2016

Annual Report and Accounts

The Nottingham

Bringing your finances closer to home

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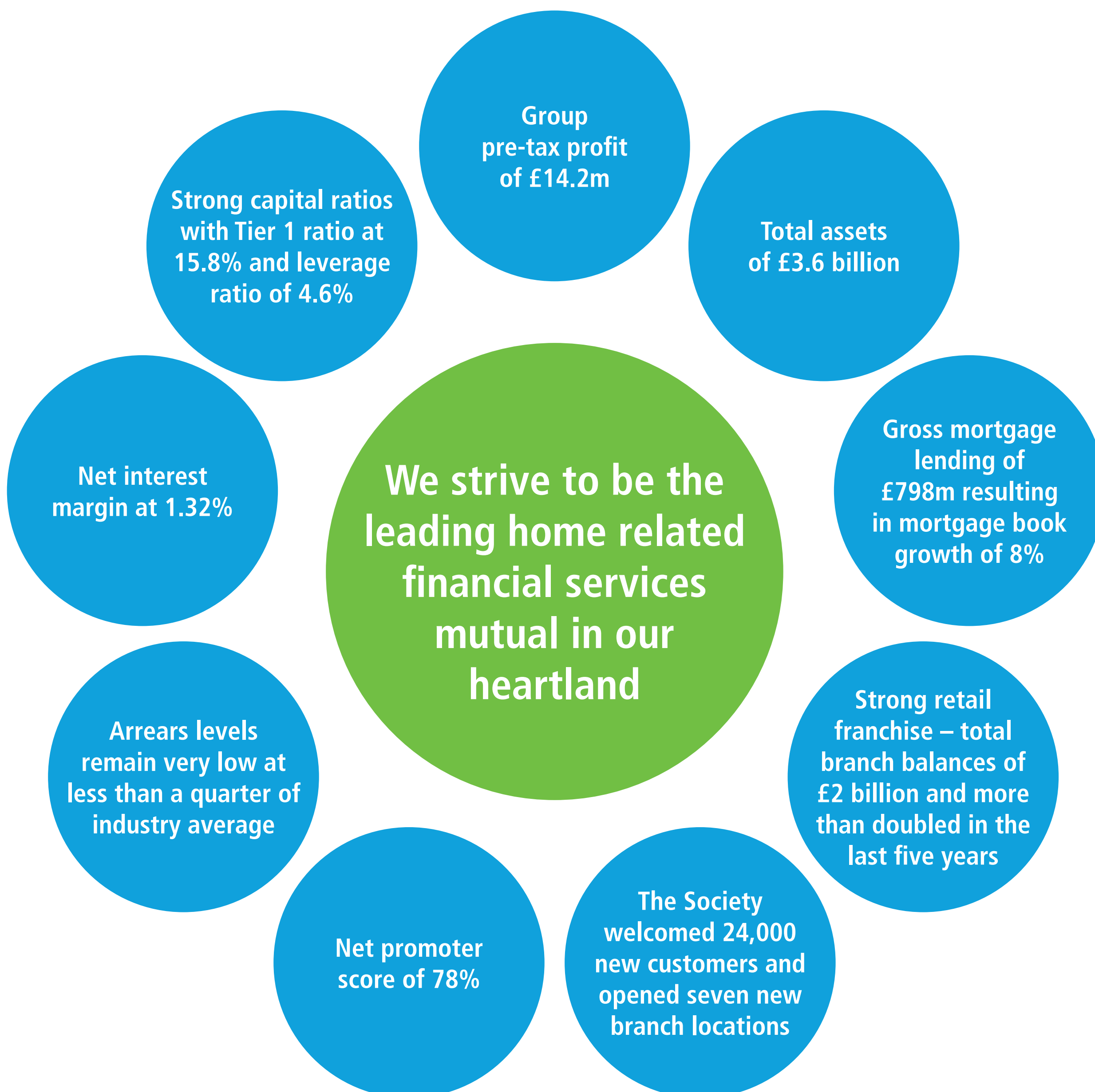
Key highlights

The Society has continued to focus on the development of its strategy to offer members a unique brand of advice, service, value and choice. The Society's approach is gathering pace, as it has delivered this unique proposition to more customers in more locations across its heartland and in doing so achieved another year of strong performance and record balance sheet growth.

Below are some of the key achievements and financial highlights of 2016:



Chairman's statement

John Edwards

Market and economic background

At the time of writing my statement last year I highlighted the challenges and uncertainties that 2016 could bring. Whilst your Board anticipated and was prepared for such uncertainty, 2016 will be remembered for a number of major global geo-political and social shocks.

As the UK began to acknowledge that we face years of uncertainty negotiating our exit and then extracting ourselves from the EU; the US Presidential election probably delivered the greatest electoral shock for 100 years and placed the world into a period of economic and political uncertainty.

These events have resulted in a unique mix of economic conditions. At home the UK economy has performed ahead of expectations with GDP for the year showing growth of 2%; inflation remains low by historical standards with CPI at 1.6% and employment is at historically high levels of 74.5%. However, the depreciation of sterling following the referendum vote has attracted extensive media coverage around the prospect of rising inflation – the battle between Unilever and Tesco over a retail price increase for Marmite provided an illustration of the potential impact of sterling's depreciation on retail prices in a Brexit world.

Another consequence of the Brexit vote was the Bank of England's decision to reduce bank base rate from 0.50% to 0.25%, in order to provide support against the uncertain economic backdrop. As a Society with a ratio of seven savers to every borrower we were disappointed by this move, believing that with the ready availability of credit and mortgage finance in a competitive marketplace and rates already at an all-time low, a base rate reduction was not necessary – we will continue to do all we can to balance the conflicting needs of our borrowers and savers – a measure of how successfully we have done this is demonstrated in the good growth of both our savings and mortgages balances in 2016.

In terms of the housing market, following a period of strong house price increases, growth has now begun to slow, with the Nationwide reporting a 4.5% increase over the past 12 months. Transaction numbers remain muted by historical standards and are forecast to be 1.1 million; 24% lower than the pre-financial crisis levels. A major influence on the UK housing stock and its value will be decisions made by landlords over the next 2-3 years, as both fiscal and regulatory moves by Government and regulators begin to potentially diminish the returns available in the buy-to-let market.

Demand for housing of all tenures remains high and supply constrained – there may be some movement of stock from the private letting sector to the privately owned residential sector over the next few years, but ultimately Government needs to do all it can to increase the level of new housing starts from the current level of approximately 150,000 to over 200,000 per year for the foreseeable future – the Society stands ready to support such a move and encourages the Government to do so – the recent White Paper being a start.

The writing of this statement coincides with the first few weeks of a Trump presidency and it still remains very unclear what the first year of this tenure will bring. Economically the sense is that policy will be expansionary with fiscal loosening – this will inevitably drive growth, inflation and rising interest rates that will ripple across the globe. This unique combination of the UK entering a period of extraction from the EU and significant regime and political change in America, increases global uncertainty. However, the Society is confident in its strategy, business model, performance and place within the UK economy and our communities. It stands ready to serve and support our growing membership to manage their financial affairs in this increasingly uncertain environment.

Regulation

The pace of change and the rate at which new requirements are demanded has continued throughout 2016. During the year we have implemented the Senior Managers Regime – designed to create clearer responsibility and accountability in financial services firms; have completely revised our liquidity monitoring and appetites to align with new European regulation and continue to work on harmonising the recently implemented UK mortgage market review with the newly required European mortgage credit directive. Furthermore, we have implemented new buy-to-let lending requirements and continue to embed revised regulatory reporting as introduced.

In train currently, with the introduction of the new accounting standard IFRS9, is a complete overhaul of how we account for loan loss impairments, which will fundamentally change the basis of the calculation and the level of capital in banks, institutions and building societies. In addition, work is commencing on delivering the requirements of the biggest overhaul of data protection legislation for many years.

Whilst not directly related to regulation, an area of increasing concern for all institutions, and indeed nations, is cyber security; with large scale incidents and hacks now reported on an almost weekly basis. The Society has always taken its responsibilities in this area seriously with an Executive Director chairing our Information Risk Committee over the past five years. We have committed to undertaking a continuous process of enhancing and strengthening of our digital defences in the face of the ever present and increasing threat.

Strategy and progress

In an ever changing and uncertain world, to have access to excellent service and advice from a trusted local source is becoming increasingly popular with people across our heartland – which now stretches over ten counties.

We have worked hard in recent years to develop services and products that are relevant to, and valued by our members and customers, whether they are looking to save for the future, search the market for the most appropriate mortgage, rent, buy, or sell a home, or plan and protect their families' future - we are here to help support all those critical needs. Indeed, David highlights the details of our activities and achievements in his Chief Executive review on page 6. The Board remains confident that this strategy continues to position us well to serve the needs and aspirations of current and future members and customers.

Our branches remain our focal point where our unique 'all under one roof' proposition is best experienced by our customers. Unlike most banks and many building societies, we have yet again increased the size of the network this year. We remain very pleased with the progress that these new branches are all making – in fact, looking at the 29 branches we have added in the past four years, they alone are now equivalent in size to a top 30 building society, demonstrating that the mutual building society model remains alive and thriving.

However we are not complacent – there remains a great deal to do to further improve our service and offering, increase our efficiency and look at ways to deliver our unique brand of advice, choice, service and value to more customers through different means. It is also essential that we clearly demonstrate the value and benefits of being a member of the Nottingham Building Society.

Board

As the Society and its trading environment evolves so does our Board. The Board was disappointed to receive the resignation of our Deputy CEO and Finance Director, Ashraf Piranie, who after 10 years' service is leaving us to take up a new role at the West Bromwich Building Society. Ash has played a significant role in the Society's progress over recent years. He was a key member of the small team that so effectively navigated the Society though the challenges of the financial crisis. We are sorry to see him leave but thank him for his excellent contribution and wish him our best in his future career.

I am delighted, however, to welcome two new non-executive directors who have joined the Board since the beginning of the year. Kerry Spooner joined the Board on 1 September 2016. Kerry is an ex-partner at Allen & Overy LLP and in addition to her extensive and impressive legal experience covering mergers, acquisitions and equity capital markets, has strong experience of building society board membership, gained at the Market Harborough and Leek United Societies where she chaired the remuneration committees and held the role of Senior Independent Director.

We also welcome Kavita Patel to the Board who joined us on 1 January 2017. Kavita is currently a partner at Shakespeare Martineau where she currently leads their investment funds sector, specialising in corporate finance transactions as well as previously having sat on the firm's main board. Kavita has deep experience in her field but also has experience of managing the challenges of a rapidly growing and developing organisation, something which will be invaluable to our Board.

It is also with sadness that I announce that our Senior Independent Director and Vice Chairman, Keith Whitesides, will be retiring from the Board when his period of office expires at the AGM in March.

Keith has been a member of The Nottingham's Board for over 12 years and has been a key instigator in encouraging the development and growth of the Society, which has been significant over the period of his tenure. I know that all Board members will miss his wise counsel and strong customer insights, along with his infectious and endless enthusiasm for the Nottingham Building Society, its members and staff. From my personal perspective, Keith has been a superb Senior Independent Director and Vice Chairman. From the day I joined the Board and especially since I became Chairman, Keith has been generous in sharing his experience, advice and support. We all wish Keith our very best wishes for a long and happy retirement and we all undertake to continue to demonstrate the same level of enthusiasm and appetite for the development of the mutual model that Keith has demonstrated in every Board meeting for the past 12 years. Thank you Keith.

Finally, I am pleased to advise that during 2016 the Board has overseen a significant project to overhaul and update the entire governance and risk management framework upon which the Society operates.

This has included a review and rewrite of all governance documents, policies, risk appetite statements and the functions/management committees that support them. The Board believes that this important project will ensure that the governance and management of the Society will be fit for purpose for many years into the future and support us in the achievement of our objectives.

Supporting the communities

In 2016 we have continued to support our communities through our Doing Good Together initiative. Our fundraising for local charities has reached £20,000 for over 40 causes ranging from the RNLI in Skegness to the Leicester Food Bank in Wigston.

Staff have also been generous with their time and have donated over 1,000 hours in 2016, providing practical help with their chosen projects and our selected charity partners, doubling what we did in 2015.

Through our Grants for Good, we donated £40,000 to fund 17 local projects to increase employability and financial education and to aid and prevent homelessness.

Our work with charity partners has also continued - 50 rising sports stars have benefitted from support via our partner, SportsAid. Through Young Enterprise we have financially supported ten local schools to complete the Company Programme and helped to deliver employability skills workshops to more than 500 students. Our monetary donations to Framework have continued to support their Skills Plus programme and we are very proud to have sponsored a number of their fundraising initiatives.

Our work in the community has been recognised through two awards during the year – Nottingham Post's 'Contribution to the Community' award and Money Age's Best Charity Partnership (SportsAid).

Summary

It is well acknowledged that the UK, and to some extent the world, is entering a period of new challenges and uncertainties. What the UK marketplace and economy will look like following our exit from the EU is difficult to predict. It will be some time before we will be able to shape any reasonable views. However, what is clear is that families and individuals right throughout our heartland increasingly want to be able to manage their financial affairs and plan for the future with a strong local organisation that they can trust. The achievements and progress made in recent years by The Nottingham to deliver this are clear.

The Society is financially strong and well placed to support members and our communities. We will therefore continue developing our strategy and investing in the Society in order to develop our unique 'all under one roof' proposition, that delivers advice, choice, service and value.

I would once again like to thank all those staff members, partners and suppliers who support our organisation in delivering this strategy and look forward to continuing this in the years ahead.

John Edwards
Chairman

22 February 2017

Chief Executive's review

David Marlow

2016 has been a year of twists and turns with a number of unexpected outcomes; despite this, we at The Nottingham have continued to focus on developing our strategy to deliver a unique brand of advice, choice, service and value 'all under one roof', which continues to be well received by members across our heartland.

Your Society

As I have said consistently, our responsibility is to differentiate ourselves against the big banks using our mutual ethos to deliver a proposition and service that is valued by our members and is also attractive to potential new ones.

One area that truly marks us apart from the big banks today is our approach to branches. As the UK continues to see large scale closures – the UK's largest bank reduced its branch network by 25% in 2016 alone, we have continued to open new branches and increase our network, with great success.

In 2016 we have opened in a further seven new locations in Belper, Burton upon Trent, Buxton, Scunthorpe, Uttoxeter and two in Sheffield. In fact since the beginning of 2012, we have increased the number of branches we have from 32 to 61, almost double.

Without exception, existing members and new customers have welcomed us to our new locations where we have already built savings balances of more than £300m. However it is not just our new locations that have proved so popular with customers; over the same five year period our total branch balances have more than doubled from £946m at the beginning of 2012 to reach £2bn for the first time in 2016.

We believe that this is clear evidence that the role of branches remains important in the eyes of UK consumers and that new customers are attracted to our unique advice and service proposition. This is further underpinned by the continuing success of our whole-of-market mortgage advice offering; with the number of customers using this service increasing by a further 31% in 2016. In fact we are now helping 73% more people find the right mortgage than in 2013, the last year we advised purely on Nottingham Building Society mortgages, demonstrating the popularity of our unique approach.

All of this activity has been supported by an extensive range of marketing activity designed to build our profile and raise awareness of The Nottingham and what we have to offer.

This has included T.V advertising, radio, print, online and a number of strategic partnerships. Our growing relationship with Leicester Tigers is a good example of this; with our sponsorship of their new stand and the largest junior rugby club in the country providing an excellent talking point that we now have a dozen branches across Leicestershire, the most of any building society, from none five years ago.

This activity is important in ensuring that we attract new members to continue to strengthen the Society. In fact during the year we have seen our brand recognition/awareness as a result of activity in our heartland grow to 87% and our spontaneous unprompted awareness at 51% places us as the most recognised building society in our heartland. This is an enormous jump from three or four years ago, where recognition was in the low to mid 20's, placing us outside the top 10.

Our performance

The strategic report on page 8 covers our 2016 performance in detail; however I would like to highlight the following:

In terms of mortgage lending the Society has delivered a performance in line with our plan. Gross lending of £798m has been achieved in the year, an increase of 23% on 2015 and a record for the Society in a single year. We have also processed over £1bn of applications in a year for the first time in the Society's history. This good performance ensures that in addition to record lending in 2016, we enter 2017 with a very healthy pipeline of mortgages.

Once again we have been very pleased with the number of mortgage customers electing to stay with us and take another product at the end of their term – our central mortgage team retained over £500m of business in the year for the first time, an increase of 16%. This excellent performance resulted in our mortgage redemptions falling by 3% in 2016. All this meant that we exceeded £3bn of mortgage balances for the first time and have increased our assets by 8% in the year.

As I stated in last year's review, we anticipated that 2016 would bring some challenges and uncertainty; however as laid out in the Chairman's statement, 2016 was an exceptional year of unexpected outcomes. The most significant event of 2016, from our perspective, was the MPC's decision to halve the bank base rate from 0.50% to 0.25% in August. Since March 2009, when base rates were taken to an all-time low of 0.50%, we have constantly strived to strike a fair and appropriate balance between the contrasting needs of our borrowers and savers. The decision to reduce rates in August to 0.25% stiffened that difficult challenge even further. We believe that the decisions we made in balancing the reductions in mortgage and savings rates were fair and appropriate.

It is vital, however, that we maintain an incentive to save. Historically over a 20 year cycle, a building society would typically expect average savings rates to be equivalent to about base rate. We believe that we are doing all we can for savers as reflected by the fact that our average saving rate at the end of 2016 is more than four times base rate; that over 50% of our current savings accounts pay a rate higher than base rate, with some regular savings accounts offering between eight times and twelve times base rate. Customers' response to this approach during 2016 has been positive with our heartland based branch savings balances increasing by 10%.

Another small way that we can protect savers from ultra-low rates is to look at the surplus the Society makes each year. Whilst we need to make sufficient profit to enable us to continue to grow and invest in the future sustainability of the Society, we do not seek to maximise profits but make sufficient to meet our needs. Whilst we were expecting a reduction in profit in 2016, as trailed at the beginning of the year, the Board decided, in response to the base rate cut, that it was acceptable to reduce the profit made by the Society further in 2016. We are therefore reporting a profit before tax of £14.2m, a reduction of 29% on 2015. However our profit after tax ratio of 0.32% per £100 assets is a strong level of profitability in historical terms and is more than sufficient to ensure that we can continue to grow, strengthen and develop the Society.

Despite this reduction in profit, which was largely driven by a conscious reduction in net interest income, we have maintained our cost efficiency; so whilst our overall costs have increased in 2016 reflecting our continuing investment in people, technology and branches, our Group management expenses ratio has remained at the same level as 2015 at 1.12%. Management's focus will be to gradually reduce this ratio in the years ahead as the Society continues to grow.

Quality and strength

The Society continues to maintain its very high level of financial strength. Our leverage ratio of 4.6% ensures that we have significantly more high quality capital available to us than is required by regulation, providing additional cover and strength in the event of significant losses or unexpected events. The very high quality and availability of liquidity also provides regulators and members with strong assurance of our ability to meet our obligations as they fall due.

Central to the ethos of a building society is the prudence we demonstrate when lending our members' money, to those people we believe have the willingness and capability to repay their loan. Whilst the overall economic conditions remain relatively benign and interest rates low, we are very proud that at present we only have 38 accounts three or more months in arrears out of a total of over 24,000 accounts. Also at the year-end we have no properties in possession, underscoring the quality of our mortgage book and the robustness of our lending policies and procedures. It is reasonable to say that this is almost the lowest achievable level of arrears for a mortgage book of this size.

Whilst it is inevitable that arrears will rise in the future, particularly when rates eventually begin to rise, the vast majority of our customers are protected to some degree by fixed rates, We remain extremely well positioned to deal strongly with any future unexpected events. Our overall asset and credit quality is reflected in the maintenance of our strong overall external credit rating from Moody's.

Serving our growing membership

Due to the success of our branch network and excellent mortgage performance we have continued to grow our membership with approximately 24,000 new customers joining the Group in the year – broadly in line with what we achieved in 2015. An impressive level of consistent growth.

We remain very focussed on delivering excellent service in all that we do; with branches and customer service teams receiving regular personalised service ratings and updates on how our customers rate them. Their hard work and focus on customers' feedback and suggestions for improvement has resulted in a further increase in our Net Promoter Score which in 2016 has risen a further 4 percentage points to a new high of 78%. This places us at the very top of all organisations and sets a standard that we will need to work hard to maintain in 2017.

During 2016, we were very pleased to run a number of member events for the first time. This gave members an opportunity to hear from executive and non-executive directors detailing our approach to running the Society and our emerging plans. It also gave members the opportunity to directly question the directors of the Society on a range of issues – foremost being the current level of savings rates in the record-breaking low interest environment. Feedback from the events overall was very positive and we hope to run more of these in the year ahead.

Summary and outlook

As we move forward we do so from firm foundations as we seek to further grow our membership by continuing to differentiate strongly against the big banks. Over recent years we have consistently invested in the infrastructure and capability of the Society, have reviewed and renewed our governance and risk management framework and during the first quarter of 2017 we will move into our newly extended head office, where we have increased our capacity by over 50% to take account of rising demand.

2017 will bring challenges and uncertainty and along with the ultra-low interest rate environment it will be essential that we focus even more strongly on how we build and reward loyal membership of The Nottingham, through the provision of our unique advice and service proposition, whilst maintaining our financial strength and strong mutual ethos.

We have a unique business model that is becoming increasingly popular, one that seeks to build long-term relationships through the consistent delivery of advice, choice, service and value. In 2017 we expect to continue to grow the Society, continue to invest in improving our offering and seek to maintain our world-class level of service. We will seek to do this whilst continuing to effectively balance the contrasting needs of our savings and mortgage customers, finding further ways to deliver value to our members and to support our communities and the causes which we are so passionate about of homelessness, employability and financial awareness.

As always I would like to thank all our team members and my colleagues on the Board. Their continuing enthusiasm and commitment to serve our customers in the way that they would wish to be served has once again been impressive to behold.

I would also like to thank our business partners, intermediaries and suppliers whose continued support has enabled us to achieve our objectives and serve our members.

David Marlow
Chief Executive

22 February 2017

Strategic report

Ashraf Piranie

Business model and Group strategy

The Nottingham is the UK's ninth largest building society with £3.6 billion of assets and a regional presence extending to 61 branches over ten counties, which has included seven new branch openings in 2016, making us the sixth largest building society branch network in the UK.

The essence of a successful building society is to provide a safe and secure home for members' savings and to use these funds to provide mortgages to members to purchase their homes. This places us in the pivotal position of balancing the conflicting needs of both borrowing and saving members; striving to find the optimal point between offering good value to savers and competitive rates to borrowers.

The Nottingham's Board believes it is also our duty to ensure that our members are well positioned to manage their own financial affairs and plan for their futures. A core focus of The Nottingham's strategy is to continue to develop its franchise as the leading "home related financial services mutual" in our heartland. Our success in doing this over recent years has been assisted through utilising existing estate agency locations and by opening new branches on our target list, particularly where other financial institutions have closed. The Nottingham is able to operate with a relatively larger branch network due to the synergy benefits of offering both estate agency and building society services from the same location.

The focus of the next phase of our strategy is to seek to deliver value to members through the provision of our range of advice services such as whole-of-market mortgage advice, financial planning advice and estate planning services. In delivering this customer value through these propositions, members will be able to enjoy more compelling reasons for being a member of The Nottingham, which in turn should help us to attract more new members.

Looking forward, whilst we expect digital services to continue to be increasingly popular, we believe our target market will be attracted by a strong combination of high street presence, digital accessibility and convenience. We will continue with our strategy to grow and develop our offering to achieve these aims in the years ahead.

Group structure and brands

The Nottingham's unique proposition places us in a strong position to meet our customers' needs and deliver advice, choice, service and value to customers. This is delivered through Nottingham Building Society, our estate agencies (Nottingham Property Services and Harrison Murray) and whole-of-market mortgage advice via Nottingham Mortgage Services. Investment and personal financial planning are offered through our partnership with independent third parties.

Principal risks and uncertainties

In common with other financial institutions, the nature of our business results in a number of inherent risks which are continuously monitored and managed by the Board. These inherent risks and how the Board manage them are considered in the risk management report on page 23 to 27.

Within our risk management framework, we categorise our principal risks and uncertainties affecting The Nottingham as capital, strategy, retail credit, market and interest rate, liquidity, conduct and regulatory, operational and business change risk, all of which are common to most financial services firms in the UK.

Whilst we are a low-risk organisation, we inevitably face challenges that pose risk to the delivery of our strategic objectives. We continue to operate in an uncertain global environment which creates risks and challenges for the mutual building society model, particularly ultra-low bank base rates. These risks and uncertainties, and how we mitigate them, are summarised below.

EU referendum result

The result of the referendum on EU membership has caused significant uncertainty across the economy and financial markets, which has inevitably impacted business and consumer confidence across all sectors. There is ongoing uncertainty about the impacts of Brexit negotiations on the UK economy, exchange rates and UK base rate. To date, the Bank of England has shown willingness and ability to provide further monetary stimulus measures, for example, through the launch of the Term Funding Scheme.

The Nottingham has undertaken a review of its risk profile in the light of the vote to leave, considering risks such as reduced availability of and higher cost of capital, the impacts of the depreciation in sterling, a wide range of different interest rate scenarios, any heightened liquidity risks and indicators of asset impairment. We will continue to assess the potential impacts of new information through our ongoing programme of stress testing and scenario planning as the picture becomes clearer, and we remain in a strong position to take any necessary actions to respond.

Core mortgage lending yield

Margin earned on core mortgage lending products has continued to be negatively impacted by falling interest rates and increased market competition from new entrants and traditional participants. The Nottingham has clear risk-adjusted return thresholds which have to be met, and will only lend if these are met. We constantly adjust our growth plans and pricing to ensure we continue to deliver long-term sustainable return on our lending whilst delivering good value, relative to the market conditions, to savers.

Term Funding Scheme

The introduction of the Funding for Lending Scheme (FLS) and Help to Buy Schemes in 2013 provided strong stimulus to the mortgage market through the availability of high levels of inexpensive funding. This inevitably resulted in a reduction in new business market rates for both mortgages and savings. In 2016, the Term Funding Scheme (TFS) by HM Treasury has been launched (replacing FLS) and has again lengthened the period this stimulus is available. There will be continued impacts on both the mortgage and savings markets as a result of the availability of this low cost funding. We remain vigilant to the forward-looking risks in terms of how the market will adjust as this stimulus is removed.

Retail lending impairments

The level of retail lending impairments has continued to remain benign with The Nottingham experiencing a very low number of arrears cases. Although arrears are expected to continue to be stable while interest rates remain low, we will need to remain vigilant over the medium term with the pace of future increases in interest rates potentially putting borrowers under additional financial pressure. The majority of our customers are currently on fixed rate mortgages and would therefore not be immediately impacted by changes in interest rates. Management regularly conducts stress testing on the mortgage book to gauge possible impacts of higher interest rate costs on our borrowers and are confident that our customers are well placed to manage rising costs.

Cyber risk

During 2016, there were a number of high profile cyber attacks on firms and institutions in the UK and across the globe. These incidents brought significant impacts on those firms and their customers and we expect this threat to remain as a constant moving forward. The regulatory authorities continue to remind financial services organisations of the need to remain vigilant in this area. Guarding against potential cyber attacks remains a key focus for management. We strive to keep pace with market trends in the prevention and detection of any potential attacks, in order to safeguard the business and protect our members' data and savings. During 2016 management approved a number of investments to enhance our cyber defences further. We expect this to be very much the norm from now on as we retain constant vigilance in this area as a permanent feature of our risk management framework.

Housing market

The Nottingham's business model has very close links to the housing market and therefore a downturn in the UK economy accompanied by challenging housing market conditions would have an adverse impact on our performance.

The UK regulatory authorities continue to remain concerned over growth in the buy-to-let market and the potential future risks this may bring. The Chancellor's changes to the tax reliefs available to buy-to-let investors, coupled with changes to stamp duty, have resulted in uncertainty in the buy-to-let sector of the market and potential knock-on impacts to the overall housing market. The Board decided more than a year ago to reduce our appetite for lending in the buy-to-let market in response to these uncertainties.

We will remain vigilant by monitoring trends in the housing market as uncertainty in the market fuelled by the EU referendum result prevails.

We actively monitor performance of the estate agency and lending activity, both in our core operations and through our whole-of-market mortgage advice offering and are therefore well positioned to identify and respond effectively to any impact, volatility or downturn in the market.

Global markets volatility

Volatility has been experienced in the global equity and commodities market throughout 2016 and the Eurozone continues to remain fragile with ongoing political tensions and social unrest arising from continued austerity measures and the refugee crisis. The US election result has also contributed to market jitters and elections in the Eurozone countries in 2017 are expected to create further uncertainty. Although The Nottingham has no direct exposure to any Eurozone countries and minimal exposure at global level, the contagion or ripple risks to the domestic economy and consumer confidence could be significant and would require us to respond effectively.

Business performance

The Chief Executive's review includes a summary of factors affecting our performance in 2016 and should be read in conjunction with this report.

This section focuses on the financial performance indicators which the Board reviews on a regular basis and are key to our business success.The Board is pleased with the overall performance of the Group in the context of its strategic objectives.

Strategic report (continued)

Strategic objective	Key Performance Indicator	2016 performance		Achieved
Capital	Maintain an excess over regulatory requirements	CET1 ratio:	14.7%	✔
		Tier 1 ratio:	15.8%	✔
	Retain the leverage ratio above 4%	Leverage ratio:	4.6%	✔
Profit	Ensure profit after tax ratio supports the capital objective for any given growth plan and investment in the business	PAT ratio:	0.32%	✔
		Interest margin:	1.32%	✔
Sustainability	Deliver strong efficiency ratio taking into account the scale of the Society	Cost income ratio:	72.6%	✔
		Manex ratio:	1.12%	✔
	Maintain strong asset quality with arrears/ impairment performance in the industry upper quartile	Arrears ratio:	0.16%	✔
Customer	To look after our member interests offering good value products and services	Net promoter score:	78%	✔
	To be seen as a leading source of expert advice	Customer satisfaction:	81%	✔

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Underlying profit before tax	**15.3**	**20.2**	**15.9**	**20.1**
FSCS costs	(0.2)	(1.4)	(0.2)	(1.4)
(Losses)/gains from derivative financial instruments	(0.9)	1.2	(0.7)	1.2
Reported profit before tax	**14.2**	**20.0**	**15.0**	**19.9**

The Board monitors both reported and underlying profit before tax. Reported profit before tax is a commonly used comparative measure of profit. However, it includes a number of items which the Board does not believe fully reflect underlying business performance and therefore underlying profit is also used to measure performance. Underlying profit before tax equates to reported results, adjusted to exclude charges in respect of the Financial Services Compensation Scheme (FSCS) and fair value gains or losses from derivatives and hedge accounting. The comparative periods are disclosed on a similar basis.

2016 Financial review and key performance indicators

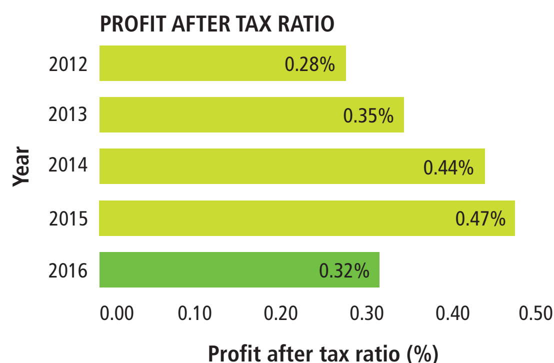
The section below provides a summary of the performance of the Group in the context of its strategic objectives including details of the Group's Key Performance Indicators used to monitor performance.

Underlying profit and profit after tax ratio

The Group's underlying profit before tax has reduced from £20.2m to £15.3m in 2016, representing a reduction of 24%. This reflects the reduction in net interest margin, in line with expectation (which was partly offset by growth in lending), lower estate agency income (due to challenging market conditions) and an increase in operating costs, reflecting an increase in spend in our risk management capability, technology, people and the short term impact of new branch openings during their initial phase.

The Group's profit before tax of £14.2m, which is a reduction of 29%, includes a £0.9m negative adjustment for fair value movements from hedge accounting compared to a £1.2m positive impact in 2016. When this is excluded, profits show a reduction of 20%, broadly in line with our expectations.

