**	71.2	**554.9**	71.2
In more than one year	**3,467.2**	3,761.5	**2,997.4**	3,027.9
Total	**4,064.8**	3,874.7	**3,593.9**	3,139.5

25. DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are held for risk mitigation purposes although not all derivatives are designated as hedging derivatives under the terms of IAS 39. The table overleaf analyses derivatives between those designated as hedging instruments and those, whilst in economic hedging relationships, are not designated as hedging instruments. Contractual/notional amounts indicate the amount on which payments flows are derived at the statement of financial position date and do not represent amounts at risk.

25. DERIVATIVE FINANCIAL INSTRUMENTS (continued)

Group	2013 Contract/ notional amount £m	2013 Fair value assets £m	2013 Fair value liabilities £m	2012 Contract/ notional amount £m	2012 Fair value assets £m	2012 Fair value liabilities £m
Derivatives designated as fair value hedges						
Interest rate swaps	**12,859.2**	**184.9**	**176.1**	11,414.0	279.3	369.8
Interest rate caps	**140.0**	**-**	**-**	458.0	-	-
Cross currency swaps	**-**	**-**	**-**	975.1	-	41.4
Derivatives designated as cash flow hedges						
Cross currency swaps*	**1,516.2**	**6.3**	**37.5**	-	-	-
Other derivatives						
Interest rate floors	**-**	**-**	**-**	40.0	0.3	-
Total derivatives	**14,515.4**	**191.2**	**213.6**	12,887.1	279.6	411.2
Derivatives have remaining maturities as follows:						
In not more than one year	**4,245.1**	**1.6**	**35.7**	4,404.6	3.7	11.4
In more than one year	**10,270.3**	**189.6**	**177.9**	8,482.5	275.9	399.8
Total derivatives	**14,515.4**	**191.2**	**213.6**	12,887.1	279.6	411.2

*Cash flows are expected to occur over a seven year period in respect of both Group and Society cross currency swaps.

For valuing collateralised derivatives the Group uses discount curves based on overnight indexed swap (OIS) rates, whilst for non-collateralised derivatives discount curves based on term LIBOR rates are used.

Society	2013 Contract/ notional amount £m	2013 Fair value assets £m	2013 Fair value liabilities £m	2012 Contract/ notional amount £m	2012 Fair value assets £m	2012 Fair value liabilities £m
Derivatives designated as fair value hedges						
Interest rate swaps	**12,109.2**	**122.9**	**176.1**	10,664.0	175.7	369.8
Interest rate caps	**140.0**	**-**	**-**	458.0	-	-
Cross currency swaps	**-**	**-**	**-**	405.0	-	4.6
Derivatives designated as cash flow hedges						
Cross currency swaps	**946.1**	**6.3**	**9.3**	-	-	-
Other derivatives						
Interest rate floors	**-**	**-**	**-**	40.0	0.3	-
Interest rate basis swaps	**500.0**	**0.3**	**-**	500.0	1.8	-
Total derivatives	**13,695.3**	**129.5**	**185.4**	12,067.0	177.8	374.4
Derivatives have remaining maturities as follows:						
In not more than one year	**3,675.0**	**1.6**	**7.5**	4,404.6	3.7	11.4
In more than one year	**10,020.3**	**127.9**	**177.9**	7,662.4	174.1	363.0
Total derivatives	**13,695.3**	**129.5**	**185.4**	12,067.0	177.8	374.4

25. DERIVATIVE FINANCIAL INSTRUMENTS (continued)

In addition to the above, the Society also has intra-group interest rate swaps with the subsidiaries that operate the Group's covered bond and RMBS programmes. Under these agreements, the Society receives the interest income of the subsidiaries' mortgage books and pays LIBOR on the same basis as the subsidiaries' interest expense. These swaps have a nominal principal amount of £5,074.5 million (2012: £5,365.9 million) and are accounted for on an accruals basis in accordance with IAS 39, see note 1 for further details.

Critical accounting estimates and judgements

Derivatives are principally valued by discounting cash flow models using yield curves that are based on observable market data or are based on valuations obtained from counterparties. The valuation of caps and floors also takes account of the optionality within these instruments.

The assumptions in these models are periodically reviewed to ensure they remain relevant and aligned with evolving market conventions and this year the following methodology changes have been implemented:

- For collateralised derivatives, the use of OIS rates was implemented in preference to the LIBOR rates that were previously used. This change resulted in a £0.4 million gain in the income statement.
- For cross currency swaps the rates used to discount expected future cash flows have been adjusted to incorporate the effect of changes in cross currency basis spread. This change resulted in a £3.0 million gain in the income statement. To better reflect the economic nature of the arrangement the Group has adopted cash flow hedging for the first time this year.
- Credit and debit valuation adjustments have been applied to all derivative exposures. A credit valuation adjustment (CVA) reflects counterparty credit risk and a debit valuation adjustment (DVA) reflects the impact of the Coventry's own credit quality on derivative fair values. The impact on the income statement was a CVA charge of £0.5 million and a DVA gain of £0.1 million.

26. PROVISIONS FOR LIABILITIES AND CHARGES

Group and Society	***FSCS 2013 £m**	**Other provisions 2013 £m**	**Total 2013 £m**	*FSCS 2012 £m	Other provisions 2012 £m	Total 2012 £m
At 1 January	**8.2**	**1.0**	**9.2**	7.2	1.8	9.0
Charge for the year	**15.4**	**0.9**	**16.3**	7.6	-	7.6
Provisions utilised	**(14.9)**	**(0.7)**	**(15.6)**	(6.6)	(0.8)	(7.4)
At 31 December	**8.7**	**1.2**	**9.9**	8.2	1.0	9.2

* Comparatives have been restated. Refer to note 1 for further details.

FSCS levy provision

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

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

As at 31 December 2013, the Group held a provision of £8.7 million with respect to the estimated FSCS levy for the period 2013/14. The FSCS provision is expected to be utilised in September 2014.

Other provisions

Other provisions have also been recognised in respect of circumstances that may give rise to various customer claims including Payment Protection Insurance (PPI) redress. During the year, the Society raised a £0.9 million provision for PPI. It is expected that the liability will mainly crystallise over the next five years.

The Group has no contingent liabilities to report.

