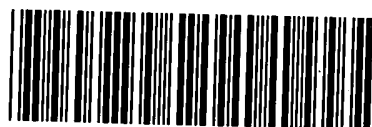


# Coventry Building Society Covered Bonds LLP

Registered number OC337802

Members Reports and Financial Statements  
for the year ended  
31 December 2017

TUESDAY



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COMPANIES HOUSE

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### Designated Members

Coventry Building Society  
Coventry Covered Bonds Finance Limited

### Auditor

Ernst & Young LLP  
1 Bridgewater Place  
Leeds  
LS11 5QR

### Registered Office

Oakfield House  
Binley Business Park  
Coventry  
CV3 2TQ

### Registered Number

OC337802  
Registered in England and Wales

## MEMBERS' REPORT

The Members present their report with financial statements of Coventry Building Society Covered Bonds LLP (the 'LLP'), for the year ended 31 December 2017.

These financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the European Union.

## PRINCIPAL ACTIVITY AND REVIEW OF THE YEAR

The LLP is a structured entity incorporated under the Limited Liability Partnerships Act 2000 and governed in accordance with the transaction documents and provisions of the Limited Liability Partnership Deed dated 17 July 2008 (the 'LLP Deed'). The LLP guarantees the covered bonds issued by Coventry Building Society (the Society) by acquiring mortgage loans and their related security pursuant to the terms of the Mortgage Sale Agreement dated 17 July 2008 when trading commenced. No change in principal activity is envisaged or occurred during the year.

The LLP operates in the United Kingdom.

The LLP has acquired mortgage loan portfolios originated by the Society, one of the designated members of the LLP. These acquisitions were funded by loans from the Society which amounted to £3.7 billion at 31 December 2017. In accordance with IAS 39, these mortgage loans have been recognised as a deemed loan asset in the LLP as the transfer fails the derecognition criteria in the Originator's accounts. This deemed loan to the Society is supported by the collateral received from the Society of £4.9 billion with respect to the acquired mortgage loans and non cash collateral, for more information see note 7.

The loans from the Society were linked to the following covered bond issuances by the Society:

- July 2008 - £1,500 million (£900 million as at 31 December 2017, following a part repayment of £600 million in 2011).
- November 2008 - £500 million.
- April 2011 - £750 million.
- November 2014 - €500 million.
- March 2015 - £650 million (includes £150 million extension in December 2015).
- January 2017 - €500 million.

The new €500 million covered bond was issued in January 2017 and this resulted in an increase to the deemed loan as mortgages were subsequently pledged to the programme.

## RISK MANAGEMENT

Full disclosure of the LLP's risk management policies, use of financial instruments and risk exposures is given in note 14 to the financial statements.

The covered bond transaction documents set out a number of trigger events which represent the main business risks for the LLP as their occurrence may lead to early repayment of the covered bonds. No such trigger events have occurred since the programme started.

## PROGRAMME PERFORMANCE

The programme performance is monitored monthly for financial and non-financial indicators including covenants and limits for managing risks. Information is then provided in a monthly investor report available from the Society's website ([www.thecoventry.co.uk/consumer/our-performance/treasury-services.html](http://www.thecoventry.co.uk/consumer/our-performance/treasury-services.html)).

The level of over-collateralisation is central to the contractual mechanics and to credit rating agency oversight. The level of over-collateralisation is calculated using the Asset Coverage Test (ACT) which is carried out each month.

## DESIGNATED MEMBERS

The designated members during the year and subsequently were as follows:

- Coventry Building Society; and
- Coventry Covered Bonds Finance Limited.

## MEMBERS' REPORT (CONTINUED)

### MEMBERS' INTERESTS

The policy regarding the allocation of excess income to members and the treatment of capital contributions is set out within the accounting policies in note 1 to the financial statements.

### GOING CONCERN

The members are satisfied that the LLP will have sufficient liquid resources available to meet its obligations as they fall due.

On the basis of their assessment of the LLP's financial position and performance, the members have a reasonable expectation that the LLP will be able to continue in business for the next 12 months. For this reason, they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

### MEMBERS' RESPONSIBILITIES STATEMENT

The members are responsible for preparing the financial statements in accordance with company law as applied to limited liability partnerships by the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008.

The members are responsible for preparing financial statements for each financial year which give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of affairs of the LLP and of the results of the LLP for that year. In preparing those financial statements, the members are required to:

- select suitable accounting policies and apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- state whether applicable accounting standards have been followed; and
- prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the LLP will continue in business.

The members confirm that they have complied with the above requirements in preparing the financial statements.

The members are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the LLP and enable them to ensure that the financial statements comply with the Companies Act 2006 as applied to limited liability partnerships by The Limited Liability Partnerships (Accounts and Audit) (Application of the Companies Act 2006) Regulations 2008. They are also responsible for safeguarding the assets of the LLP and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

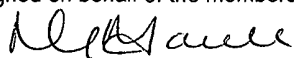
Each designated member of the LLP at the date of this report confirms that:

- so far as the designated member is aware, there is no relevant audit information of which the LLP auditor is unaware; and
- each designated member has taken all the relevant steps that ought to have been taken as a designated member, in order to become aware of any relevant audit information and to establish that the LLP's auditor is aware of that information.

### INDEPENDENT AUDITOR

In accordance with the Limited Liabilities Partnerships Act and Companies Act 2006, a resolution for the re-appointment of Ernst & Young LLP as auditor of the LLP will be proposed at the forthcoming Annual Members' Meeting.