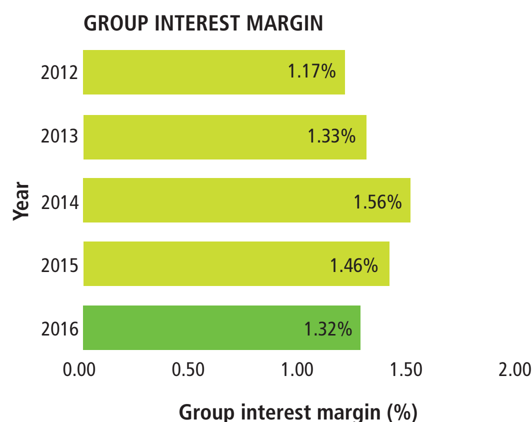
The Society as a mutual has no shareholders and does not need to maximise profits. The objective is to optimise our net interest margin and profit after tax ratio so that we balance the requirements to offer attractive rates for savers and low rates for borrowers, whilst ensuring sufficient profits are generated to maintain a strong capital position and continue to invest in the Society in line with our plans.



The Group's profit after tax ratio has reduced from 0.47% in 2015 to 0.32% in 2016. As highlighted by the Board last year, the 2015 ratio of 0.47% was at the top end of the Board's appetite reflecting exceptional market conditions in the previous couple of years, and that we expected the profit after tax ratio to decline, alongside the net interest margin in 2016 more towards the longer term requirement.

Net interest income

Net interest income reduced by £2.4m in the year to £45.6m representing a reduction in our net interest margin by 14 basis points to 1.32%.



The main driver was a reduction in asset yields driven by the highly competitive mortgage market and the unexpected reduction in bank base rate which led to a reduction in our Standard Variable Rate (SVR). This has been partially offset by a reduction in the overall cost of funding from the continued fall in retail savings rates and lower wholesale funding costs as the Society utilised FLS and TFS funding.

However, we made a conscious decision in 2016 to try and protect our savings members from the low interest rate environment as much as possible. To highlight this, our average savings rate in 2016 was 1.43%, more than five times current bank base rate and our average rate payable at the end of the year stood at over four times current base rate. Our members have responded positively to this move which is best reflected in our branch savings balances, which increased by 9% in 2016 and now stand at £2bn, double the level of four years ago.

Fee income

Fee income consists of commission from mortgage related insurance products, financial planning and protection, rental income, along with property sales and lettings fees from the estate agency business, and commissions from our whole-of-market mortgage advice business.

	2016 £m	2015 £m
Building society	3.3	2.7
Estate agency	5.2	6.2
Mortgage broking	1.3	1.0
Total	**9.8**	**9.9**

The total Group fee income has remained broadly flat in 2016.

The overall fee income for the Society has increased against the prior year as a result of increased lending volumes in 2016. Levels of fee income continue to be impacted by intense competition in the mortgage market which has seen mortgage arrangement fees fall or disappear altogether on new mortgage lending. Third party estate planning income, through provision of wills, financial planning and protection products, has continued to perform well and is in line with our expectations.

Income from the estate agency business reduced by 16% to £5.2m, driven by the downturn in the housing market which has been particularly impacted by uncertainty following the EU referendum and changes in stamp duty which particularly impacted the buy-to-let market in our heartland.

This has resulted in a loss for the year of £0.7m. However this loss includes additional costs incurred for relaunching our lettings proposition and opening two new locations as part of our network expansion. The Board recognise the strategic contribution which estate agency makes towards our 'all under one roof' proposition.

The success of the Group's whole-of-market mortgage advice proposition continues with income up by 30% to £1.3m in the year.

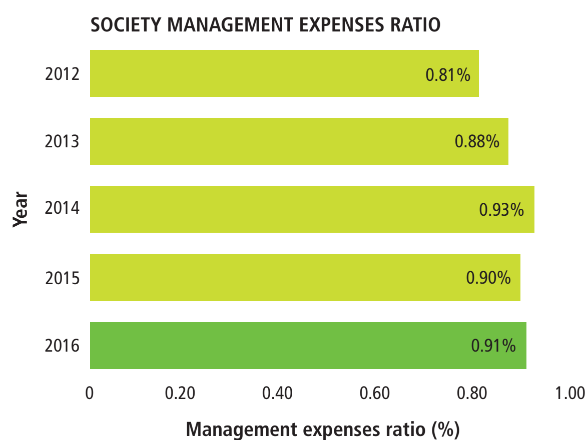
Derivatives

The Nottingham uses derivative instruments to manage exposure to changes in interest rates which arise from fixed rate mortgage lending and fixed rate retail savings products. This leads to volatility in results; such volatility would only be realised if we chose to sell the derivatives before they reach maturity. The Nottingham has no need or intention to sell these derivatives and so expects the £0.9m negative fair value adjustment to reverse out over the derivatives' remaining lives. As this volatility arises primarily due to timing differences, the Board excludes its impact from underlying performance.

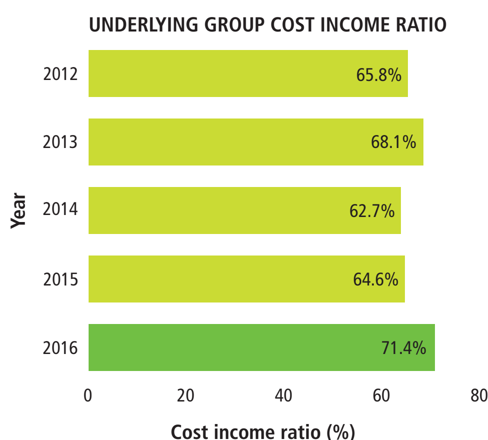
Management expenses

The Group's management expenses have increased by 4.9% to £38.7m in 2016, representing a real increase of 3% and includes the costs associated with strengthening our overall approach to risk and governance across the whole Society, continued investment in technology and people and a small increase, of less than 1%, associated with new branch openings in 2016.

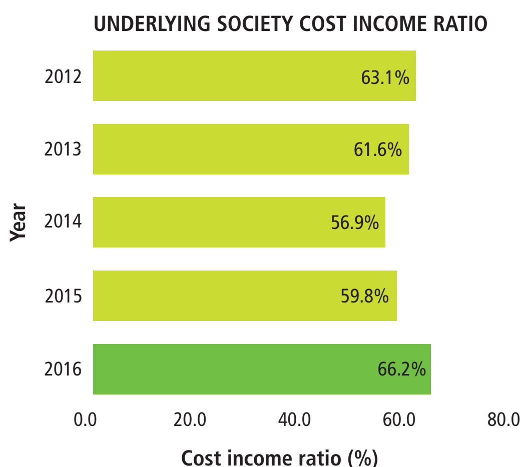
The Society's management expenses ratio has remained broadly flat at 0.91% and demonstrates continued strong cost management notwithstanding the additional investments in the business outlined above.



The Group's underlying cost income ratio is defined as total administrative expenses as a percentage of total income (excluding the impact of fair value gains or losses from derivatives and hedge accounting). The Group's underlying cost income ratio increased to 71.4% from 64.6%.



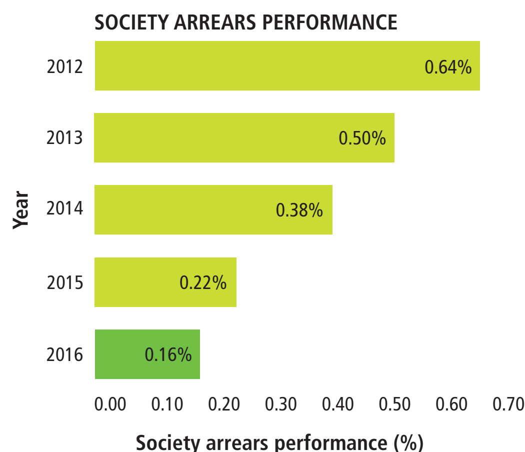
The increase in the ratio reflects a reduction in total income of 5% predominantly due to lower net interest margin and lower income in estate agency. The Society's cost efficiency position remains good, as noted above with the Society management expenses ratio remaining at the same level as in 2015. Notwithstanding the increase in the year the ratio remains within the Board's target range.



At the Society level the underlying cost income ratio has increased to 66.2%, in the main reflecting the reduction in net interest margin and increase in costs as explained above.

Impairment and provisions

The Society's arrears ratio measures the number of loans three months and more in arrears as a percentage of the total loan book.



The Society's arrears ratio has continued to reduce, with the ratio at the end of 2016 at 0.16%. This incredibly low level of arrears should be regarded as almost deminimus for a mortgage book of this size given that only 38 cases out of 24,000 mortgage accounts are 3 months or more in arrears and in fact at the year end, the Society had no properties in possession.

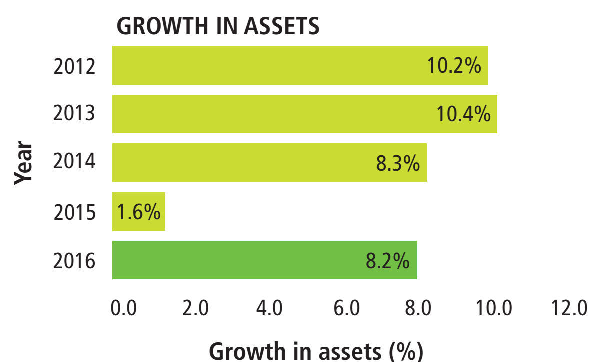
The reduction in the arrears ratio is reflective of the macroeconomic environment with continued low mortgage rates assisting customer repayment obligations coupled with low levels of unemployment and growth in household incomes. However it also reflects our low risk business model and prudent underwriting approach. We always seek to ensure that customers can afford to meet their mortgage repayments from the outset. It is this approach that has ensured arrears levels have remained below industry average and have reduced consistently over the last few years despite the difficult economic conditions.

The Society's total overall impairment provisions remained flat at £4.5m, which equates to 0.15% of the total book. The impact of reducing arrears and positive house price inflation seen over the last few years are reflective in that there has been no further impairment charge in the year.

In common with all other UK regulated deposit takers the Society is required to pay levies under the Financial Services Compensation Scheme (FSCS) and has made provisions for the costs. For 2016 the FSCS levy has reduced to £0.2m (£1.4m in 2015) and covers the interest element of the scheme only following the final capital payment being made in 2015.

Assets

The Group balance sheet increased by 8% in the year to £3.6bn.



The growth was driven by an 8.5% increase to our residential mortgage book, and a 7% increase in liquidity balances at year end.

Liquid assets

The Society maintains a prudent level of liquid resources, of an appropriate level and quality, to meet its financial obligations as they fall due under normal and stressed conditions.

The Group's liquidity resources comprise a combination of 'on-balance sheet' liquid assets and contingent liquidity held with the Bank of England secured against approved mortgage portfolios. In time of a stress the Group is able to exchange these assets for cash.

The Group's liquidity is made up as follows:

	2016	2015
	£m	£m
Bank of England	389.2	369.4
Multilateral Development Banks	15.2	15.7
UK Gilts & T'Bills	51.5	32.6
Certificates of deposit	9.1	15.1
Floating rate notes	16.2	33.5
Fixed rate notes	5.4	5.4
Other	40.4	19.9
Total	**527.0**	**491.6**

By holding liquid resources of the highest quality which can be turned readily into cash, termed 'buffer' assets, the Group is able to reduce the total amount of on-balance sheet liquidity it holds. During the year, the Group continued to maintain a level in excess of the regulatory minimum.

The two key measures of liquidity introduced under CRD IV are the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). The final requirements for the NSFR are still to be finalised, but the Society is currently in excess of the minimum levels required for both measures, with the LCR at the end of year being 177% (2015: 159%).The ratio of liquid assets to shares and deposits reduced to 15.8% compared to 16.0% at the end of 2015.

The Society also has access to the Bank of England's contingent liquidity facilities, which includes the Funding for Lending Scheme (FLS) and Term Funding Scheme (TFS). When taking into account both on- and off-balance sheet liquidity, total liquid resources was 20.7% (2015: 24.9%).

Mortgages

Gross lending totalled £798m, a record for the Society, of which £617m related to prime residential lending and £175m to buy-to-let. This mix is in line with prior years with mortgage lending remaining concentrated in prime high quality mortgage assets. Residential mortgages, excluding buy-to-let, account for 74% of the total lending book.

The Secured Business Lending (SBL) book reduced to £69.0m.

	2016	2015
	£m	£m
Residential	2,950.4	2,719.7
SBL	69.0	72.5
Total	**3,019.4**	**2,792.2**

Total mortgage balances increased by 8.1% during the year to £3,019.4m, driven by 23% increase in gross lending and lower redemptions compared to 2015 reflecting our continued success on customer retention where we retained 72% of customers who reached the end of their fixed or discounted product term in the year.

Residential mortgage lending is focused primarily in the 60% to 80% LTV category but performance continues to be underpinned by the low interest rate environment and levels of House Price Inflation (HPI). The Society's LTV increased marginally from 54% to 55% during the year.

	2016	2015
	%	%
<60%	41.2	37.0
60% - 80%	46.0	53.6
80% - 90%	10.4	9.0
>90%	2.4	0.4

Strategic report (continued)

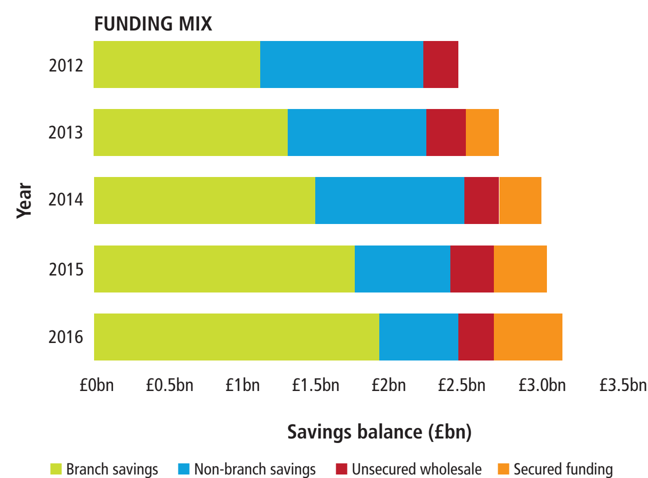
Geographic distribution continues to remain focused in two broad areas, our heartland of the East Midlands/Yorkshire and London/South East.

	2016	2015
	%	%
Heartland	33.1	33.0
London & South East	21.8	23.6
North	14.9	13.4
Eastern	9.8	10.3
West Midlands	9.6	9.5
South West	7.8	7.5
Other	3.0	2.7

The Society funds its mortgages through a combination of retail savings and wholesale funds.

Retail and wholesale funding

The Group operates a diverse funding strategy to ensure an optimum mix and duration of retail and wholesale funding. The graph below details the Society's funding mix:



Retail savings continue to be the cornerstone of our funding requirement with the remainder obtained from the wholesale secured and unsecured funding markets. The Society completed its first bilateral funding transaction in July 2016, which provided £100m secured wholesale funding. The new Bank of England Term Funding Scheme (TFS) has also provided access to secured funding and has supported asset growth during the year, with £130m funding drawn down under TFS at 31 December. This is in addition to the £530m drawn down under the FLS scheme at 31 December (2015: £485m) and this has resulted in a higher proportion of secured wholesale funding than in previous years.

We have continued to see inflows into our branch based retail accounts with branch balances having increased by £168m to £2.0bn by the end of the year, representing an increase of 9%. Branch balances have now more than doubled over the last four years. Branch balances represent over 80% of total retail balances and this provides further support of the Group's combined operating model. It also continues to demonstrate the growing strength of our retail franchise and provides strong evidence that customers have responded positively to our moves to maintain good rates for heartland savers alongside our unique advice and service offering.

The Society continues to place lower reliance on internet only savings given its objective to grow sustainable long-term relationships with members in its heartland.

Overall retail savings have increased by £24m to £2.46bn in 2016 but as we have looked to utilise the benefits of the Bank of England's Funding for Lending and Term Funding Schemes as planned, our wholesale funding ratio has increased from 20.9% to 26.2%.

Customer satisfaction

In addition to financial measures, the Board also monitors a range of customer measures designed to ensure we continue to meet our customers' needs.

Our customer satisfaction survey is central to assessing how well we are delivering customer service and is based on customers' responses to actual transactions and activity with The Nottingham. In 2016 we have maintained our industry leading levels of satisfaction, with 81% of our customers rating us as excellent, an increase from 72% in 2015.

The net promoter score measures the percentage of customers strongly prepared to recommend The Nottingham to others, less those who are not prepared to recommend The Nottingham, which results in a net percentage of our customers who would recommend our products and services.

The Nottingham's net promoter score also saw an improvement, increasing to 78.0% compared to 74.2% in 2015.

Capital

The Society continues to focus on maintaining strong capital ratios to protect members' interests.

Common Equity Tier 1 (CET1) capital is the strongest form of capital and comprises the Society's general reserves. Whilst CET1 resources have increased by £7.4m, driven by the retained profit of the Society, this has been offset by an increase in risk weighted assets, primarily driven by the growth in mortgage assets. Overall this resulted in a CET1 ratio of 14.7%.

The following table shows the composition of The Nottingham's regulatory capital as at 31 December under CRD IV rules, and includes details of key ratios:

	2016 Society Transitional CRD IV £m	2015 Society Transitional CRD IV £m
COMMON EQUITY TIER 1 CAPITAL		
General reserves	201.2	193.5
Available for sale reserve	0.3	0.2
Regulatory adjustments and deductions	(13.1)	(12.7)
TOTAL COMMON EQUITY TIER 1 CAPITAL	**188.4**	**181.0**
ADDITIONAL TIER 1 CAPITAL		
Permanent Interest Bearing Shares	14.3	16.7
TOTAL ADDITIONAL TIER 1 CAPITAL	**14.3**	**16.7**
TIER 2 CAPITAL		
Collective provision	2.9	2.2
TOTAL TIER 2 CAPITAL	**2.9**	**2.2**
TOTAL REGULATORY CAPITAL	**205.6**	**199.9**
RISK WEIGHTED ASSETS	1,279.3	1,184.9
CAPITAL RATIOS		
Common Equity Tier 1 ("CET1") ratio	14.7%	15.3%
Total Tier 1 ratio	15.8%	16.7%
Leverage ratio – final rules	4.6%	4.8%
Leverage ratio – transitional rules	5.0%	5.2%

Regulatory adjustments includes deductions for investments in qualifying holdings, deferred tax and goodwill.

At 15.8%, the Society's Tier 1 ratio – which compromises both CET1 and Additional Tier 1 capital – has also fallen in the year driven by the increased risk weighted assets and the transitional provisions applied to the Society's PIBS.

The leverage ratio, which is calculated as Tier 1 capital divided by total balance sheet exposure, has increased slightly in the year to 4.6% under the final rules basis. This is driven by the retained profit of the Society in the year offset by an increase in risk weighted assets from the growing mortgage book.

Despite the falls in ratios noted against the prior year position, all the Society's capital ratios remained comfortably in excess of regulatory requirements throughout the year.

Further information regarding the Society's capital management can be found in the Pillar 3 report available at www.thenottingham.com.

Ashraf Piranie
Deputy CEO and Finance Director

22 February 2017

Corporate responsibility report

Doing good together

For over 165 years The Nottingham has been making a difference to the communities we serve.

As a mutual building society, with no shareholders, we still hold true to the vision of our founders who wanted to see people thrive and become more prosperous. Our aim has always been to support community projects that share our vision.

Over five years ago we launched our community programme, 'Doing Good Together,' and in that time it has gone from strength to strength. Once again this year we have continued to focus on the themes of homelessness, financial education and employability.

Through our Grants for Good scheme in 2016 we donated £40,000 to 17 local charities

Sam Offley and Sarah Wallace from our Newark branch give pupils from Highfields School a lesson in finance.

A major part of our fundraising programme is our Grants for Good scheme and this year we have donated £40,000 to 17 local charities. These have included the Caanan Trust, a charity that provides safe and secure supported accommodation for homeless men aged between 16 and 54 and Forces in the Community, a charity committed to supporting ex-service personnel and their families.

Another important donation this year has seen us fund 100 emergency homelessness packs for the Malt Cross in Nottingham, to be distributed by their Street Pastor scheme. The scheme sees trained volunteers out on the city street on Friday and Saturday nights working with emergency services and other charities such as Framework to deliver emergency help to vulnerable people.

The new branded stand at Leicester Tigers.

Each of the packs contained essentials such as toiletries, clothing and food vouchers as well as giving information that signposts people to services offering long term assistance to help keep people off the streets.

Our branches play a major part in our annual fundraising events and this year our staff have raised £35,000 for local charities in their areas. We have supported everything from local food banks to hospices and the RNLI. To add to the total our staff have also clocked up almost 1,000 voluntary hours this year – double our total last year.

A highlight of 2016 has been our support for ten schools in Nottinghamshire and Leicestershire through Young Enterprise's Company Programme. Volunteer Business Advisers have also provided practical support to students. This has also been reflected in our staff Tenner Challenge which saw members of our teams given £10 and challenged to make as much profit as possible. The event raised over £300 to support the same challenge in local schools next year.

Through our continued sponsorship of the charity SportsAid we sponsored 50 local athletes in 2016

We have also launched the Money Academy which provides financial awareness classes for children between the ages of eight and nine.

Our continued sponsorship of the charity SportsAid has seen us sponsor 50 local athletes and our fundraising has topped £5,000.

Homelessness charity Framework remains one of our main partners and this year we have supported Do It For Framework (DIFF) Day and their Off the Street campaign.

David Marlow, Chief Executive of The Nottingham and Steve Arscott from Young Enterprise help Rebekah Ward from our Ruddington branch get started with the Tenner Challenge.

Sports sponsorship

This year has marked our eleventh season of supporting Nottingham Forest Youth Academy and our second season of sponsoring Leicester City's Schools League. Our Harrison Murray Estate Agency sponsors the Harrison Murray Schools League, which sees over 500 children under the age of 11 in Leicestershire playing in school teams for a place in the finals that are held on the pitch at the King Power Stadium in May.

During the year we strengthened our presence in Leicestershire by extending our sponsorship with Leicester Tigers, which began the previous year. We also became Official Building Society of Leicester Tigers and the sponsor of their new West Stand (pictured). We continue to support the Junior Tigers Club and also the tag rugby programme which runs in 50 schools across the region during the season.

Simon Taylor, Chief Operating Officer at The Nottingham, gives Robin Hood a run for his money.

It was the fourth consecutive year we sponsored the Archery GB Finals. The event was held at Wollaton Hall, Nottingham, in September. We also held two public 'have a go' archery days at Nottingham Castle and in the city's Old Market Square to encourage participation in the sport.

For the second year running we sponsored the Aegon Open Nottingham tennis tournaments and promoted The Nottingham at both the women's WTA and the men's ATP tournaments. We also hosted four community tennis days in the city during the spring, allowing the public to try the sport for free.

A highlight this year has been the decision to hold the European Archery Championships in Nottingham – it was only the second time it had been held in the UK – and The Nottingham sponsored the event. After three years of being the headline sponsor of the Archery GB Finals this was a natural extension to our archery sponsorship and over 4,000 people attended the event.

Our sponsorship of local football teams continues and throughout 2016 we have supported 30 teams.

To find out more about our community investment programme, visit **www.thenottingham.com/Your-Society/Sponsorship-and-Community**.

Our people strategy

Our people are important to us and play a pivotal role in our success. We have a strategy which focuses on recruiting the right people to support the delivery of the Society's strategic goals and ambitions and to develop, inspire and motivate them throughout their career with us as well as rewarding and recognising great performance.

In 2016, recruitment has been focused on the strategic sourcing of individuals into key roles within the corporate functions of the organisation whilst maintaining a pipeline of talent for key operational roles across the branch network and estate agency. We are delighted to have welcomed 213 new colleagues throughout the year including 17 apprentices across different areas of the business who will be supported and guided through what we hope to be a long and successful career with us.

We have continued to invest in increasing professional competence and capability within the organisation, supporting a number of our people to gain professional qualifications. During 2016, our management milestones programme has seen three building society branch managers gain a level 5 qualification with the Institute of Leadership and Management, we launched the moving on up management development programme which supports estate agency colleagues to gain qualifications with the National Association of Estate Agents and we introduced a mortgage academy for our central mortgage team to provide a pathway to further qualifications.

Our successful relationship with the Building Societies Association and Loughborough University has continued and another one of our aspiring leaders joined the Masters programme geared specifically for those who work in a customer-owned/mutual financial services firm.

The Nottingham is proud to be a signatory to the Women in Finance Charter, a government initiative designed to improve gender diversity in senior positions within the financial services sector. We were delighted to see that The Nottingham featured as one of the leading organisations in the rankings of female leadership representation across the financial services industry.

In 2016 we held two "Golden Arrows" recognition events for 50 individuals who have gone above and beyond their day job. Nominations were put forward by colleagues with a record number being received.

Environment

Protection of the environment in which we live and operate is part of the Society's values and principles and we consider it sound business practice. Care for the environment is one of our key responsibilities and an important part of the way in which we do business. The Society recognises that improving its management of energy, use of paper and digital expansion offers environmental benefits as well as improvements to the customer experience.

Your Board of directors

Non-executive Directors

John Edwards

Chairman

John joined the Board in February 2012 and was appointed Chairman in May 2014. In his executive career, he held a number of roles at a CEO level in the insurance and investment sector, retiring in 2009 from Lloyds Banking Group where he was CEO of their International Financial Services Division. He was the senior independent non-executive director of the LV Group and Chairman of their Investment Committee until September 2015 and is currently a non-executive director of Saga Services Ltd.

Keith Whitesides

MBE, LL.D, M Phil, LL.B

Vice-Chairman & Senior Independent Director

Keith joined the Board in 2004. He retired from his position as Director of Investor Relations at The Boots Company Plc after working for the company for 27 years. He was awarded an MBE in 1996 for services to the community in the East Midlands. Keith, a barrister, also served as a Justice of the Peace in Nottinghamshire, was a national Commissioner for Racial Equality and a Council member of The University of Nottingham. He is Chairman of the Society's Pension Scheme Trustees.

Jane Kibbey

BSc, MCIPD

Jane joined the Board in 2006. She has a wealth of experience gained in financial services and human resources. Jane has worked in a range of high profile companies, retiring as Group Human Resources Director for Prudential Plc, a role she held for nine years.

Andrew Neden

MA, FCA

Andrew joined the Board in 2014. He is a Chartered Accountant with over 30 years' experience in financial services in the UK and overseas. After a number of years running KPMG's UK financial sector transaction services team, he was the global Chief Operating Officer for KPMG's financial services business. Current directorships include the Wesleyan Assurance Society and ABC International Bank Plc; he chairs the Audit committee for both organisations.

Kerry Spooner

LLB (Hons)

Kerry joined the Board in September 2016. Kerry had 10 years of financial services experience in the building society sector before joining the Board. She acted as a Non-Executive Director at two other building societies and has experience as Vice Chair, Senior Independent Director and Chair of Remuneration Committee. Prior to that Kerry worked as a solicitor for 20 years, the last nine years as a corporate finance partner of the international law firm Allen & Overy LLP. Kerry is also a member of the Lord Chancellor's Advisory Committee (Magistrates) and a Non-Executive Director of Scotiabank Europe plc.

Guy Thomas

BSc (Hons), ACA, FCT, C.Dir, FIoD

Guy joined the Board in 2014. He is a qualified accountant with nearly 30 years in the financial services industry with specific experience in Finance, Treasury, Risk and General Management. Guy has an excellent building society pedigree with more recent experience in market operations, mergers and acquisitions and disposals. Guy was previously Chief Operating Officer of The Principality Building Society. Prior to that he was Finance Director at three different building societies.

Executive Directors

David Marlow

ACIB

Chief Executive

David joined the Board in 2006 and became Chief Executive in 2011. Prior to his appointment as Chief Executive, David held the post of Retail Director. David has over 25 years' experience in a variety of roles in the financial services industry. Before joining The Nottingham, David held a number of senior posts in retail banking at Alliance & Leicester Plc, including Director of Current Accounts & Savings and Managing Director Alliance & Leicester Direct. He is a director of Nottingham Property Services Ltd, Nottingham Mortgage Services Ltd, Harrison Murray Ltd and HM Lettings Ltd.

Mahomed Ashraf Piranie

FCCA, MBA

Deputy Chief Executive & Finance Director

Ashraf joined the Board in 2007 as Finance Director and since 2011 he has held a broader role as Deputy CEO and Finance Director. Previously, he held the positions of Finance Director and Joint Managing Director at the Islamic Bank of Britain and Director of Finance at Alliance & Leicester Plc. He is a director of Nottingham Property Services Ltd, Nottingham Mortgage Services Ltd, Harrison Murray Ltd and HM Lettings Ltd. Ashraf is also a member of the PRA Practitioner Panel.

Simon Taylor

ACIB, MBA

Chief Operating Officer

Simon joined the Board in 2011 and is responsible for Customer Service, Distribution, the Branch Network, Estate Agency, Marketing and I.T. He is also the Chairman of Nottingham Mortgage Services Ltd, Nottingham Property Services Ltd, Harrison Murray Ltd and HM Lettings Ltd. Simon joined the Society from Lloyds Banking Group where he was Regional Director for the North of England. Prior to this he had a number of senior roles within Lloyds Banking Group.

Board Committees

Audit

Andrew Neden – Chairman
Jane Kibbey
Guy Thomas

Nominations

John Edwards – Chairman
David Marlow
Keith Whitesides

Remuneration

Jane Kibbey – Chairman
John Edwards
Guy Thomas

Risk

Guy Thomas – Chairman
John Edwards
Jane Kibbey
David Marlow
Andrew Neden
Ashraf Piranie
Kerry Spooner
Simon Taylor
Keith Whitesides

Directors' report

The Directors' report should be read in conjunction with the Chairman's statement, Chief Executive's review and Strategic report on pages 4 to 15.

Business objectives and activities

The Nottingham is a strong and successful mutual building society which builds upon its strong regional foundations, with a track record of serving our members for over 165 years. At The Nottingham we aim to build long lasting relationships with our customers and to be recognised for the excellent service we provide.

Information on the Group's business objectives and activities are provided in the Strategic report on pages 8 to 15.

Business review, future developments and key performance indicators

The Group's business activities and future plans are reviewed in the Strategic report section of the Annual Report and Accounts on pages 8 to 15. Additionally within the Strategic report, we comment upon the financial (and other) key performance indicators used by the board during the year to assist its control, direction and drive for business results.

Principal risks and uncertainties

The principal risks and uncertainties faced by the Group are outlined on page 8 and our approach to managing these risks can be found in the Risk management report on pages 23 to 27.

Financial risk management objectives and policies

As a result of its normal business activities, the Group is exposed to a variety of risks, including credit, market and liquidity. The Group's objective is to minimise the impact of these risks as well as financial risk upon its performance. The risk management report on pages 23 to 27 considers this in detail. A further explanation of the financial risks and the controls in place to manage them (including the use of derivatives) is given in note 30 to the annual accounts.

Results

Group reported profit before tax for the year was £14.2 million (2015: £20.0 million). The Group profit after tax for the year transferred to general reserves was £11.0 million (2015: £15.4 million.) As at 31 December 2016, total Group reserves and equity were £199.8 million (2015: £192.5 million).

Capital

Group gross capital at 31 December 2016 was £226.0 million, (2015: £218.7 million) being 6.79% (2015: 7.11%) of total shares and borrowings. Free capital, at the same date, amounted to £208.5 million (2015: £199.6 million) and 6.26% (2015: 6.49%) of total shares and borrowings.

The annual business statement on page 94 gives the explanation of these ratios. The directors remain committed to maintaining a strong capital position.

Loans and advances

During 2016, total lending was £798 million (2015: £651 million) and the average advance made was £149,352 (2015: £154,485), with the average debt at the end of the year being £122,990 (2015: £119,711).

At 31 December 2016 there was one case (2015: 7 cases) of properties being 12 or more months in arrears or in possession. The total amount of balances outstanding in those cases was £127,802, with arrears of £10,371.

No mortgage losses were realised during the year from existing provisions. Provisions for potential mortgage losses total £4.5 million, (0.15% of mortgage balances).

The Group offers a number of different forbearance options to customers including reduced payment concessions, payment plans, capitalisations and mortgage term extensions. At 31 December 2016 the Group had 127 loans (2015: 163) subject to some form of forbearance. Note 30 to the accounts on page 83 provides further details.