27. SUBORDINATED LIABILITIES

Group and Society	2013 £m	2012 £m
Subordinated liabilities owed to note holders are as follows:		
Fixed rate subordinated notes 2016 - 12.25%	**7.1**	7.0
Fixed rate subordinated notes 2021 - 6.12%	**10.1**	10.1
Fixed rate subordinated notes 2022 - 6.469%	**15.5**	15.5
Fixed rate subordinated notes 2026 - 6.33%	**10.1**	10.1
Fixed rate subordinated notes 2032 - 7.54%	**15.4**	15.4
Total	**58.2**	58.1

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

The rights of repayment of the holders of the notes are subordinated to the claims of all depositors, creditors and members holding shares as to principal and interest.

28. SUBSCRIBED CAPITAL

Group and Society	Call date	2013 £m	2012 £m
Subscribed capital owed to permanent interest holding members is as follows:			
Permanent Interest Bearing Shares 1992 - 12 1/8%	n/a	**41.4**	41.6
Permanent Interest Bearing Shares 2006 - 6.092%	June 2016	**120.1**	119.8
Total		**161.5**	161.4

Interest is paid in arrears on £40 million Permanent Interest Bearing Shares at the rate of 12 1/8% per annum in half-yearly instalments, and on £120 million Permanent Interest Bearing Shares at the rate of 6.092% per annum in half-yearly instalments. The shares are repayable only in the event of a winding up of the Society or otherwise with the prior consent of the PRA. In a winding up or dissolution of the Society the claims of the holders of Permanent Interest Bearing Shares would rank behind all other creditors of the Society including subordinated liabilities and the claims of members holding shares as to principal and interest. The holders of Permanent Interest Bearing Shares are not entitled to any share in any final surplus upon a winding up or final dissolution of the Society.

29. AVAILABLE-FOR-SALE RESERVE

Amounts within the Available-for-sale reserve are transferred to the income statement upon the disposal of debt securities, and where a fair value hedging relationship exists between the debt securities and a derivative instrument.

During the year, £137.6 million loss (2012: £26.1 million gain) was transferred to net gains from derivative financial instruments in the income statement with respect of hedge accounting adjustments to offset the effect of changes in the fair value of derivatives hedging Available-for-sale debt securities. Amounts transferred to interest receivable and similar income totalled £2.8 million gain (2012: £15.1 million gain) in respect of the disposal of Available-for-sale debt securities.

30. FINANCIAL COMMITMENTS

Subject to the satisfaction of previously agreed loan to value ratios, the Group and Society are committed to the following undrawn mortgage loan facilities relating to equity release and flexible mortgage products.

	Group 2013 £m	Group 2012 £m	**Society 2013 £m**	Society 2012 £m
Undrawn mortgage loan facilities	**97.7**	110.5	**75.0**	83.7

In addition, the Society has also agreed but not contractually committed to advance £934.9 million (2012: £779.6 million) in respect of loans and advances to customers.

31. CAPITAL AND LEASING COMMITMENTS

Capital commitments

Group and Society	**2013 £m**	2012 £m
Capital expenditure contracted for but not provided for in the accounts	**1.0**	0.8

Leasing commitments

Future minimum lease payments under non-cancellable operating leases relating to land and buildings were as follows:

Group and Society	**2013 £m**	2012 £m
Amounts falling due:		
Within one year	**3.1**	3.2
Between one and five years	**9.0**	9.6
After five years	**7.3**	9.1
Total	**19.4**	21.9
Lease payments recognised as an expense in the period	**3.7**	3.7

Leasing payments due as lessor

Future minimum sub-leasing payments receivable under non-cancellable subleases were as follows:

Group and Society	**2013 £m**	2012 £m
Within one year	**0.1**	0.1
Between one and five years	**0.3**	0.4
Total	**0.4**	0.5

Future minimum lease payments receivable under non-cancellable leases were as follows:

Group and Society	**2013 £m**	2012 £m
Within one year	**-**	0.1
Total	**-**	0.1

32. 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 at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that 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.

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 and the disaggregation by the fair value hierarchy, and separately those of the Society.

32. FINANCIAL INSTRUMENTS - CLASSIFICATION AND FAIR VALUE MEASUREMENT (continued)

2013 Group	Carrying amount £m	Fair value Level 1 £m	Fair value Level 2 £m	Fair value Level 3 £m	Fair value Total £m
Financial assets					
Cash and balances with the Bank of England	**2,042.1**	**-**	**2,042.1**	**-**	**2,042.1**
Loans and advances to credit institutions	**179.3**	**-**	**179.3**	**-**	**179.3**
Loans and advances to customers	**24,117.1**	**-**	**-**	**23,997.0**	**23,997.0**
Financial liabilities					
Shares	**21,311.7**	**-**	**-**	**21,395.5**	**21,395.5**
Deposits from banks	**1,032.6**	**-**	**1,023.6**	**-**	**1,023.6**
Other deposits	**4.0**	**-**	**4.0**	**-**	**4.0**
Amounts owed to other customers	**337.1**	**-**	**337.3**	**-**	**337.3**
Debt securities in issue	**4,064.8**	**4,273.2**	**13.8**	**-**	**4,287.0**
Subordinated liabilities	**58.2**	**-**	**62.8**	**-**	**62.8**
Subscribed capital	**161.5**	**192.4**	**-**	**-**	**192.4**

2012 Group	Carrying amount £m	Fair value Level 1 £m	Fair value Level 2 £m	Fair value Level 3 £m	Fair value Total £m
Financial assets					
Cash and balances with the Bank of England	1,814.2	-	1,814.2	-	1,814.2
Loans and advances to credit institutions	323.7	-	323.7	-	323.7
Loans and advances to customers	22,018.9	-	-	21,710.8	21,710.8
Financial liabilities					
Shares	20,110.5	-	-	20,140.7	20,140.7
Deposits from banks	715.9	-	715.9	-	715.9
Other deposits	9.5	-	9.5	-	9.5
Amounts owed to other customers	450.0	-	450.0	-	450.0
Debt securities in issue	3,874.7	4,120.4	73.9	-	4,194.3
Subordinated liabilities	58.1	-	61.3	-	61.3
Subscribed capital	161.4	181.1	-	-	181.1