Signed on behalf of the members:



Michele Faull  
For and on behalf of  
Coventry Building Society  
Designated member  
29 March 2018

## **INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF COVENTRY BUILDING SOCIETY COVERED BONDS LIMITED LIABILITY PARTNERSHIP ('LLP')**

**Independent auditor's report to the members of Coventry Building Society Covered Bonds Limited Liability Partnership ('LLP')**

### **Opinion**

We have audited the financial statements of Coventry Building Society Covered Bonds LLP for the year ended 31 December 2017 which comprise the Income Statement, Statement of Other Comprehensive Income, Balance Sheet, Statement of Changes in Members' Interests, Statement of Cash Flows and the related notes 1 to 18, including a summary of significant accounting policies. 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.

In our opinion the financial statements:

- give a true and fair view of the state of the limited liability partnership's affairs as at 31 December 2017 and of its results for the year then ended;
- have been properly prepared in accordance with IFRS as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 as applied to limited liability partnerships.

### **Basis for opinion**

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the limited liability partnership in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### **Use of our report**

This report is made solely to the members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006 as applied to Limited Liability Partnerships. Our audit work has been undertaken so that we might state to the 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 limited liability partnership and the limited liability partnership's members as a body, for our audit work, for this report, or for the opinions we have formed.

### **Conclusions relating to going concern**

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the members use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the members have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the limited liability partnership's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

### **Matters on which we are required to report by exception**

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 as applied to limited liability partnerships requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- we have not received all the information and explanations we require for our audit.

## **INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF COVENTRY BUILDING SOCIETY COVERED BONDS LIMITED LIABILITY PARTNERSHIP ('LLP') (CONTINUED)**

### **Responsibilities of members**

As explained more fully in the Members' Responsibilities Statement set out on page 3, the members are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the members determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the members are responsible for assessing the partnership's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the members either intend to liquidate the partnership or to cease operations, or have no realistic alternative but to do so.

### **Auditor's responsibilities for the audit of the financial statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at <https://www.frc.org.uk/auditorsresponsibilities>. This description forms part of our auditor's report.



Steven Robb (Senior statutory auditor)  
for and on behalf of Ernst & Young LLP, Statutory Auditor  
Leeds

29 March 2018

**INCOME STATEMENT**  
**FOR THE YEAR ENDED 31 DECEMBER 2017**

	Notes	2017 £000	2016 £000
Interest receivable and similar income	3	39,211	32,872
Interest payable and similar charges	4	(40,714)	(33,691)
Net gains from derivatives and hedge accounting	5	1,543	871
Total income		40	52
Administrative expenses	6	(40)	(52)
<b>Results for the financial year available for distribution to members</b>		-	-

The results for the year arise from the continuing operations of the business.

**STATEMENT OF OTHER COMPREHENSIVE INCOME**  
**FOR THE YEAR ENDED 31 DECEMBER 2017**

	2017 £000	2016 £000
<b>Results for the financial year</b>	-	-
<b>Other comprehensive income</b>		
Available-for-sale investments:		
Fair value movements taken to reserves	(1)	2
Cash flow hedges:		
Fair value movements taken to reserves	18,342	69,546
Amount transferred to Income Statement	(32,051)	(59,403)
<b>Total comprehensive income</b>	<b>(13,710)</b>	<b>10,145</b>

The results for the year arise from the continuing operations of the business.

The accounting policies and notes on pages 10 to 21 form part of these financial statements.

# **BALANCE SHEET**

AS AT 31 DECEMBER 2017

REGISTRATION NO: OC337802

	Notes	31 Dec 2017 £000	31 Dec 2016 £000
<b>Assets</b>			
Loans and other debts due from members	7	3,530,685	3,108,871
Cash		132,488	141,509
Debt securities	8	29,988	-
Derivative financial instruments	9	92,567	100,081
<b>Total assets</b>		<b>3,785,728</b>	<b>3,350,461</b>
<b>Liabilities</b>			
Loans from LLP members	10	3,711,174	3,250,274
Deposits from credit institutions	11	58,719	49,784
Hedge accounting adjustment		5,557	25,923
Derivative financial instruments	9	1,266	1,874
Other debts due to members	12	5,038	4,922
<b>Total liabilities</b>		<b>3,781,754</b>	<b>3,332,777</b>
<b>Members' other interests</b>			
Available-for-sale reserve	8	(1)	-
Cash flow hedge reserve		3,975	17,684
<b>Total members' other interests</b>		<b>3,974</b>	<b>17,684</b>
<b>Total members' other interests and liabilities</b>		<b>3,785,728</b>	<b>3,350,461</b>
<b>Members' interests</b>			
Members' other interests		3,974	17,684
Loans from LLP members		3,711,174	3,250,274
Other debts due to members		5,038	4,922
Loans and other debts due from members		(3,530,685)	(3,108,871)
<b>Total members' interests</b>		<b>189,501</b>	<b>164,009</b>

The accounting policies and notes on pages 10 to 21 form part of these financial statements.

The financial statements were approved by the members on 29 March 2018.