Property, plant and equipment

Freehold premises owned by the Group are shown in the accounts at cost less depreciation. An estimate of the value of those properties, prepared in late 2016 by the Group's professional services team, indicates that market value is £1.4 million (2015: £0.8 million) higher than book value.

Supplier payment policy

The Group's policy is that payment will be made 30 days from the receipt of the invoice, provided that the supplier has complied with all relevant terms and conditions. Variation of the 30 day policy can be agreed at the time an order is placed.

At 31 December 2016, the total amount owed to suppliers was equivalent to one days' credit. (2015: 10 days)

Charitable and political donations

During the year the Group made charitable donations of £103,000 (2015: £106,000). No contributions were made for political purposes.

Country-by-country reporting

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 came into effect on 1 January 2014 and place certain reporting obligations on financial institutions within scope of the Capital Requirements Directive (CRD IV).

The nature of the activities of the Society are set out under business objectives of this report and for each of the Society's subsidiaries in note 16 to the accounts. All of the activities of the Society and its subsidiaries are conducted in the United Kingdom and therefore 100% of the total income, profit before tax and tax shown in the Income Statement as well as employee figures disclosed in note 7 are related to the United Kingdom. The Society and its subsidiaries have not received any public subsidies.

Environmental policy

The environmental policy is set out in the corporate responsibility report on pages 16 to 17.

Our people

Recruiting and retaining the best talent is key to delivering The Nottingham's vision and is reflected in the Society's people strategy, as outlined in the corporate responsibility report on page 17.

We remain committed to equality of opportunity in all aspects of employment, and the provision of the services we offer. New employees are briefed as part of their induction, online training is available for all people managers and all training reflects the principles of our equal opportunities policy and relevant legislation.

Open and clear communication amongst all our team members is vital to the success of The Nottingham. To this end we held a Staff Conference in January to share business performance and our goals over the next few years as well as congratulate our teams on their contribution. In addition we run regular training and communication sessions for our teams to keep everyone informed.

To help gather team member views and opinions, we hold regular meetings with our Staff Council and seek feedback through management channels.

Finally, as reported on page 16, our Doing Good Together initiative continued to flourish during 2016 with many of our teams working together to organise fund raising activities for our chosen causes.

Directors' responsibilities in respect of the annual report, the annual business statement, the directors' report and the annual accounts

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 ('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 IFRSs as adopted by the EU and applicable law and have elected to prepare the Society annual accounts on the same basis.

The Group and Society annual accounts are required by law and IFRSs 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.

In preparing each of the Group and Society annual accounts, the directors are required to:

- select suitable accounting policies in accordance with International Accounting Standard 8: Accounting Polices, Changes in Accounting Estimates and Errors and apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- 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 for 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; and
- 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 Financial Conduct Authority and the Prudential Regulation Authority under the Financial Services and Markets Act 2000.

The directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Society's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' statement pursuant to the disclosures and transparency rules

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware:

- the annual accounts, prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group and Society; and
- the management report contained in the Chairman's statement and Chief Executive's review 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 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 and 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. Details of the governance procedures which have been implemented to support this can be found in the Board Audit Committee report on page 33.

Going concern and viability

Going concern

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

The directors have considered the risks and uncertainties discussed on pages 8 to 9 and pages 23 to 27, and the extent to which they might affect the preparation of the annual report and accounts on a going concern basis.

Directors' report (continued)

The Group's business activities and future plans are reviewed in the Chairman's statement and Chief Executive's review on pages 4 to 7. In addition, note 30 to the annual report and accounts includes the Group's policies and processes for managing financial instrument risk such as liquidity risk, interest rate risk and credit risk.

As with many other financial institutions, the Group meets its day-to-day liquidity requirements through prudent management of its retail and wholesale funding sources. It ensures it maintains sufficient liquidity to meet both normal business demands and those that may arise in stressed circumstances.

Furthermore the Group's forecasts and plans, taking account of current and possible future operating conditions, including stress tests and scenario analysis, indicate that the Group has sufficient operating liquidity and capital for the foreseeable future.

As such, the directors are satisfied that the Group has adequate resources to continue in business and to use the going concern basis in preparing the accounts.

Viability statement

In accordance with the 2014 revision of the Corporate Governance Code, the Board have also assessed the prospects of the Society over a period longer than the 12 months required by the going concern provision. The Board has conducted this review for a period of four years, which has been selected to align it to the Group's corporate planning period, however the Board has less certainty over the last year of the planning period.

The four year corporate plan considers the Group's profitability, cash flows, liquidity and capital requirements as well as other key financial ratios over the period. These ratios are subject to sensitivity analysis and stress testing, which involves varying a number of the main assumptions underlying the forecast both individually and in unison. Where appropriate, this stress testing is carried out to evaluate the potential impact of the Group's principal risks, as outlined on pages 8 to 9 of the Strategic report and the risk management report on page 23, actually occurring. Based on the reviews completed, the Board considers that the Society is viable over the medium term.

Directors

The names of the directors of the Society who served during the year and up to the date of signing the accounts, their roles and membership of Board committees are detailed in the governance section on pages 18 to 19. Other business interests are shown in the annual business statement. None of the directors have any beneficial interest in, or any rights to subscribe for shares in, or debentures of, any connected undertaking of the Society, at 31 December 2016.

In accordance with the agreement made by the Board and in line with the rules for re-election outlined on page 29, John Edwards, David Marlow, and Jane Kibbey, will all stand for re-election at the 2017 AGM. Kerry Spooner joined the Board in September 2016 and will seek election at the 2017 AGM alongside Kavita Patel, who joins the Board in January 2017. Keith Whitesides is retiring at the end of the AGM and will not seek re-election. Mary Phibbs also served as a director during the year, retiring at the AGM in March 2016.

Auditor

A resolution to reappoint Ernst & Young LLP as auditors of the Society will be proposed at the Annual General Meeting.

On behalf of the Board of directors,

John Edwards
Chairman

22 February 2017

Risk management report

For the year ended 31 December 2016

The Nottingham recognises risk as a natural consequence of its business activities and environment. It endeavours through positive risk strategies, to manage these in a manner that ensures delivery of its strategic objectives and business plan, whilst protecting members' interests and its financial resources.

The Board is responsible for ensuring that an effective framework is in place to promote and embed an effective risk-aware culture that identifies, appropriately mitigates and manages the risks which the Group and Society face in the course of delivering its strategic objectives. This includes both current risks and those associated with the implementation of future strategy.

The Board annually reviews and approves a risk appetite statement.

In pursuing its strategy the Board ensures there are appropriate capabilities and resources available, along with sufficient capital strength to succeed. This includes focusing on risk and reward to ensure it is at an acceptable level.

During 2016, the Board has sponsored a Group-wide initiative culminating in the design, delivery and implementation of an enhanced governance and risk management framework. This will ensure that The Nottingham has robust and scalable governance and risk management processes to enable delivery of its long term strategy.

The scope of the initiative included the implementation of a revised risk management framework containing the following key elements:

- A revised governance framework, incorporating improvements to the Risk Management Committee structure, Committee membership and responsibilities;
- Redefined key risk categories with individually assigned risk category ownership;
- Standardised and aligned risk management policy and appetite documentation; and
- Standardised reporting of risk profile against appetite through Management and Board Risk Committees.

The revised framework became fully operational during 2016.

The Board Risk Framework

The Board Risk Committee is an integral part of the Group's formal structure, assisting the Board in overseeing all aspects of risk management. It regularly reviews and approves policy statements, risk appetite statements, and management committee terms of reference. It receives summary management information and minutes from all of the individual management committees, as detailed below:

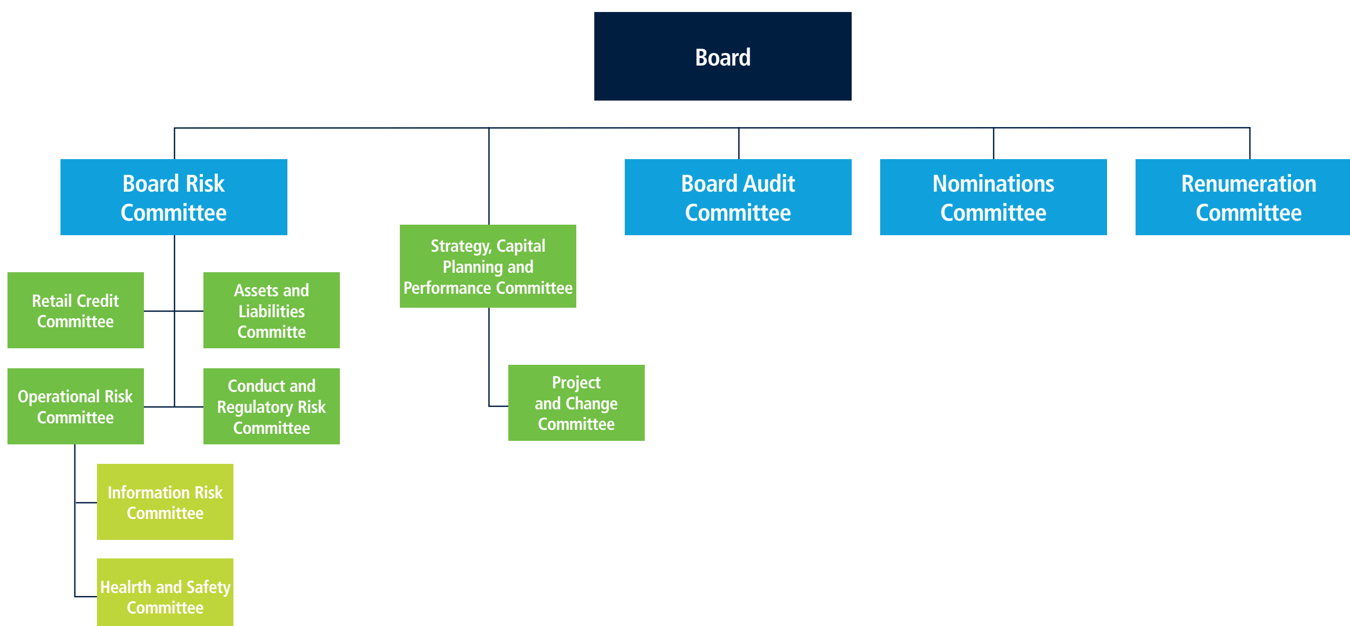
The risk management framework is based on the three lines of defence model (described on page 30) and focuses on:

- clear accountability and ownership;
- defined roles and responsibilities;
- the identification of business objectives;
- identification of the risks arising from these objectives;
- an assessment of the identified risks and controls using the board approved risk framework;
- assessing the effectiveness of the documented controls;
- monitoring the risks and controls on an ongoing basis; and
- reporting risks to the relevant committees.

Board Risk Committee

As detailed on page 19, the Board Risk Committee comprises all full Board members, both executive and non-executive. It is responsible for:

- ensuring key risks are identified and steps taken by management to mitigate them;
- ensuring due consideration is given to all significant matters relating to governance, control, regulatory and compliance issues;
- monitoring the Group's key risk and controls; and
- ensuring adequate capital is maintained to address the Group's key risk exposures, both to ensure regulatory compliance and the achievement of strategic goals.



Governance

Risk management report (continued)

The Board Risk Committee meets quarterly to review risk management activities and consolidated management information regarding existing and emerging areas of risk.

The scope of the Board Risk Committee extends to all types of risk faced by the Group with the management of certain risks delegated to the six 'management' committees. These committees are:

Assets and Liabilities Committee

The Assets and Liabilities Committee (ALCO) is responsible for overseeing The Nottingham's liquidity risk, market and interest rate risk and its wholesale credit risk. In addition, ALCO reviews treasury activity for compliance with approved treasury policies and procedures.

The Committee comprises two Executive Directors and relevant senior managers.

Market and interest rate risk

The Nottingham defines market and interest rate risk as the risk to net interest income and economic value arising from changes in market interest rates and mismatches in The Nottingham's balance sheet. Economic value is the present value of The Nottingham's future cash flows.

The economy is still dominated by low interest rates and an uncertain economic environment. Current LIBOR futures and gilt yields indicate this will remain the case for some months to come. The Nottingham has a greater proportion of LIBOR earning assets than liabilities, which is being actively monitored against its basis risk appetite to ensure any future change to interest rates does not adversely affect The Nottingham's interest margin.

Previous Bank of England intervention to stimulate the economy such as the Funding for Lending Scheme (FLS) has seen reductions to market rates for both retail lending and savings products. In 2016 a further stimulus was launched, the Term Funding Scheme (TFS). Additionally, increasing competition in an already highly competitive lending market continues to drive tighter interest margins across the industry. We continue to monitor anticipated market rate changes and assess the impact of TFS on The Nottingham's position.

The Nottingham's limits for the management of market and interest rate risk are documented in the market and interest rate risk appetite statement which is developed, defined and recommended by ALCO and considered and approved by the Board.

Basis risk, which arises from changes in the relationship between different interest rates which have similar but not identical characteristics, is included within this risk category as a subset of interest rate risk.

The Treasury Risk team measure the levels of basis risk inherent in The Nottingham's balance sheet as well as subjecting the balance sheet to monthly stress tests designed to measure the likely impact of a sudden change in interest rates. This is assessed and monitored against our approved risk appetite.

The Treasury team is responsible for day-to-day management of The Nottingham's interest rate and basis risk exposures within the approved risk appetite. Typically interest rate risk is managed by taking advantage of natural hedging opportunities within our balance sheet or through the use of appropriate hedging strategies.

ALCO is responsible for reviewing Treasury activity, performance and compliance with the approved policy and risk appetite statements. A detailed analysis of The Nottingham's interest rate sensitivity exposure can be found in note 30 to the annual accounts.

Liquidity risk

The Nottingham defines liquidity risk as the risk that the Society will not have sufficient financial resources available to meet its obligations as they fall due, under either normal business conditions or a stressed environment. It is managed through holding cash, other high quality liquid assets and maintaining wholesale funding facilities.

ALCO develops, defines and recommends a liquidity risk appetite which is considered and approved by the Board. The liquidity risk appetite helps to ensure that the management of the liquidity portfolio by the Treasury team supports the corporate plan.

The liquidity policy sets the framework for the day-to-day activities of the Treasury team to ensure that all liquidity management activities are conducted within approved risk appetites. The Nottingham maintains a diverse funding base and ensures compliance with applicable regulatory requirements. Defined control limits determine the overall level of liquidity to be maintained. The base level and composition of The Nottingham's liquidity is subject to PRA guidance and regular stress testing and is documented as part of our Individual Liquidity Adequacy Assessment Process (ILAAP) document, as required by the PRA.

Since 1 October 2015 the Society has been required to be compliant with a new short-term liquidity stress metric, the Liquidity Coverage Ratio (LCR), which measures the amount of high quality liquid assets relative to estimated net stressed cash outflows within a 30 day period.

In addition, a longer term funding measure, the Net Stable Funding Ratio (NSFR), is to be introduced from 2018. The final rules are yet to be published.

Based on our current interpretations of the standards, the liquidity portfolio held by The Nottingham comfortably exceeds the minimum requirements of both the LCR and NSFR.

Furthermore, The Nottingham has documented and regularly tests a Liquidity Contingency Plan which describes those metrics that would indicate an emerging market-wide or Nottingham-specific stress event. The Plan includes a range of options available to The Nottingham in the event of such a stress to ensure an adequate level of liquidity is maintained.

Regular stress testing is performed to confirm that The Nottingham's available liquidity is adequate, within risk appetite and is sufficient to support extreme cash outflows.

Responsibility for the day-to-day operational management of liquidity risk lies with The Nottingham's Treasurer with operational oversight provided by the Treasury Risk team and reported to ALCO.

A detailed analysis of the Society's liquidity profile can be found in note 30 to the annual accounts.

Wholesale credit risk

Wholesale credit risk arises from counterparties who may be unable to repay loans and other financial instruments that The Nottingham holds as part of its liquidity portfolio.

The Nottingham's risk of counterparty default has reduced over the past couple years due to the high proportion of total liquidity held in UK Sovereign debt securities and the Bank of England reserve account. Total liquidity remains significantly above the level required by the PRA. The composition of the Treasury loans can be found on page 79.

The Nottingham' liquidity policy sets out the counterparties which the Treasury team may transact with, currently limited to lending in sterling to the UK government, UK banks and building societies plus highly rated overseas banks. In addition, all counterparties must hold a minimum 'A' rating from an external rating agency and satisfy The Nottingham's internal assessment thresholds. This has led to a reduction in the number of available counterparties over the past few years. However, as permitted by policy we have continued to hold liquidity with carefully selected European based Multilateral Development Banks in instances where it qualifies as High Quality Liquid Assets (HQLA). Our Board has not permitted any lending directly to sovereign states, other than the UK.

The Board, via the approved policy, further restricts the level of risk by placing limits on the amount of exposure that can be taken in relation to one counterparty or group of counterparties, and to industry sectors and geographical regions.

The Nottingham's Treasury team have day-to-day responsibility for operating within Board approved credit limits. Monitoring and oversight, including assessment of counterparty credit worthiness, is undertaken by the Treasury Risk team to ensure all exposures remain within risk appetite. This information is shared with ALCO.

Retail Credit Committee

The Retail Credit Committee (RCC) is responsible for oversight of The Nottingham's retail assets which includes residential and buy-to-let mortgages and Secured Business Loans.

It comprises two Executive Directors and a number of relevant senior managers.

Retail credit risk

The Nottingham defines retail credit risk as the risk that a financial loss arises from the failure of a customer to meet their contractual obligations. As a building society this is most likely to arise through the inability of borrowers to repay a mortgage. Our exposure to retail credit risk is limited to the provision of loans secured on property within the UK.

A Retail Credit Risk Appetite Statement and Policy are proposed by the Retail Credit Committee and considered and approved by the Board.The Nottingham manages the level of credit risk it undertakes by applying various control disciplines, the objectives of which are to maintain asset quality in line with approved risk appetite. The Board receives monthly information on key risk appetite limits.

Exposure to retail credit risk is carefully monitored by the RCC. Day-to-day retail credit risk is managed through the application of prudent lending policies which are aligned to the stated risk appetite. This ongoing monitoring provides assurance that current and future exposures, such as Loan To Value levels, geographic concentration and probability of default are managed within the risk appetite limits set by the Board.

We regularly stress-test the mortgage portfolio to detect any signs of potential payment stress or sensitivity for our borrowers to the impact of future rate rises. The mortgage portfolio shows resilience to the impact of rate rises, but we maintain a watching brief to ensure the adequate monitoring and analysis is in place to detect any signs of deterioration.

The Nottingham remains committed to promoting home ownership and its risk appetite allows lending to first time buyers, with a minimum deposit of 5%, but restricts the overall level to ensure the risk is managed sufficiently. Similarly, we continue to follow our long term policy of offering interest only products. However, we operate strict policies and monitoring procedures to ensure an appropriate repayment vehicle is in place.

All mortgage loan applications are reviewed by an individual underwriter supported by the use of application scorecards. Credit reference bureau data is obtained on all applications in line with industry best practice. The Nottingham also shares account performance data with the selected bureau.

Whilst The Nottingham lends throughout the UK, geographic distribution is focused in two broad areas (as detailed on page 14), our heartland of the East Midlands/Yorkshire and London/South East which has generally been driven by buy-to-let (BTL) lending.

The Nottingham has reduced its appetite for further BTL growth and is targeting to reduce the proportion of BTL lending over the next few years. However, the BTL market remains a core part of our offering and the BTL proposition of the mortgage portfolio stands at 24% with a track record of low arrears.

The Nottingham continues to be a responsible lender and its approach to lending is based on making sure that customers can afford to meet their mortgage repayments from the outset, through the use of a prudent affordability calculator, as well as our manual underwriting processes. Should customers find themselves in financial difficulty, we respond with appropriate forbearance activities to ensure fair customer outcomes. The purpose of forbearance is to support customers who have temporary financial difficulties and assist them to get back on their feet. Only as a matter of last resort would The Nottingham take the property into possession. In addition we continue to work within best practice guidelines to ensure customers with interest only loans have appropriate repayment vehicles in place.

Residential, BTL and Secured Business Lending (SBL) loans are granted only against the 'bricks and mortar' value (i.e. loans are provided only for the purchase or re-mortgaging of a property and not for working capital or machinery etc.).

A SBL policy is used to manage levels of business lending risk with loans manually underwritten. To ensure appropriate management of lending risk The Nottingham maintains watch lists to monitor those loans which are a possible cause for concern in order that risk mitigating action can be taken as appropriate. Primarily, SBL loans are made available to Small and Medium sized Enterprises (SMEs) for either owner-occupied or investment property purposes.

The Nottingham does not have any exposure to the sub-prime mortgage market, has never purchased assets from other organisations, lends only to 'prime' customers and has never undertaken 'self- certified' lending business.

Risk management report (continued)

Conduct and Regulatory Risk Committee

The Nottingham, being a retailer of mortgage, savings and insurance products, is regulated by both the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA).

The Conduct and Regulatory Risk Committee (CRRC) is responsible for overseeing how The Nottingham conducts its business, ensuring that all customer-impacting activities are conducted in a clear, transparent and fair manner, delivering fair outcomes for customers. The CRRC is also responsible for overseeing compliance with all applicable laws and regulations.

The Committee is chaired by the Chief Operating Officer supported by a number of relevant senior managers.

Each business area is responsible for ensuring that all regulatory and statutory requirements are complied with on a day-to-day basis. Formal oversight is provided by the compliance team through a programme of compliance monitoring.

The Nottingham has a very low appetite for breaches of regulation or for any activity which may lead to an unfair outcome for our customers. Accordingly, The Nottingham carefully chooses the products and services it is willing to offer to its customers and ensures the appropriate level of expertise exists in the organisation to ensure good customer outcomes and compliant sales processes.

Operational Risk Committee

The Operational Risk Committee (ORC) is responsible for overseeing actively the management of operational risk across The Nottingham.

The Committee is chaired by the Chief Operating Officer supported by relavent senior managers.

The Nottingham defines operational risk as the risk of loss resulting from human factors, inadequate or failed internal processes and systems or from external events. Operational risk exists in every aspect of The Nottingham's business activities. Procative management of operational risk is essential in helping us achieve both short-term operational objectives and longer-term strategic goals.

To ensure the effective monitoring and reporting of risk, The Nottingham maintains a number of risk registers, including a Group Risk Register, an Executive risk register and individual departmental and project risk registers. These risk registers help management assess the probability and impact of the risks identified, and the effectiveness of mitigating controls.

Furthermore, as part of the risk management framework all business areas are required to maintain an Objectives, Risks and Control Assessment (ORCA). Documented within the ORCA are the business area's objectives and an assessment of inherent risk and residual risk where specific controls have been identified and evaluated. The ORCA is used by management to document the effective management of both risks and controls within their business areas.

Key processes which support the effective identification and management of operational risk include the risk event process, which provides a mechanism for operational incidents to be reported, their impacts assessed, remediation to be performed and root cause analysis to be undertaken, to reduce the risk of recurrence.

Information Risk Committee

The Information Risk Committee (IRC) is a sub-committee of the Operational Risk Committee and supports the Board in ensuring that The Nottingham's information is securely managed . It performs this role through the approval of appropriate frameworks and policy, oversight of policy implementation and receipt and review of management information.

The Committee is chaired by the Chief Operating Officer and comprises business area representatives from across The Nottingham.

Given the nature of our business we place significant focus on managing information security, data protection and fraud risks whilst also ensuring appropriate staff awareness.

Cyber crime represents an increasing risk to all businesses with a number of high profile cases being reported during the year. As financial criminals continue to innovate and exploit new vulnerabilities, we aim to stay ahead through robust technical and organisational controls which have been developed and implemented to ensure the ongoing safety and security of members' funds.

Project and Change Committee

The Project and Change Committee supports the Board in ensuring the optimum use of resources when delivering The Nottingham's programme of projects. It performs this role through the approval and prioritisation of all requests to initiate or materially change a project and ensures their status is monitored.

The Committee is chaired by the Chief Operating Officer, supported by relevant senior managers.

As the scale and pace of change intensifies, it is essential that The Nottingham manages and prioritises resources effectively to serve both current and future members while maximising member benefit.

Strategy, Capital, Planning and Performance Committee

The Nottingham defines Strategy and Capital Sustainability risk as the risk that The Nottingham does not have sufficient capital or allocates it ineffectively in pursuit of its long term strategy to deliver sustainable value to members. This includes The Nottingham's ability to manage its capital and strategy effectively in a range of business and economic Environments.

The Committee is chaired by the Chief Executive and comprises all three Executive Directors and certain senior managers from across the business.

Strategic risk

When discussing future strategy the Committee and subsequently the Board takes care to ensure that risks such as system changes, long term funding approach and acquisitions are evaluated and that management has plans in place to effect any required mitigation. The Strategy, Capital, Planning and Performance Committee oversees the detailed evaluation of these risks.

The Committee also oversees management of the risks that unexpected changes in the external environment have the potential to affect the Group's business model either through the level of demand for the Group's products and services and/or its ability to meet that demand. This includes proposed or agreed changes to regulation which may impact upon The Nottingham's ability to compete, how it conducts business and its liquidity and capital requirements.

The Nottingham looks to mitigate this exposure through regular review of its annual corporate plan, to ensure activities remain within risk appetites. It also maintains a diverse range of products and services to avoid over-reliance on one income source or one product or one area of its business.

Capital sustainability risk

The Nottingham conducts timely evaluations of its capital adequacy and financial resources to determine the level of capital required to support current and future risks contained within its strategic plan. This process is known as the Internal Capital Adequacy Assessment Process (ICAAP).

The ICAAP assesses The Nottingham's future capital requirements by considering changes to business volumes, the type and mix of assets and business activities within the context of current and future anticipated risks and stress scenarios. The ICAAP also incorporates the Capital Requirement Directive IV (CRD IV) requirements.

The Prudential Regulation Authority (PRA) use the ICAAP during their Supervisory Review and Evaluation Process (SREP) through which it determines the amount of capital which it requiresThe Nottingham to hold: its Individual Capital Guidance (ICG).

The Board monitors the level of capital held by the Society in relation to its ICG on a regular basis. The Society's current and future capital levels remain well in excess of the PRA requirements. An analysis of the components of The Nottingham's current capital position can be found in the strategic report on page 15.

On behalf of the Board of directors,

Guy Thomas
Chairman of the Board Risk Committee

22 February 2017

Corporate governance report

Nottingham Building Society is committed to best practice in corporate governance and has considered the requirements of the UK Corporate Governance Code.

The Board has reviewed the Society's corporate governance practices against the revised UK Corporate Governance Code (September 2014), which is intended to apply to listed companies, to the extent that they are relevant to a building society. In the interest of transparency, the regulator encourages each building society to explain in its Annual Report and Accounts whether, and to what extent, it adheres to the Code.

In the prior year, the Society reviewed its corporate governance practices in line with the revised Code issued by the Financial Reporting Council (FRC) in September 2014. This report sets out how the Board has operated in 2016 and complied with the provisions of the Code. The Board is committed to complying with best practice in corporate governance but where it believes that there is a justifiable reason to depart from the Code then it will do so. The key consideration is that such a departure is believed to be in the best interests of members and that the governance of the Society is not compromised.

The Board does not comply with the Code provision that all directors should be subject to annual election. The Board is concerned that in extreme circumstances that requirement could have implications for the financial stability of the Society which would not be in the best interests of members.

All directors are submitted for election at an annual general meeting in accordance with the Society's rules. The rules require re-election at three-yearly intervals. The Board has decided that from the 2016 AGM onwards the Chairman and the Chief Executive will each stand for re-election annually. Subject to that, the Board considers that the current voting arrangements are satisfactory and provide for a continuity of experience and knowledge. However, the issue will continue to be kept under review.

Leadership

The Board

At 31 December 2016, the Board consists of six non-executive directors (including the Chairman) all of whom are considered to be independent in character and judgement, and three executive directors, providing a complementary balance of skills and expertise.

The Board held 11 meetings and two strategy review meetings during 2016.

In addition the non-executive directors meet regularly, without the executive directors present, and consider all aspects of Board responsibilities, governance and performance.

In line with Code principles, the Board operates effectively and is collectively responsible for the long-term success of the Group and ensuring that the necessary resources are in place for the Group to meet this objective. It has a schedule of reserved matters and its principal function is to focus on the formulation of strategy, approving and reviewing policy. Additionally, it ensures the appropriate financial and business systems and controls are in place to safeguard members' interests, maintain effective corporate governance and measure business performance. All directors are able to obtain independent professional advice, at the Society's expense, should that be necessary in the fulfilment of their duties, and have access to the services and advice of the Group Secretary.

Division of responsibilities

The roles of the Chairman of the Board and the Chief Executive are held by different people and are distinct in their purpose, with division of responsibility set out in writing.

The Chief Executive has direct charge of the Group on a day-to-day basis and is accountable to the Board for the financial and operational performance of the Group as well as for the formation of its strategy.

Some responsibilities are delegated to the Group's managers and officers and these are listed and reviewed by the Board.

The Chairman

The Chairman, who is elected by the Board annually, leads the Board in approving its strategy and in the achievement of its objectives. The Chairman is responsible for organising the business of the Board, ensuring its effectiveness and setting its agenda.

Non-executive directors

Independent non-executive directors play a vital role in challenging and helping develop strategy, whilst providing independent judgement, knowledge and experience.

The Board considers all non-executive directors to be independent in character and judgement and free of any relationship or circumstances which could interfere with the exercise of their independent judgement.

One of the independent non-executive directors is appointed as the senior independent director, to provide a sounding board for the Chairman and to serve as an intermediary for the other directors as necessary. The senior independent director is identified on page 18.

Effectiveness

Composition of the Board

The names of the directors together with brief biographical details are set out on pages 18 and 19.

The Board uses four committees (Risk, Nominations, Remuneration, and Audit) to help it discharge its duties.

The four committees meet regularly and current membership of these committees is shown on page 19.

The table below shows the attendance of each director at the relevant Board and Board committee meetings. The number to the left is the number of meetings actually attended; the number to the right is the number of meetings the director was eligible to attend during 2016.

Director	Board	Risk	Nominations	Remuneration	Audit
J. Edwards	11/11	4/4	3/3	5/6	-
J. Kibbey	11/11	4/4	-	6/6	6/6
D. Marlow	11/11	4/4	3/3	-	-
A. Neden	11/11	4/4	-	-	6/6
M. Phibbs	2/2	1/1	-	-	-
M. Piranie	11/11	4/4	-	-	-
K Spooner	3/4	1/1	-	-	-
S. Taylor	10/11	4/4	-	-	-
G. Thomas	11/11	4/4	-	6/6	6/6
K. Whitesides	8/11	3/4	3/3	-	-

The minutes of committee meetings are reviewed by the Board. The Board also receives reports from the Chairman of each of the committees and recommendations arising. The terms of reference for these four committees are available on request from the Group Secretary and are on the Society's website.

Appointments to the Board

The Nominations Committee assists the Board by making timely recommendations on the Board and executive succession plan, board recruitment and composition and other relevant matters. The Committee considers annually the competence and suitability of those directors seeking election or re-election at each annual general meeting.

The Committee meets at least annually. Additional meetings may be convened if necessary.

Appointments to the Board are made on merit and against objective criteria balancing skills, experience, independence and knowledge on the Board. The Society gives consideration to diversity in respect of gender and other measures, both at Board level and in recruitment throughout the business; however it is not thought to be in the interests of the business to set measurable objectives in this regard. Candidates for both executive and non-executive directorships are recommended by the Nominations Committee to the Board for approval, with the assistance of external consultants.

All directors must meet the requirements of the Senior Manager Regime prescribed by the Financial Conduct Authority and Prudential Regulation Authority including, where appropriate, receiving regulatory approval.

Commitment

Prior to appointment, non-executive directors are expected to disclose their other significant commitments. Before appointment non-executive directors undertake that they will have sufficient time to meet what is expected of them, recognising the need for availability in the event of crises. In addition, throughout their tenure with the Society, directors are required to inform the Board in advance of any other positions they wish to take up so the time commitment and any potential conflicts of interest can be considered.

Development

Upon appointment, new directors receive a full, formal and tailored induction and throughout their tenure all directors receive timely and appropriate training to enable them to properly fulfil their roles. The information and training requirements of all directors are reviewed annually.