32. FINANCIAL INSTRUMENTS - CLASSIFICATION AND FAIR VALUE MEASUREMENT (continued)

2013 Society	**Carrying amount £m**	**Fair value Level 1 £m**	**Fair value Level 2 £m**	**Fair value Level 3 £m**	**Fair value Total £m**
Financial assets					
Cash and balances with the Bank of England	**1,883.7**	**-**	**1,883.7**	**-**	**1,883.7**
Loans and advances to credit institutions	**86.7**	**-**	**86.7**	**-**	**86.7**
Loans and advances to customers	**16,195.2**	**-**	**-**	**16,092.8**	**16,092.8**
Financial liabilities					
Shares	**21,311.7**	**-**	**-**	**21,395.5**	**21,395.5**
Deposits from banks	**1,032.6**	**-**	**1,023.6**	**-**	**1,023.6**
Other deposits	**4.0**	**-**	**4.0**	**-**	**4.0**
Amounts owed to other customers	**337.1**	**-**	**337.3**	**-**	**337.3**
Debt securities in issue	**3,593.9**	**3,793.0**	**13.8**	**-**	**3,806.8**
Subordinated liabilities	**58.2**	**-**	**62.8**	**-**	**62.8**
Subscribed capital	**161.5**	**192.4**	**-**	**-**	**192.4**

2012 Society	Carrying amount £m	Fair value Level 1 £m	Fair value Level 2 £m	Fair value Level 3 £m	Fair value Total £m
Financial assets					
Cash and balances with the Bank of England	1,730.3	-	1,730.3	-	1,730.3
Loans and advances to credit institutions	220.3	-	220.3	-	220.3
Loans and advances to customers	14,937.1	-	-	14,708.2	14,708.2
Financial liabilities					
Shares	20,110.5	-	-	20,140.7	20,140.7
Deposits from banks	715.9	-	715.9	-	715.9
Other deposits	9.5	-	9.5	-	9.5
Amounts owed to other customers	450.0	-	450.0	-	450.0
Debt securities in issue	3,139.5	3,362.0	73.9	-	3,435.9
Subordinated liabilities	58.1	-	61.3	-	61.3
Subscribed capital	161.4	181.1	-	-	181.1

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. Prudent assumptions are applied regarding expected levels of customer prepayments and the risk of defaults. The resulting estimated future cash flows are discounted at current market rates to determine a fair value. These fair values have been adjusted where necessary to reflect any observable market conditions at the time of valuation.

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

32. FINANCIAL INSTRUMENTS - CLASSIFICATION AND FAIR VALUE MEASUREMENT (continued)

Debt securities in issue, subordinated liabilities and subscribed capital

The estimated fair value of longer dated liabilities are calculated based on quoted market prices where available or using similar issues as a proxy for those liabilities that are not of significant 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.

The following table summarises the fair value of the Group's and Society's financial assets and liabilities measured at fair value on the face of the Group's and Society's statements of financial position and the disaggregation by fair value hierarchy and product type.

2013 Group	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Financial assets				
Derivative financial instruments				
Interest rate swaps	**-**	**184.9**	**-**	**184.9**
Cross currency swaps	**-**	**6.3**	**-**	**6.3**
Total	**-**	**191.2**	**-**	**191.2**
Debt securities				
UK Government investment securities	**1,333.8**	**-**	**-**	**1,333.8**
Analysis of transferable debt securities				
Listed	**332.2**	**-**	**-**	**332.2**
Total	**1,666.0**	**-**	**-**	**1,666.0**
Financial liabilities				
Derivative financial instruments				
Interest rate swaps	**-**	**141.5**	**34.6**	**176.1**
Cross currency swaps	**-**	**37.5**	**-**	**37.5**
Total	**-**	**179.0**	**34.6**	**213.6**

2012 Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments				
Interest rate swaps	-	279.3	-	279.3
Interest rate floors	-	0.3	-	0.3
Total	-	279.6	-	279.6
Debt securities				
UK Government investment securities	1,597.7	-	-	1,597.7
Analysis of transferable debt securities				
Listed	589.4	-	-	589.4
Unlisted	-	151.1	-	151.1
Total	2,187.1	151.1	-	2,338.2
Financial liabilities				
Derivative financial instruments				
Interest rate swaps	-	323.5	46.3	369.8
Cross currency swaps	-	41.4	-	41.4
Total	-	364.9	46.3	411.2

32. FINANCIAL INSTRUMENTS - CLASSIFICATION AND FAIR VALUE MEASUREMENT (continued)

2013 Society	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Financial assets				
Derivative financial instruments				
Interest rate swaps	**-**	**122.9**	**-**	**122.9**
Cross currency swaps	**-**	**6.3**	**-**	**6.3**
Interest rate basis swaps	**-**	**0.3**	**-**	**0.3**
Total	**-**	**129.5**	**-**	**129.5**
Debt securities				
UK Government investment securities	**1,313.8**	**-**	**-**	**1,313.8**
Analysis of transferable debt securities				
Listed	**332.2**	**-**	**-**	**332.2**
Total	**1,646.0**	**-**	**-**	**1,646.0**
Financial liabilities				
Derivative financial instruments				
Interest rate swaps	**-**	**141.5**	**34.6**	**176.1**
Cross currency swaps	**-**	**9.3**	**-**	**9.3**
Total	**-**	**150.8**	**34.6**	**185.4**

2012 Society	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments				
Interest rate swaps	-	175.7	-	175.7
Interest rate floors	-	0.3	-	0.3
Interest rate basis swaps	-	1.8	-	1.8
Total	-	177.8	-	177.8
Debt securities				
UK Government investment securities	1,597.7	-	-	1,597.7
Analysis of transferable debt securities				
Listed	564.4	-	-	564.4
Unlisted	-	151.1	-	151.1
Total	2,162.1	151.1	-	2,313.2
Financial liabilities				
Derivative financial instruments				
Interest rate swaps	-	323.5	46.3	369.8
Cross currency swaps	-	4.6	-	4.6
Total	-	328.1	46.3	374.4

32. FINANCIAL INSTRUMENTS - CLASSIFICATION AND FAIR VALUE MEASUREMENT (continued)

Financial instruments recorded at fair value

The following is a description of the determination of fair value for financial instruments which are recorded at fair value using valuation techniques. These incorporate the Group's estimate of assumptions that a market participant would make when valuing the instruments.

Level 1 - Debt securities - Available-for-sale - Listed

Market prices have been used to determine the fair value of listed debt securities.

Level 2 - Derivatives

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

Level 2 - Debt securities - Available-for-sale - Unlisted

Debt securities valued using a valuation technique with observable market inputs are certificates of deposits. The valuation techniques applied are models using present value calculations. The models incorporate various assumptions including interest rate curves. All inputs are based on observable market inputs.

Level 3 - Derivatives

The items included within Level 3 are balance tracking swaps. These are valued using the same valuation technique as Level 2 derivatives, namely present value calculations based on market interest rate 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. 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 balance sheet impact would be negligible.

The following table analyses movements in the Level 3 portfolio for both the Group and the Society.