Signed on behalf of the members



Michele Faul  
For and on behalf of  
Coventry Building Society  
Designated member



**STATEMENT OF CHANGES IN MEMBERS' INTERESTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2017**  
**REGISTRATION NO: OC337802**

	Available-for-sale reserve £000	Cash flow hedge reserve £000	Loans from members £000	Total £000
<b>As at 1 January 2017</b>	-	17,684	146,325	164,009
Net movement in Available-for-sale reserve	(1)	-	-	(1)
Net movement in cash flow hedge reserve	-	(13,709)	-	(13,709)
Loans from LLP members	-	-	460,900	460,900
Other debts due to members	-	-	116	116
Loans and other debts due from members	-	-	(421,814)	(421,814)
<b>As at 31 December 2017</b>	<b>(1)</b>	<b>3,975</b>	<b>185,527</b>	<b>189,501</b>

	Available-for-sale reserve £000	Cash flow hedge reserve £000	Loans from members £000	Total £000
<b>As at 1 January 2016</b>	(2)	7,541	89,200	96,739
Net movement in Available-for-sale reserve	2	-	-	2
Net movement in cash flow hedge reserve	-	10,143	-	10,143
Loans from LLP members	-	-	59,382	59,382
Other debts due to members	-	-	197	197
Loans and other debts due from members	-	-	(2,454)	(2,454)
<b>As at 31 December 2016</b>	-	17,684	146,325	164,009

The accounting policies and notes on pages 10 to 21 form part of these financial statements.

**STATEMENT OF CASH FLOWS**  
**FOR THE YEAR ENDED 31 DECEMBER 2017**

	2017 £000	2016 £000
<b>Results for the financial year available for distribution to members</b>	-	-
Adjustments for:		
Non-cash items included in results for the financial year:		
Change in derivatives, hedge accounting and foreign exchange	2,926	(773)
Change in accrued interest on derivatives	(2,262)	(200)
Change in accrued interest on loans due from LLP members	2,288	(117)
Other non-cash movements	-	2
Change in operating assets		
Debt securities	(29,989)	73,959
Change in operating liabilities		
Deposits from credit institutions	8,935	49,784
Other debts due to members	116	197
<b>Net cash flows from operating activities</b>	<b>(17,986)</b>	<b>122,852</b>
<b>Cash flows from investing activities</b>		
Change in loans due from members	8,965	(2,454)
<b>Net cash flows from investing activities</b>	<b>8,965</b>	<b>(2,454)</b>
<b>Net (decrease)/increase in cash</b>	<b>(9,021)</b>	<b>120,398</b>
<b>Cash and cash equivalents at start of year</b>	<b>141,509</b>	<b>21,111</b>
<b>Cash and cash equivalents</b>	<b>132,488</b>	<b>141,509</b>
<b>Operational cash flows from interest</b>		
Interest paid	29,800	34,332
Interest received	41,528	34,348

The accounting policies and notes on pages 10 to 21 form part of these financial statements.

## NOTES TO THE ACCOUNTS

### 1 ACCOUNTING POLICIES

The following accounting policies have been applied consistently in dealing with items that were considered material in relation to the financial statements.

#### BASIS OF PREPARATION

The LLP financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC), in accordance with the requirements of the Companies Act 2006, as applied to limited liability partnerships by The Limited Liability Partnerships (Accounts and Audit) (Application of the Companies Act 2006) Regulations 2008, applicable to partnerships reporting under IFRS.

The financial statements have been prepared on a historical cost basis as modified by the revaluation of derivative financial instruments and associated fair value hedge adjustments and are presented in sterling thousand (£000) except where otherwise indicated.

The going concern basis has been used in preparing these financial statements.

#### CHANGES IN ACCOUNTING POLICY

There were no new or amended standards and interpretations that had a significant impact on the preparation of the 2017 financial statements other than IAS 7 *Statement of Cash Flows*. An additional movement analysis is included in note 10 to meet IAS 7 requirements.

#### FUTURE ACCOUNTING DEVELOPMENTS

##### IFRS 9 Financial Instruments

IFRS 9 replaces IAS 39 Financial Instruments: Recognition and Measurement and will be implemented in the financial statements for the year beginning 1 January 2018. It has not been applied in preparing these financial statements. The standard requires changes to the classification and measurement of financial assets and liabilities, the recognition of impairment, and also to hedge accounting. The LLP does not currently plan to adopt the changes to hedge accounting until the International Accounting Standards Board finalises its revised approach to macro hedge accounting.

The LLP will not restate comparatives on the initial adoption of IFRS 9 and will provide detailed transitional disclosures in the 2018 financial statements.

IFRS 9 replaces the existing IAS 39 incurred loss approach to calculating impairment with an expected loss approach, resulting in earlier recognition of credit losses. IFRS 9 requires the LLP to categorise its financial assets, principally its deemed loan to Originator (deemed loan), into three stages at the Balance Sheet date. This will be determined by the performance of the mortgages against which the deemed loan is ultimately secured. The assets that are performing are shown in stage 1, assets where there has been a significant increase in credit risk since inception in stage 2 and accounts which are in default in stage 3. The LLP will then be required to recognise a 12 month expected credit loss allowance on all stage 1 assets and a lifetime expected credit loss allowance on all stage 2 and stage 3 assets.

The assessment of whether a significant increase in credit risk has occurred is a key aspect of the IFRS 9 methodology and involves quantitative measures such as forward looking probabilities of default that are derived from reasonable and supportable forecasts (scenarios) of future economic conditions, as well as other qualitative factors, and therefore requires significant management judgement. The stage 2 assessment is also supported by an objective 'back stop' measure of arrears.