Information and support

The Chairman ensures that all directors receive accurate, timely and clear information. All directors have access to the advice and services of the Group Secretary and independent professional advisers should this be required.

The Society has in place appropriate insurance cover in respect of the board directors.

Evaluation

Executive directors are evaluated using the performance management framework for all employees. The executive directors are appraised by the Chief Executive. The Chief Executive is appraised by the Chairman.

The performance of non-executive directors is reviewed annually by the Chairman. The senior independent director conducts interviews with each director in order to appraise the performance of the Chairman, the results of which are discussed with the Chairman by the non-executives.

The Board and each of the committees formally evaluate their own performance and effectiveness each year. These evaluations take into consideration the balance of skills, experience, independence and knowledge, and consider the diversity of the group and its ability to work together. The process is co-ordinated by the senior independent director and the outcome of each evaluation is presented to the nominations committee who assess the results for trends and themes. This process also includes an overall assessment of the performance reviews undertaken by the key management committees, which report to the various board committees. The overall outcome of the review is then reported to the Board. In addition, mindful of the requirements of the Code , an externally facilitated Board dynamics review was carried out by Grant Thornton in 2016. The review concluded that there is good interaction between the Board members of the Society. The Board is satisfied that the evaluation process meets the needs of the Society and its members. The Board will keep under review and consider, for 2019 , the Code requirement for FTSE 350 companies to conduct an external evaluation every three years.

Re-election

All directors are submitted for election at an annual general meeting (the 'AGM') in accordance with the Society's rules, and in this regard the Society has departed from the recommendations of the Code.

The Code indicates that all directors should stand for re-election annually whereas the Society's rules require re-election at three-yearly intervals. The Board consider that the current voting arrangements are satisfactory and provide for stability of the Society as well as a continuity of experience and knowledge. However the requirement will continue to be kept under review.

Non-executive directors can serve up to a maximum of three three-year terms. Any extension must be approved annually, subject to rigorous review and be explained giving due consideration to the continuing independence and objectivity of the non-executive director. Jane Kibbey has completed more than nine years as a non-executive director and will now seek re-election. The Board considers that her experience and contribution continue to be extremely valuable and she continues to be independent in character and judgement and recommends her re-election to members. Keith Whitesides will retire at the end of the 2017 AGM and is therefore not seeking re-election.

The Nominations Committee makes recommendations for the Board concerning the re-appointment of any non-executive director at the conclusion of their specified term of office, having due regard to their performance and ability to continue to contribute to the Board in light of knowledge, skills and experience required.

Accountability and audit

Financial and business reporting

The Directors' report on pages 20 to 22 details the responsibilities of the directors in preparing the Group's accounts.

This includes ensuring suitable accounting policies are followed, that a true and fair view of the Group's financial position is given and that the Group's business is a going concern.

The Board has responsibility to present a fair, balanced and understandable assessment of the Group's performance and financial position, business model and strategy, consideration of which is contained within the Chief Executive's review on pages 6 to 7, the Strategic report on pages 8 to 15 and within the report and accounts taken as a whole.

Viability statement

In accordance with the 2014 revision of the Code, the Board have assessed the prospects of the Society over a period longer than the 12 months required by the going concern provision. The viability statement is considered on page 22 within the Directors' report.

Risk management and internal control

The Board Risk Committee oversees the entire risk management framework of the Group. It advises the Board on determination of risk appetite and setting of risk limits. The Committee fulfils its obligations through two approaches. Firstly it is responsible for monitoring operational risks to ensure they are in line with the Group's prudent policies and with its agreed Group risk appetite statement. In doing so the Committee considers any emerging risks and ensures significant changes in exposures to existing risks are promptly identified and addressed by management. This includes overseeing the identification and management of project risks across the Group. The Committee also reviews the Group's policy on whistle-blowing' in respect of financial or other matters.

The second approach involves the Committee focusing its attention on the risks within the Group's strategy and the management of these risks.

To assist in monitoring the risk management framework, the Assets and Liabilities, Retail Credit, Conduct Risk, Operational Risk, Information Security and Programme Board Committees report into the Board Risk Committee. The Committee meets at least quarterly.

The Board have carried out a robust assessment of the principal risks facing the Group, including those that would threaten the business model, future performance, solvency and liquidity. These principal risks are detailed on pages 8 to 9 of the Strategic report and further information on risk management is given in the report commencing on page 23.

In accordance with the UK Corporate Governance Code the Society's Board is committed to maintaining a sound system of internal controls to safeguard both its own assets and those of its members and there is an annual review of risk management and internal control systems. During the prior year, the Board oversaw an extensive exercise to further enhance the governance and risk management and to formalise the lines of risk identification and acceptance. These improvements have been fully operational throughout 2016.

The operation of these three lines of defence is embodied in the terms of reference of the Society's seven risk committees (Assets and Liabilities, Retail Credit, Conduct & Regulatory, Operational, Information and Strategy, Capital Planning and Performance) along with the Board Risk Committee as well as a range of policies and procedures that relate to the identification, assessment, monitoring and control of all the main areas of risk that the Group faces.

The information received and considered by the risk committees provided reasonable assurance that during 2016 there were no material breaches of control or regulatory standards and that the Society maintained an adequate system of internal control. Where weaknesses in controls are identified by the three lines of defence the Board monitors the steps taken to remedy the issues and to ensure that the Society responds to changing external threats and economic circumstances and to the changing regulatory environment.

Remuneration

Policy and procedures

The level and make-up of director remuneration and the procedure for developing policy on executive remuneration, including fixing the remuneration packages of individual directors, is considered by the Remuneration Committee.

The Remuneration Committee's work and the Society's compliance with the Code principles relating to remuneration, is covered in the directors' remuneration report on pages 34 to 38.

Membership

The Committee consists of non-executive directors only and met on six occasions during the year. Additional meetings may be convened if necessary.

The Remuneration Committee reviews employment terms for the Group's employees, reporting recommended changes to the Board.

Relations with members

Dialogue with members

The Society's members are all customers of the Society. Engagement with customers is undertaken in various ways including social media, customer panels, regular literature and main stream media.

The Society is keen to find out its members' views so that it can continually improve. It provides them with a number of ways and opportunities to give their feedback. It surveys a selection of its members on a regular basis through its customer satisfaction survey and uses its 'Customer Panel' to provide input into the services and products it offers. The results of this feedback are shared in Board meetings. Members of the Board visit branches and meet with members as part of their role. The Society also encourages its members to attend its annual general meeting where they are able to ask questions and voice their opinions.

Furthermore, each year as part of the AGM documentation, the Society produces a members' magazine called 'The Nottingham and You' which provides news about the Society as well as information on its products and services. In addition the Society also sends a copy of its Members' Newsletter and summary financial statement which provides an abridged version of information contained within the Annual Report and Accounts.

Constructive use of the AGM

Each year, notice of the AGM is given to all members who are eligible to vote. Members are sent voting forms and are encouraged to vote online, by post, at a local branch or by person or proxy at the AGM.

All postal and proxy votes are counted using independent scrutineers.

All members of the Board are present at the AGM each year (unless, exceptionally, their absence is unavoidable) and the Chairman of the Audit, Nominations, Risk and Remuneration Committees are therefore available to answer questions.

The Notice of the AGM and related papers are sent at least 21 days before the AGM in accordance with the Building Societies Act 1986.

On behalf of the Board of directors,

John Edwards
Chairman

22 February 2017

Board Audit Committee report

Board Audit Committee

The principal role of the Board Audit Committee is to have oversight of financial reporting, internal control, internal audit operations and effectiveness and external audit operations and effectiveness. The Committee's primary functions are:

- Monitor the integrity of the financial statements of the Society, including significant financial reporting issues and judgements within;
- Review the financial statements;
- Review the integrity of the Society's systems of internal control and risk management;
- Monitor and review the performance of the internal audit function;
- Oversee the relationship with the external auditor; monitor the independence of the external auditor; and consider the effectiveness of the external audit process;
- Review and approve the annual internal and external audit plans;
- Monitor the provision of non-audit services by the external auditor; and
- Review the adequacy and security of the Society's arrangements for handling concerns raised through the Society's whistleblowing policy.

Membership and attendance

The Board Audit Committee consists of three non-executive directors. The members of the Committee are Andrew Neden (Chairman), Jane Kibbey and Guy Thomas.

The Committee invites the Chief Executive, Deputy Chief Executive and Finance Director, Chief Operating Officer, Head of Risk, Head of Internal Audit, Head of Finance and the external auditor to attend meetings on a regular basis. Other senior managers are invited to attend as required. Private meetings are held at least once a year with the external auditor and with the Head of Internal Audit in the absence of management to enable issues to be raised directly if necessary. The Committee chairman also meets regularly with the Head of Internal Audit and the external auditor.

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.

Meeting frequency and reporting

The Committee met six times during 2016 and the main activities during the year were:

- Reviewed the results and draft annual report and accounts for the year ending 31 December 2015 ;
- Reviewed the going concern assumptions and all key issues and areas of judgement relating to the financial statement reporting;
- Considered reports by the external auditor on its audit and review of the financial statement reporting;
- Reviewed the year-end and interim financial statements and draft press releases, with consideration of the fair, balanced and understandable requirements of the Corporate Code;
- Considered the audit strategy for 2016;
- Received and reviewed reports from internal audit;
- Reviewed and approved the Society's risk-based internal audit plan for the next year;
- Reviewed the adequacy and effectiveness of the Society's arrangements for handling matters raised through the whistleblowing policy;
- Reviewed the adequacy and effectiveness of the Society's internal financial controls, internal control and risk management systems;
- Carried out a review of the Committee's own effectiveness.

Significant issues in relation to the financial statements

The Committee considers a wide range of issues in relation to the financial statements, which relate mainly to judgements and estimates which management have to make during the preparation of the statements. During 2016, the significant issues considered by the Committee included:

- **Loan loss provisioning – residential and SBL mortgages**
  The Society estimates the level of provisions required in the residential and commercial book using historical default and loss experience and applying judgement. The Committee reviewed and challenged the approach to calculating the provisions and confirmed that the assumptions made are appropriate. The Committee is satisfied with the approach adopted to calculate the provision for impairment and the overall level of provision recognised.
- **Effective Interest Rate ('EIR') methodology**
  The Society recognises interest income using a constant level of interest over the expected behavioural life of the loan. The Committee reviewed the basis of the EIR calculations as well as the results from the testing performed by the external auditor and concluded it was appropriate.
- **FSCS levy provision and other provisions**
  The Committee reviewed and challenged the estimates and assumptions made by management when calculating the level of such provisions at the reporting period and concluded it was appropriate.
- **Hedge accounting**
  The Committee reviewed the Society's approach to hedge accounting, including valuation techniques, accounting ineffectiveness and key movements during the year. The Committee concluded that the approach adopted was appropriate and the hedging activity had been effective in mitigating the underlying risk.
- **Calculation of the defined benefit pension plan position**
  The Society has a defined benefit pension scheme which was closed to new entrants in 1997 and closed to future service accrual from 31 January 2009. The Committee reviewed the methodologies and 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 report provided by the Society's advisors. Noting that the assumptions adopted by management were consistent with this report, the Committee is satisfied with the position reported in the accounts.

- **Fair value of investment in subsidiary undertakings**
  The Society purchased the Harrison Murray estate agency business in 2013 and the Committee considered the carrying value of the investment and intercompany loan balances held in the Society books as well as the level of consolidated goodwill recognised at a Group level. Having reviewed forecast profitability and cash flows for the business unit, the Committee is satisfied that the carrying value is appropriate and there was no impairment arising.
- **Going concern assumption**
  The Committee evaluated whether the going concern basis of accounting was appropriate by considering forecast profitability, liquidity position, funding availability and regulatory capital positions. The review also took into account the detailed stress testing scenarios completed as part of the annual liquidity and capital adequacy assessments.
- **Fair, balanced and understandable**
  The Committee reviewed the integrity of the financial statements and any formal announcements. The content of the annual report and accounts was reviewed and the Committee advised the Board, that, in its view, and taken as a whole, it is fair, balanced and understandable and provides the information necessary for members to assess the Society's performance, business model and strategy. The Committee therefore recommended that the Board approve the annual report and accounts.
- **Viability statement**
  The Committee reviewed the requirements of the Corporate Governance Code to provide the medium-term viability statement in the annual report and accounts and agreed the definition of the medium-term period.
- **New accounting standards**
  Regular updates on financial reporting developments were presented to the Committee during the year to enable it to provide effective oversight of the financial reporting within the interim and full year accounts.
- **External audit findings**
  The external auditor did not highlight any material control weaknesses arising from their review of key financial reporting processes and systems.

Internal controls

The Board recognises the importance of strong systems of internal control in the protection of member and Group assets. Robust internal controls can also facilitate efficient and effective operations, reliable internal and external reporting and compliance with applicable laws and regulations.

The Society operates a risk management framework that is designed to provide a strong internal control framework. It is accepted that it is the responsibility of management to design, operate and monitor internal controls which adhere to the Board's policies on risk and control. All colleagues have a responsibility for internal control as part of their role and accountabilities.

The Committee reviews the effectiveness of the Society's risk management and internal control systems throughout the year to ensure they continue to be appropriate.

Further details on the risk management framework are provided in the corporate governance report on pages 28 to 31.

Independence and effectiveness of external auditor

In 2014, the Society tendered its external audit relationship in line with best practice and Ernst & Young LLP were engaged during 2015. The UK Corporate Governance Code now requires the audit contract to be put out to tender every 10 years, with transitional provisions for compliance and the Board will monitor this.

In advance of the commencement of the annual audit, the Committee reviewed a report presented by the external auditor, Ernst & Young LLP, detailing the audit plan, planning materiality, areas of audit focus, terms of engagement and fees payable. Following the review of the interim financial statements and the audit of the annual financial statements, the Committee received a report detailing the work performed in areas of significant risk, a summary of misstatements identified and internal control related issues identified. The Committee considered the matters set out in these reports as part of recommending the interim and annual financial statements for approval.

In order to monitor and assess any threats to the independence of the auditor, the Committee reviews a report on the level of spend with the auditor on audit and non-audit services. The Audit Committee has an approved policy on the Society's use of the external auditor for non-audit work, to ensure their continued independence and objectivity. The external auditor undertook a number of non-audit related assignments during the year, conducted in accordance with this policy and details of any fees paid for non-audit services are outlined in note 6 to the accounts.

The Committee considered the performance of Ernst & Young LLP as external auditor for 2016, and is satisfied with their objectivity, independence and effectiveness and therefore recommended that they be re-appointed at the AGM for the current year.

Oversight and effectiveness of internal audit

The Committee receives regular reports from the Head of Internal Audit setting out the results of assurance activity, proposed changes to the audit plan and level of resource available. Significant findings and themes identified were considered by the Committee, alongside management's response and the tracking and completion of outstanding actions. In addition to approving the annual plan and budget, throughout the year, the Committee reviewed and approved amendments to the Internal Audit plan and resources.

The Committee therefore regularly monitors whether internal audit have delivered their reports in accordance with the agreed plan and to the expected standard. On this basis, the Committee regards the internal audit function to be effective.

Audit committee performance and effectiveness

As outlined in the corporate governance report on page 29, the Board and each of the committees formally evaluate their own performance and effectiveness annually. The Board Audit Committee therefore considers itself to be effective.

On behalf of the Board of directors,

Andrew Neden
Chairman of the Board Audit Committee

22 February 2017

Directors' remuneration report

Nottingham Building Society is committed to best practice in its remuneration of directors. This report explains how The Nottingham applies the relevant principles and requirements of the remuneration regulations and Codes.

Statement by the Chairman of the Remuneration Committee

On behalf of the Committee, I am pleased to present the directors' remuneration report, which sets out the remuneration policy, and details of the basic salary, variable pay and benefits for the directors in the year to 31 December 2016.

Context for remuneration in 2016

The Chairman's statement, Chief Executive's review and Strategic report on pages 4 to 15 describe 2016 as a year of good strategic progress with the footprint of the Society extended further with seven new locations opened; excellent trading performance with regard to mortgage lending and increased assets in the year. There has been very strong growth in the area of branch savings balances. The bank base rate reduction in August led the Board to reduce some savings rates but also agree on a lower profit profile for the Society to partially mitigate the reduction in income.

During the 2016 performance year there has been continued focus on sustainability for The Nottingham and its members. The asset size has grown by 8%, savings balances by 1% and an additional seven new locations were opened bringing the total number of branches to 61.

It is in this context that the payments to Executive Directors have been determined and are detailed in this report.

The Directors Annual Bonus Plan – the Directors received 40% of the total bonus payment for 2016 following the end of the performance year with 60% being deferred for 3 years and subject to malus[1] and clawback rules in line with Regulatory best practice.

The 2013 -2015 LTI payments made to directors during 2016 reflect the significant progress made over the period with regard to the key measures of cost income ratio, profit after tax ratio against the comparator peer group and delivery of strategic objectives.

Remuneration Committee

The primary objective of the Remuneration Committee, under delegated authority from the Board, is to make recommendations to the Board on the general remuneration policy of The Nottingham and specifically on the remuneration of Executive Directors. The Committee also has oversight of the remuneration of both the senior management team and remuneration code staff, ensuring that remuneration is in line with The Nottingham's' business drivers, values and ambitions and adheres to the Remuneration Policy. In addition, the Committee is responsible for approving the reward scheme principles and compliance with the Remuneration Code and policy statement.

The Committee met six times in 2016 and is made up of a minimum of three non-executive directors, as detailed on page 19. The Chief Executive, Head of HR and Group Secretary attend the meetings.

The Nottingham adheres to the requirements of the Remuneration Code as defined by the Regulator. The non-executive directors do not receive variable remuneration. Information on The Nottingham's' other Remuneration Code Staff is set out in the Pillar 3 disclosures published on our website www.thenottingham.com, along with the Committee terms of reference.

The Remuneration Committee's activities in 2016 also included:

- Reviewing regulatory updates and assessing the impact on The Nottingham;
- Reviewing and recommendation to the Board for approval of the Remuneration Policy for 2016;
- Reviewing and approving the Remuneration Policy Statement ensuring its compliance with the Remuneration Code;
- Oversight of the activities undertaken by the Reward Management Committee;
- Consideration of the annual pay review and bonus scheme approval and payment;
- Reviewing the findings and actions from a Remuneration Code Internal Audit review;
- Reviewing and approving of executive variable pay for the 2016 financial year; and
- Set the direction and principles for all variable pay schemes for 2017 in order to simplify and streamline schemes.

Remuneration policy

The Nottingham's Remuneration Policy reflects its objectives for good governance, appropriate risk management and acting in the long-term best interests of members.

The policy is there to ensure that:

- Remuneration should be sufficient to attract, reward, retain and motivate high quality leaders and employees to run The Nottingham successfully, delivering value for our members whilst avoiding paying more than is necessary for this purpose in line with our mutual ethos; and

[1] Malus: Where issues associated with executive conduct are evident, or where the Group suffers a material downturn, a material failure of risk management, or a misstatement of the Group's audited results, the Remuneration Committee may reduce whole or part of a bonus.

- Remuneration is structured to strike the right balance between fixed and variable pay. Variable pay schemes are designed to incentivise and reward appropriate behaviour and performance, aligned with The Nottingham's position on risk; rewards are only attributed to the delivery of success and achievement of objectives.

The Nottingham is classified as a level 3 firm and seeks to apply appropriate remuneration best practice for all remuneration code and other staff.

Recruitment policy for Executive Directors

The Nottingham's approach to recruitment is to pay no more than is necessary to attract appropriate candidates to the role across the business, including Executive roles. Any new Executive Director's remuneration package will be consistent with our remuneration policy as outlined in this report. Any payments made to executives on joining The Nottingham to compensate them for forfeited remuneration from their previous employer will be compliant with the provisions of the Remuneration Code and will be approved by Remuneration Committee.

Service contracts

All Executive Directors, in line with best practice, have contracts on a 12 months 'rolling' basis requiring 12 months' notice by the Society to terminate and 6 months' notice by the individual.

Payment for loss of office of Executive Directors

Any compensation in the event of early termination is subject to Remuneration Committee recommendation and Board approval. Pension contributions cease on termination under the rules of the pension scheme.

Other directorships

None of the Executive Directors currently hold any paid external directorships.

Executive Director's total remuneration

Executive Directors' emoluments comprise a basic salary, variable pay, pension entitlement and other taxable benefits as outlined on page 36 and 37.

The total remuneration received by Executive Directors is detailed on page 38. The information has been audited and shows remuneration for the years ending 31 December 2015 and 31 December 2016 as required under the Building Society's (Accounts and Related Provisions) Regulations 1998.

The remuneration of Executive Directors is considered annually by the Remuneration Committee attended by The Nottingham's Chief Executive, who (except in respect of his own remuneration) makes recommendations regarding executive pay. All agreed recommendations are referred to the Board.

The Chief Executive is the Society's most highly paid employee and no employee earns more than any Executive Director.

Non-executive directors

The Chairman and other non-executive directors each receive an annual fee reflective of the time commitment and responsibilities of the role. Fees for non-executive directors are set by reference to benchmark information from a building society comparator group, agreed with the Board and taking into consideration the principles underpinning the annual Society salary review.

The non-executive directors' fees are reviewed by the Chairman together with the executive directors before recommendations are referred to the Board. Remuneration of the Chairman is considered by the Remuneration Committee together with the Society's Chief Executive without the Chairman being present.

Non-Executive Directors do not receive variable pay or pensions in order to encourage their independence.

Non-Executive Directors are reimbursed for reasonable expenses incurred during the course of their work on the Society's business.

Remuneration Code Staff (Material Risk Takers)

The remuneration of all Remuneration Code Staff is overseen directly by the Remuneration Committee. Fixed and variable pay decisions (including appointment packages) for code staff, excluding the Head of Internal Audit, are proposed by the Executive and all decisions are recommended to the Remuneration Committee for approval.

The Society's Remuneration Code staff are informed of their status through written communication. This communication includes the implications of their status including the potential for remuneration which does not comply with certain requirements of the Remuneration Code to be rendered void and recoverable by the firm.

Executive Directors

The table below provides a summary of the different components of remuneration for Executive Directors:

Component	Purpose	Operation	Performance measures	Opportunity
Basic salary	Fixed remuneration set to attract and retain executives of appropriate calibre and experience. Basic salary is assessed by reference to roles carrying similar responsibilities in comparable organisations. A comparator group is used that consists of executive director positions within building societies of a similar size and complexity.	Reviewed annually and linked to personal performance and market sector benchmarking.	Increases based on: • Role and experience; • Personal performance; • Benchmarking comparisons; and • Overall employee pay increases in the Group.	The base salaries of Executive Directors are reviewed as for any other employee in accordance with the reward matrix, except in circumstances where: • Market peer benchmarking indicates that remuneration is moving out of line of the appropriate peer group; • There has been a material increase in scope or responsibility to the Executive Director's role.
Variable pay Executive Bonus Plan	Linked to the delivery of the Society and personal objectives. Used to reward Executive Directors within the context of achieving the Society's goals and objectives. Payments under the variable pay schemes are not pensionable.	The bonus will only be awarded if the threshold criteria and Society and individual performance targets are met and a payment is triggered in the Society Core Bonus Scheme. 60% of the bonus is deferred for three years and payment is subject to meeting Society and individual performance threshold criteria in each of the years from award to payment. The Committee has the discretion to reduce or withhold the deferred element if it becomes apparent that the basis on which the variable pay award was made was wrong or that financial performance has deteriorated materially since the award. The deferred payment is also subject to clawback for a period of three years after payment.	The scheme is based upon three elements: • **The Building Society Core Scheme Balanced Scorecard** which has a 50% weighting. This scorecard measures Society financial performance, customer satisfaction, teamwork and risk & quality; • **Additional Group measures** which have a 20% weighting; and • **Individual performance** including achievement of strategic objectives with a 30% weighting. The weightings of each element of the bonus are agreed at the beginning of each performance year. Personal performance objectives, appropriate to the responsibilities of the director, including the achievement of appropriate strategic progress over a three year period are set at the start of each year. Objectives are set within board risk appetite and regulatory requirements.	On target of 30% and maximum of 50% of basic salary payable with 60% of the award deferred over a three year period.

Executive Directors (continued)

Variable pay Legacy Long Term Incentive (LTI)	Linked to the delivery of the Society and personal objectives. Used to reward Executive Directors within the context of achieving the Society's goals and objectives and designed to incentivise individuals to produce successful, sustainable business results. Payments under the variable pay schemes are not pensionable.	There are two remaining LTI schemes, 2014-16 & 2015-17 which are payable in 2017 & 2018 respectively. The schemes require achievement of Society and individual performance threshold criteria. Payment under these legacy schemes is made in the July following the year-end when all comparator societies' annual accounts are available.	Payments under the remaining schemes are determined using a balanced scorecard and require achievement of: • Group cost income ratio targets; • Successful implementation of strategic initiatives; • The Society's profit after tax ratio relative to a comparator group of societies; and • Customer satisfaction targets for the period.	**2014-16 LTI Schemes** On target of 22% and maximum of 40% of basic salary This scheme will be paid with a salary reference date of December 2014, to reflect the previous reward structure. **2015-17 LTI Scheme** On target of 16% and maximum of 30% of eligible basic salary as at 31 December 2015.
Pension or pension allowance	A part of fixed remuneration to attract and retain executives of appropriate calibre and experience.	Executive Directors are invited to join the Society's defined contribution pension plan, or, as an alternative be provided with an equivalent cash allowance.	Not applicable	Contribution of 15% of base salary or paid as cash allowance.
Benefits	A part of fixed remuneration to attract and retain executives of appropriate calibre and experience.	The benefits received by Executive Directors are private medical insurance and a car allowance.	Not applicable	Set at a level considered appropriate for each Executive Director by the Committee in line with market practice.

Annual report on remuneration

Executive Director remuneration

Audited Society	2016 D J Marlow £000	2016 M A Piranie £000	2016 S J Taylor £000	2016 Total £000	2015 D J Marlow £000	2015 M A Piranie £000	2015 S J Taylor £000	2015 Total £000
Fixed remuneration								
Salary	290	239	218	**747**	273	228	207	**708**
Benefits	10	10	9	**29**	10	9	9	**28**
Variable remuneration								
Annual bonus[1]	31	-	22	**53**	35	28	25	**88**
Long term incentive plans	71	65	56	**192**	68	63	54	**185**
	402	314	305	**1,021**	386	328	295	**1,009**
Pension contribution	43	36	33	**112**	40	36	31	**107**
	445	**350**	**338**	**1,133**	**426**	**364**	**326**	**1,116**

The directors are able to sacrifice elements of their salary and variable pay. All figures disclosed in the table above are presented pre-sacrifice.

[1] The annual bonus figure reflects the amount awarded in the year which is not subject to deferral and is the total paid. The remaining 60%, which is subject to deferral and the achievement of future performance measure, will be disclosed in the year of payment.

The unpaid deferred elements of the annual bonus scheme are as follows:

Executive Directors	Performance Year	Due 2019 £000	Due 2020 £000	Total Deferred £000
D J Marlow	2015	53	-	53
	2016	-	47	47
		53	**47**	**100**
S J Taylor	2015	38	-	38
	2016	-	33	33
		38	**33**	**71**
		91	**80**	**171**

M.A. Piranie tendered his resignation as Deputy CEO and Finance Director during 2016 and as a consequence forfeited rights to any entitlements under the 2016 Executive Annual Bonus Scheme and rights to previously deferred elements of the annual bonus scheme.

Non-Executive Director remuneration

Audited Society		2016 £000	2015 £000
J S Edwards (Chairman)		67	66
J C Kibbey		42	39
A F J Neden		46	43
M C Phibbs	(retired 22 March 2016)	9	37
K M Spooner	(appointed 1 September 2016)	12	-
W G Thomas		46	37
K R Whitesides (Vice-Chairman)		41	42
TOTAL EMOLUMENTS FOR SERVICES AS DIRECTORS		**263**	**264**

On behalf of the Board of directors,

Jane Kibbey
Chair of the Remuneration Committee

22 February 2017

Independent auditor's report to the members of Nottingham Building Society

Our opinion on the financial statements

In our opinion:

- the Group's and Society's financial statements (the 'financial statements') give a true and fair view of the state of the Group's and Society's affairs as at 31 December 2016 and of the Group's and Society's profit for the year then ended;
- the Group and Society financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union;
- the Group and Society's financial statements 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 International Accounting Standards (IAS) Regulation.

What we have audited

Nottingham Building Society's financial statements comprise:

Group	Society
Consolidated statement of financial position as at 31 December 2016	Statement of financial position as at 31 December 2016
Consolidated income statement for the year then ended	Income statement for the year then ended
Consolidated statement of comprehensive income for the year then ended	Statement of comprehensive income for the year then ended
Consolidated statement of changes in members' interests for the year then ended	Statement of changes in members' interests
Consolidated cash flow statement for the year then ended	Cash flow statement for the year then ended
Related notes 1 to 34 to the financial statements	Related notes 1 to 34 to the financial statements

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.

Overview of our audit approach

Risks of material misstatement	• Revenue recognition in relation to effective interest rate (EIR) accounting. • Valuation of loan impairment relating to commercial mortgages. • Valuation of goodwill.
Audit scope	• We performed an audit of the complete financial information of the Group and Society. • Our Group audit scope included all of the Society's subsidiaries. Our audit did not involve any component teams.
Materiality	• Overall Group materiality of £2m which represents 1% of members' interests and equity.

Our assessment of risk of material misstatement

We identified the risks of material misstatement described below as those that had the greatest effect on our overall audit strategy, the allocation of resources in the audit and the direction of the efforts of the audit team. In addressing these risks, we have performed the procedures below which were designed in the context of the financial statements as a whole and, consequently, we do not express any opinion on these individual areas. In addition, we have also considered whether or not fraud risk factors due to management override of internal controls were present in each of our significant audit risks.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Revenue recognition in relation to effective interest rate (EIR) accounting		
Refer to the Audit Committee report (page 32); Accounting policies (page 50). Effective interest rate accounting is a judgemental area driven by customer payment behaviours and management's assumptions. Changes in these variables and assumptions, notably the expected life of mortgages and prepayments rates within the EIR calculation, can have a material impact on income recognition in the year and therefore we have classified this as a significant audit risk.	We tested internal controls operated by the Group over the EIR process, and on a sample basis tested the completeness and accuracy of data, from the Society's source system to the EIR models. We challenged assumptions regarding the expected lives of loans by comparing them to recent actual redemption behaviours, and compared assumptions about future changes in interest rates to current market data. We performed sensitivity analysis over the EIR models to assess the significance of individual assumptions. We verified the logic and accuracy of the EIR calculation across products and agreed the total EIR balance to the general ledger. We performed testing of journals recorded throughout the year and at the year-end using an approach based on risk of management override of controls. In each case we substantiated journals recorded to supporting evidence.	We concluded to the Audit Committee that the effective interest rate adjustments made to the Group's loan portfolios were materially correct at 31 December 2016. We gained assurance from effective controls operated within the Group's processes, and the completeness and accuracy of data used within EIR models. We found that key assumptions in relation to behavioural lives of assets and prepayment rates were consistent with the underlying data and observed characteristics of the Society's portfolios. We found that the models were operating effectively in the calculation of EIR adjustments and that the results were accurately reflected in the general ledger. We found no significant errors or evidence of management override of controls from testing of journal entries.
Valuation of loan impairment relating to commercial mortgages		
Refer to Audit Committee report (page 32); Accounting policies (page 51); and Note 15 of the Consolidated financial statements (page 62) Valuation of loan impairment provisions is an area of estimation that requires significant management judgement. Whilst the vast majority of the Society's loan book is high quality with low arrears and low historical loss rates, impairment estimates are an inherently subjective area and involve a number of assumptions. Such assumptions include the probability of default, and the likely loss in the event of default. The loss in event of default depends on the value of the secured property, assumptions on forced sale discounts and the costs to sell. Given the amount of estimation involved and the value of the loan impairment provisions compared to audit materiality, we have classified this as a significant audit risk.	We tested the design and operating effectiveness of key controls over the impairment provisioning process. We tested the completeness and accuracy of data used within the impairment models through reconciliation to source systems and the general ledger. Our substantive audit procedures over the collective and specific provision models included assessing, challenging and substantiating the key assumptions, such as: • Probabilities of default; • Collateral valuations; • Costs of sale; • Forced sale discounts; • Estimated time to sell. We assessed these assumptions through substantiating to historical data and with reference to our knowledge of the Society's portfolios and the industry. We independently determined a range for each assumption and assessed whether Management's provision sat within an acceptable range. For specific provisions we engaged our in-house Real Estate valuation specialists to test a sample of collateral valuations to assess whether they were reasonably estimated.	We concluded to the Audit Committee that the provision levels held by the Group in relation to commercial mortgages loan impairment adequately reflected incurred losses in the lending portfolios at the year end. We gained satisfactory assurance from our testing of the completeness and accuracy of data, review of assumptions and recalculation of individual provision amounts. We noted that the balance of the provision has decreased compared to prior year and remains lower than general industry averages due to the Society's conservative lending policies and the small number of customers in arrears. We concluded that the costs of sale and forced sale discount assumptions were within an acceptable range. The probabilities of default and estimated time to sell assumptions were conservative and sat outside our ranges, but did not result in a material audit difference. Our in-house Real Estate valuation specialists concluded that all sampled collateral valuations were within an acceptable range.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Valuation of goodwill		
Refer to Audit Committee report (page 33); Accounting policies (page 52); and Note 18 of the Consolidated financial statements (page 65). The valuation of goodwill is assessed by management through an annual impairment assessment. The nature of this assessment is judgemental and involves future projections of future cash flows that are inherently uncertain. There are a number of assumptions used in the goodwill impairment assessment which could materially impact the outcome, including growth rates and the selection of an appropriate discount rate. Given the carrying value of goodwill compared to audit materiality, we classified this as a significant audit risk.	We reviewed the design effectiveness of the key controls in operation over the goodwill impairment assessment. Our audit approach did not seek to rely on the controls identified. We examined management's impairment assessment to assess compliance with IAS 36 Impairment of assets. We challenged the forecasts and assumptions used within the assessment including assessing the discount rate assumption with our valuation specialists. A core element of our challenge was to compare current forecasts and assumptions with those determined by the Society at the time of acquisition, to determine consistency in approach and basis of preparation of cash flow forecasts. We also tested current forecasts to validate the appropriate inclusion of actual performance since acquisition, and consistency of future cash flow projections with the Group-wide corporate plan.	We concurred with management's assessment that the carrying value of goodwill did not require an impairment adjustment at 31 December 2016. We concluded that the discount rate used of 12.5% was reasonable and conservative. We observed that the updated cash flow forecasts for the acquired business had been prepared on a consistent basis with the original business case at the time of acquisition, and that the discounted cash flows exhibited headroom above the carrying value of goodwill.