Group and Society	**2013 £m**	2012 £m
As at 1 January	**(46.3)**	(45.8)
Gains/(losses) recognised in the income statement		
Interest payable and similar expense	**6.4**	5.7
Net unrealised gains/(losses) from derivative financial instruments	**11.8**	(0.4)
Settlements	**(6.5)**	(5.8)
As at 31 December	**(34.6)**	(46.3)

There have been no transfers between any of the levels during the period. 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 it must instead be valued using a method lower down the hierarchy. Transfers are considered to occur at the end of the reporting period for the purposes of this disclosure.

33. OFFSETTING FINANCIAL ASSETS AND LIABILITIES

The Group and Society does not have any financial assets or financial liabilities that are offset with the net amount presented in the statements of financial position as IAS 32 Financial Instruments – *Presentation* conditions state that there should be both an enforceable right to set off and the intention either to settle on a net basis or to realise the asset and settle the liability simultaneously. Neither of these conditions are met by the Group or the Society.

However, the Group has entered into master netting arrangements such as ISDA master agreements for its derivatives (other than derivatives held by the Coventry Building Society Covered Bonds LLP) and some of its global master sale and repurchase agreements whereby outstanding transactions with the same counterparty can be settled net following a default or other predetermined event. Credit Support Annexes (CSAs) are executed in conjunction with these ISDA master agreements which typically provide for the exchange of collateral on a weekly basis to mitigate net mark to market credit exposure.

The Coventry Building Society Covered Bonds LLP does not enter into a master netting agreement due to the structure of the transaction but a CSA has been entered into which provides for full collateralisation when the counterparty bank credit rating falls below a certain threshold.

The table below shows the net exposure for derivative contracts after netting benefits and collateral and also for sale and repurchase agreements after collateral. The Group does not enter into securities lending or reverse sale and repurchase agreements.

2013 Group	***Gross amounts £m**	**Master netting arrangements £m**	****Financial collateral £m**	**Net amount £m**
Financial assets				
Derivative financial instruments	**191.2**	**(102.8)**	**(46.4)**	**42.0**
Total financial assets	**191.2**	**(102.8)**	**(46.4)**	**42.0**
Financial liabilities				
Derivative financial instruments	**213.6**	**(102.8)**	**(77.2)**	**33.6**
Sale and repurchase agreements	**248.6**	**-**	**(248.6)**	**-**
Total financial liabilities	**462.2**	**(102.8)**	**(325.8)**	**33.6**

2012 Group	*Gross amounts £m	Master netting arrangements £m	**Financial collateral £m	Net amount £m
Financial assets				
Derivative financial instruments	279.6	(166.7)	(1.2)	111.7
Total financial assets	279.6	(166.7)	(1.2)	111.7
Financial liabilities				
Derivative financial instruments	411.2	(166.7)	(203.1)	41.4
Sale and repurchase agreements	676.3	-	(676.3)	-
Total financial liabilities	1,087.5	(166.7)	(879.4)	41.4

* As reported in the statements of financial position.

** The financial collateral disclosed is limited to the amount of the related financial asset or related financial liability.

33. OFFSETTING FINANCIAL ASSETS AND LIABILITIES (continued)

2013 Society	***Gross amounts £m**	**Master netting arrangements £m**	****Financial collateral £m**	**Net amount £m**
Financial assets				
Derivative financial instruments	**129.5**	**(102.8)**	**(15.5)**	**11.2**
Total financial assets	**129.5**	**(102.8)**	**(15.5)**	**11.2**
Financial liabilities				
Derivative financial instruments	**185.4**	**(102.8)**	**(77.2)**	**5.4**
Sale and repurchase agreements	**248.6**	**-**	**(248.6)**	**-**
Total financial liabilities	**434.0**	**(102.8)**	**(325.8)**	**5.4**

2012 Society	*Gross amounts £m	Master netting arrangements £m	**Financial collateral £m	Net amount £m
Financial assets				
Derivative financial instruments	177.8	(166.7)	(1.2)	9.9
Total financial assets	177.8	(166.7)	(1.2)	9.9
Financial liabilities				
Derivative financial instruments	374.4	(166.7)	(203.1)	4.6
Sale and repurchase agreements	676.3	-	(676.3)	-
Total financial liabilities	1,050.7	(166.7)	(879.4)	4.6

* As reported on the statement of financial position.

** The financial collateral disclosed is limited to the amount of the related financial asset or related financial liability.

For derivative financial assets, collateral received is in the form of both cash and UK Government investment securities. Where cash is received it is included as a liability within deposits from banks (see note 23). Where UK Government investment securities are received, these are not recognised on the statement of financial position, as the Group does not obtain the risks and rewards of ownership (see note 16).

For derivative financial liabilities, collateral paid is in the form of cash and is included as an asset in loans and advances to credit institutions (see note 15).

For sale and repurchase agreements, collateral provided is predominantly in UK Government investment securities with some in cash. Again, cash paid is included as an asset in loans and advances to credit institutions (see note 15). UK Government investment securities are not derecognised as the Group has retained, substantially all the risks and rewards of ownership (see note 16).

34. CAPITAL MANAGEMENT

As at 31 December 2013, and throughout the year, the Group complied in full with the capital requirements that were in force. Further information on the Group's capital resources and capital management can be found on pages 23 to 27 and pages 75 to 76.

35. RELATED PARTY TRANSACTIONS

The Group is controlled by Coventry Building Society registered in England and Wales, which is also considered to be the ultimate parent.

	Group Undertakings		Key Management	
	2013 £m	***2012 £m	**2013 £m**	2012 £m
Loans payable to the Society				
Loans outstanding as at 1 January	**6,830.5**	5,270.1	**1.1**	1.2
Loans issued during the year	**1,013.8**	1,846.1	**-**	-
Repayments during the year*	**-**	(285.7)	**(0.8)**	(0.1)
Loans outstanding as at 31 December	**7,844.3**	6,830.5	**0.3**	1.1
Deposits payable by the Society				
Deposits outstanding at 1 January	**356.6**	-	**2.1**	2.9
Deposits received during the year**	**-**	356.6	**1.6**	1.0
Repayments during the year*	**(105.7)**	-	**(1.3)**	(1.8)
Deposits outstanding at 31 December	**250.9**	356.6	**2.4**	2.1
Net interest income/(expense)				
Interest receivable	**277.9**	249.8	**-**	-
Interest payable	**(7.0)**	(7.7)	**(0.1)**	(0.1)
Total	**270.9**	242.1	**(0.1)**	(0.1)
Other income and expenses				
Dividends received by the Society	**-**	9.4	**-**	-
Fees and expenses paid to the Society	**6.0**	4.6	**-**	-

*Includes existing loans and deposits for key management on retirement.
**Includes existing deposits for key management on appointment.
***Comparatives have been restated. Refer to note 1 for further details.