These changes are expected to have a negligible impact on the Company's Balance Sheet due to the high credit quality of the underlying mortgages which support the deemed loan. In addition, the Company is insulated from credit loss as a result of the excess proceeds that are available to make good any defaults by customers.

Further information regarding the IFRS 9 transition is included in the Coventry Building Society Annual Report & Accounts.

## NOTES TO THE ACCOUNTS (CONTINUED)

### 1 ACCOUNTING POLICIES (CONTINUED)

#### LOANS AND OTHER DEBTS DUE FROM MEMBERS

Under International Accounting Standard 39 *Financial Instruments: Recognition and Measurement* (IAS 39), where a transfer of a financial asset does not qualify for derecognition by the transferor (the Society), the transferee (the LLP) does not recognise the transferred asset as its own. The Society derecognises the cash and other consideration paid and recognises a deemed loan from the LLP. In respect of the transferred mortgage portfolio, derecognition is considered inappropriate for the Society's own financial statements as the Society has retained substantially all the risks and rewards of ownership of that financial asset.

The deemed loan to the Society is included in 'loans and other debts due from members' on the LLP's Balance Sheet. The initial amount of the deemed loan to members corresponds to the consideration paid by the LLP for the mortgage loans. The LLP recognises principal and interest cash flows from the underlying pool of mortgage loans only to the extent that it is entitled to retain such cash flows. Cash flows attributable to the members are not recognised by the LLP.

To manage interest rate risk the LLP has entered into derivative transactions with the Society, paying a rate of interest based on the underlying mortgages and receiving 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 by the Society or recognised by the LLP. Cash flows arising from these internal derivatives are accounted for on an accruals basis. All other derivatives are treated as explained in the Derivative Financial Instruments and Hedge Accounting policies.

#### CONTRIBUTIONS

Under the terms of the transaction documents for the sale of the mortgage loans, including the LLP Deed, the Society is legally treated as having made a capital contribution to the LLP in an amount equal to the difference between the current balance of the loans sold at transfer date and the cash payment made by the LLP for the loans and relevant security on that transfer date (the over-collateralisation).

The LLP does not recognise either the contributed non-cash assets or the related liability. This reflects the nature of the contributed assets as non-cash collateral.

The Society, as a member of the LLP, may also make cash capital contributions from time to time. These cash contributions are included as part of 'Loans and other debts due from members'.

Capital distributions may only be made in accordance with the LLP Deed where sufficient principal receipts are available and higher priority payments in accordance with the transaction documents have been made.

#### DEFERRED PURCHASE CONSIDERATION

Under the terms of the Mortgage Sale Agreement, the Society, as the originator of the mortgage loans, retains the right to receive the excess income (deferred consideration) arising on those loans, after all other payments have been made by the LLP. On application of IFRS, deferred consideration is treated as a deduction against mortgage interest income so a net amount is shown as income on the deemed loan.

#### INTEREST RECEIVABLE AND INTEREST PAYABLE

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

## NOTES TO THE ACCOUNTS (CONTINUED)

### 1 ACCOUNTING POLICIES (CONTINUED)

#### TAXATION INCLUDING DEFERRED TAXATION

Taxation on all partnership profits is solely the liability of members. Consequently, neither taxation nor related deferred taxation in the LLP are accounted for in these financial statements.

#### DERIVATIVE FINANCIAL INSTRUMENTS

As noted under 'Loans and other debts due from members – derecognition', the LLP holds derivative financial instruments to hedge interest rate risk associated with the beneficial interest on the mortgage portfolio. 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 by the Society or recognised by the LLP.

The LLP holds other derivative financial instruments for the purposes of managing the risks associated with its fixed and floating rate liabilities and its foreign currency transactions. These 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. For collateralised positions the LLP uses discount curves based on overnight indexed swap (OIS) rates and for non-collateralised positions the LLP uses discount curves based on term LIBOR rates. In measuring fair value, separate adjustments are made for credit risk to the extent not already included in the valuation.

#### HEDGE ACCOUNTING

All derivatives entered into by the LLP are for the purpose of providing an economic hedge and where the documentation, eligibility and testing criteria set out in IAS 39 are met, the LLP 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 qualify as fair value hedges are recorded in the Income Statement under net losses from derivatives and hedge accounting in the period in which the movement occurs together with the change in fair value of the hedged asset or liability that is attributable to the hedged risk (interest rate risk). This also applies if the hedged item is classified as an Available-for-sale financial asset.

##### *Cash flow hedges*

Gains and losses on derivative financial instruments hedging the variability in cash flows of a designated asset or liability are recognised directly through the Statement of Comprehensive Income in the Cash Flow Hedge Reserve. The relevant portion of the gain or loss on the hedging instrument is recognised in the Income Statement immediately to the extent that the hedge is deemed ineffective under IAS 39. Any amounts deferred to the Cash Flow Hedge Reserve are subsequently recycled to the Income Statement when the underlying asset or liability being hedged impacts the Income Statement, for example when foreign exchange movements occur.

#### FOREIGN CURRENCY TRANSLATION

The financial statements are presented in pounds sterling, the LLP's functional currency. 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 Balance Sheet date. Foreign exchange gains and losses resulting from the retranslation and settlement are recognised in the Income Statement.

## NOTES TO THE ACCOUNTS (CONTINUED)

### 1 ACCOUNTING POLICIES (CONTINUED)

#### IMPAIRMENT OF FINANCIAL ASSETS

At each Balance Sheet date, the LLP assesses whether, as a result of one or more events occurring after initial recognition, there is objective evidence that a financial asset has become impaired.