In the prior year, our auditor's report included a risk of material misstatement in relation to the valuation of loan impairment of retail mortgages, and the risk of revenue recognition in relation to Estate Agency commissions. We do not believe these elements represent significant audit risks in the period ending 31 December 2016 as they are immaterial in the context of the financial statements as a whole.

Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Group to be £2 million, (2015: £1.9 million) which is 1% (2015: 1%) of members' interests and equity. We believe that members' interests and equity to be an appropriate basis for materiality given the Group focuses on its mutual status above maximisation of profit generation.

Performance materiality

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 75% (2015: 50%) of our planning materiality, namely £1.5 million (2015: £1 million). We have set performance materiality at this percentage based upon our recent experience of auditing the Group, from which we concluded that there is a lower expectation of undetected misstatement due to the effective control environment and only minor audit differences resulting from our work. As a result, we determined that the higher of our permissible thresholds for our performance materiality was appropriate.

We used a proportion of this value for performing the audit work on the subsidiaries. The performance materiality set for each subsidiary is based on the relative scale and risk of the subsidiary to the Group as a whole and our assessment of the risk of misstatement at that subsidiary. 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.

Reporting threshold

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.1 million (2015: £0.1 million), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

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's 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.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 21, 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 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.

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.

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 accounting records and 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

ISAs (UK and Ireland) reporting	We are required to report to you if, in our opinion, financial and non-financial 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 • otherwise misleading. In particular, we are required to report whether we have identified any inconsistencies between our knowledge acquired in the course of performing the audit and the directors' statement that they consider the annual report and accounts taken as a whole is fair, balanced and understandable and provides the information necessary for members to assess the entity's performance, business model and strategy; and whether the annual report appropriately addresses those matters that we communicated to the audit committee that we consider should have been disclosed.	We have no exceptions to report.
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 financial statements are not in agreement with the accounting records; or • we have not received all the information and explanations and access to documents we require for our audit.	We have no exceptions to report.
UK Corporate Governance Code	The Society prepares a Corporate Governance Statement in accordance with the Disclosure Rules and Transparency Rules of the Financial Conduct Authority and has chosen voluntarily to comply with the Code. We have reviewed and reported to the Audit Committee on, compliance with the Code in respect of: • The Directors' statements in relation to going concern, set out on page 21, and longer-term viability, set out on page 22; and • The part of the Corporate governance statement on page 28 relating to the Company's compliance with the provisions of the UK Corporate Governance Code specified for our review.	We have nothing to report having performed our review.

Statement on the Directors' assessment of the principal risks that would threaten the solvency or liquidity of the Society

ISAs (UK and Ireland) reporting	We are required to give a statement as to whether we have anything material to add or to draw attention to in relation to: • the directors' confirmation in the annual report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity; • the disclosures in the annual report that describe those risks and explain how they are being managed or mitigated; • tthe directors' statement in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements; and • the directors' explanation in the annual report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.	We have nothing material to add or to draw attention to.

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

22 February 2017

Notes:

1. The maintenance and integrity of the Nottingham Building Society's web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.

2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Income statements

for the year ended 31 December 2016

	Notes	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Interest receivable and similar income	3	89.3	94.6	89.9	94.6
Interest payable and similar charges	4	(43.7)	(46.6)	(44.4)	(46.6)
NET INTEREST INCOME		**45.6**	**48.0**	**45.5**	**48.0**
Fees and commissions receivable		9.8	9.9	3.3	2.7
Fees and commissions payable		(1.2)	(0.5)	(1.2)	(0.5)
Other income		0.3	-	0.3	-
Net (losses)/gains from derivative financial instruments	5	(0.9)	1.2	(0.7)	1.2
TOTAL NET INCOME		**53.6**	**58.6**	**47.2**	**51.4**
Administrative expenses	6	(35.4)	(33.6)	(28.5)	(26.6)
Depreciation and amortisation	17,18	(3.3)	(3.3)	(3.0)	(3.2)
Finance cost	27	(0.2)	(0.2)	(0.2)	(0.2)
Impairment losses on loans and advances	15	-	(0.2)	-	(0.2)
Provisions for liabilities - FSCS levy and other	26	(0.4)	(1.4)	(0.4)	(1.4)
(Loss)/profit on disposal of property, plant and equipment	17	(0.1)	0.1	(0.1)	0.1
PROFIT BEFORE TAX		**14.2**	**20.0**	**15.0**	**19.9**
Tax expense	8	(3.2)	(4.6)	(3.3)	(4.6)
PROFIT AFTER TAX FOR THE FINANCIAL YEAR		**11.0**	**15.4**	**11.7**	**15.3**

Profit for the financial year arises from continuing operations.

Both the profit for the financial year and total comprehensive income for the period are attributable to the members of the Society.

A reconciliation from profit before tax for the financial year to underlying profit used by management can be found on page 10.

The notes on pages 49 to 93 form part of these accounts.

Statements of comprehensive income

for the year ended 31 December 2016

	Notes	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Profit for the financial year		11.0	15.4	11.7	15.3
Items that will not be re-classified to the income statement					
Remeasurements of defined benefit obligation	27	(4.5)	0.3	(4.5)	0.3
Tax on items that will not be re-classified	8	0.7	(0.1)	0.7	(0.1)
Items that may subsequently be re-classified to the income statement					
Available-for-sale reserve					
Valuation gains/(losses) taken to reserves	12	0.2	(0.2)	0.2	(0.2)
Tax on items that may subsequently be re-classified	8	(0.1)	-	(0.1)	-
Other comprehensive expense for the period net of income tax		(3.7)	-	(3.7)	-
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**7.3**	**15.4**	**8.0**	**15.3**

The notes on pages 49 to 93 form part of these accounts.

Accounts

Statements of financial position

as at 31 December 2016

	Notes	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
ASSETS					
Cash in hand and balances with the Bank of England	9	390.5	370.7	390.5	370.7
Loans and advances to credit institutions	10	39.1	18.6	33.6	18.1
Debt securities	12	97.4	102.3	97.4	102.3
Derivative financial instruments	13	4.7	3.8	4.7	3.8
Loans and advances to customers	14	3,032.6	2,796.5	3,032.6	2,796.5
Investments in subsidiary undertakings	16	-	-	21.7	7.7
Other assets		4.6	3.2	3.9	2.6
Property, plant and equipment	17	12.7	13.1	11.7	11.9
Intangible assets	18	7.7	8.2	3.1	3.5
Deferred tax assets	19	2.1	2.0	2.1	2.0
TOTAL ASSETS		**3,591.4**	**3,318.4**	**3,601.3**	**3,319.1**
LIABILITIES					
Shares	20	2,457.4	2,433.2	2,457.4	2,433.2
Amounts owed to credit institutions	21	557.6	410.4	557.6	410.4
Amounts owed to other customers	22	215.7	223.6	215.7	223.6
Amounts owed to subsidiary undertakings	23	-	-	101.6	-
Debt securities in issue	24	98.7	9.0	6.0	9.0
Derivative financial instruments	13	19.7	9.3	19.5	9.3
Other liabilities and accruals	25	4.7	4.8	4.0	4.3
Current tax liabilities		1.3	2.1	1.3	2.1
Deferred tax liabilities	19	-	0.4	-	0.4
Provisions for liabilities	26	0.9	1.4	0.9	1.4
Retirement benefit obligations	27	9.4	5.5	9.4	5.5
Subscribed capital	28	26.2	26.2	26.2	26.2
TOTAL LIABILITIES		**3,391.6**	**3,125.9**	**3,399.6**	**3,125.4**
RESERVES					
General reserves		199.5	192.3	201.4	193.5
Available-for-sale reserves	29	0.3	0.2	0.3	0.2
Total reserves attributable to members of the Society		**199.8**	**192.5**	**201.7**	**193.7**
TOTAL RESERVES AND LIABILITIES		**3,591.4**	**3,318.4**	**3,601.3**	**3,319.1**

The notes on pages 49 to 93 form part of these accounts.

These accounts were approved by the Board of directors on 22 February 2017 and signed on its behalf:

John Edwards
Chairman

David Marlow
Chief Executive

Ashraf Piranie
Deputy Chief Executive
and Finance Director

Statements of changes in members' interests

for the year ended 31 December 2016

	General reserves £m	Available-for-sale reserves £m	Total £m
GROUP 2016			
Balance as at 1 January 2016	192.3	0.2	192.5
Profit for the year	11.0	-	11.0
Other comprehensive income for the period (net of tax)			
Net gains from changes in fair value	-	0.1	0.1
Remeasurement of defined benefit obligation	(3.8)	-	(3.8)
Total other comprehensive (expense)/income	(3.8)	0.1	(3.7)
Total comprehensive income for the period	7.2	0.1	7.3
BALANCE AS AT 31 DECEMBER 2016	**199.5**	**0.3**	**199.8**
GROUP 2015			
Balance as at 1 January 2015	176.7	0.4	177.1
Profit for the year	15.4	-	15.4
Other comprehensive income for the period (net of tax)			
Net losses from changes in fair value	-	(0.2)	(0.2)
Remeasurement of defined benefit obligation	0.2	-	0.2
Total other comprehensive income/(expense)	0.2	(0.2)	-
Total comprehensive income/(expense) for the period	15.6	(0.2)	15.4
BALANCE AS AT 31 DECEMBER 2015	**192.3**	**0.2**	**192.5**

	General reserves £m	Available-for-sale reserves £m	Total £m
SOCIETY 2016			
Balance as at 1 January 2016	193.5	0.2	193.7
Profit for the year	11.7	-	11.7
Other comprehensive income for the period (net of tax)			
Net gains from changes in fair value	-	0.1	0.1
Remeasurement of defined benefit obligation	(3.8)	-	(3.8)
Total other comprehensive (expense)/income	(3.8)	0.1	(3.7)
Total comprehensive income for the period	7.9	0.1	8.0
BALANCE AS AT 31 DECEMBER 2016	**201.4**	**0.3**	**201.7**
SOCIETY 2015			
Balance as at 1 January 2015	178.0	0.4	178.4
Profit for the year	15.3	-	15.3
Other comprehensive income for the period (net of tax)			
Net losses from changes in fair value	-	(0.2)	(0.2)
Remeasurement of defined benefit obligation	0.2	-	0.2
Total other comprehensive income/(expense)	0.2	(0.2)	-
Total comprehensive income/(expense) for the period	15.5	(0.2)	15.3
BALANCE AS AT 31 DECEMBER 2015	**193.5**	**0.2**	**193.7**

The notes on pages 49 to 93 form part of these accounts.

Cash flow statements

for the year ended 31 December 2016

	Notes	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
CASH FLOWS FROM OPERATING ACTIVITIES					
Profit before tax		14.2	20.0	15.0	19.9
Depreciation and amortisation		3.3	3.3	3.0	3.2
Loss/(profit) on disposal of property, plant and equipment		0.1	(0.1)	0.1	(0.1)
Interest on subscribed capital		2.0	2.0	2.0	2.0
Net gains on disposal and amortisation of debt securities		0.8	(0.6)	0.8	(0.6)
Increase in impairment of loans and advances		-	0.2	-	0.2
		20.4	**24.8**	**20.9**	**24.6**
CHANGES IN OPERATING ASSETS AND LIABILITIES					
(Increase)/decrease in prepayments, accrued income and other assets		(2.3)	5.4	85.4	6.0
Increase/(decrease) in accruals, deferred income and other liabilities		9.6	(5.9)	9.2	(6.2)
Increase in loans and advances to customers		(236.1)	(78.4)	(236.1)	(78.4)
Increase/(decrease) in shares		24.2	(142.2)	24.2	(142.2)
Increase in amounts owed to other credit institutions and other customers		139.3	180.6	139.3	180.6
(Increase)/decrease in loans and advances to credit institutions		(15.7)	6.2	(15.7)	6.2
Increase/(decrease) in debt securities in issue		89.7	5.5	(3.0)	5.5
Decrease in retirement benefit obligation		(0.6)	(1.1)	(0.6)	(1.1)
Taxation paid		(3.9)	(3.6)	(4.0)	(3.6)
NET CASH GENERATED BY/(USED IN) OPERATING ACTIVITIES		**24.6**	**(8.7)**	**(1.3)**	**(8.6)**
CASH FLOWS FROM INVESTING ACTIVITIES					
Purchase of debt securities		(152.9)	(124.3)	(152.9)	(124.3)
Disposal of debt securities		157.3	188.4	157.3	188.4
Purchase of property, plant and equipment		(1.5)	(2.5)	(1.5)	(2.3)
Disposal of property, plant and equipment		-	0.1	-	0.1
Purchase of intangible assets		(1.0)	(0.5)	(1.0)	(0.5)
NET CASH GENERATED BY INVESTING ACTIVITIES		**1.9**	**61.2**	**1.9**	**61.4**
CASH FLOWS FROM FINANCING ACTIVITIES					
Interest paid on subscribed capital		(1.9)	(1.9)	(1.9)	(1.9)
NET INCREASE IN CASH AND CASH EQUIVALENTS		**24.6**	**50.6**	**19.6**	**50.9**
Cash and cash equivalents at 1 January		369.2	318.6	368.7	317.8
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	**11**	**393.8**	**369.2**	**388.3**	**368.7**

The notes on pages 49 to 93 form part of these accounts.

Notes to the accounts

1. ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these financial statements are set out below.

Basis of preparation

Both the Society and Group annual accounts are prepared and approved by the directors in accordance with IFRSs as adopted by the EU and those parts of the Building Societies Act 1986 and Building Societies (Accounts and Related Provisions) Regulations 1998 applicable to societies reporting under IFRS. The annual accounts are prepared under the historical cost convention as modified by the fair value of available-for-sale assets and derivatives.

The accounts have been prepared on the going concern basis as outlined in the Directors' report on pages 21 and 22.

The accounting policies for the Group also include those for the Society unless otherwise stated.

The preparation of accounts in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. These estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results may differ from those estimates.

Changes in accounting policy

There were no IFRS prouncements, relevant to the Group, that have been adopted with effect from 1 January 2016.

Future accounting developments

A number of International Accounting Standards Board (IASB) pronouncements have been issued but are not effective for this financial year. The standards considered most relevant to the Group are as follows:

- *IFRS 9 'Financial Instruments'* – effective from 1 January 2018. The standard will eventually replace IAS 39. The standard requires financial assets to be classified at amortised cost or at fair value (through either the income statement or through other comprehensive income) depending on the Group's business model and the contractual cash flow characteristics of the financial assets. Consequently, the available-for-sale category currently used will become void. The changes in classification from the accounting treatment under IAS 39 are not expected to be significant for the Group.

  In addition the standard will address impairment of financial assets, which will be based on expected credit losses rather than incurred losses as at present. The impact of the expected credit loss approach is likely to be material to the Group and during the next financial year, work will include building and testing of impairment models and validating outputs as well as implementing business process changes. The financial impact will be quantified once models and systems allow the Group to provide reliable estimates.
- *IFRS 15 'Revenue from contracts with Customers'* – effective from 1 January 2018. The standard provides guidance on when revenue should be recognised. The standard is not expected to have a significant impact to the Group;
- *IFRS 16 'Leases'* – effective from 1 January 2019. The standard provides a single lessee accounting model requiring lessees to recognise assets and liabilities for all leases. The financial impact of IFRS 16 will be considered by the Group during the next financial period but is expected to have an impact on the financial statements.

Basis of consolidation

Subsidiary companies are defined as those in which the Society has the power over relevant activities, has exposure to the rights of variable returns and has the influence to affect those returns. Subsidiaries are fully consolidated from the date on which control is transferred to the Group and de-consolidated from the date that control ceases. The Group accounts consolidate the assets, liabilities and results of the Society and all of its subsidiaries, eliminating intercompany balances and transactions. All entities have accounting periods ending on 31 December.

The results of subsidiary undertakings acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date that ownership ceases.

Special purpose funding vehicles

The Society has transferred the beneficial interest in certain loans and advances to customers to special purpose funding vehicles (SPVs). These SPVs enable a subsequent raising of debt to investors who gain the security of the underlying assets as collateral. The SPVs are fully consolidated into the Group accounts in accordance with IFRS 10 as the Society is deemed to have control over the SPV because it has power and exposure to variable returns.

The transfer of the beneficial interest in these loans to the SPVs are not treated as sales by the Society. The Society continues to recognise these assets within its own Statement of Financial Position after the transfer because it retains substantially all the risk and rewards of the portfolio through the receipt of the majority of profits of the structured entity. In the accounts of the Society, the proceeds received from the transfer are accounted for as a deemed loan repayable to the SPV.

Business combinations between mutual organisations

Identifiable assets and liabilities are measured at fair value. Intangible assets are amortised through the income statement over their estimated useful lives, being between one and ten years.

A deemed purchase price is calculated by measuring the fair value of the acquired business. Goodwill is measured as the difference between the adjusted value of the acquired assets and liabilities and the deemed purchase price. Goodwill is recorded as an asset; negative goodwill is recognised in the income statement.

Business combinations

Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition date fair values of the assets transferred by the acquiree, the liabilities incurred by the acquirer to former owners of the acquiree and the equity interests issued by the acquiree. Acquisition related costs are recognised in the income statement as incurred.

1. ACCOUNTING POLICIES (CONTINUED)

Interest income and expense

Interest income and interest expense for all interest-bearing financial instruments are recognised in 'interest receivable and similar income' or 'interest payable and similar charges' using the effective interest rates of the financial assets or financial liabilities to which they relate. The effective interest rate is the rate that discounts the expected future cash flows, over the expected life of the financial instrument, to the net carrying amount of the financial asset or liability. This may include fees and commissions if they are an integral part of the effective interest rate of a financial instrument.

Interest on impaired financial assets is recognised at the original effective interest rate of the financial asset applied to the carrying amount as reduced by an allowance for impairment.

Fees and commissions

Fees receivable are generally recognised when all contractual obligations have been fulfilled, with fees earned on the sale of properties recognised on the date contracts are exchanged.

Commission receivable from the sale of third party products is recognised upon fulfilment of contractual obligations, that is the inception date of the product or on completion of a mortgage.

If the fees are an integral part of the effective interest rate of a financial instrument, they are recognised as an adjustment to the effective interest rate and recorded in interest receivable/payable.

Fees payable are recognised on an accruals basis when the service has been provided or on the completion of an act to which the fee relates.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash, treasury bills and other eligible bills and loans and advances to credit institutions.

Derivative financial instruments and hedge accounting

The Group uses derivatives only for risk management purposes. It does not use derivatives for trading purposes. Derivatives are measured at fair value in the statement of financial position. Fair values are obtained by applying quoted market rates to a discounted cash flow model. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The Group looks to designate derivatives held for risk management purposes as hedging instruments in qualifying hedging relationships. On initial designation of the hedge, the Group documents formally the relationship between the hedging instruments and hedged items, including the risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationship. The Group makes an assessment, both at the inception of the hedge relationship as well as on an ongoing basis, as to whether the hedging instruments are expected to be highly effective in offsetting the changes in the fair value of the respective hedged items during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80-125 percent.

If derivatives are not designated as hedges, then changes in fair values are recognised immediately in the Income Statement in the period in which the hedged item affects the Income Statement.

Fair value hedges

Portfolio fair value hedges are used to hedge exposures to variability in the fair value of financial assets and liabilities, such as fixed rate mortgages and savings products. Changes in the fair value of derivatives are recognised immediately in the income statement together with changes in the fair value of the hedged item that are attributable to the hedged risk (in the same line item in the income statement as the hedged item).

If the hedging derivative expires or is sold, terminated, or exercised, or the hedge no longer meets the criteria for fair value hedge accounting, or the hedge designation is revoked, hedge accounting is discontinued prospectively. Any adjustment up to that point to a hedge item for which the effective interest method is used, is amortised to the income statement as part of the recalculated effective interest rate of the item over its remaining life.

Financial assets

The Group classifies non-derivative financial assets as either loans and receivables or available-for-sale assets. Management determines the classification of financial assets at initial recognition. No assets have been classified as held to maturity.

Loans and receivables

The Group's loans and advances to customers are classified as 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 measures its loans and receivables at amortised cost less impairment provisions.

The initial value may, if applicable, include certain upfront costs and fees such as procuration fees, legal fees, mortgage indemnity guarantee premiums and application fees, which are recognised over the expected life of mortgage assets. Mortgage discounts are also recognised over the expected life of mortgage assets as part of the effective interest rate.

Throughout the year and at each year end, the mortgage life assumptions are reviewed for appropriateness. Any changes to the expected life assumptions of the assets are recognised through interest receivable and similar income and reflected in the carrying value of the mortgage assets.

Included in loans and advances to customers of the Society are balances which have been used to secure funding issued by the Group's special purpose vehicle, which is consolidated into the Group Accounts. The beneficial interest in the underlying loans has been transferred to this entity. The loans are retained within the Society's Statement of Financial Position however, as the Society retains substantially all of the risks and rewards relating to the loans.

1. ACCOUNTING POLICIES (CONTINUED)

Available-for-sale assets

Available-for-sale assets are non-derivative assets that are intended to be held for an indefinite period of time. They may be sold in response to needs for changes in liquidity or changes in interest rates. The Group's debt securities are classified as available-for-sale assets. The Group measures debt securities at fair value, with subsequent changes in fair value being recognised through other comprehensive income except for impairment losses which are recognised in profit or loss. Further information regarding how fair values are determined can be found in note 30 to the accounts.

Upon sale or maturity of the asset, the cumulative gains and losses recognised in other comprehensive income are removed from available-for-sale reserves and recycled to the income statement.

Impairment of financial assets not carried at fair value through profit and loss

Assets carried at amortised cost

Throughout the year and at each year-end, individual assessments are made of all loans and advances against properties which are in possession or in arrears by two months or more and/or are subject to forbearance activities. Individual impairment provision is made against those loans and advances where there is objective evidence of impairment.

Objective evidence of impairment may include:

- significant financial difficulty of the borrower/issuer;
- deterioration in payment status;
- renegotiation of the terms of an asset due to financial difficulty of the borrower or issuer, including granting a concession/forbearance to the borrower or issuer;
- becoming probable that the borrower or issuer will enter bankruptcy or other financial reorganisation; and
- any other information discovered during regular review suggesting that a loss is likely in the short to medium term.

If there is objective evidence of impairment, the amount of loss is measured as the difference between the assets carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. In considering expected future cash flows, account is taken of any discount which may be needed against the value of the property at the statement of financial position date thought necessary to achieve a sale; amounts recoverable under mortgage indemnity policies; and anticipated realisation costs.

In addition the Group assesses quarterly whether there is objective evidence to suggest a financial asset or group of financial assets is likely to be impaired. Where a collective assessment is made, each category or class of financial asset is split into groups of assets with similar credit risk characteristics. The Group measures the amount of impairment loss by applying expected loss factors based on the Group's experience of default, loss emergence periods, the effect of movements in house prices and any adjustment for the expected forced sales value

Where certain emerging impairment characteristics are considered significant but not assessed as part of the impairment calculation, management may elect to apply an overlay to the impairment provision.

The amount of impairment loss is recognised immediately through the income statement and a corresponding reduction in the value of the financial asset is recognised through the use of provisions.

Available-for-sale assets

The Group assesses at each statement of financial position date whether there is objective evidence that an available-for-sale asset or group of available-for-sale assets is impaired. Available-for-sale assets are impaired and impairment losses incurred if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event has an impact on the estimated future cash flows of those assets. Loss events may include default of a counterparty or disappearance of an active market for the assets. Impairment is measured as the difference between the current amortised cost and the current fair value, less any impairment loss on that asset previously recognised.

The amount of the impairment loss is recognised in the income statement; any loss previously recognised through other comprehensive income is reversed out and charged to the income statement as part of the impairment cost.

Forbearance strategies and renegotiated loans

A range of forbearance options are available to support customers who are in financial difficulty. The purpose of forbearance is to support customers who have temporary financial difficulties and help them get back on their feet.

The main options offered by the Society include:

- Reduced monthly payment;
- An arrangement to clear outstanding arrears;
- Capitalisation of arrears; and
- Extension of mortgage term.

Customers requesting a forbearance option will need to provide information to support the request which is likely to include a budget planner, statement of assets and liabilities, bank/credit card statements, payslips etc. in order that the request can be properly assessed. If the forbearance request is granted the account is monitored in accordance with our policy and procedures. At the appropriate time the forbearance option that has been implemented is cancelled, with the exception of capitalisation of arrears, and the customer's normal contractual payment is restored.

Loans that are subject to restructuring may only be classified as restructured and up-to-date once a specified number and/or amount of qualifying payments have been received. These qualifying payments are set at a level appropriate to the nature of the loan and the customer's ability to make the repayment going forward. Typically the receipt of six months qualifying payments is required. Loans that have been restructured and would otherwise have been past due or impaired are classified as renegotiated.

The carrying amount of loans that have been classified as renegotiated retain this classification until maturity or derecognition. Interest is recorded on renegotiated loans on the basis of new contractual terms following renegotiation.

Derecognition of financial assets and liabilities

Financial assets are derecognised when the contractual rights to receive cash flows have expired or where substantially all the risks and rewards of ownership have been transferred. Financial liabilities are derecognised only when the obligation is discharged, cancelled or has expired.

1. ACCOUNTING POLICIES (CONTINUED)

Financial liabilities

All non-derivative financial liabilities, that include shares and wholesale funds, held by the Group are measured at amortised cost with interest recognised using the effective interest rate method.

Discounts and other costs incurred in the raising of wholesale funds are amortised over the period to maturity using the effective interest method.

Fair value of financial assets and liabilities

IFRS 13 requires an entity to classify financial instruments held at fair value and those not measured at fair value but for which the fair value is disclosed according to a hierarchy that reflects the significance of observable market inputs in calculating those fair values. The three levels of the fair value hierarchy are defined as:

Level 1 – Valuation using quoted market process

Financial instruments are classified as level 1 if their value is observable in an active market. Such instruments are valued by reference to unadjusted quoted prices for identical assets or liabilities in active markets where the quoted price is readily available, and the price reflects actual and regularly occurring market transactions on an arm's length basis. An active market is one in which transactions occur with sufficient volume and frequency to provide pricing information on an ongoing basis.

Level 2 – Valuation technique using observable inputs

Financial instruments classified as Level 2 have been valued using models whose inputs are observable in an active market. Valuations based on observable inputs include derivative financial instruments such as swaps and forwards which are valued using market standard pricing techniques and options that are commonly traded in markets where all the inputs to the market standard pricing models are observable. They also include investment securities valued using consensus pricing or other observable market prices.

Level 3 – Valuation technique using significant unobservable inputs

Financial instruments are classified as level 3 if their valuation incorporates significant inputs that are not based on observable market data ('unobservable inputs'). A valuation input is considered observable if it can be directly observed from transactions in an active market, or if there is compelling external evidence demonstrating an executable exit price. Unobservable input levels can generally be determined based on observable inputs of a similar nature, historical observations or other analytical techniques.

Subscribed capital

Subscribed capital comprises Permanent Interest Bearing Shares (PIBS) which have no voting rights and have contractual terms to settle interest and is therefore classified as a financial liability. It is presented separately on the face of the statement of financial position. Subscribed capital is initially recognised at 'fair value' being its issue proceeds net of transaction costs incurred.

The interest on the subscribed capital is recognised on an effective interest basis in the income statement as interest expense.

Intangible assets

Computer Software

Purchased software and costs directly associated with the internal development of computer software are capitalised as intangible assets where the software is an identifiable asset controlled by the Group which will generate future economic benefits and where costs can be reliably measured. Costs incurred to establish technological feasibility or to maintain existing levels of performance are recognised as an expense as incurred.

Intangible assets are stated at cost less cumulative amortisation and impairment losses.

Amortisation begins when the asset becomes available for operational use and is charged to the income statement on a straight-line basis over the estimated useful life of the software, which is generally between 3 to 8 years. The amortisation periods used are reviewed annually.

Assets are reviewed for impairment at each statement of financial position date or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount, if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell, and its value in use.

Goodwill

Goodwill arising on the acquisition of subsidiary undertakings represents the excess of the fair value of consideration over the fair value of identifiable net assets and contingent liabilities acquired at the date of acquisition. In accordance with IFRS 3 (Revised), Business Combinations, goodwill is not systematically amortised but is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses.

Goodwill which is recognised as an asset is reviewed for impairment at least annually. Any impairment is recognised in the income statement and is not subsequently reversed.

For the purpose of impairment testing, goodwill is allocated to each of the Group's cash generating units expected to benefit from the synergies of combination. The impairment test compares the carrying value of goodwill to its associated value in use. The value in use calculations are carried out by discounting the future cash flows of the cash generating unit. Future cash flows are based upon approved profit budgets for the next three years and assumed growth thereafter for the next 12 years in line with long-term growth rates. The Group estimates the post-tax discount rate based upon the weighted average cost of capital which takes into account the risks inherent in each cash generating unit. A 15 year time horizon has been used to reflect that cash generating units are held for the long-term.

Other intangibles

Other intangible assets acquired in a business combination and recognised separately from goodwill are initially recognised at their fair value at the acquisition date which is regarded as their cost.

Subsequent to initial measurement, other intangible assets are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to the income statement on a straight-line basis over the estimated useful life of the asset which is typically 1 to 5 years. The amortisation periods used are reviewed annually.

1. ACCOUNTING POLICIES (CONTINUED)

Other intangible assets are reviewed for impairment at each statement of financial position date or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An asset's carrying amount is written down immediately to its recoverable amount, if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell, and its value in use.

Property, plant and equipment

Additions and improvements to office premises and equipment, including costs directly attributable to the acquisition of the asset, are capitalised at cost. The property, plant and equipment value in the statement of financial position represents the original cost, less cumulative depreciation.