Interest on outstanding loans and deposits accrues at a transfer price rate agreed between the Society and its subsidiaries.

Deposits payable by the Society to Group undertakings relate to amounts owing to the Society's SPEs, in accordance with the accounting policy set out in note 1 of the accounts. These intercompany balances have been presented within other liabilities on the statement of financial position.

Transactions with key management personnel

Transactions with key management personnel are on the same terms and conditions applicable to members and other employees within the Group. The directors are considered to be the only 'key management' for the purposes of the related party transactions disclosures under IAS 24. Key management personnel also incorporate non-executive directors. No director has any interest in the shares or debentures of any connected undertaking of the Society.

During the year, David Stewart entered into an agreement in relation to his decision to resign his position as Chief Executive. Further details are provided in the Directors' Remuneration Report (page 81).

35. RELATED PARTY TRANSACTIONS (continued)

In accordance with Section 68 of the Building Societies Act 1986, the Society maintains a register of loans falling within Section 65 made to directors and connected persons. A statement containing requisite particulars of such transactions may be inspected by members at the Society's AGM or at the Principal Office of the Society during the period 15 days prior to the AGM.

Transactions with related undertakings

Transactions are entered into with related parties in the normal course of business. These include loans, deposits and the payment and recharge of interest and administrative expenses. During the year, the Society made an investment of £3.5 million in loan notes issued by Arkose Funding Limited.

ANNUAL BUSINESS STATEMENT

For year ended 31 December 2013

1. STATUTORY PERCENTAGES

	2013 %	Statutory limits %
Lending limit	**1.3**	25.0
Funding limit	**20.4**	50.0

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986 as amended by the Building Societies Act 1997.

The lending limit measures the proportion of the business assets not in the form of loans fully secured on residential property and is calculated as (X-Y)/X where:

X=business assets, being the total assets of the Group plus loan impairment less liquid assets, intangible assets and property, plant and equipment. The value of X used is the value at 31 December 2013.

Y=the principal value of, and interest accrued on, loans owed to the Group which are fully secured on residential property. The value of Y used is the value at 31 December 2013.

The funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals and is calculated as (X-Y)/X where:

X=shares and borrowings, being the aggregate of:

I. the principal value of, and interest accrued on, shares in the Society
II. the principal value of, and interest accrued on, the amounts deposited with the Society or any subsidiary undertaking, by banks, credit institutions and other customers; and
III. the principal value of, and interest accrued on, the amounts of debt securities of the Society or any subsidiary undertaking.

The value of X used is the value at 31 December 2013.

Y=the principal value of, and interest accrued on, shares in the Society held by individuals other than bare trustees (or, in Scotland, simple trustees) for bodies corporate or for persons that include bodies corporate. The value of Y used is the value at 31 December 2013.

2. OTHER PERCENTAGES

	2013 %	2012 %
As a percentage of shares and borrowings:		
Gross capital	**4.17**	4.10
Free capital	**4.05**	3.97
Liquid assets	**14.5**	17.8
As a percentage of mean total assets:		
Profit for the financial year	**0.37**	0.27
Management expenses	**0.39**	0.38

The above percentages have been calculated from the Group accounts. The 2012 gross capital, free capital and profit for the financial year percentages have been restated for the prior year adjustment for change in accounting policy in respect of IFRIC 21 Levies (see note 1 for further details).

'Shares and borrowings' represents the total of shares, deposits from banks, other deposits, amounts owed to other customers and debt securities in issue.

'Gross capital' represents the aggregate of reserves, subordinated liabilities and subscribed capital.

'Free capital' represents the aggregate of gross capital and collective impairment less intangible assets and property, plant and equipment.

'Liquid assets' represent the total of cash and balances with the Bank of England, loans and advances to credit institutions, debt securities and other liquid assets.

'Mean total assets' represent the average of the 2013 and 2012 total assets (2012: average of the 2012 and 2011 total assets).

'Management expenses' represent the aggregate of administrative expenses, amortisation of intangible assets and depreciation of property, plant and equipment.

ANNUAL BUSINESS STATEMENT

(continued)

3. INFORMATION RELATING TO DIRECTORS AND OTHER OFFICERS

Part 1 - Directors

Name (Date of birth)	Occupation	Other directorships and appointments	Date of appointment as a director of the Society
Ian Pickering, MA (Cantab), FCA (16.10.1955)	Company Director	Electrocab Limited Latchways PLC (resigned 25.02.2014)	01.09.2005
Janet Ashdown, BSc (Hons) (05.07.1959)	Company Director	SIG plc Essar Oil (UK) Limited	18.09.2013
Peter Ayliffe, BA (Hons), FCIBS, CMgr (05.03.1953)	Company Director	Chartered Management Institute Monitise Plc	01.05.2013
Feike Brouwers, MSc, MBA (12.10.1967)	Building Society Chief Risk Officer	None	24.04.2013
Bridget Blow (02.06.1949)	Company Director	Birmingham Hippodrome Limited Birmingham Hippodrome Theatre Trust Limited Bridget Blow Consulting Limited City of Birmingham Symphony Orchestra Kensington Green (Management) Limited	01.02.2007
Roger Burnell, BSc, FCA (08.04.1950)	Company Director	Clarence Mansions Management Company Limited Thomas Cook Group plc (resigned 20.02.2014)	01.09.2008
Colin Franklin, FCIB (15.06.1955)	Building Society Sales & Marketing Director	Godiva Mortgages Limited Five Valleys Property Company Limited ITL Mortgages Limited	07.07.2009
Peter Frost, BA (Hons) (27.10.1965)	Building Society Chief Operating Officer	None	01.11.2012
Ian Geden, BSc (Hons), FCII (08.07.1953)	Company Director	The Police Mutual Assurance Society Limited Faraday Underwriting Limited Syndicate 435 Faraday Reinsurance Limited	01.09.2008
John Lowe, BA (Oxon), ACA (26.10.1972)	Building Society Finance Director	Godiva Mortgages Limited Coventry Financial Services Limited Coventry Property Services Limited Godiva Financial Services Limited Godiva Housing Developments Limited Godiva Savings Limited Godiva Securities and Investments Limited Five Valleys Property Company Limited Coventry Building Society Covered Bonds LLP ITL Mortgages Limited Arkose Funding Limited	14.10.2010