In respect of the deemed loan due from members, a charge for impairment would be recognised where there is a risk that the income and capital on the deemed loan would be insufficient to meet the liabilities of the LLP. This could occur if the credit quality of the mortgage assets that are pledged as collateral for the loan significantly deteriorated. Taking into account the credit enhancements provided, and in particular the over-collateralisation of the LLP, the members currently consider that no provision for impairment is required.

#### DEBT SECURITIES

Debt securities are non-derivative financial assets and are accounted for as Available-for-sale assets.

Available-for-sale assets are initially measured and subsequently carried 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 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.

#### DEPOSITS FROM CREDIT INSTITUTIONS

Deposits from credit institutions are measured on an amortised cost basis. The amortisation is recognised in 'Interest payable and similar charges' using the effective interest rate method.

Deposits from credit institutions are derecognised when the obligation is discharged cancelled or have expired.

#### CASH AND CASH EQUIVALENTS

Cash and cash equivalents in the Statement of Cash Flows comprise balances with less than three months' maturity from the date of acquisition, including cash and loans and advances to credit institutions.

### 2 SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

The preparation of the financial statements in accordance with IFRSs as adopted by the European Union requires the use of certain critical judgements and estimates. The areas involving judgement and estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under current or normal operating circumstances.

In the process of applying the LLP's accounting policies, the designated members have made the following judgements and estimates that may have a significant effect on the amounts recognised in the financial statements.

## NOTES TO THE ACCOUNTS (CONTINUED)

### 2 SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES (CONTINUED)

#### Deemed loan to Originator - derecognition

As the Originator has retained substantially all the significant risks and rewards of ownership of the mortgage portfolio, derecognition is considered to be inappropriate for the Originator's own financial statements, and therefore, the mortgage portfolio remains on the Balance Sheet of the Originator.

Judgement is required in assessing whether risks or rewards of ownership of the mortgage portfolio have transferred. The factors considered in arriving at the conclusion that risk and rewards were not transferred include that the Originator continues to retain the right to receive excess income arising on the securitised mortgages (deferred consideration) after certain priority payments have been met by the LLP. Furthermore, the Originator and the LLP entered into a derivative transaction which returns substantially all the interest on the securitised mortgages to the Originator in exchange for the payment of a floating rate to the LLP.

### 3 INTEREST RECEIVABLE AND SIMILAR INCOME

	2017 £000	2016 £000
Interest receivable from members	37,933	35,891
Foreign currency gain/(loss)	1,148	(3,295)
Interest and other income on other liquid assets	124	154
Bank and other interest receivable	6	122
<b>Total</b>	<b>39,211</b>	<b>32,872</b>

### 4 INTEREST PAYABLE AND SIMILAR CHARGES

	2017 £000	2016 £000
Interest expense on loans from members	82,514	115,444
Net expense on derivatives hedging liabilities	(25,803)	(19,138)
Foreign currency gain	(15,997)	(62,615)
<b>Total</b>	<b>40,714</b>	<b>33,691</b>

### 5 NET GAINS/(LOSSES) FROM DERIVATIVES AND HEDGE ACCOUNTING

	2017 £000	2016 £000
(Losses) from derivatives designated as fair value hedges	(20,414)	(8,259)
Movement in fair value of hedged items attributable to hedged risk	20,366	8,389
	(48)	130
Gains on derivatives designated as cash flow hedges*	998	139
Gains on other derivatives	593	602
<b>Total</b>	<b>1,543</b>	<b>871</b>

\* Represents ineffectiveness on cash flow hedge relationships which will mature over a period of seven years.

### 6 ADMINISTRATIVE EXPENSES

	2017 £000	2016 £000
Servicer and cash management fee	4	4
Other	36	48
<b>Total</b>	<b>40</b>	<b>52</b>

The LLP employed no staff during the year (2016: nil). The Society acts as servicer of the mortgage portfolio and cash manager.

The audit fee of £9,785 (2016: £9,500) is borne by the Society on behalf of the LLP.

## NOTES TO THE ACCOUNTS (CONTINUED)

### 7 LOANS AND OTHER DEBTS DUE FROM MEMBERS

Loans and other debts due from members of £3,530.7 million (2016: £3,108.9 million) represents a deemed loan from the Society, generated as a result of the transferred beneficial interest in the mortgage portfolio failing the derecognition criteria in the Society, as described by IAS 39. The beneficial interest in mortgages of £4,855.4 million (2016: £4,837.9 million) reflects the transfer of the mortgage portfolio legally held by the LLP. The difference between the amount of the beneficial interest in mortgages and the loan due from members (see table below) represents non-cash collateral not recognised in the Balance Sheet (see accounting policy note 1 'Contributions').

	2017 £000	2016 £000
Beneficial interest in mortgages	3,530,685	3,108,871
Beneficial interest in mortgages – non-cash collateral	1,324,715	1,729,049
<b>Total</b>	<b>4,855,400</b>	<b>4,837,920</b>

### 8 DEBT SECURITIES

	2017 £000	2016 £000
Listed transferable debt securities	29,988	-

All debt securities have remaining maturities of less than one year. Negative amounts recognised in the Available-for-sale reserve in respect of changes in the fair value of debt securities amounted to negative £1,000 (2016: £nil).