The costs, less estimated residual values of assets, are depreciated on a straight-line basis over their estimated useful economic lives as follows:

- Freehold buildings 50 - 100 years
- Leasehold premises over the remainder of the lease or 100 years if shorter
- Refurbishment of premises over 5 to 10 years or length of lease if shorter
- Equipment, fixtures, fittings and vehicles over 4 to 10 years
- No depreciation is provided on freehold land.

Assets are reviewed for impairment at each statement of financial position date or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell, and its value in use.

Employee benefits

Long term incentive schemes

The costs of bonuses payable after the end of the year in which they are earned are recognised in the year in which the employees render the related service. Where long term incentive schemes run over more than one year, the costs are recognised over the life of the scheme. The long term incentive bonuses disclosed in the Directors' remuneration report are included when paid. The annual bonus figure disclosed reflects the amount awarded in the year which is not subject to deferral and is the total paid. The element subject to deferral is disclosed in the year of payment.

Pensions

The Group operated a contributory defined benefit pension scheme until 31 January 2009 when it was closed to future service accrual. The assets are held in a separate trustee administered fund. Included within the statement of financial position is the Group's net obligation calculated as the present value of the defined benefit obligation less the fair value of plan assets less any unrecognised past service costs. Any remeasurements that arise are recognised immediately in other comprehensive income through the statement of comprehensive income. The finance cost is recognised within finance income and expense in the income statement. The finance cost is the increase in the defined benefit obligation which arises because the benefits are one period closer to settlement.

Contributions are transferred to the trustee administered fund on a regular basis to secure the benefits provided under the rules of the scheme. Pension costs are assessed in accordance with the advice of a professionally qualified actuary.

The Group also operates a contributory defined contribution pension scheme,the assets of which are held separately from those of the Group. For this scheme the cost is charged to the income statement as contributions become due.

Leases

The leases entered into by the Group are operating leases. The rental charges payable under operating leases are charged to the income statement on a straight-line basis over the life of the lease.

Taxation

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the Income statement except to the extent that it relates to items recognised directly in other comprehensive income, in which case it is recognised in other comprehensive income.

Current tax is the expected tax payable on the taxable income and gains arising in the accounting period.

Deferred tax is recognised on all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax assets and liabilities are offset, only if a legally enforceable right exists to set off current tax assets against current tax liabilities, the deferred income taxes relate to the same taxation authority and that the authority permits the company to make a single net payment. Deferred tax assets are only recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Both current and deferred taxes are determined using the rates enacted or substantively enacted at the statement of financial position date.

Tax relating to fair value re-measurement of available-for-sale investments, which are charged or credited directly to other comprehensive income, is also credited or charged directly to other comprehensive income and is subsequently recognised in the income statement when the deferred fair value gain or loss is recognised in the income statement.

Tax relating to actuarial gains/(losses) on retirement benefit obligations is recognised in other comprehensive income.

Provisions and contingent liabilities

The Group recognises a provision when there is a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources will be required to settle the obligation, and the amount has been reliably estimated.

The Society has an obligation to contribute to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet compensation claims from, in particular, retail depositors of failed banks. A provision is recognised to the extent it can be reliably estimated and when the Society has an obligation in accordance with IFRIC 21. The amount provided is based on information received from the FSCS, forecast future interest rates and the Society's historic share of industry protected deposits.

Contingent liabilities are potential obligations from past events which will only be confirmed by future events. Contingent liabilities are not recognised in the Statement of financial position.

Accounting estimates and judgements

The Group makes estimates and judgements that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. These estimates are described as follows:

Impairment losses on loans and advances to customers

The Group reviews its mortgage advances portfolio at least on a quarterly basis to assess impairment. In determining whether an impairment loss should be recorded, the Group is required to exercise a degree of judgement. Impairment provisions are calculated using historical arrears experience, modelled credit risk characteristics and expected cash flows. Estimates are applied to determine prevailing market conditions (e.g. interest rates and house prices), customer behaviour (e.g. default rates) and the length of time expected to complete the sale of properties in possession. The accuracy of the provision would therefore be affected by unexpected changes to these assumptions.

To the extent that default rates differ from that estimated by 10%, the impairment provisions on loans and advances would change by an estimated £0.5 million.

Expected mortgage life

In determining the expected life of mortgage assets, the Group uses historical and forecast redemption data as well as management judgement. At regular intervals throughout the year, the expected life of mortgage assets is reassessed for reasonableness. Any variation in the expected life of mortgage assets will change the carrying value in the statement of financial position and the timing of the recognition of interest income.

A 10% increase in the life profile of mortgage assets would result in an increase in the value of loans on the statement of financial position by approximately £2.4 million.

Employee benefits

The Group operates a defined benefit pension scheme. Significant judgements (on such areas as future interest and inflation rates and mortality rates) have to be exercised in estimating the value of the assets and liabilities of the scheme, and hence of its net deficit. The assumptions are outlined in a note 27 to the accounts. Of these assumptions, the main determinant of the liability is the discount rate. A variation of 0.1% in the discount rate will change liabilities by approximately £2.1 million.

Goodwill

The Group has recognised goodwill in the statement of financial position, in relation to the acquisition of subsidiary undertakings. Judgement is used in estimating the appropriateness of the carrying value of such balances, in particular the discount rate applied in testing for impairment. A 1% movement in the discount rate does not result in any impairment of the goodwill balance recognised.

2. SEGMENTAL REPORTING

Nottingham Building Society and its subsidiaries are all UK registered entities, the activities of which are detailed below and in Note 16. The Group operates throughout the UK therefore no geographical analysis has been presented.

The chief operating decision maker has been identified as the Group Board. The Board reviews the Group's internal reporting in order to assess performance and allocate resources. Operating segments are reported in a manner consistent with the internal reporting provided to the Board.

The Group reports through three operating segments:

- **Retail financial services** – Provides mortgages, savings, third party insurance and investments. Includes all income and costs associated with Nottingham Building Society and Arrow Mortgage Finance No. 1 Ltd.
- **Estate Agency** – Provides estate agency and lettings services. Includes all income and costs associated with Nottingham Property Services Ltd, Harrison Murray Ltd and HM Lettings Ltd.
- **Mortgage Broking** – Provides whole-of-market mortgage broking services. Includes all income and costs associated with Nottingham Mortgage Services Ltd.

2016	Retail financial services £m	Estate Agency £m	Mortgage Broking £m	Consolidation adjustments £m	Total £m
Net interest income	45.6	-	-	-	45.6
Net fees and commission receivable	2.1	5.2	1.3	-	8.6
Other income	0.3	-	-	-	0.3
TOTAL INCOME	**48.0**	**5.2**	**1.3**	**-**	**54.5**
Administrative expenses	(28.4)	(5.9)	(1.1)	-	(35.4)
Depreciation and amortisation	(3.1)	(0.1)	-	(0.1)	(3.3)
Finance cost	(0.2)	-	-	-	(0.2)
Impairment losses on loans and advances	-	-	-	-	-
Provisions for other liabilities	(0.2)	-	-	-	(0.2)
Loss on disposal of property, plant and equipment	(0.1)	-	-	-	(0.1)
UNDERLYING PROFIT/(LOSS)	**16.0**	**(0.8)**	**0.2**	**(0.1)**	**15.3**
Net losses from derivative financial instruments	(0.9)	-	-	-	(0.9)
Provisions for liabilities – FSCS levy	(0.2)	-	-	-	(0.2)
PROFIT/(LOSS) BEFORE TAX	**14.9**	**(0.8)**	**0.2**	**(0.1)**	**14.2**
Tax expense	(3.3)	0.1	-	-	(3.2)
PROFIT/(LOSS) AFTER TAX	**11.6**	**(0.7)**	**0.2**	**(0.1)**	**11.0**
Total assets	3,592.6	8.1	0.2	(9.5)	3,591.4
Total liabilities	3,391.2	9.8	0.1	(9.5)	3,391.6
Capital expenditure	2.5	-	-	-	2.5

2. SEGMENTAL REPORTING (CONTINUED)

2015	Retail financial services £m	Estate Agency £m	Mortgage Broking £m	Consolidation adjustments £m	Total £m
Net interest income	48.0	-	-	-	48.0
Net fees and commission receivable	2.2	6.2	1.0	-	9.4
TOTAL INCOME	**50.2**	**6.2**	**1.0**	**-**	**57.4**
Administrative expenses	(26.6)	(6.1)	(0.9)	-	(33.6)
Depreciation and amortisation	(3.2)	-	-	(0.1)	(3.3)
Finance cost	(0.2)	-	-	-	(0.2)
Impairment losses on loans and advances	(0.2)	-	-	-	(0.2)
Provisions for other liabilities	-	-	-	-	-
Profit on disposal of property, plant and equipment	0.1	-	-	-	0.1
UNDERLYING PROFIT	**20.1**	**0.1**	**0.1**	**(0.1)**	**20.2**
Net gains from derivative financial instruments	1.2	-	-	-	1.2
Provisions for liabilities – FSCS levy	(1.4)	-	-	-	(1.4)
PROFIT/(LOSS) BEFORE TAX	**19.9**	**0.1**	**0.1**	**(0.1)**	**20.0**
Tax expense	(4.6)	-	-	-	(4.6)
PROFIT/(LOSS) AFTER TAX	**15.3**	**0.1**	**0.1**	**(0.1)**	**15.4**
Total assets	3,319.1	6.9	0.1	(7.7)	3,318.4
Total liabilities	3,125.4	8.1	0.1	(7.7)	3,125.9
Capital expenditure	2.3	0.2	-	-	2.5

Any transactions between operating segments are conducted on an arm's length basis and relate to introducer fees, central cost recharges and rents. All revenue with the exception of introducer fees and central recharges is externally generated with no one segment relying on a significant customer.

There are no further reportable segments or activities which are not presented above or in the primary statements on pages 44 to 48.

3. INTEREST RECEIVABLE AND SIMILAR INCOME

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
On loans fully secured on residential property	93.4	99.1	93.4	99.1
On other loans	2.5	2.6	2.5	2.6
On amounts due from group undertakings	-	-	0.6	-
On liquid assets	1.2	1.8	1.2	1.8
On instruments held at amortised cost	97.1	103.5	97.7	103.5
On debt securities	1.1	1.3	1.1	1.3
On derivative hedging of financial assets	(8.9)	(10.2)	(8.9)	(10.2)
	89.3	**94.6**	**89.9**	**94.6**

Interest on debt securities includes £0.7 million (2015: £0.8 million) arising from fixed income investment securities.

Included within interest income is £0.3 million (2015: £0.4 million) in respect of interest income accrued on impaired loans two or more months in arrears.

4. INTEREST PAYABLE AND SIMILAR CHARGES

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
On shares held by individuals	35.0	40.0	35.0	40.0
On amounts due to group undertakings	-	-	1.5	-
On deposits and other borrowings	7.4	5.7	6.6	5.7
On subscribed capital	2.0	2.0	2.0	2.0
On derivative hedging of financial liabilities	(0.7)	(1.1)	(0.7)	(1.1)
	43.7	**46.6**	**44.4**	**46.6**

5. NET (LOSSES)/GAINS FROM DERIVATIVE FINANCIAL INSTRUMENTS

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Derivatives in designated fair value hedge relationships	(9.7)	3.9	(9.7)	3.9
Adjustments to hedged items in fair value hedge accounting relationships	9.1	(2.6)	9.3	(2.6)
Derivatives not in designated fair value hedge relationships	(0.3)	(0.1)	(0.3)	(0.1)
	(0.9)	**1.2**	**(0.7)**	**1.2**

The net loss from derivative financial instruments of £0.9 million (2015: £1.2 million gain) represents the net fair value movement on derivative instruments that are matching risk exposure on an economic basis. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting is not achievable on certain items. The movement is primarily due to timing differences in income recognition between derivative instruments and the hedged assets or liabilities. This gain or loss will trend to zero over time and this is taken into account by the Board when considering the Group's underlying performance.

Notes to the accounts (continued)

6. ADMINISTRATIVE EXPENSES

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Wages and salaries	19.4	18.5	15.3	184.1
Social security costs	1.6	1.4	1.3	1.1
Other pension costs	0.8	0.8	0.7	0.7
Total staff costs	**21.8**	**20.7**	**17.3**	**15.9**
Operating lease rentals	1.0	0.9	0.6	0.5
Other administrative costs	12.6	12.0	10.6	10.2
	35.4	**33.6**	**28.5**	**26.6**

	Group 2016 £000	Group 2015 £000	Society 2016 £000	Society 2015 £000
Other administrative costs include:				
Remuneration of auditors and associates (excluding VAT)				
Audit of these financial statements	128	120	128	120
Audit of subsidiary undertakings	42	29	-	-
Audit of associated pension schemes	15	6	15	6
Other assurance services	41	27	41	27

7. EMPLOYEES

	Group 2016 Number	Group 2015 Number	Society 2016 Number	Society 2015 Number
The average number of persons employed during the year was:				
Full time	501	477	378	348
Part time	195	201	106	115
	696	**678**	**484**	**463**
Building Society				
Central Administration	240	229	240	229
Branches	244	234	244	234
Subsidiaries	212	215	-	-
	696	**678**	**484**	**463**

The average number of employees on a full time equivalent basis in the Society was 473 (2015: 430) and all of these are employed within the United Kingdom.

8. TAX EXPENSE

		Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Current tax		3.0	4.2	3.2	4.2
Adjustments for prior years		0.1	0.2	-	0.2
TOTAL CURRENT TAX		**3.1**	**4.4**	**3.2**	**4.4**
Deferred tax	19	0.1	0.1	0.1	0.1
Adjustments for prior years		-	0.1	-	0.1
TOTAL DEFERRED TAX		**0.1**	**0.2**	**0.1**	**0.2**
		3.2	**4.6**	**3.3**	**4.6**

The total tax charge for the period differs from that calculated using the UK standard rate of corporation tax. The differences are explained below.

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Profit before taxation	14.2	20.0	15.0	19.9
Expected tax at 20.25% (2015: 20.25%)	2.8	4.0	3.0	4.0
Expenses not deductible for corporation tax	0.1	0.1	0.2	0.1
Effect of tax change in tax rate on deferred tax	0.1	0.2	0.1	0.2
Effective securitisation	0.1	-	-	-
Adjustment for prior years	0.1	0.3	-	0.3
	3.2	**4.6**	**3.3**	**4.6**

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Tax recognised directly in other comprehensive income				
Tax on available-for-sale assets	0.1	-	0.1	-
Deferred tax on pension scheme	(0.7)	0.1	(0.7)	0.1
TAX (CREDIT)/CHARGE FOR THE YEAR	**(0.6)**	**0.1**	**(0.6)**	**0.1**

Factors affecting future tax charges

The Finance Act 2015 reduced the future rate of UK corporation tax from 20% to 19% with effect from 1 April 2017. Furthermore, the Finance Act 2016, following its enactment in September 2016, reduced the future rate further to 17% with effect from 1 April 2020.

Deferred tax assets and liabilities are measured at whichever of these enacted tax rates are expected to apply when the related asset is realised or liability is settled.

9. CASH IN HAND AND BALANCES WITH THE BANK OF ENGLAND

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Cash in hand	1.3	1.3	1.3	1.3
Balances with the Bank of England	389.2	369.4	389.2	369.4
	390.5	**370.7**	**390.5**	**370.7**

Balances with the Bank of England includes cash ratio deposits of £3.0 million (2015: £2.8 million) which are not readily available for use in the Group's day to day operations and therefore are excluded from cash and cash equivalents.

Balances with the Bank of England of £369.4m have been reclassified from loans and advances to credit institutions in the prior year.

10. LOANS AND ADVANCES TO CREDIT INSTITUTIONS

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Repayable on call and short notice	6.3	1.3	0.8	0.8
Other loans and advances to credit institutions	32.8	17.3	32.8	17.3
	39.1	**18.6**	**33.6**	**18.1**

At 31 December 2016 £30.8 million (2015: £17.2 million) of cash has been deposited by the Group and Society as collateral against derivative contracts.

11. CASH AND CASH EQUIVALENTS

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Cash in hand and balances with the Bank of England	387.5	367.9	387.5	367.9
Loans and advances to credit institutions	6.3	1.3	0.8	0.8
	393.8	**369.2**	**388.3**	**368.7**

12. DEBT SECURITIES

Group and Society	Notes	2016 £m	2015 £m
Securities available-for-sale			
Gilts		41.5	30.6
Treasury bills		10.0	2.0
Certificate of deposit		9.1	15.1
Fixed rate notes		20.6	21.1
Floating rate notes		16.2	33.5
		97.4	**102.3**
Movements on debt securities during the year may be analysed as follows:			
At 1 January		102.3	165.8
Additions		152.6	124.9
Disposals and maturities		(157.6)	(188.2)
Net gains/(losses) from changes in fair value recognised in other comprehensive income	29	0.1	(0.2)
		97.4	**102.3**

Of this total £81.2 million (2015: £68.9 million) is attributable to fixed income debt securities. Debt securities include items with a carrying value of £15.7 million (2015: £2.1 million) which have been pledged as collateral under Bank of England facilities.

13. DERIVATIVE FINANCIAL INSTRUMENTS

Group	2016 Contract/ notional amount £m	2016 Fair value of assets £m	2016 Fair value of liabilities £m	2015 Contract/ notional amount £m	2015 Fair value of assets £m	2015 Fair value of liabilities £m
Unmatched derivatives						
Interest rate swaps	132.6	-	(0.6)	166.7	0.1	(0.2)
Derivatives designated as fair value hedges						
Interest rate swaps	1,774.7	4.7	(19.1)	1,440.2	3.7	(9.1)
	1,907.3	**4.7**	**(19.7)**	**1,606.9**	**3.8**	**(9.3)**

Society	2016 Contract/ notional amount £m	2016 Fair value of assets £m	2016 Fair value of liabilities £m	2015 Contract/ notional amount £m	2015 Fair value of assets £m	2015 Fair value of liabilities £m
Unmatched derivatives						
Interest rate swaps	132.6	-	(0.4)	166.7	0.1	(0.2)
Derivatives designated as fair value hedges						
Interest rate swaps	1,668.3	4.7	(19.1)	1,440.2	3.7	(9.1)
	1,800.9	**4.7**	**(19.5)**	**1,606.9**	**3.8**	**(9.3)**

14. LOANS AND ADVANCES TO CUSTOMERS

Group and Society	Notes	2016 £m	2015 £m
Loans fully secured on residential property		2,950.4	2,719.7
Other loans fully secured on land		69.0	72.5
		3,019.4	2,792.2
Provision for impairment losses on loans and advances	15	(4.5)	(4.5)
		3,014.9	2,787.7
Fair value adjustment for hedged risk		17.7	8.8
		3,032.6	**2,796.5**

Certain residential mortgages have been pledged to the Society's secured funding arrangements or utilised as mortgage loan pools for the Bank of England's Funding for Lending and Term Funding Schemes. The programmes have enabled the Society to obtain secured funding or to create additional collateral which could be used to source additional funding. The Funding for Lending Scheme, provides Treasury bills in return for eligible collateral but for accounting purposes the underlying collateral is retained on balance sheet and the Treasury bills are not.

Bank of England funding

The table below summarises the mortgages pledged and encumbered assets.

	Mortgages pledged		Drawn	
	2016 £m	2015 £m	2016 £m	2015 £m
Bank of England funding				
Other whole mortgage schemes	790.3	987.4	837.1	706.7
Term Funding Scheme	206.3	-	176.9	-
	996.6	**987.4**	**1,014.0**	**706.7**

Accounts

14. LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

Other secured funding

At 31 December 2016, loans and advances to customers also includes £102.4m (2015: £nil) for both the Group and Society which have been used in secured funding arrangements, resulting in the beneficial interest of these loans being transferred to Arrow Mortgage Finance No.1 Limited, a special purpose vehicle consolidated into the Group Accounts. The carrying value of these loans at the date the beneficial interest was transferred was £111.5m (2015: £nil). All of the loans pledged are retained within the Society's Statement of Financial Position as the Society retains substantially all the risk and rewards relating to the loans. These loans secure £93m (2015: £nil) of funding for the Group (note 24).

15. PROVISION FOR IMPAIRMENT LOSSES ON LOANS AND ADVANCES TO CUSTOMERS

Impairment provisions have been deducted from the appropriate asset values on the Statement of Financial Position. Movement in provision for impairment losses on loans and advances may be analysed as follows:

Group and Society	Notes	2016 Loans fully secured on residential property £m	2016 Other loans fully secured on land £m	2016 Total £m	2015 Loans fully secured on residential property £m	2015 Other loans fully secured on land £m	2015 Total £m
At 1 January							
Collective impairment		0.7	1.5	2.2	0.6	1.1	1.7
Individual impairment		0.4	1.9	2.3	0.3	2.8	3.1
		1.1	**3.4**	**4.5**	**0.9**	**3.9**	**4.8**
Income statement							
Charge/(release) for the year							
Collective impairment		0.4	0.3	0.7	0.1	0.4	0.5
Individual impairment		-	(0.7)	(0.7)	0.1	(0.3)	(0.2)
		0.4	**(0.4)**	**-**	**0.2**	**0.1**	**0.3**
Amount utilised in the year							
Individual impairment		-	-	-	-	(0.6)	(0.6)
At 31 December							
Collective impairment		1.1	1.8	2.9	0.7	1.5	2.2
Individual impairment		0.4	1.2	1.6	0.4	1.9	2.3
	14	**1.5**	**3.0**	**4.5**	**1.1**	**3.4**	**4.5**

Other loans fully secured on land represents Secured Business Lending (SBL) assets.

The charge/(credit) to the income statement comprises:

Group and Society	2016 Loans fully secured on residential property £m	2016 Other loans fully secured on land £m	2016 Total £m	2015 Loans fully secured on residential property £m	2015 Other loans fully secured on land £m	2015 Total £m
Provision for impairment	0.4	(0.4)	-	0.2	0.1	0.3
Recoveries of debts previously written off	-	-	-	(0.1)	-	(0.1)
	0.4	**(0.4)**	**-**	**0.1**	**0.1**	**0.2**

16. INVESTMENTS IN SUBSIDIARY UNDERTAKINGS

Society	2016 Shares £m	2016 Loans £m	2015 Shares £m	2015 Loans £m
At 1 January	-	7.7	-	8.2
Additions/(repayments)	-	14.0	-	(0.5)
	-	**21.7**	-	**7.7**

Details of the loan balances outstanding with subsidiary undertakings is disclosed in the related parties transactions note 33.

The Society has the following subsidiary undertakings which all operate and have a registered office in the United Kingdom and are included in the Group accounts:

Name of subsidiary undertaking	Principal business activity	Ownership interest
Arrow Mortgage Finance No. 1 Limited	Funding vehicle	See below
Harrison Murray Ltd	Estate Agency and related services	100%
HM Lettings Ltd	Lettings	100%
Nottingham Mortgage Services Ltd	Mortgage Broking	100%
Nottingham Property Services Ltd	Estate Agency and related services	100%
The Mortgage Advice Centre (East Midlands) Ltd	Dormant	100%

The registered office of Arrow Mortgage Finance No. 1 Limited is 35 Great St. Helen's, London, EC3A 6AP. The registered office address for all other subsidiary companies listed above is detailed in note 34.

The special purpose vehicle (SPV), Arrow Mortgage Finance No. 1 Limited, has been formed with nominal share capital, is funded through loans from the Society and its activities are carried out under the direction of the Society, under the legal terms of its operation. The Society is exposed to variable returns from this entity and therefore the SPV passes the test of control under IFRS 10. Consequently it is fully consolidated into the Group Accounts.

The intercompany loans outstanding with Arrow Mortgage Finance No. 1 Ltd have a contractual maturity of five years, however are expected to be repaid within two years in line with the secured funding term.

All other intercompany loans are payable on demand. The directors have reviewed the recoverability of outstanding loans and holdings in subsidiary undertakings and no impairment provision is deemed necessary.

17. PROPERTY, PLANT AND EQUIPMENT

2016	Group Land and buildings £m	Group Equipment, fixtures, fittings £m	Group Total £m	Society Land and buildings £m	Society Equipment, fixtures, fittings £m	Society Total £m
Cost						
At 1 January 2016	16.1	19.1	35.2	14.1	18.5	32.6
Additions	0.1	1.4	1.5	0.1	1.4	1.5
Disposals	(0.2)	-	(0.2)	(0.2)	-	(0.2)
At 31 December 2016	**16.0**	**20.5**	**36.5**	**14.0**	**19.9**	**33.9**
Depreciation						
At 1 January 2016	8.3	13.8	22.1	7.2	13.5	20.7
Charge for the year	0.4	1.4	1.8	0.4	1.2	1.6
On disposals	(0.1)	-	(0.1)	(0.1)	-	(0.1)
At 31 December 2016	**8.6**	**15.2**	**23.8**	**7.5**	**14.7**	**22.2**
Net Book Value						
At 31 December 2016	**7.4**	**5.3**	**12.7**	**6.5**	**5.2**	**11.7**

2015	Group Land and buildings £m	Group Equipment, fixtures, fittings £m	Group Total £m	Society Land and buildings £m	Society Equipment, fixtures, fittings £m	Society Total £m
Cost						
At 1 January 2015	15.3	17.5	32.8	13.3	17.1	30.4
Additions	0.8	1.7	2.5	0.8	1.5	2.3
Disposals	-	(0.1)	(0.1)	-	(0.1)	(0.1)
At 31 December 2015	**16.1**	**19.1**	**35.2**	**14.1**	**18.5**	**32.6**
Depreciation						
At 1 January 2015	7.9	12.4	20.3	6.8	12.1	18.9
Charge for the year	0.4	1.4	1.8	0.4	1.4	1.8
On disposals	-	-	-	-	-	-
At 31 December 2015	**8.3**	**13.8**	**22.1**	**7.2**	**13.5**	**20.7**
Net Book Value						
At 31 December 2015	**7.8**	**5.3**	**13.1**	**6.9**	**5.0**	**11.9**

17. PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
The net book value of land and buildings comprises:				
Freehold	6.8	7.1	6.0	6.2
Short Leasehold	0.6	0.7	0.5	0.7
	7.4	**7.8**	**6.5**	**6.9**
The net book value of land and buildings occupied for own use:				
Building Society	6.5	6.5	6.1	6.5
Subsidiaries	0.5	0.9	-	-
Non - Group	0.4	0.4	0.4	0.4
	7.4	**7.8**	**6.5**	**6.9**

18. INTANGIBLE ASSETS

Group 2016	Goodwill £m	Purchased Software £m	Developed Software £m	Other Intangibles £m	Total £m
Cost					
At 1 January 2016	4.5	7.0	12.0	0.7	24.2
Additions	-	0.3	0.7	-	1.0
At 31 December 2016	**4.5**	**7.3**	**12.7**	**0.7**	**25.2**
Amortisation					
At 1 January 2016	-	6.8	8.7	0.5	16.0
Charge for the year	-	0.1	1.3	0.1	1.5
At 31 December 2016	**-**	**6.9**	**10.0**	**0.6**	**17.5**
Net Book Value					
At 31 December 2016	**4.5**	**0.4**	**2.7**	**0.1**	**7.7**

18. INTANGIBLE ASSETS (CONTINUED)

Group 2015	Goodwill £m	Purchased Software £m	Developed Software £m	Other Intangibles £m	Total £m
Cost					
At 1 January 2015	4.5	6.9	11.6	0.7	23.7
Additions	-	0.1	0.4	-	0.5
At 31 December 2015	**4.5**	**7.0**	**12.0**	**0.7**	**24.2**
Amortisation					
At 1 January 2015	-	6.6	7.5	0.4	14.5
Charge for the year	-	0.2	1.2	0.1	1.5
At 31 December 2015	**-**	**6.8**	**8.7**	**0.5**	**16.0**
Net Book Value					
At 31 December 2015	**4.5**	**0.2**	**3.3**	**0.2**	**8.2**

The goodwill relates to the 2013 acquisition of 100% of the ordinary share capital of Harrison Murray Ltd and 100% of the lettings trade and assets of Harrison Murray Commercial Ltd. In accordance with the requirements of IAS 36, the Group completed an impairment review of the carrying value for goodwill as at 31 December 2016 to ensure that the carrying value is stated at no more than its recoverable amount. No impairment arose as a result of this review.

Society	2016 Purchased Software £m	2016 Developed Software £m	2016 Total £m	2015 Purchased Software £m	2015 Developed Software £m	2015 Total £m
Cost						
At 1 January	6.9	12.0	18.9	6.8	11.6	18.4
Additions	0.3	0.7	1.0	0.1	0.4	0.5
At 31 December	**7.2**	**12.7**	**19.9**	**6.9**	**12.0**	**18.9**
Amortisation						
At 1 January	6.7	8.7	15.4	6.5	7.5	14.0
Charge for the year	0.1	1.3	1.4	0.2	1.2	1.4
At 31 December	**6.8**	**10.0**	**16.8**	**6.7**	**8.7**	**15.4**
Net Book Value						
At 31 December	**0.4**	**2.7**	**3.1**	**0.2**	**3.3**	**3.5**

19. DEFERRED TAX

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
At 1 January	1.6	1.9	1.6	1.9
Charge to the income statement	(0.1)	(0.2)	(0.1)	(0.2)
Recognised directly in other comprehensive income	0.6	(0.1)	0.6	(0.1)
	2.1	**1.6**	**2.1**	**1.6**

The deferred tax (charge)/ credit in the income statement comprises the following temporary differences:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Property, plant and equipment	-	(0.1)	-	(0.1)
IFRS transitional adjustment	-	0.2	-	0.2
Pensions and other post tax retirement benefits	(0.1)	(0.1)	(0.1)	(0.1)
Adjustment for prior years	-	(0.1)	-	(0.1)
Intangible assets	0.2	0.2	0.2	0.2
Effect of change in tax rate	(0.1)	(0.2)	(0.1)	(0.2)
Other provisions	(0.1)	(0.1)	(0.1)	(0.1)
	(0.1)	**(0.2)**	**(0.1)**	**(0.2)**

Deferred income tax assets and liabilities as at 31 December are attributable to the following items:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Deferred tax assets				
Pensions and other post-retirement benefits	1.6	1.0	1.6	1.0
Property, plant and equipment	0.4	0.5	0.4	0.5
Other provisions	0.1	0.1	0.1	0.1
Transfer of engagements – fair value adjustments	0.3	0.4	0.3	0.4
	2.4	**2.0**	**2.4**	**2.0**
Deferred tax liabilities				
Available-for-sale reserve	0.1	-	0.1	-
Intangibles	0.2	0.4	0.2	0.4
	0.3	**0.4**	**0.3**	**0.4**
Net deferred tax asset	**2.1**	**1.6**	**2.1**	**1.6**

Deferred tax liabilities have been offset against deferred tax assets in the statement of financial position in the current year as it is deemed that there is a legal right of offset. The prior year comparative has not been restated.

20. SHARES

Group and Society	2016 £m	2015 £m
Held by individuals	2,457.4	2,433.1
Fair value adjustment for hedged risk	-	0.1
	2,457.4	**2,433.2**

21. AMOUNTS OWED TO CREDIT INSTITUTIONS

Group and Society	2016 £m	2015 £m
Amounts owed to credit institutions	557.6	410.4
	557.6	**410.4**

At 31 December 2016 £nil (2015: £nil) cash has been received by the Group and Society as collateral against derivative contracts. Amounts owed to credit institutions include £244.0 million (2015: £314.1 million) secured against certain loans and advances to credit institutions and loans and advances to customers.

22. AMOUNTS OWED TO OTHER CUSTOMERS

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Demand accounts				
Retail customers	2.0	2.3	2.0	2.3
Other	4.6	6.1	4.6	6.1
	6.6	**8.4**	**6.6**	**8.4**
Term deposits				
Local Authorities	122.2	112.3	122.2	112.3
Pension Funds/ Insurers	20.0	10.0	20.0	10.0
Other	66.9	92.9	66.9	92.9
	209.1	**215.2**	**209.1**	**215.2**
	215.7	**223.6**	**215.7**	**223.6**

23. AMOUNTS OWED TO SUBSIDIARY UNDERTAKINGS

Society	2016 £m	2015 £m
At 1 January	-	-
Advance	111.5	-
Repayment	(9.9)	-
	101.6	**-**

The amounts owed to subsidiary undertakings represents a deemed loan as part of a secured funding balance. The repayment of the loan will follow the collection of the principal and interest of the underlying mortgage assets and whilst its contractual maturity is within five years, it is expected to be settled within two years.