3. INFORMATION RELATING TO DIRECTORS AND OTHER OFFICERS (continued)

Part 1 - Directors (continued)

Name (Date of birth)	Occupation	Other directorships and appointments	Date of appointment as a director of the Society
Glyn Smith, MA (Cantab), FCA (15.09.1952)	Company Director	Covent Garden Market Authority Examiner - ICAEW	22.09.2010
David Stewart, BA, ACA (18.08.1965)	Building Society Chief Executive	Godiva Mortgages Limited Coventry Financial Services Limited Coventry Property Services Limited Godiva Financial Services Limited Godiva Housing Developments Limited Godiva Savings Limited Godiva Securities and Investments Limited Coventry Building Society Covered Bonds LLP ITL Mortgages Limited Member of the Council of the Building Societies Association Member of the Council of Mortgage Lenders Chairman's Committee Member of the Council of Mortgage Lenders Executive Committee	11.02.2002

Documents may be served on the above named directors at:

Coventry Building Society, C/O Ernst & Young LLP, 1 More London Place, London SE1 2AF.

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

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

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

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

In 2013 the Society appointed Feike Brouwers (Chief Risk Officer) to the Board. A service contract has been entered into which is terminable by Feike Brouwers on six months' notice and by the Society on one year's notice.

ANNUAL BUSINESS STATEMENT

(continued)

3. INFORMATION RELATING TO DIRECTORS AND OTHER OFFICERS (continued)

Part 2 - The Secretary

Name	Occupation	Directorships
Thomas Crane, MA	General Counsel and Secretary	Clanbrassil Ventures Limited

Part 3 - Senior management team

Name	Occupation	Directorships
Julian Atkins, BSc, MBA, FCIPD, FCIB	Head of Human Resources	Coventry and Warwickshire Chambers of Commerce Training Limited. National Financial Services Skills Academy
Rachel Haworth, BA, MCIM	Head of Customer Experience	None
Darin Landon	Head of Distribution and Marketing	Trustee of the Coventry Building Society Staff Superannuation Fund
Siobhan Moynihan, BSc (Hons), ACA	Head of Internal Audit	None
Steve A Oerton, BA	Head of Business Systems	None

4. PRINCIPAL OFFICE

Coventry Building Society is a building society, incorporated and domiciled in the United Kingdom. The address of the principal office is: Economic House, PO Box 9, High Street, Coventry CV1 5QN.

GLOSSARY

The following glossary defines terminology within the Annual Report & Accounts to assist the reader and to facilitate comparison with publications by other institutions:

Arrears	The financial value of unpaid obligations, which arise when contractual payments are not paid as they fall due.
Available-for-sale reserve (AFS)	The Available-for-sale reserve contains unrealised gains and losses arising from changes in the fair values of non-derivative financial assets that are categorised as Available-for-sale.
Average loan to value (LTV)	The 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 LTV'
Basel II	The recommendations on banking regulation made by the Basel Committee on Banking Supervision, and implemented in the EU via the Capital Requirements Directive II, which came into force on 1 January 2007. The Basel II framework introduced the concept of three 'pillars' for regulation. Pillar 1 sets out the minimum capital requirements for firms, and under Pillar 2 firms will take a view of whether additional capital is required for risks not covered in Pillar 1. Pillar 3 improves market information by requiring firms to publish details of risks and capital management.
Basel III	The Basel Committee on Banking Supervision issued strengthened proposals in response to the recent financial crisis, which are referred to as Basel III. These standards will be implemented in the EU via CRD IV, which came into force on 1 January 2014.
Basis point	One hundredth of a percent (0.01 percent). 100 basis points is one percent. Used when quoting movements in interest rates and yields on securities.
BIPRU	The Prudential sourcebook for Banks, Building Societies and Investment Firms, which sets out detailed prudential requirements applicable to the Society. This has largely been superseded by CRD IV.
Business risk	Business risk is the risk arising from changes to the business model and also the risk of the business model or strategy proving inappropriate due to macroeconomic, geopolitical, regulatory or other factors.
Buy-to-let (BTL) mortgage	A mortgage secured on a residential property that is rented out to tenants.
Capital requirements	Amount to be held by the Group to cover the risk of losses set by regulators and firms 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 resources	Capital comprising the general reserve, Permanent Interest Bearing Shares (PIBS), subordinated debt and collectively assessed impairment allowances, less all required regulatory adjustments. Under Basel II the PIBS and subordinated debt were allowable as capital resources for regulatory purposes, and the Available-for-sale (AFS) reserve was excluded. Under CRD IV PIBs and subordinated debt do not meet the requirements for capital reserves and so their eligibility for capital requirements is adjusted by transitional rules, furthermore the AFS reserve is included in capital resources.
Certificates of Deposit	Bearer-negotiable instruments issued on the receipt of a fixed term deposit at a specified interest rate.
Code Staff	A group of employees to which the PRA's Remuneration Code applies. Code staff consist of executive directors, non-executive directors and certain senior managers in control functions (e.g. audit, risk and compliance) who could have a material impact on the firm's risk profile.

GLOSSARY

(continued)

Common Equity Tier 1 capital (CET1)	Common Equity Tier 1 capital comprises general reserves and the negative balance on the Available-for-sale reserve, less intangible assets, pension surplus and other regulatory deductions.
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 Tier 1 capital	Core Tier 1 capital comprises general reserves, less intangible assets, pension surplus and other regulatory deductions.
Core Tier 1 ratio	Core Tier 1 capital as a percentage of risk-weighted assets.
Council of Mortgage Lenders (CML)	A trade association for the residential mortgage lending industry.
Covered bonds	Debt securities 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 risk	Credit risk is the risk that borrowers or counterparties do not meet their financial obligations to the Society as they fall due.
Credit valuation adjustment (CVA)	The difference between the risk free value of a derivative and the market value which takes into account the counterparty's credit risk. The CVA therefore represents an estimate of the change in fair value that a market participant would make, to incorporate the credit risk inherent in counterparty derivative exposures.
Currency swap	An arrangement in which two parties exchange equivalent principal amounts of different currencies at inception and subsequently exchange interest payments on the principal amounts. At the maturity of the swap, the principal amounts are re-exchanged at the original rates, protecting the participants from changes in exchange rates.
Debit valuation adjustment (DVA)	The difference between the risk free value of a derivative and the market value which takes into account the Society's credit risk. The DVA therefore represents an estimate of the change in fair value that a market participant would make, in order to incorporate the credit risk of the Society.
Debt securities	Transferable instruments creating or acknowledging indebtedness. They include bonds, certificates of deposit and loan notes. The holder of a debt security is typically entitled to the payment of principal and interest, together with other contractual rights under the terms of the issue. Debt securities are generally issued for a fixed term and redeemable by the issuer at the end of that term. Debt securities can be secured on other assets or unsecured.
Debt securities in issue	Transferable certificates of indebtedness of the Group to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit.
Deferred tax asset/(liability)	Corporation tax recoverable (or payable) in future periods resulting from temporary or timing differences, between the accounting value of assets and liabilities and the tax base of those assets and liabilities.
Defined benefit obligation	The present value of expected future payments required to settle the obligations of a defined benefit pension plan resulting from past employee service.
Defined benefit plan	Pension or other post-retirement benefit plan offering guaranteed benefits usually as a fraction of the final salary.
Defined contribution plan	Pension or other post-retirement benefit plan where the employer's obligation is limited to its contributions to the fund.
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.