### 9 DERIVATIVE FINANCIAL INSTRUMENTS

	2017 Contract/ notional amount £000	2017 Fair value assets £000	2017 Fair value liabilities £000	2016 Contract/ notional amount £000	2016 Fair value assets £000	2016 Fair value liabilities £000
Derivatives designated as fair value hedges						
Interest rate swaps*	750,000	30,658	-	750,000	50,907	-
Derivatives designated as cash flow hedges						
Cross currency swaps**	822,300	61,909	-	394,300	49,174	-
Other derivatives						
Interest rate basis swaps***	650,000	-	1,266	650,000	-	1,874
<b>Total</b>	<b>2,222,300</b>	<b>92,567</b>	<b>1,266</b>	<b>1,794,300</b>	<b>100,081</b>	<b>1,874</b>

\*The remaining swap has a maturity of less than one year.

\*\*Cash flows expected to occur over a period of three and seven years.

\*\*\*The £650 million interest rate swap has a maturity over a period of two and three years.

In addition to the above, the LLP also holds two interest rate swap agreements with the Society to hedge interest rate risk associated with the beneficial interest on the mortgage portfolio. These derivatives are not fair valued, as under IAS 39 they are accounted for as part of the loan included in 'Loans and other debts due from members'. Under these agreements, the LLP pays a blended rate of interest based on the mortgage portfolios in which it retains a beneficial interest and receives one month LIBOR on one of the swaps and a fixed 1.7625% on the other. As at the year end, the notional swap principal on the former swap amount totalled £4,523.7 million (2016: £4,307.2 million) and an additional £428.0 million (2016: £nil) in relation to the new cross currency swap.



## NOTES TO THE ACCOUNTS (CONTINUED)

### 10 LOANS FROM LLP MEMBERS

The amount owing to members is to the Society and is equivalent to the amounts issued by the Society under its Covered Bonds Programme, as follows:

		2017 £000	2016 £000
1m LIBOR plus 0.5%	Due 2022* (GBP 1.5bn, 0.6bn part repayment in 2011)	900,122	900,075
1m LIBOR plus 0.5%	Due 2022** (GBP 0.5bn)	500,068	500,042
Fixed 4.625%	Due 2018 (GBP 0.75bn)	774,424	774,424
3m LIBOR plus	Due 2020 (GBP 0.65bn)	650,203	650,155
Fixed 0.625%	Due 2021 (EUR 0.5bn)	444,112	425,578
Fixed 0.5%	Due 2024 (EUR 0.5bn)	442,245	-
<b>Total</b>		<b>3,711,174</b>	<b>3,250,274</b>

\*With the consent of Bondholders the final maturity date was extended from 25 July 2016 to 24 July 2022.

\*\* With the consent of Bondholders the final maturity date was extended from 24 November 2016 to 24 November 2022.

The change in loans from LLP members arises as follows:

	2017 £000
Balance at 1 January	3,250,274
Cash flows	430,838
Foreign exchange movements	27,107
Change in accrued interest	2,195
Amortisation	760
<b>Balance at 31 December</b>	<b>3,711,174</b>

The Society will not be relying upon repayment of any term advance by the LLP or the interest thereon in order to meet its repayment or interest obligations under the Covered Bonds Programme. The term advances will not be repaid by the LLP until all amounts payable under the covered bonds have been repaid in full. Amounts owed by the LLP to the Society are subordinate to amounts owed by the LLP under the Covered Bond Guarantee.

### 11 DEPOSITS FROM CREDIT INSTITUTION

The deposits from credit institutions are in respect of collateral deposited by counterparties under a cross currency swap collateralisation agreements.

### 12 OTHER DEBTS DUE TO MEMBERS

All of the other debts due to members fall due within one year.

### 13 RELATED PARTIES

#### Ownership structure of Coventry Building Society Covered Bonds LLP

The members of the LLP are Coventry Building Society, the controlling party under IAS 24 *Related Party Disclosures*, and Coventry Covered Bonds Finance Limited.

#### Key management personnel

The Management Committee (comprise of directors and employees of the Coventry Building Society) manage and conduct the business of the LLP and have a majority of the rights, power and authority to act at all times for and on behalf of the LLP in accordance with the terms of the LLP Deed and transaction documents.

No transactions were entered into with key management personnel. A number of transactions are entered into with the members in the normal course of business. Details of these transactions can be found in the notes to these financial statements.

## NOTES TO THE ACCOUNTS (CONTINUED)

### 14 RISK MANAGEMENT

#### Overview

Financial instruments incorporate the vast majority of the LLP's assets and liabilities and the LLP's activities expose it to a variety of financial risks including interest rate risk, credit risk, foreign currency and liquidity risk.

The LLP's exposure to risk arising from the LLP's financial instruments and the management of such was determined at the initial set up of the LLP. The LLP's activities and the role of each party to the transaction is clearly defined and documented.

Following initial set up, the Management Committee monitors the LLP's performance regularly. Such review is designed to ensure that the terms of the transaction documents have been complied with, no unforeseen losses have arisen and that interest and principal on the term loans are capable of being paid on a timely basis. This is supported by the Society's central risk management function. Details of the Society's centralised risk management framework are available in the Society's Annual Report & Accounts.

#### Interest rate risk

Interest rate risk arises from the interest rate mismatch between fixed and variable rates on the securitised mortgages and the floating interest rate payable on the issued notes.

The LLP is exposed to interest rate risk in that its interest expense is at both floating and fixed rates, denominated in sterling and euros, in respect of loans from LLP members, whilst its interest income originates from its beneficial interest in a pool of the Society's mortgages at fixed and floating rates and denominated in sterling only.

The LLP hedges its exposure to both fixed and floating interest rate risk through entering into derivative transactions with the Society and external counterparties. Through a combination of basis, interest rate and cross currency swaps, the LLP is able to swap the interest receivable from its beneficial interest in the pool of mortgages and the interest payable on its loan liabilities such that the resulting cash flows are matched. As a result of these swaps, the LLP's total interest income and expense is economically hedged and it therefore has no material sensitivity to changes in interest rates. Both the interest rate and cross currency swaps with external parties are utilised for hedge accounting.

As the LLP does not invest its reserves by reference to a fixed rate maturity profile, and employs hedging techniques referred to above, it has no requirement to use sensitivity testing to analyse interest rate risk.

#### Foreign currency risk

Foreign currency risk mainly arises as a result of raising funds.

As the LLP prepares its financial statements in sterling these will be affected by movements in the currency exchange rate. The LLP hedges the exposure on its euro currency borrowings back to sterling by the use of a cross currency derivative and it therefore does not have a material economic exposure to foreign currency exchange gains and losses. Accordingly, it does not separately monitor value at risk arising from open foreign currency positions.

#### Operational risk

Operational risk is the risk of a loss arising from inadequate internal processes, systems or people, or from external events. In accordance with the transaction documents, the Company's operations are outsourced to third parties. The Society has been appointed to act as Servicer and Cash Manager on behalf of the Company. Intertrust Management Limited has been appointed to provide services in accordance with the terms of a Corporate Service Agreement.

## NOTES TO THE ACCOUNTS (CONTINUED)

### 14 RISK MANAGEMENT (CONTINUED)

#### Credit risk

Credit risk is the risk that the borrowers or counterparties do not meet their financial obligations to the Company as they fall due.

'Loans and other debts due from members' are secured under the Covered Bond covenants, whereby retail mortgages may be transferred to the LLP, depending on changes in the Society's credit rating. Details of the credit risk attached to the Society's retail mortgages are contained in the Society's Annual Report and Accounts.

For the LLP, credit risk is additionally mitigated by the over-collateralisation of the beneficial interest in mortgages and by eligibility for selection under the Covered Bond covenants. Subsequent to selection, credit risk is mitigated through the application of a monthly asset coverage test. Details of the eligibility criteria and asset coverage test are listed in the Coventry Building Society Global Covered Bond Programme Prospectus dated 17 July 2008. The extent of the over-collateralisation is disclosed in note 7.

The LLP also has credit risk exposures with its swap counterparties. The swap counterparties are both internal to the Society as well as external. The LLP has a low risk appetite for wholesale credit risk. As such, exposures are restricted to good quality counterparties with a low risk of failure. Exposures are reviewed continuously to ensure that they remain within the approved limits and ongoing developments with treasury counterparties are closely monitored by the Treasury Credit Committee.

Risk with such swap counterparties is managed via the depositing of cash and other collateral, dependent upon credit agency ratings and the net position of derivatives. Further information on derivative exposures and collateral is included in note 16.

#### Liquidity risk

Liquidity risk is the risk that the LLP has insufficient funds to meet its obligations as and when they fall due.

The LLP liquidity policy is to maintain sufficient liquid resources in the reserve bank account to service the swap payments, interest on the loan and any service fees for the next three months. This is reviewed by the Cash Manager, which is the Society, and any shortfall is funded. Liquidity risk is also mitigated through the additional income collected on the over-collateralisation of the beneficial interest in mortgages.

Note 9 contains a maturity analysis of the LLP's derivative financial instruments. All derivatives have the same notional amount and maturity date as the corresponding loans from LLP members.

The LLP's ability to meet payments on the term loans as they fall due is dependent on timely receipt of funds from the deemed loan to the Society which may be delayed due to slow repayment on the mortgage portfolio.

Principal repayments are made on the term loans with the Society in accordance with the LLP's principal priority of payment. In the event that the LLP does not have sufficient cash flows from the underlying mortgage loans in order to be able to repay the term loans as and when they fall due, the Society may be required to make a cash capital contribution, extend the repayment of the term loans for up to 12 months or sell mortgages from the mortgage pool in accordance with the terms of the transaction documents.

## NOTES TO THE ACCOUNTS (CONTINUED)

### 15 FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

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 LLP has access at that date.

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

- Level 1: unadjusted quoted prices 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.

Where applicable, the LLP 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. Where this is not applicable, the LLP determines fair values using other valuation techniques described below.

The following table summarises the fair value of the LLP's financial assets and liabilities measured at amortised cost on the face of the Balance Sheet by the fair value hierarchy.

	Carrying amount £000	Fair value Level 1 £000	Fair value Level 2 £000	Fair value Level 3 £000	Fair value Total £000
<b>2017</b>					
<b>Financial assets</b>					
Loans and other debts due from members	3,530,685	-	-	3,524,862	3,524,862
<b>Financial liabilities</b>					
Loans from LLP members	3,711,174	-	-	3,730,161	3,730,161
Deposits from credit institutions	58,719	58,719	-	-	58,719
	Carrying amount £000	Fair value Level 1 £000	Fair value Level 2 £000	Fair value Level 3 £000	Fair value Total £000
<b>2016</b>					
<b>Financial assets</b>					
Loans and other debts due from members	3,108,871	-	-	3,092,542	3,092,542
<b>Financial liabilities</b>					
Loans from LLP members	3,250,274	-	-	3,285,349	3,285,349
Deposits from credit institutions	49,784	49,784	-	-	49,784

Loans and other debts due from members has been assessed as the value of the expected future cash flows. Future cash flows are projected using forecast interest rates. Given the extent of the over collateralisation in the covered bond structure, the resulting estimated future cash flows are discounted at current market rates appropriate to a AAA rated asset to determine a fair value.