Enhanced Disclosure Task Force (EDTF)	Body established by the Financial Stability Board with a remit to broaden and deepen the risk disclosures of financial institutions in a number of areas of risk management.
Effective interest rate (EIR)	The effective interest rate is the rate of interest income or expense that produces a level yield, either to maturity or to the next re-pricing date, equivalent to the projected cash flows on an instrument.
Effective tax rate	The tax charge in the income statement as a percentage of profit before tax.
Encumbered assets	Assets used to secure third party 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.
Eurozone	An economic and monetary union (EMU) of EU member states that have adopted the euro (€) as their common currency and sole legal tender.
Expected loss (EL)	A Basel II and Basel III calculation under the IRB approach to estimate the potential losses on current exposures due to expected defaults over a one year time period.
Exposure	The maximum loss that a financial institution might suffer if a borrower or wholesale counterparty fails to meet their obligations.
Fair value	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 at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date.
Final salary pension arrangements	A defined benefit pension arrangement where the pension payable is based on the employee's final pensionable salary.
Financial Conduct Authority (FCA)	A statutory body responsible for the conduct of business regulation and supervision of UK financial institutions in the UK from 1 April 2013.
Financial Ombudsman Service (FOS)	Financial Ombudsman Service provides an independent and impartial service to resolve individual complaints that consumers and financial institutions have been unable to settle themselves.
Financial Services Authority (FSA)	Financial Services Authority (UK) was an independent non-governmental supervisory body superseded by the PRA and the FCA on 1 April 2013.
Financial Services Compensation Scheme (FSCS)	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every deposit taking firm authorised by the PRA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.
Financial Stability Board (FSB)	Body established at the international level to coordinate the work of national financial authorities and international standard setting bodies to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies in the interest of financial stability.
Fitch Ratings	Fitch Ratings is 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 is made on the contractual terms of a loan in response to the borrower's financial difficulties.
Foreign currency risk	The risk of loss arising as a result of movements in exchange rates on investments or obligations in foreign currencies.
Free capital	The aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers, less; property, plant and equipment, non-current assets held for sale and intangible assets.

GLOSSARY

(continued)

Funding for Lending Scheme (FLS)	An initiative by the Bank of England and HM Treasury to incentivise banks and building societies to boost their lending to UK households and small and medium sized enterprises, by providing funding to banks and building societies for an extended period.
General reserve	The general reserve is the accumulation of historic and current year profits and includes remeasurements of the defined benefit pension plan (net of tax).
Gilts	Gilts is the name given to long-term fixed income debt securities (bonds) issued by the UK Government.
Gross capital	The aggregate of equity, subscribed capital and subordinated liabilities.
Gross mortgage lending	The total of mortgage lending advanced during the year.
IFRIC	International Financial Reporting Interpretations Committee. IFRIC interpret the application of IASs and IFRSs and provide timely guidance on financial reporting issues not specifically addressed in IASs and IFRSs, in the context of the International Accounting Standards Board framework.
IFRS/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 more than three months in arrears or in possession. However other indicators of impairment may result in provisioning for losses.
Impairment losses	The reduction in value that arises following an impairment review of an asset that determines that the recoverable amount is less than its carrying value.
Impairment provision	Provisions held against assets on the statement of financial position. The provisions represent management's best estimate of losses incurred in the loan portfolio at the statement of financial position date.
Indexed LTV (Loan to value)	Loan to value (see opposite) calculated on the basis of the latest property valuation being adjusted by the relevant house price index movement since that date.
Individual Capital Guidance (ICG)	Guidance from the PRA on the levels of capital to be held by the Society to meet its minimum regulatory capital requirements.
Individual Liquidity Adequacy Assessment (ILAA)	The Society's own assessment of the liquidity resources 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.
Individual liquidity guidance (ILG)	Guidance from the PRA on a company's required quantity of liquidity resources and funding profile.
Individual/collectively assessed loan impairment provisions	Impairment is measured specifically for assets that are individually identified as being impaired at the statement of financial position date, and collectively for homogenous asset classes where there is evidence of impairment event(s) but these have not yet manifested themselves as individually identified impaired accounts.
Interest rate risk	Interest rate risk arises from the different interest rate characteristics of the Society's mortgages and savings products and from other financial instruments. The Society is subject to the risk that changes in interest rates will cause material variations in earnings because of different interest rates charged for the mortgages and paid for the funding that comprise the bulk of the balance sheet.
Interest rate swap	A contract under which two counterparties agree to exchange periodic interest payments based on a predetermined notional principal amount.
Internal capital adequacy assessment process (ICAAP)	The Society's own assessment of the amount of capital that it needs to hold in respect of its regulatory requirements (for credit, market and operational risks) and for other risks. This assessment includes determination of a capital buffer to be held in case of potential economic stress.

Internal ratings-based approach (IRB)	An advanced approach to measuring capital requirements in respect of credit risk under Pillar 1 of Basel II and Basel III. 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	The ratio of Tier 1 capital (see page 149) to total exposures. Where total exposures include on and off-balance sheet items (after netting derivatives).
LIBOR	London Inter-Bank Offer Rate. The interest rate at which banks can borrow funds from other banks. The LIBOR is derived from a filtered average of the interbank deposit rates for large loans with maturities between overnight and one full year. Administration of LIBOR rates has recently been transferred from the BBA to the ICE Benchmark Administration Ltd.
Liquid assets	An amount as defined by The Building Societies (Accounts and Related Provisions) Regulations 1998. This comprises cash in hand, balances with the Bank of England, debt securities (including gilts), loans to credit institutions and other liquid assets.
Liquid assets buffer (LAB)	The liquid assets that the PRA currently allow in their liquidity measures, which shall be replaced by LCR liquid assets from 1 January 2015.
Liquidity and funding risk	Liquidity risk is the risk the Society has insufficient funds to meet its obligations as and when they fall due. Funding risk is the inability to access funding markets or to only do so at excessive cost and/or liquidity risk.
Liquidity coverage ratio (LCR)	A measure brought in as part of Basel III 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 80% will apply to the Society from 1 January 2015.
Liquidity resources	Assets held in order to manage liquidity risk. Liquidity resources comprises cash and balances with the Bank of England, UK Government Securities and multi-lateral development banks, other securities and bank deposits and self issued covered bonds, RMBS and Bank of England approved mortgage portfolios.
Loan to value (LTV)	LTV is the amount of mortgage loan as a percentage of the value of the property.
Management expenses	The aggregate of administrative expenses, depreciation and amortisation.
Market risk	Market risk is the risk that the value of income derived from the Society's assets and liabilities may change adversely as a result of changes in interest rates or foreign exchange rates.
Medium term notes (MTN)	Securities offered by a company to investors, through a dealer, across a range of maturity periods.
Member	A person who has a share investment or a mortgage loan with the Society.
Moody's Investor Services	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 (MBS)	Asset backed securities that represent interests in a group of mortgages which give the investor the right to cash received from future mortgage payments of both principal and interest.
Near-prime	Loans to borrowers with marginally weakened credit histories such as County Court Judgements (CCJ) or default less than or equal to £1,000 or with one missed mortgage payment in the last 12 months.
Net interest income	The difference between interest receivable on assets and similar income and interest paid on liabilities and similar charges.
Net interest margin	Net interest income as a percentage of average total assets.
Net stable funding ratio (NSFR)	A ratio which assesses the amount of stable, long-term funding sources (customer deposits and long-term wholesale funding), as a proportion of the Society's less liquid funding requirements. A minimum requirement for the NSFR is due to be set by 1 Jan 2018.

Operational risk	Operational risk is the risk of loss arising from inadequate internal processes, systems, people, or from external events.
Overnight indexed swap (OIS) rate	A rate reflecting the overnight interest earned or paid in respect of overnight interbank loans, being typically SONIA for sterling loans. OIS is used to value collateralised interest rate derivatives.
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.
Past due	A financial asset such as a loan is past due when the counterparty has failed to make a payment when contractually due.
Pension fund surplus	The assets in a pension fund that are in excess of its liabilities.
Permanent Interest Bearing Shares (PIBS)	Unsecured, perpetual deferred shares of the Society offering a fixed coupon. These are a form of Tier 1 capital under Basel II. PIBS rank behind the claims of all subordinated debt holders, depositors, or creditors of the Society. PIBS are also known as subscribed capital. Under Basel III PIBS are included as Tier 1 under transitional rules only.
Prudential Regulation Authority (PRA)	The statutory body responsible for the prudential supervision of banks, building societies, insurers and a small number of significant investment firms in the UK from 1 April 2013. The PRA is a subsidiary of the Bank of England.
PV200	Present Value 200. A calculation of the theoretical change in the net present value (NPV) of financial instruments for a 200 basis point (2%) parallel shift in interest rates.
Redenomination risk	The risk that in the event that the euro ceases to be traded or a particular country leaves the euro, previously matched foreign exchange positions, designated in euros, become unmatched when these are exchanged for an alternative currency (valued against a local currency equivalent).
Residential mortgage backed securitisation (RMBS)	Asset backed securities that represent interests in a group of residential mortgages which give the investor the right to cash received from future mortgage payments of both principal and interest.
Retail deposits	See Shares.
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 (RWA)	The value of assets, after adjustment to reflect the degree of risk they represent in accordance with the relevant rules under Basel II and Basel III.
Sale and repurchase agreement (repo)	An agreement to sell a financial security together with a commitment by the seller to repurchase the asset at a specified price on a given date. In substance this forms a secured loan, with the difference between the purchase price and repurchase price being the interest rate.
Securitisation	A pool of loans used to back the issuance of new securities. The loans are transferred to a special purpose entity (SPE) which then issues securities (RMBS) backed by the assets. The Society has used retail mortgages as the loan pool for securitisation purposes.
Senior unsecured funding	Bonds issued by corporate bodies and financial institutions, which are not secured by any collateral and are not subordinated to any other liabilities of the issuer.
Shares	Funds deposited by a person in a retail savings account with the Society. Such funds are recorded as liabilities of the Society.
Shares and borrowings	The total of shares, deposits from banks, other deposits, amounts due to customers and debt securities in issue.

Special purpose entities (SPEs)	Entities that are created to accomplish a narrow and well defined objective. The Group uses SPEs to facilitate securitisation and covered bond programmes. Where the Group has control of these entities or retains risks and rewards relating to them they are consolidated within the Group results.
Standardised approach	The basic method used to calculate capital requirements for credit risk under Basel II and Basel III. In this approach the risk weighting used in the capital calculation are determined by specified percentages.
Stress testing	Various techniques that are used to gauge the potential vulnerability of the Society to stressed conditions.
Subordinated liabilities	Liabilities which, in the event of insolvency or liquidation of the issuer, are subordinated to the claims of depositors and other creditors of the issuer.
Subscribed capital	See Permanent Interest Bearing Shares (PIBS).
Tier 1 capital	A component of regulatory capital comprising Core Tier 1 capital (Common Equity Tier 1 under CRD IV) and Permanent Interest Bearing Shares (PIBS). Common Equity Tier 1 must absorb losses on a going concern basis but only contains PIBS under transitional rules.
Tier 2 capital	A component of regulatory capital comprising qualifying subordinated debt and eligible collective impairment allowances, less certain regulatory deductions.
Trading book	A regulatory classification consisting of positions in financial instruments or commodities held by a bank with intention to trade. The Society does not have a trading book.
UK Corporate Governance Code (the Code)	The Code (formerly known as the Combined Code), issued by the Financial Reporting Council and last updated in September 2012, that sets out standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders.
Underlying profit	The purpose of this measure is to reflect management's view of the Group's underlying performance with like-for-like comparisons of performance across years without distortion of one-off volatility and items that are not reflective of the Group's ongoing business activities.
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.

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Coventry Building Society. Principal Office: Economic House, PO Box 9, High Street, Coventry CV1 5QN.