Loans from LLP members are fair valued by reference to the fair value of the covered bonds issued by the Society the proceeds of which were lent on back to back terms to the LLP.

Deposits from credit institutions are valued in accordance with the cash flows projected from the contractual terms of the deposits. The fair value of deposits that are available on demand approximates to the carrying value.

## NOTES TO THE ACCOUNTS (CONTINUED)

### 15 FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (CONTINUED)

The following table summarises the fair value of the LLP's financial assets and liabilities measured at fair value on the face of the Balance Sheet and the disaggregation by fair value hierarchy and product type. There have been no transfers between any of the levels during the period.

As at 31 December 2017	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Financial assets				
Derivative financial instruments				
Cross currency swap	-	61,909	-	61,909
Interest rate swap	-	30,658	-	30,658
Debt securities	29,988	-	-	29,988
<b>Total</b>	<b>29,988</b>	<b>92,567</b>	<b>-</b>	<b>122,555</b>

Financial liabilities				
Derivative financial instruments				
Interest rate basis swap	-	1,266	-	1,266
<b>Total</b>	<b>-</b>	<b>1,266</b>	<b>-</b>	<b>1,266</b>

As at 31 December 2016	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Financial assets				
Derivative financial instruments				
Cross currency swap	-	49,174	-	49,174
Interest rate swap	-	50,907	-	50,907
<b>Total</b>	<b>-</b>	<b>100,081</b>	<b>-</b>	<b>100,081</b>

Financial liabilities				
Derivative financial instruments				
Interest rate swap	-	1,874	-	1,874
<b>Total</b>	<b>-</b>	<b>1,874</b>	<b>-</b>	<b>1,874</b>

#### 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 utilise observable market inputs for interest rate swaps and cross currency swaps. Valuations are generated by swap models which use present value calculations and incorporate assumptions for interest rate curves and foreign exchange spot and forward rates.

### 16 OFFSETTING FINANCIAL ASSETS AND LIABILITIES

The LLP does not have any financial assets or financial liabilities that are offset with the net amount presented in the Balance Sheet. IAS 32 *Financial Instruments: Presentation* states 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 is met by the LLP.

Coventry Building Society Covered Bonds LLP does not enter into a master netting agreement for external swaps, but for the transactions with a swap counterparty outside of the Group, a Credit Support Annex (CSA) has been entered into for each swap which provides for the counterparty to fully collateralise one of the swaps, and for partial collateralisation on the second (unless the counterparty credit rating falls below a certain threshold at which point full collateralisation is required).

## NOTES TO THE ACCOUNTS (CONTINUED)

### 16 OFFSETTING FINANCIAL ASSETS AND LIABILITIES (CONTINUED)

The table below shows the net exposure for derivative contracts after collateral benefits.

	Gross amounts £000	Master netting arrangements £000	Financial collateral* £000	Net amount £000
<b>2017</b>				
<b>Financial assets</b>				
Derivative financial instruments	92,567	-	58,025	34,542
<b>Total financial assets</b>	<b>92,567</b>	<b>-</b>	<b>58,025</b>	<b>34,542</b>
<b>Financial liabilities</b>				
Derivative financial instruments	1,266	-	-	1,266
<b>Total financial liabilities</b>	<b>1,266</b>	<b>-</b>	<b>-</b>	<b>1,266</b>
<b>2016</b>				
<b>Financial assets</b>				
Derivative financial instruments	100,081	-	68,386	31,695
<b>Total financial assets</b>	<b>100,081</b>	<b>-</b>	<b>68,386</b>	<b>31,695</b>
<b>Financial liabilities</b>				
Derivative financial instruments	1,874	-	-	1,874
<b>Total financial liabilities</b>	<b>1,874</b>	<b>-</b>	<b>-</b>	<b>1,874</b>

\*The financial collateral disclosed is limited to the amount of the related financial asset and at the 2017 year end was all in cash. At the 2016 year end financial collateral was in the form of both UK Government investment securities £19,212,000 and in cash £49,174,000. The UK Government investment securities were not recognised in the Balance Sheet as the LLP did not have the risks and rewards of ownership.

At 31 December 2017, the £34,542,000 is made up of two exposures. One is to a Aa3 rated UK institution for £30,658,000 and the other one is to a A2 rated European institution for £3,884,000.

### 17 CAPITAL MANAGEMENT

The Coventry Building Society Group is subject to capital requirements imposed by its regulator, the Prudential Regulation Authority (PRA). During the year, the Coventry Building Society Group, incorporating the LLP, complied with the capital requirements set by the PRA.

### 18 PARENT UNDERTAKING AND CONTROLLING PARTY

The member companies of the LLP are Coventry Building Society, the controlling party under IFRS, and Coventry Covered Bonds Finance Limited. Both entities are incorporated in the UK and registered in England and Wales. The ultimate parent undertaking is Coventry Building Society.

Copies of Coventry Building Society Group accounts, which include the results of the LLP, are available from the Company Secretary, Oakfield House, Binley Business Park, Coventry, CV3 2TQ or on its website.