24. DEBT SECURITIES IN ISSUE

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Senoir secured debt	92.7	-	-	-
Certificates of deposit	6.0	9.0	6.0	9.0
	98.7	**9.0**	**6.0**	**9.0**

The underlying security for the senior secured debt are certain loans and advances to customers (see note 14 for further detail).

25. OTHER LIABILITIES AND ACCRUALS

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Income tax	-	0.2	-	0.2
Trade creditors	0.1	0.1	0.1	0.1
Accruals and deferred income	2.9	2.9	2.5	2.5
Other creditors	1.7	1.6	1.4	1.5
	4.7	**4.8**	**4.0**	**4.3**

26. PROVISION FOR LIABILITIES

Group and Society	2016 FSCS £m	2016 Customer redress & other provisions £m	2016 Total £m	2015 FSCS £m	2015 Customer redress & other provisions £m	2015 Total £m
At 1 January	1.0	0.4	1.4	1.2	0.6	1.8
Charge for the year	0.2	0.2	0.4	1.4	-	1.4
Provision utilised	(0.8)	(0.1)	(0.9)	(1.6)	(0.2)	(1.8)
	0.4	**0.5**	**0.9**	**1.0**	**0.4**	**1.4**

FSCS levy

The levy represents the estimated amount payable under the FSCS for the 2016/2017 scheme year, which runs from March 2016 to March 2017, and is calculated with reference to the protected deposits held at 31 December 2015. The amount payable represents the Society's share of interest payable.

Customer redress and other related provisions

Other provisions have been made in respect of various customer claims, including claims in relation to previous sales of payment protection insurance and endowment policies. It is expected that the liability will predominately crystallise over the next 12 to 24 months.

27. RETIREMENT BENEFIT OBLIGATIONS

a) Defined benefit obligations

The Group operates a contributory defined benefit scheme, the assets of which are held in a separate trustee administered fund. The scheme closed to new members in 1997 and was closed for future service accrual from 31 January 2009.

The pension cost is assessed following the advice of a qualified independent actuary using the projected unit method. The latest funding review of the scheme was at 1 April 2014. This review showed that the market value of the scheme assets at 1 April 2014 was £40.8 million and that the actuarial value of those assets represented 85% of the benefits that had accrued to members after allowing for expected future increase in salaries.

An updated actuarial valuation at 31 December 2016 was carried out on a market value basis by a qualified independent actuary, as follows:

Group and Society	2016 %	2015 %
The principal actuarial assumptions used were as follows:		
Discount rate	2.7	3.7
Rate of increase in salaries	3.4	3.1
Rate of increase in pensions	3.5	3.5
Inflation	3.4	3.1

The assumptions applied follow the requirements of IAS 19, which are different to the technical valuation approach. This requires the discount rate to be benchmarked against AA corporate rated bonds, which at 31 December 2016 were lower than the rate of inflation.

The table below shows the assumptions used for expected life at 31 December (normal retirement age of 62).

Group and Society	2016 Male Years	2016 Female Years	2015 Male Years	2015 Female Years
Expected life at retirement for a new pensioner	26.3	28.4	26.4	28.6
Expected life at retirement in 20 years' time	27.7	29.9	27.9	30.1

Approximate sensitivities of the principal assumptions are set out in the table below which shows the increase or reduction in the pension obligations that would result. Each sensitivity considers one change in isolation.

Group and Society	Change in assumption	2016 £m	2015 £m
Principal actuarial assumption			
Discount rate	+/- 0.25%	(2.9)	(2.3)
Rate of increase in salaries	+/- 0.25%	0.1	0.2
Rate of increase in pensions	+/- 0.25%	0.8	0.5
Mortality age adjustment	+/- 0.25%	0.8	0.6
Inflation	+/- 0.25%	0.8	1.1

27. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

Group and Society	2016 £m	2015 £m
Fair value of scheme assets:		
As at 1 January	45.3	45.8
Interest on pension scheme assets	1.7	1.5
Contributions by employer	0.8	1.0
Benefits paid	(1.6)	(1.4)
Expenses paid by trustees	(0.1)	(0.1)
Decrease in secured pensioners value due to scheme experience	-	(0.1)
Gain/(loss) on asset returns	4.3	(1.4)
As at 31 December	**50.4**	**45.3**
Present value of defined benefit obligations:		
As at 1 January	(50.8)	(52.4)
Interest on pension scheme liabilities	(1.9)	(1.7)
Benefits paid	1.6	1.4
Decrease in secured pensioners value due to scheme experience	-	0.1
Experience gain/(loss) on liabilities	0.8	(0.6)
(Loss)/gain on changes in financial assumptions	(9.5)	2.1
Gain/(loss) on changes in demographic assumptions	-	0.3
As at 31 December	**(59.8)**	**(50.8)**
LIABILITY IN THE STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER	**(9.4)**	**(5.5)**

The actual return on plan assets was a gain of £5.9 million (2015: £0.2 million gain).

The major categories of plan assets are as follows:

Group and Society	2016 £m	2015 £m
Equities	22.3	20.8
Bonds	26.3	23.0
Cash	0.3	0.2
Secured pensioners	1.5	1.3
Fair value of scheme assets	**50.4**	**45.3**
The amounts recognised in finance income are:		
Interest cost	(1.9)	(1.7)
Interest on pension scheme assets	1.7	1.5
	(0.2)	**(0.2)**

The movement in the liability recognised in the statement of financial position is as follows:

Group and Society	2016 £m	2015 £m
Opening defined benefit obligation at 1 January	(5.5)	(6.6)
Amount recognised in the income statement	(0.2)	(0.2)
Employer contributions	0.8	1.0
Remeasurement (losses)/gains	(4.5)	0.3
CLOSING DEFINED BENEFIT OBLIGATION AS AT 31 DECEMBER	**(9.4)**	**(5.5)**

27. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

The amount recognised in the statement of other comprehensive income for remeasurement gains and losses is as follows:

Group and Society	2016 £m	2015 £m
Actual return less expected return on plan assets	4.2	(1.5)
Experience gain/(loss) arising on scheme liabilities	0.8	(0.6)
Changes in assumptions underlying the present value of the scheme liabilities	(9.5)	2.4
REMEASUREMENT OF DEFINED BENEFIT OBLIGATION	**(4.5)**	**0.3**

The average duration of the defined benefit obligation at 31 December 2016 is 18 years (2015: 17 years). This number can be analysed as follows:

Group and Society	2016 Years	2015 Years
Active members	23	22
Deferred members	23	22
Retired members	14	10

During the year, the Group made additional contributions of £0.8 million (2015: £1.0 million) as part of its funding plan. The Group and Society have committed to contribute £0.7m in 2017 under the agreed funding plan.

b) Defined contribution obligations

The Group also operates contributory defined contribution schemes. The assets of these schemes are held separately from those of the Group.

The pension charge for the period represents contributions payable by the Group and Society to the schemes and amounted for the Group to £0.8 million (2015: £0.7 million) and for the Society £0.7 million (2015: £0.6 million). There were no outstanding or prepaid contributions at either the beginning or end of the year.

28. SUBSCRIBED CAPITAL

Group and Society	2016 £m	2015 £m
7.875% sterling permanent interest bearing shares	23.9	23.9
Fair value adjustment for hedged risk	2.3	2.3
	26.2	**26.2**

The subscribed capital was issued for an indeterminate period and is only repayable in the event of the winding up of the Society. PIBS holders do not have any right to a residual interest in the Society.

29. AVAILABLE-FOR-SALE RESERVES

Group and Society	2016 £m	2015 £m
At 1 January	0.2	0.4
Net gain/(loss) from changes in fair value	0.1	(0.2)
	0.3	**0.2**

30. FINANCIAL INSTRUMENTS

Classification & Measurement

A financial instrument is a contract that gives rise to a financial asset or financial liability. Nottingham Building Society is a retailer of financial instruments, mainly in the form of mortgages and savings products. The Group uses wholesale financial instruments to invest in liquid assets, raise wholesale funding and to manage the risks arising from its operations.

The Group has a formal structure for managing risk, including established risk limits, reporting lines, mandates, credit risk appetite and other control procedures. The Board Risk Committee (BRC) is tasked with monitoring the Group's overall exposure to risk. Six sub committees, the Assets and Liabilities Committee (ALCO), Retail Credit Committee (RCC), Operational Risk Committee (ORC), Information Security Committee (ISC), Conduct Risk Committee (CRC) and the Project and Change Committee monitor the individual areas of risk and report to the Board Risk Committee quarterly.

The ALCO monitors statement of financial position risks (including the use of derivative financial instruments), funding and liquidity in line with the Group's prudent policy statements.

The RCC ensures that the management of retail credit risk is consistent with the retail credit risk appetite statement.

Key performance indicators are provided to the Board monthly by both the ALCO and RCC and summary information from ALCO on a weekly basis.

Instruments used for risk management purposes include derivative financial instruments (derivatives), which are contracts whose value is derived from one or more underlying price, rate or index inherent in the contract or agreement, such as interest rates, exchange rates or stock market indices.

The objective of the Group in using derivatives is in accordance with the Building Societies Act 1986 and is to limit the extent to which the Group will be affected by changes in interest rates. Derivatives are not used in trading activity or for speculative purposes.

The derivative instruments used by the Group in managing its statement of financial position risk exposures are interest rate swaps. These are used to protect the Group from exposures arising principally from fixed rate mortgage lending, fixed rate savings products and fixed rate wholesale funding. An interest rate swap is a contract to exchange one set of interest rate cash flows for another. Such swaps result in the economic exchange of interest rates. No exchange of principal takes place. Instead interest payments are based on notional principal amounts agreed at inception of the swap. The duration of the interest rate swap is generally short to medium term and their maturity profile reflects the nature of the exposures arising from the underlying business activities.

The Group applies portfolio fair value hedging techniques to reduce its exposure to interest rate risk as follows:

Hedged item	Risk	Fair value interest rate hedge
Fixed rate mortgage	Increase in interest rates	Group pays fixed, receives variable
Fixed rate savings bond	Decrease in interest rates	Group receives fixed, pays variable
Fixed rate funding	Decrease in interest rates	Group receives fixed, pays variable

The fair values of these hedges at 31 December 2016 are shown in note 13.

30. FINANCIAL INSTRUMENTS (CONTINUED)

Classification & Measurement (continued)

Below are the summary terms and conditions and accounting policies of financial instruments:

Financial instrument	Terms and conditions	Accounting policy
Loans and advances to credit institutions	Fixed or LIBOR linked interest rate Fixed term Short to medium term maturity	Loans and receivables at amortised cost Accounted for at settlement date
Debt securities	Fixed or LIBOR linked interest rate Fixed term Short to medium term maturity	Available-for-sale at fair value Accounted for at settlement date
Loans and advances to customers	Secured on residential property or land Standard maximum contractual term of 25 years Fixed or variable rate interest	Loans and receivables at amortised cost Accounted for at settlement date
Shares	Variable term Fixed or variable interest rates	Amortised cost Accounted for at settlement date
Amounts owed to credit institutions	Fixed or LIBOR linked interest rate Fixed term Short to medium term maturity	Amortised cost Accounted for at settlement date
Amounts owed to other customers	Fixed or LIBOR linked interest rate Fixed term Short to medium term maturity	Amortised cost Accounted for at settlement date
Debt securities in issue	Fixed or LIBOR linked interest rate Fixed term Short to medium term maturity	Amortised cost Accounted for at settlement date
Subscribed capital	Fixed interest rate Issued for indeterminate period Only repayable upon winding up of the Society	Amortised cost Accounted for at settlement date
Derivative financial instruments	Fixed interest received/paid converted to variable interest paid/received Based on notional value of the derivative	Fair value through profit and loss Accounted for at trade date

30. FINANCIAL INSTRUMENTS (CONTINUED)

Classification & Measurement (continued)

Financial assets and liabilities are measured on an on-going basis either at fair value or at amortised cost. Note 1: ' Accounting policies' describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The tables below analyse the Group's assets and liabilities by financial classification:

Carrying values by category	**Held at amortised cost**		**Held at fair value**			
Group **As at 31 December 2016**	Loans and receivables **£m**	Financial assets and liabilities at amortised cost **£m**	Available-for-sale **£m**	Derivatives designated as fair value hedges **£m**	Unmatched derivatives **£m**	Total **£m**
Financial assets						
Cash in hand and balances with the Bank of England	-	390.5	-	-	-	390.5
Loans and advances to credit institutions	39.1	-	-	-	-	39.1
Debt securities	-	-	97.4	-	-	97.4
Derivative financial instruments	-	-	-	4.7	-	4.7
Loans and advances to customers	3,032.6	-	-	-	-	3,032.6
Other assets	-	27.1	-	-	-	27.1
	3,071.7	**417.6**	**97.4**	**4.7**	**-**	**3,591.4**
Financial liabilities						
Shares	-	2,457.4	-	-	-	2,457.4
Amounts owed to credit institutions	-	557.6	-	-	-	557.6
Amounts owed to other customers	-	215.7	-	-	-	215.7
Debt securities in issue	-	98.7	-	-	-	98.7
Derivative financial instruments	-	-	-	19.1	0.6	19.7
Subscribed capital	-	26.2	-	-	-	26.2
Other liabilities	-	16.3	-	-	-	16.3
	-	**3,371.9**	**-**	**19.1**	**0.6**	**3,391.6**

30. FINANCIAL INSTRUMENTS (CONTINUED)

Classification & Measurement (continued)

Carrying values by category	Held at amortised cost		Held at fair value			
Group **As at 31 December 2015**	Loans and receivables **£m**	Financial assets and liabilities at amortised cost **£m**	Available-for-sale **£m**	Derivatives designated as fair value hedges **£m**	Unmatched derivatives **£m**	Total **£m**
Financial assets						
Cash in hand and balances with the Bank of England	-	370.7	-	-	-	370.7
Loans and advances to credit institutions	18.6	-	-	-	-	18.6
Debt securities	-	-	102.3	-	-	102.3
Derivative financial instruments	-	-	-	3.7	0.1	3.8
Loans and advances to customers	2,796.5	-	-	-	-	2,796.5
Other assets	-	26.5	-	-	-	26.5
	2,815.1	**397.2**	**102.3**	**3.7**	**0.1**	**3,318.4**
Financial liabilities						
Shares	-	2,433.2	-	-	-	2,433.2
Amounts owed to credit institutions	-	410.4	-	-	-	410.4
Amounts owed to other customers	-	223.6	-	-	-	223.6
Debt securities in issue	-	9.0	-	-	-	9.0
Derivative financial instruments	-	-	-	9.1	0.2	9.3
Subscribed capital	-	26.2	-	-	-	26.2
Other liabilities	-	14.2	-	-	-	14.2
	-	**3,116.6**	**-**	**9.1**	**0.2**	**3,125.9**

Balances with the Bank of England have been reclassified from loans and advances to credit institutions.

30. FINANCIAL INSTRUMENTS (CONTINUED)

Fair values of financial assets and liabilities carried at amortised cost

The table below analyses the book and fair values of the Group's financial instruments held at amortised cost at 31 December:

Group		2016 Book value £m	2016 Fair value £m	2015 Book value £m	2015 Fair value £m
Financial assets					
Cash in hand and Balances with the Bank of Engand	a	390.5	390.5	370.7	370.7
Loans and advances to credit institutions	b	39.1	39.1	18.6	18.6
Loans and advances to customers	c	3,032.6	3,042.6	2,796.5	2,804.6
Financial liabilities					
Shares	d	2,457.4	2,455.0	2,433.2	2,436.4
Amounts owed to credit institutions	d	557.6	559.0	410.4	411.2
Amounts owed to other customers	d	215.7	216.1	223.6	224.2
Debt securities in issue	e	98.7	98.8	9.0	9.1
Subscribed capital	f	23.9	29.4	23.9	30.2

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. The estimated fair value of the financial assets and liabilities above has been calculated using the following valuation methodology:

a) Cash in hand – Level 1
The fair value of cash in hand and deposits with central banks is the amount repayable on demand.

b) Loans and advances to credit institutions – Level 2
The fair value of overnight deposits is the amount repayable on demand.

The estimated fair value of collateral loans and advances to credit institutions is based on its market price as at the period end.

c) Loans and advances to customers – Level 3
Loans and advances are recorded net of provisions for impairment together with the fair value adjustment for hedged items as required by IAS 39. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received taking account of expected prepayment rates.

Estimated cash flows are discounted at prevailing market rates for items of similar remaining maturity. The fair values have been adjusted where necessary to reflect any observable market conditions at the time of valuation.

d) Shares, deposits and borrowings – Level 3
The fair value of shares and deposits and other borrowings with no stated maturity is the amount repayable on demand.

The fair value of fixed interest bearing deposits and other borrowings without a quoted market price is based on expected future cash flows determined by the contractual terms and conditions discounted at prevailing market rates for items of similar remaining maturity.

e) Debt securities in issue – Level 2
The fair value is calculated using a discounted cash flow model. Expected cash flows are discounted at prevailing market rates for items of similar remaining maturity.

f) Subscribed capital – Level 1
The estimated fair value of fixed interest bearing debt is based on its active market price as at the period end.

30. FINANCIAL INSTRUMENTS (CONTINUED)

Fair values of financial assets and liabilities carried at fair value

The table below summarises the fair values of the Group's financial assets and liabilities that are accounted for at fair value, analysed by the valuation methodology used by the Group to derive the financial instruments fair value:

Group	Notes	2016 Level 1 £m	2016 Level 2 £m	2016 Total £m	2015 Level 1 £m	2015 Level 2 £m	2015 Total £m
Financial assets							
Available-for-sale – Debt securities	12	88.3	9.1	97.4	87.2	15.1	102.3
Derivative financial instruments –Interest rate swaps	13	-	4.7	4.7	-	3.8	3.8
		88.3	**13.8**	**102.1**	**87.2**	**18.9**	**106.1**
Financial liabilities							
Derivative financial instruments –Interest rate swaps	13	-	(19.7)	(19.7)	-	(9.3)	(9.3)
		-	**(19.7)**	**(19.7)**	**-**	**(9.3)**	**(9.3)**

There are no level 3 financial instruments carried at fair value.

Valuation techniques

The following is a description of the determination of fair value for financial instruments which are accounted for at fair value using valuation techniques.

The fair value hierarchy detailed in IFRS 13: 'Fair Value Measurement' splits the source of input when deriving fair values into three levels, as follows:

- **Level 1** – quoted prices (unadjusted) in active markets for identical assets or liabilities
- **Level 2** – inputs other than quoted prices included within level 1 that are observable for the asset or liability either directly or indirectly
- **Level 3** – inputs for the asset or liability that are not based on observable market data

The main valuation techniques employed by the Group to establish fair value of the financial instruments disclosed above are set out below:

Debt securities

- **Level 1** – Market prices have been used to determine the fair value of listed debt securities
- **Level 2** - Debt securities for which there is no readily available traded price are valued based on the 'present value' method. This requires expected future principal and interest cash flows to be discounted using prevailing LIBOR yield curves. The LIBOR yield curves are generally observable market data which is derived from quoted interest rates in similar time bandings which match the timings of the cash flows and maturities of the instruments.

Interest rate swaps

The valuation of interest rate swaps is also based on the 'present value' method. Expected interest cash flows are discounted using the prevailing SONIA yield curves. The SONIA yield curves are generally observable market data which is derived from quoted interest rates in similar time bandings which match the timings of the interest cash flows and maturities of the instruments. All swaps are fully collateralised and therefore no adjustment is required for credit risk in the fair value of derivatives.

Transfers between fair value hierarchies

Transfers between fair value hierarchies 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. There have been no transfers during the current or previously reported periods.

30. FINANCIAL INSTRUMENTS (CONTINUED)

Fair values of financial assets and liabilities carried at fair value (continued)

Credit risk

Credit risk is the risk that the Group incurs a financial loss arising from the failure of a customer or counterparty to meet their contractual obligations. The Group structures the level of credit risk it undertakes, by maintaining a credit governance framework involving delegated approval authority levels and credit procedures, the objective of which is to build and maintain risk asset portfolios of high quality.

The Group's maximum credit risk exposure is detailed in the table below:

Group and Society	2016 £m	2015 £m
Credit risk exposure		
Cash in hand and Balances with the Bank of England	390.5	370.7
Loans and advances to credit institutions	39.1	18.6
Debt securities	96.9	102.0
Derivative financial instruments	4.7	3.8
Loans and advances to customers	3,032.6	2,796.5
Total statement of financial position exposure	**3,563.8**	**3,291.6**
Off balance sheet exposure – mortgage commitments	182.2	157.7
	3,746.0	**3,449.3**

a) Loans and advances to credit institutions, debt securities and derivative financial instruments

The ALCO is responsible for approving treasury counterparties for both derivatives and investment purposes. Limits are placed on the amount of risk accepted in relation to one counterparty, or group of counterparties, and to industry sectors. This is monitored daily by the Society's Treasury risk team and reviewed monthly by the ALCO.

The Group's policy only permits lending to central government (which includes the Bank of England), UK local authorities, banks with a high credit rating and building societies.

The Group's Treasury team perform regular analysis of counterparty credit risk and monitoring of publicly available information to highlight possible indirect exposures.

An analysis of the Group's treasury asset concentration is shown in the table below:

Group	2016 £m	2016 %	2015 £m	2015 %
Industry sector				
Banks	120.6	22.9	106.6	21.7
Building Societies	2.0	0.3	-	-
Multilateral Development Banks	15.2	2.9	15.7	3.2
Central Government	389.2	73.9	369.3	75.1
	527.0		**491.6**	

Group	2016 £m	AAA %	AA %	A %	Other %	2015 £m
Geographic region						
United Kingdom	490.2	-	85.6	3.0	11.4	446.9
Multilateral Development banks	15.2	100	-	-	-	15.7
Canada	12.7	-	100	-	-	20.1
Australia	8.9	-	100	-	-	8.9
	527.0					**491.6**

Accounts

30. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk (continued)

a) Loans and advances to credit institutions, debt securities and derivative financial instruments (continued)

The Group has no exposure to foreign exchange risk. All instruments are denominated in sterling. The Group also has no direct exposure to any sovereign states, other than the UK.

The Group's derivative financial instruments are fully collateralised with a central clearing house in the United Kingdom and as a result there is no exposure to the Group.

There are no impairment charges against any of the Group's treasury assets at 31 December.

b) Loans and advances to customers

All mortgage loan applications are assessed with reference to the Group's retail credit risk appetite statement and lending policy, which includes assessing applicants for potential fraud risk, and which is approved by the Board. When deciding on the overall risk appetite that the Group wishes to adopt, both numerical and non-numerical considerations are taken into account, along with data on the current UK economic climate, portfolio information derived from the Group's rating system and competitor activity. The statement must comply with all the prevailing regulatory policy and framework.

The lending portfolio is monitored by the RCC to ensure that it remains in line with the stated risk appetite of the Group, including adherence to the lending principles, policies and lending limits.

For new customers the first element of the retail credit control framework is achieved via credit scoring, which assesses the credit quality of potential customers prior to making loan offers. The customers' credit score combines demographic and financial information. A second element is lending policy rules which are applied to new applications to ensure that they meet the risk appetite of the Group. All mortgage applications are overseen by the Lending Services team who ensure that any additional lending criteria are applied and that all information submitted within the application is validated.

For existing customers who have been added to the lending portfolio, management use behavioural scorecards to review the ongoing credit-worthiness of customers by determining the likelihood of them defaulting over a rolling 12 month period together with the amount of loss if they do default.

Credit risk management information is comprehensive and is circulated to the RCC on a monthly basis to ensure that the portfolio remains within the Group's risk appetite.

It is the Group's policy to ensure good customer outcomes and lend responsibly by ensuring at the outset that the customer can meet the mortgage repayments. This is achieved by obtaining specific information from the customer concerning income and expenditure but also external credit reference agency data.

The Group does not have any exposure to the sub-prime market.

The maximum credit risk exposure is disclosed in the table on page 79.

Loans and advances to customers are predominantly made up of retail loans fully secured against UK residential property (£2,950.4 million), split between residential and buy-to-let loans with the remaining £69.0 million being secured on commercial property.

The Group operates throughout England & Wales with the portfolio well spread throughout the geographic regions

30. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk (continued)

b) Loans and advances to customers (continued)

An analysis of the Group's geographical concentration is shown in the table below:

Group and Society	2016 %	2015 %
Geographical analysis		
Eastern	9.8	10.3
East Midlands	20.7	21.3
London	7.9	9.3
North East	4.7	4.0
North West	10.3	9.4
South East	13.9	14.3
South West	7.8	7.5
Wales	2.6	2.4
West Midlands	9.6	9.5
Yorkshire & Humberside	12.3	11.7
Other	0.4	0.3
	100.0	**100.0**

Retail loans (Loans fully secured on residential properties)

Loans fully secured on residential property are split between residential and buy-to-let. The average loan to value (LTV) is the mean LTV for the portfolio. Each individual LTV is calculated by comparing the value of the mortgage loan to the value of collateral held adjusted by a house price index. The simple average LTV of residential mortgages is 53% (2015: 52%). All residential loans above 80% LTV are insured.

The indexed loan-to-value analysis on the Group's residential mortgage portfolio is shown below:

Group and Society	2016 Residential %	2016 Buy-to-let %	2015 Residential %	2015 Buy-to-let %
Loan to Value analysis				
< 60%	37.1	54.1	36.0	40.1
60% - 80%	46.2	45.4	52.1	58.4
80% - 90%	13.6	0.4	11.4	1.4
> 90%	3.1	0.1	0.5	0.1
	100.0	**100.0**	**100.0**	**100.0**
Average loan to value of loans	53.5	58.3	52.2	60.8
Average loan to value of new business	75.9	63.6	68.4	75.0

The quality of the Group's retail mortgage book is reflected in the number and value of accounts in arrears. By volume 0.2% (2015: 0.2%) of loans are three months or more in arrears and by value it is 0.1% (2015: 0.1%).

30. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk (continued)

b) Loans and advances to customers (continued)

Retail loans (continued)

The main factor for loans moving into arrears tends to be the condition of the general economic environment. In general, the lower the loan-to-value percentage, the greater the equity within the property, and the lower the losses expected to be realised in the event of default or repossession.

The table below shows the fair value of collateral held for residential mortgages.

Group and Society	2016 Indexed £m	2016 Unindexed £m	2015 Indexed £m	2015 Unindexed £m
Value of collateral held:				
Neither past due or impaired	5,585.7	4,636.1	5,132.7	4,283.4
Past due but not impaired	29.3	22.3	35.0	27.6
Impaired	2.1	1.8	1.5	1.4
	5,617.1	**4,660.2**	**5,169.2**	**4,312.4**

The collateral held consists of residential property. Collateral values are adjusted by the Halifax price index produced by the Lloyds Banking Group Plc to derive the indexed valuation at 31 December. This is the UK's longest running house price index and takes into account regional data from the 12 standard planning regions of the UK. The Group uses the index to update the property values of its residential and buy-to-let portfolios on a quarterly basis.

With collateral capped to the amount of outstanding debt, the value of collateral held against loans 'past due but not impaired' at 31 December is £12.1 million (2015: £15.6 million) against outstanding debt of £12.1 million (2015: £15.6 million). In addition, the value of collateral held against 'Impaired' assets at 31 December is £1.6 million (2015: £1.3 million) against outstanding debt of £1.7 million (2015: £1.3 million).

Mortgage indemnity insurance acts as additional security. It is taken out for all residential loans where the borrowing exceeds 80% of the value of the property at the point of application.

The table below provides information on retail loans by payment due status:

Group and Society	2016 £m	2016 %	2015 £m	2015 %
Arrears analysis				
Not impaired:	2,948.7	99.94	2,718.5	99.96
Impaired:				
Not past due	0.2	-	0.7	0.03
Past due up to 3 months	0.5	0.02	-	-
Past due over 3 months	1.0	0.04	0.4	0.01
Possessions	-	-	0.1	-
	2,950.4	**100.0**	**2,719.7**	**100.0**

The status 'past due up to three months but not impaired' and 'past due over three months but not impaired' includes any asset where a payment due is received late or missed but no individual provision has been allocated. The amount included is the entire loan amount rather than just the overdue amount.

Possession balances represent those loans where the Group has taken ownership of the underlying security pending its sale. The Group has various forbearance options to support customers who may find themselves in financial difficulty. These include payment plans, capitalisations, term extensions and reduced payment concessions.

30. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk (continued)

b) Loans and advances to customers (continued)

Forbearance

Temporary interest only concessions were, prior to the start of 2012 when the option was withdrawn for new forbearance cases, offered to customers in financial difficulty on a temporary basis with formal periodic review. The concession allowed the customer to reduce monthly payments to cover interest only, and if made, the arrears status will not increase. Interest only concessions are no longer offered and have been replaced by reduced payment concessions.

Reduced payment concessions allow a customer to make an agreed underpayment for a specific period of time. The monthly underpaid amount accrues as arrears and agreement is reached at the end of the concession period on how the arrears will be repaid.

Payment plans are agreed to enable customers to reduce their arrears balances by an agreed amount per month which is paid in addition to their standard monthly repayment.

Capitalisations occur where arrears are added to the capital balance outstanding for the purposes of re-structuring the loan.

The term of the mortgage is extended in order to reduce payments to a level which is affordable to the customer based on their current financial circumstances.

All forbearance arrangements are formally discussed with the customer and reviewed by management prior to acceptance of the forbearance arrangement. By offering customers in financial difficulty the option of forbearance the Society potentially exposes itself to an increased level of risk through prolonging the period of non-contractual payment and/or potentially placing the customer into a detrimental position at the end of the forbearance period.

Regular monitoring of the level and different types of forbearance activity are reported to the Retail Credit Committee (RCC) on a monthly basis. In addition the Conduct Risk Committee monitors the level of arrears and forbearance cases. In addition all forbearance arrangements are reviewed and discussed with the customer on a regular basis to assess the ongoing potential risk to the Society and suitability of the arrangement for the customer.

The table below details the number of forbearance cases within the 'Not impaired' category:

Group and Society	2016 Number	2015 Number
Type of forbearance		
Interest only concessions	12	15
Reduced payment concessions	1	1
Payment plans	42	73
Capitalisations	61	65
Mortgage term extensions	63	70
Less: cases with more than one form of forbearance	(56)	(66)
	123	**158**

These cases are covered by an individual impairment provision of £0.04 million (2015: £0.03 million). In total, £2.5 million (2015: £2.7 million) of loans that would be past due are subject to forbearance.

30. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk (continued)

b) Loans and advances to customers (continued)

Secured Business Loans (Other loans fully secured on land)

Secured Business Loans ('SBL') are primarily made available to Small and Medium sized enterprises for either owner occupied or investment property purposes. Loans are also only granted against the 'bricks and mortar' of the property and not against working capital or machinery etc.

The make-up of the SBL book at 31 December is as follows:

Group and Society	2016 £m	2016 %	2015 £m	2015 %
Owner occupied	32.9	47.7	34.7	47.9
Investment property	36.1	52.3	37.8	52.1
	69.0	**100.0**	**72.5**	**100.0**

The table below provides information on the original LTV of the Group's SBL mortgage portfolio:

Group and Society	2016 %	2015 %
Loan to Value analysis		
< 60%	31.3	29.4
60% - 80%	48.8	48.6
80% - 90%	19.6	21.4
> 90%	0.3	0.6
	100.0	**100.0**
Average loan to value of loans	61.3	62.6
Average loan to value of new business	54.4	53.0

The table below shows the fair value of collateral held for SBL loans:

Group and Society	2016 Indexed £m	2016 Unindexed £m	2015 Indexed £m	2015 Unindexed £m
Value of collateral held:				
Neither past due or impaired	125.9	136.3	125.7	137.6
Past due but not impaired	2.3	3.1	2.6	3.1
Impaired	4.2	6.3	4.7	7.1
	132.4	**145.7**	**133.0**	**147.8**

Collateral reflects the latest valuation. If a property has had a desktop valuation since the latest full valuation, the collateral reflects the desktop valuation (82% of the SBL book has had a desktop valuation (2015: 71%)).

With collateral capped to the amount of outstanding debt, the value of collateral held against loans 'past due but not impaired' at 31 December is £1.5 million (2015: £1.4 million) against outstanding debt of £1.5 million (2015: £1.5 million). In addition, the value of collateral held against 'Impaired' assets at 31 December is £3.5 million (2015: £4.0 million) against outstanding debt of £3.8 million (2015: £4.5 million).

30. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk (continued)

b) Loans and advances to customers (continued)

Secured Business Loans (continued)

The table below provides information on SBL loans by payment due status:

Group and Society	2016 £m	2016 %	2015 £m	2015 %
Arrears analysis				
Not impaired:	65.2	94.5	68.0	93.79
Impaired:				
Not past due	3.5	5.0	3.5	4.83
Past due up to 3 months	0.1	0.2	0.5	0.69
Past due over 3 months	0.2	0.3	0.5	0.69
Possessions	-	-	-	-
	69.0	**100.0**	**72.5**	**100.0**

The status 'past due up to three months but not impaired' and 'past due over three months but not impaired' includes any asset where a payment due is received late or missed. The amount included is the entire loan amount rather than just the overdue amount.

In terms of SBL risk, the single largest borrower represents less than 1.7% (2015: 1.7%) of the SBL mortgage book. SBL assets totalling £3.8 million (2015: £4.5 million) have individual provisions against them.

Possession balances represent those loans where the Group has taken ownership of the property pending its sale.

Forbearance

The Group has various forbearance options to support customers who may find themselves in financial difficulty. These include 'interest only' concessions, re-negotiation of contractual payment, payment plans and capitalisations.

'Interest only' concessions are offered to customers in financial difficulty on a temporary basis with formal periodic review. The concession allows the customer to reduce monthly payments to cover interest only, and if made, the arrears status will not increase.

Re-negotiation of contractual payments is provided to reduce the monthly payment to a level affordable by the customer. The agreement remains within the Society's lending policy, for example within the maximum mortgage term.

Payment plans are agreed to enable customers to reduce their arrears balances by an agreed amount per month which is paid in addition to their standard monthly repayment.

Capitalisations occur where arrears are added to the capital balance outstanding for the purpose of re-structuring the loan.

The table below shows those loans subject to forbearance with the 'Not impaired' category:

Group and Society	2016 Number	2015 Number
Type of forbearance		
Interest only concessions	2	-
Re-negotiation of contractual payment	2	4
	4	**4**

These loans are covered by the £1.7 million (2015: £1.5 million) collective provision.

£0.7 million (2015: £1.0 million) of loans that would be past due or impaired are subject to forbearance.

30. FINANCIAL INSTRUMENTS (CONTINUED)

Liquidity risk

Liquidity risk is the risk that the Society will not have sufficient financial resources available to meet its obligations as they fall due, under either normal business conditions or a stressed environment. It is the Society's policy that a significant amount of its total assets are carried in the form of cash and other readily realisable assets in order to:

i) meet day-to-day business needs;
ii) meet any unexpected cash needs;
iii) maintain public confidence; and
iv) ensure maturity mismatches are provided for.

Monitoring of liquidity, in line with the Society's prudent policy framework, is performed daily. Compliance with these policies is reported to the Assets and Liabilities Committee (ALCO) monthly and to the Board Risk Committee.

The Society's liquidity policy is designed to ensure the Society has sufficient liquid resources to withstand a range of stressed scenarios. A series of liquidity stress tests have been developed as part of the Individual Liquidity Adequacy Assessment Process (ILAAP). They include scenarios that fulfil the specific requirements of the PRA (the idiosyncratic, market-wide and combination stress tests) and scenarios identified by the Society which are specific to its business model. The stress tests are performed monthly and reported to ALCO to confirm that liquidity policy remains appropriate.

The Society's liquid resources comprise high quality liquid assets, including a Bank of England reserves account, Gilts, time deposits and investment grade fixed and floating rate notes issued by highly rated financial institutions, supplemented by unencumbered mortgage assets. At the end of the year the ratio of liquid assets to shares and deposits was 16.0% compared to 16.8% at the end of 2015. When the FLS Treasury Bills are taken into account, the ratio of liquid resources to shares and deposits was 20.7% (2015: 24.9%).

The Society maintains a contingency funding plan to ensure that it has so far as possible, sufficient liquid financial resources to meet liabilities as they fall due under each of the scenarios.

The table below analyses the Group's assets and liabilities into relevant maturity groupings, based on the remaining period to contractual maturity at the statement of financial position date. This is not representative of the Group's management of liquidity. Loans and advances to customers rarely run their full course. The actual repayment profile is likely to be significantly different from that shown in the analysis. For example most mortgages have a contractual maturity of around 25 years but are generally repaid much sooner. The average life of a mortgage at the Group, currently in product, is 3.5 years (2015: 3.5 years). Conversely, retail deposits repayable on demand generally remain on the balance sheet much longer.

Group Residual maturity as at 31 December 2016	On demand £m	Not more than three months £m	More than three months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Total £m
Financial assets						
Cash in hand and balances with the Bank of England	387.5	-	3.0	-	-	390.5
Loans and advances to credit institutions	6.3	30.8	2.0	-	-	39.1
Debt securities	-	17.1	27.5	52.8	-	97.4
Total liquid assets	393.8	47.9	32.5	52.8	-	527.0
Derivative financial instruments	-	1.1	-	3.6	-	4.7
Loans and advances to customers	1.0	26.1	78.1	449.3	2,478.1	3,032.6
Other assets	-	2.8	3.1	0.8	20.4	27.1
	394.8	**77.9**	**113.7**	**506.5**	**2,498.5**	**3,591.4**
Financial liabilities and reserves						
Shares	431.9	1,201.2	299.0	525.3	-	2,457.4
Amounts owed to credit institutions	-	281.6	56.6	219.4	-	557.6
Amounts owed to other customers	10.6	99.1	91.9	14.1	-	215.7
Debt securities in issue	-	3.0	3.0	92.7	-	98.7
Derivative financial instruments	-	0.1	2.4	17.2	-	19.7
Subscribed capital	-	0.1	-	-	26.1	26.2
Reserves	-	-	-	-	199.8	199.8
Other liabilities	0.8	2.6	2.5	1.0	9.4	16.3
	443.3	**1,587.7**	**455.4**	**869.7**	**235.3**	**3,591.4**
NET LIQUIDITY GAP	**(48.5)**	**(1,509.8)**	**(341.7)**	**(363.2)**	**2,263.2**	**-**

30. FINANCIAL INSTRUMENTS (CONTINUED)

Liquidity risk (continued)

Group Residual maturity as at 31 December 2015	On demand £m	Not more than three months £m	More than three months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Total £m
Financial assets						
Liquid assets						
Cash in hand and balances with the Bank of England	367.8	-	2.9	-	-	370.7
Loans and advances to credit institutions	18.6	-	-	-	-	18.6
Debt securities	-	18.6	31.7	52.0	-	102.3
Total liquid assets	386.4	18.6	34.6	52.0	-	491.6
Derivative financial instruments	-	-	0.6	0.7	2.5	3.8
Loans and advances to customers	1.0	21.1	67.3	401.3	2,305.8	2,796.5
Other assets	-	1.5	3.5	0.2	21.3	26.5
	387.4	**41.2**	**106.0**	**454.2**	**2,329.6**	**3,318.4**
Financial liabilities and reserves						
Shares	552.7	967.0	333.6	579.9	-	2,433.2
Amounts owed to credit institutions	-	160.0	135.9	114.5	-	410.4
Amounts owed to other customers	17.5	98.8	87.0	20.3	-	223.6
Debt securities in issue	-	2.0	7.0	-	-	9.0
Derivative financial instruments	-	-	1.1	8.2	-	9.3
Subscribed capital	-	0.1	-	-	26.1	26.2
Reserves	-	-	-	-	192.5	192.5
Other liabilities	0.9	2.6	4.2	1.0	5.5	14.2
	571.1	**1,230.5**	**568.8**	**723.9**	**224.1**	**3,318.4**
NET LIQUIDITY GAP	**(183.7)**	**(1,189.3)**	**(462.8)**	**(269.7)**	**2,105.5**	**-**

There is no material difference between the maturity profile for the Group and that for the Society. At 31 December 2016, £1,060.6 million (2015: £751.7 million) of the Group's assets were encumbered.

30. FINANCIAL INSTRUMENTS (CONTINUED)

Liquidity risk (continued)

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

Group 31 December 2016	Repayable on demand £m	Not more than three months £m	More than three months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Total £m
Shares	463.5	1,222.3	299.0	525.3	-	2,510.1
Amounts owed to credit institutions	10.1	165.6	163.2	221.0	-	559.9
Amounts owed to other customers	10.6	88.8	102.7	14.3	-	216.4
Debt securities in issue	-	3.0	3.0	-	-	6.0
Derivative financial instruments	-	0.4	6.0	47.7	-	54.1
Subscribed capital	-	0.5	1.5	7.9	23.9	33.8
TOTAL LIABILITIES	**484.2**	**1,480.6**	**575.4**	**815.2**	**23.9**	**3,380.3**
Group 31 December 2015						
Shares	574.9	979.0	333.6	579.9	-	2,467.4
Amounts owed to credit institutions	1.3	161.0	134.2	117.7	-	414.2
Amounts owed to other customers	17.5	98.9	87.7	20.8	-	224.9
Debt securities in issue	-	2.0	7.1	-	-	9.1
Derivative financial instruments	-	0.8	6.4	51.1	1.4	59.7
Subscribed capital	-	0.5	1.5	7.9	23.9	33.8
TOTAL LIABILITIES	**593.7**	**1,242.2**	**570.5**	**777.4**	**25.3**	**3,209.1**

The analysis of gross contractual cash flows differs from the analysis of residual maturity due to the inclusion of interest accrued at current rates, for the average period until maturity on the amounts outstanding at the statement of financial position date.

30. FINANCIAL INSTRUMENTS (CONTINUED)

Market risk

Market risk is the risk of changes to the Society's financial condition caused by market interest rates. The Society is exposed to market risk in the form of changes (or potential changes) in the general level of interest rates, changes in the relationship between short and long-term interest rates and divergence of interest rates for different balance sheet elements (basis risk).

The Society has adopted the 'Extended' approach to interest rate risk, as defined by the PRA, which aims to undertake the hedging of individual transactions within an overall strategy for structural hedging, based on a detailed analysis of the statement of financial position. This analysis is then used to enable the positioning of the Group's statement of financial position to take advantage of a particular interest rate view.

The management of interest rate risk is based on a full statement of financial position gap analysis. The statement of financial position is subjected to a stress test of a 2% rise in interest rates on a weekly basis and the results are reported to the monthly ALCO meeting. In addition management review interest rate basis risk. Both sets of results are measured against the risk appetite for market risk which is currently set at a maximum of 4.0% of capital. These are in turn reviewed monthly by the ALCO and reported to the Board Risk Committee.

The table below summarises the Group's exposure to interest rate risk. Included in the table are Group assets and liabilities, including derivative financial instruments which are principally used to reduce exposure to interest rate risk, categorised by repricing date.

Group **Interest rate risk as at 31 December 2016**	Not more than three months **£m**	More than three months but not more than one year **£m**	More than one year but not more than five years **£m**	More than five years **£m**	Non interest bearing **£m**	Total **£m**
Financial assets						
Cash in hand and Balances with the Bank of England	386.2	-	-	-	4.3	390.5
Loans and advances to credit institutions	36.6	2.0	-	-	0.5	39.1
Debt securities	33.2	27.2	36.5	-	0.5	97.4
Derivative financial instruments	-	-	-	-	4.7	4.7
Loans and advances to customers	742.8	552.1	1,709.8	1.6	26.3	3,032.6
Other assets	-		-	-	27.1	27.1
	1,198.8	**581.3**	**1,746.3**	**1.6**	**63.4**	**3,591.4**
Financial liabilities and reserves						
Shares	1,595.3	332.7	514.8	-	14.6	2,457.4
Amounts owed to credit institutions	306.3	161.5	88.7	-	1.1	557.6
Amounts owed to other customers	109.4	91.8	14.0	-	0.5	215.7
Debt securities in issue	95.8	2.9	-	-	-	98.7
Derivative financial instruments	-	-	-	-	19.7	19.7
Subscribed capital	-	-	-	23.9	2.3	26.2
Reserves	-	-	-	-	199.8	199.8
Other liabilities	-	-	-	-	16.3	16.3
	2,106.8	**588.9**	**617.5**	**23.9**	**254.3**	**3,591.4**
Impact of derivative instruments	1,244.5	(77.5)	(1,167.0)	-	-	-
Interest rate sensitivity gap	**336.5**	**(85.1)**	**(38.2)**	**(22.3)**	**(190.9)**	**-**
Sensitivity to profit and reserves						
Parallel shift of +1%	0.1	0.2	(3.1	0.2	-	(2.6)
Parallel shift of +2%	0.1	0.4	(6.1)	0.3	-	(5.3)

Accounts

30. FINANCIAL INSTRUMENTS (CONTINUED)

Market risk (continued)

Group Interest rate risk as at 31 December 2015	Not more than three months £m	More than three months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Non interest bearing £m	Total £m
Financial assets						
Cash in hand and balances with the Bank of England	366.6	-	-	-	4.1	370.7
Loans and advances to credit institutions	384.7	-	-	-	0.5	18.6
Debt securities	50.6	15.9	35.8	-	-	102.3
Derivative financial instruments	-	-	-	-	3.8	3.8
Loans and advances to customers	801.0	521.0	1,426.4	35.3	12.8	2,796.5
Other assets	-	-	-	-	26.5	26.5
	1,236.3	**536.9**	**1,462.2**	**35.3**	**47.7**	**3,318.4**
Financial liabilities and reserves						
Shares	1,452.7	385.5	577.5	-	17.5	2,433.2
Amounts owed to credit institutions	160.9	133.9	114.5	-	1.1	410.4
Amounts owed to other customers	119.4	83.0	20.4	-	0.8	223.6
Debt securities in issue	2.0	7.0	-	-	-	9.0
Derivative financial instruments	-	-	-	-	9.3	9.3
Subscribed capital	-	-	-	23.9	2.3	26.2
Reserves	-	-	-	-	192.5	192.5
Other liabilities	-	-	-	-	14.2	14.2
	1,735.0	**609.4**	**712.4**	**23.9**	**237.7**	**3,318.4**
Impact of derivative instruments	1,066.0	(171.5)	(839.5)	(55.0)	-	-
Interest rate sensitivity gap	**567.3**	**(244.0)**	**(89.7)**	**(43.6)**	**(190.0)**	**-**
Sensitivity to profit and reserves						
Parallel shift of +1%	(0.1)	0.9	(0.4)	(0.6)	-	(0.2)
Parallel shift of +2%	(0.2)	1.8	(0.8)	(1.2)	-	(0.4)

There is no material difference between the interest rate risk profile for the Group and that for the Society.

The Group is not exposed to foreign currency risk.

The Society does not have any financial assets or liabilities that are offset with the net amount presented in the statement of financial position as IAS32 'Financial Instruments – Presentation' requires both an enforceable right to set off and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously. Neither of these conditions are met by the Society.

All financial assets and liabilities are presented on a gross basis in the statement of financial position.

The Society centrally clears its derivatives instruments,which requires it to enter into Credit Support Annexes (CSA's) and which typically provide for the exchange of collateral on a daily basis to mitigate net mark to market credit exposure.

30. FINANCIAL INSTRUMENTS (CONTINUED)

Market risk (continued)

The following table shows the impact on derivative financial instruments and repurchase agreements after collateral:

Group and Society	2016 Gross* Amounts £m	2016 Financial collateral** £m	2016 Net amounts £m	2015 Gross* Amounts £m	2015 Financial collateral** £m	2015 Net amounts £m
Financial assets						
Derivative financial instruments	4.7	(4.7)	-	3.8	(3.8)	-
TOTAL FINANCIAL ASSETS	**4.7**	**(4.7)**	**-**	**3.8**	**(3.8)**	**-**
Financial liabilities						
Derivative financial instruments	19.7	(19.7)	-	9.3	(9.3)	-
Repurchase agreements	384.0	(384.0)	-	379.1	(379.1)	-
TOTAL FINANCIAL LIABILITIES	**403.7**	**(403.7)**	**-**	**388.4**	**(388.4)**	**-**

*As reported in the statement of financial position.

** Financial collateral disclosed is limited to the amount of the related financial asset and liability.

31. CAPITAL STRUCTURE

The Society's policy is to maintain a strong capital base to maintain member, creditor and market confidence and to sustain future development of the business. The formal Internal Capital Adequacy Assessment Process ("ICAAP") assists the Society with its management of capital. Through its quarterly business plan update the Board monitors the Society's capital position to assess whether adequate capital is held to mitigate the risks it faces in the course of its business activities. The Society's actual and expected capital position is reviewed against stated risk appetite which aims to maintain capital at a specific level above its Individual Capital Guidance ('ICG').

The Board manages the Society's capital and risk exposures to maintain capital in line with regulatory requirements which includes monitoring of:

- **Lending and Business Decisions** – The Society uses application scorecards to help it assess whether mortgage applications fit within its appetite for credit risk. Once loan funds have been advanced behavioural scorecards are used to review the ongoing risk profile of both the portfolio's and individual customers. In addition, for residential and buy-to-let mortgages property values are updated on a quarterly basis.
- **Pricing** – Pricing models are utilised for all mortgage product launches. The models include expected loss estimates and capital utilisation enabling the calculation of a risk adjusted return on capital.
- **Concentration risk** – The design of retail products takes into account the overall mix of products to ensure that exposure to market risk remains within permitted parameters.
- **Counterparty risk** – Wholesale lending is only carried out with approved counterparties in line with the Society's lending criteria and is subject to a range of limits. The limits are monitored daily to ensure the Society remains within risk appetite.

This is subjected to regular stress tests to ensure the Society maintains sufficient capital for future possible events.

The Group's capital requirements are set and monitored by the Prudential Regulation Authority ('PRA'). During 2016, the Society has complied with the requirements included within the EU Capital Requirements Directive IV (Basel III). Further details of these requirements and their impact on the Society are provided in the Strategic report on page 15.

There were no reported breaches of capital requirements during the year. There have been no material changes in the Society's management of capital during the year.

Under Basel III Pillar 3, the Society is required to publish further information regarding its capital position and exposures. The Society's Pillar 3 disclosures are available on our website **www.thenottingham.com**.

32. FINANCIAL COMMITMENTS

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Capital commitments				
Capital expenditure contracted for but not provided for in the accounts	1.1	0.4	1.1	0.4
Leasing commitments				
The total of future minimum lease payments under non-cancellable operating leases are payable as follows:				
Land and buildings:				
Commitments due:				
Less than one year	0.1	-	-	-
Between one year and five years	0.7	1.0	0.4	0.5
In more than five years	3.2	3.7	2.4	3.1
	4.0	**4.7**	**2.8**	**3.6**
Other:				
Commitments due:				
Less than one year	-	-	-	-
Between one year and five years	0.2	0.5	0.2	0.4
	4.2	**5.2**	**3.0**	**4.0**

33. RELATED PARTY TRANSACTIONS

Transaction with Group companies

Details of the Society's shares in group undertakings are given in note 16.

During the normal course of business the following transactions were undertaken during the year:

Society	2016 Nottingham Mortgage Services £m	2016 Nottingham Property Services £m	2016 Harrison Murray £m	2015 Nottingham Mortgage Services £m	2015 Nottingham Property Services £m	2015 Harrison Murray £m
Management charges paid	0.1	0.1	0.1	0.1	0.1	0.1

During the year, Nottingham Building Society has received £0.1m in fees for providing cash manager and mortgage servicer fees to Arrow Mortgage Finance No.1 Ltd.

Movement on the intercompany loan are disclosed in note 16.

At the end of the year the following balances were outstanding between the Society and its subsidiaries:

	2016 Loans owed (to)/by subsidiaries £m	2015 Loans owed by subsidiaries £m
Arrow Mortgage Finance No. 1 Limited	(87.7)	-
Harrison Murray Ltd	0.7	0.4
HM Lettings Ltd	0.2	0.2
Nottingham Mortgage Services Ltd	(0.1)	-
Nottingham Property Services Ltd	7.1	7.1
	(79.8)	**7.7**

The balance outstanding with Arrow Mortgage Finance No. 1 Limited comprises amounts owed by the subsidiary of £13.9m offset by amounts owed to the subsidiary of £101.6m.

Interest accrues on the balances outstanding with Arrow Mortgage Finance at LIBOR plus a margin. The repayment of the loans will follow the collection of the principal and interest of the underlying mortgage assets, used as security and whilst the contractual maturity is within five years, it is expected to be settled within two years.

No interest is charged on balances between the other Group companies.

33. RELATED PARTY TRANSACTIONS (CONTINUED)

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 personnel as defined by IAS 24, which includes non-executive directors.

Compensation for key management personnel for the year totalled £1.4 million (2015: £1.4 million) and a breakdown is disclosed on page 38 in the Directors' remuneration report.

In addition,the following transactions were undertaken through the normal course of business:

Group and Society	2016 Number of key management personnel and their close family members Number	2016 Amounts in respect of key management personnel and their close family members £000	2015 Number of key management personnel and their close family members Number	2015 Amounts in respect of key management personnel and their close family members £000
Loans and advances				
Net movements in the year	-	(13)	-	(13)
Balances outstanding 31 December	2	182	2	195
Share accounts				
Net movement in the year	(1)	(40)	2	75
Balances outstanding 31 December	11	204	12	244
Interest receivable on loans & advances		6		6
Interest payable on share accounts		3		3

Directors' loans and transactions

At 31 December 2016 there was one (2015: one) outstanding secured mortgage loan made in the ordinary course of business at a normal commercial rate to directors and their connected persons. A register is maintained at the head office of the Society which shows details of all loans, transactions and arrangements with directors and their connected persons. A statement of the appropriate details contained in the register, for the financial year ended 31 December 2016, will be available for inspection at the head office for a period of 15 days up to and including the annual general meeting.

34. REGISTERED OFFICE

Nottingham Building Society is a building society, incorporated and domiciled in the United Kingdom. The address of its registered office is: Nottingham House, 3 Fulforth Street, Nottingham, NG1 3DL.

Annual business statement

for the year ended 31 December 2016

1. Statutory percentages	2016 %	Statutory limit %
Lending limit		
Proportion of business assets not in the form of loans fully secured on residential property	3.22	25
Funding limit		
Proportion of shares and borrowings not in the form of shares held by individuals	26.19	50

The percentages are calculated in accordance with, and the statutory limits are those prescribed by, sections 6 and 7 of the Building Societies Act 1986 and are based on the Group statement of financial position.

Business assets are the total assets of the Society and its subsidiary undertakings as shown in the Group statement of financial position plus impairment for losses on loans and advances (note 15), less property, plant and equipment, intangible assets and liquid assets.

Loans fully secured on residential property are the amount of principal owing by borrowers and interest accrued not yet payable.

Total 'shares and borrowings' are the aggregate of 'shares', 'amounts owed to credit institutions', 'amounts owed to other customers' and 'debt securities in issue' in the Group statement of financial position. Shares held by individuals are found in note 20.

2. Other percentages	2016 %	2015 %
As a percentage of shares and borrowings		
Gross capital	6.79	7.11
Free capital	6.26	6.49
Liquid assets	15.83	15.98
As a percentage of mean total assets		
Profit after taxation	0.32	0.47
Management expenses (Group)	1.12	1.12
Management expenses (Society)	0.91	0.90
As a percentage of year end assets		
Return on assets	0.31	0.46

The above percentages have been calculated from the Group accounts.

'Shares and borrowings' are the aggregate of 'shares', 'amounts owed to credit institutions', 'amounts owed to other customers' and 'debt securities in issue' in the Group statement of financial position.

'Gross capital' is the aggregate of subscribed capital and aggregated reserves as shown in the Group statement of financial position.

'Free capital' is gross capital plus collective impairment for losses on loans and advances (note 15) less property, plant and equipment and intangible assets in the Group statement of financial position.

'Mean total assets' are calculated by halving the aggregate of total assets at the beginning and end of the financial year for the Group/Society.

'Liquid assets' are the first three items on the asset side of the Group statement of financial position.

'Management expenses' are the aggregate of administrative expenses (excluding acquisition and merger costs) and depreciation and amortisation taken from the Group/Society statements of comprehensive income.

3. Information about the directors at 31 December 2016:

Director's name	Date of appointment	Age	Business occupation	Other directorships (and offices)
J. S. Edwards Chairman	10.01.12	61	Director	Saga Services Ltd
K. R. Whitesides MBE, LLB, MPhil Vice-Chairman	18.08.04	73	Director	Dingley Hall Apartments Ltd The Staff Pension Scheme of Nottingham Building Society (Trustee)
J.C. Kibbey BSc, MCIPD	01.05.06	66	Director	Governor Oundle School
D.J. Marlow ACIB Chief Executive	16.01.06	51	Building Society Executive	Harrison Murray Limited HM Lettings Limited Nottingham Mortgage Services Ltd Nottingham Property Services Ltd
A.F.J. Neden MA, FCA	17.09.14	54	Director	Ashmill Worcester Ltd Grace Church Dulwich Ltd Northgate (Warwick) Developments Ltd The Great St Helen's Trust Ltd St Peter's Canary Wharf Trust Ltd Wesleyan Assurance Society ABC International Bank plc
M. A. Piranie MBA, FCCA Deputy Chief Executive & Finance Director	16.04.07	53	Building Society Executive	Dubai Property Consortium (2011) Ltd Elite Star Investment Ltd Harrison Murray Ltd HM Lettings Ltd Nottingham Mortgage Services Ltd Nottingham Property Services Ltd
K.M. Spooner LLB (Hons)	01.09.16	55	Director	Scotiabank Europe plc
S. J. Taylor ACIB, MBA Chief Operating Officer	01.02.11	46	Building Society Executive	Harrison Murray Ltd HM Lettings Ltd Nottingham Mortgage Services Ltd Nottingham Property Services Ltd
W.G. Thomas BSc (Hons), ACA, FCT, C.Dir, FIoD	01.12.14	61	Director	Tai Tirion Ltd

Correspondence to directors jointly or individually should be addressed 'Private and Confidential' and c/o Ernst & Young LLP, 1 Bridgewater Place, Water Lane, Leeds LS11 5QR.

Directors' service contracts:

David Marlow entered into his contract as Chief Executive on 21 February 2011, however, he has been a Director of the Society since 16 January 2006. Ashraf Piranie entered into his current contract as Deputy Chief Executive and Finance Director on 21 February 2011 however, he has been a Director of the Society since 16 April 2007. Simon Taylor entered into his contract as Operations Director on 1 February 2011.

All contracts are terminable at any time by the Society on 12 months' notice and by the individual on six months' notice. Unless notice to terminate is given by either party, the contracts continue automatically.

Glossary

Set out below are the definitions of the terms used within the Annual Report and Accounts to assist the reader and to facilitate comparison with other financial institutions:

Arrears	A customer is in arrears when they are behind in meeting their contractual obligations with the result that an outstanding loan payment is overdue. The value of the arrears is the value of any payments that have been missed.
Additional Tier 1 capital (AT1)	Capital that meets certain rules under CRD IV and which comprises the Society's PIBS but only under the transitional provisions.
Basel III	Basel III became effective in the UK on 1 January 2014 through CRD IV and sets out the details of strengthened global regulatory standards on bank capital adequacy and liquidity.
Buy to let loans	Buy-to-let loans are those loans which are offered to customers buying residential property specifically to let out and generate a rental income.
Common Equity Tier 1 capital (CET1)	CET1 capital consists of internally generated capital generated from retained profits, other reserves less intangible assets and other regulatory deductions. CET1 capital is fully loss absorbing.
Common Equity Tier 1 ratio	Common Equity Tier 1 capital as a percentage of risk weighted assets.
Contractual maturity	The date at which a loan or financial instrument expires, at which point all outstanding principal and interest has been paid.
Credit risk	This is the risk that a customer or counterparty fails to meet their contractual obligations.
Capital Requirements Directive (CRD IV)	CRD IV is the European legislation which came into force from 1 January 2014 to implement Basel III. It is made up of the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD), outlining the capital requirements framework and introduced liquidity requirements, which regulators use when supervising firms.
Debt securities	Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings excluding those issued by central banks.
Debt securities in issue	Transferable certificates of indebtedness of the Society to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit.
Derivative financial instruments	A derivative financial instrument is a contract between two parties whose value is based on an underlying price or index rate it is linked to, such as interest rates, exchange rates of stock market indices. The Society uses derivative financial instruments to hedge its exposure to interest rate risk.
Effective interest rate method (EIR)	The method 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 calculation includes all fees and penalties paid and received between parties which are integral to the contract.
Fair value	Fair value is the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
Financial Conduct Authority (FCA)	The statutory body responsible for conduct of business regulation and supervision of UK authorised firms.
Financial Services Compensation Scheme	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 firm authorised by the FCA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.
Forbearance strategies	Strategies to support borrowers in financial difficulty, such as agreeing a temporary reduction in the monthly payment, extending mortgage terms and a conversion to an interest-only basis. The aim of forbearance strategies is to avoid repossession.
Free Capital	The aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment and intangible assets.
Funding Limit	Measures the proportion of shares and borrowings (excluding the fair value adjustment for hedged risk) not in the form of shares held by individuals. The calculation of the funding limit is explained in the Annual Business Statement.

Funding for Lending Scheme (FLS)	A scheme launched by the Bank of England and HM Treasury, which provides funding to participating banks and building societies with the aim of stimulating lending within the economy.
General reserves	The accumulation of the Society's historic and current year profits which is the main component of Common Equity Tier 1 capital.
Gross capital	The aggregate of general reserves, available for sale reserves and subscribed capital.
Impaired loans	Loans where there is objective evidence that an impairment event has occurred, meaning that the Society does not expect to collect all the contractual cash flows or expect to collect them later than they are contractually due.
Individual liquidity adequacy assessment Process (ILAAP)	The Society's own assessment of the liquidity resources it requires in order to remain within the risk tolerances it has set. This will include an evaluation of potential stresses based on multiple market environments.
Individually/collectively assessed impairment	Individual assessments are made of all mortgage loans where objective evidence indicates losses are likely or the property is in possession. A collective impairment provision is made against the remaining group of loans and advances where objective evidence indicates that it is likely that losses may be realised.
Interest rate risk	The risk of loss due to a change in market interest rates. Interest rate risk can have an impact on Society's mortgages and savings products.
Internal Capital Adequacy Assessment Process (ICAAP)	The Society's own assessment, as part of Basel II requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements for risks it faces under a business as usual scenario including stress events.
Individual Capital Guidance (IGG)	Guidance from the PRA on a firm's required level of capital.
Lending limit	Measures the proportion of business assets not in the form of loans fully secured on residential property.
Leverage ratio	The ratio of Tier 1 capital divided by the total exposures, which includes on and off balance sheet items.
Liquid assets	Total of cash in hand, loans and advances to credit institutions, and debt securities.
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 multilateral development banks, other securities and bank deposits and Bank of England approved mortgage portfolios.
Liquidity risk	Liquidity risk is the risk that the Society is unable to meet its financial obligations as they fall due, or can only secure them at excessive cost. This risk arises from timing mismatches of cash inflows and outflows.
Loan to value (LTV)	LTV expresses the amount of a mortgage as a percentage of the value of the property.
Loans past due	Loans on which a payment has not been made as of its due date.
Management expenses	The aggregate of administrative expenses, depreciation and amortisation. The management expense ratio is management expenses expressed as a percentage of mean total assets.
Market risk	The risk that movements in market risk factors, including foreign exchange rates, interest rates, credit spreads and customer-driven factors will create potential losses or decrease the value of the Society balance sheet.
Mean total assets	Represents the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
Member	A person who has a share investment or a mortgage loan with the Society.
Net interest income	The difference between interest receivable on assets and similar income and interest paid on liabilities and similar charges.
Operational risk	The risk of loss arising from inadequate or failed internal processes, people and systems, or from external events.
Permanent interest bearing shares (PIBS) / Subscribed capital	Unsecured, deferred shares of the Society that are a form of Additional Tier 1 capital under the transitional rules of CRD IV. PIBS rank behind the claims of all depositors, payables and investing members of the Society. PIBS are also known as subscribed capital.
Prudential Regulation Authority (PRA)	The statutory body responsible for the prudential supervision of banks, building societies, insurers and small number of significant investment firms in the UK .The PRA is a subsidiary of the Bank of England.

Glossary

Renegotiated loans	Loans are classed as renegotiated where an agreement between a borrower and a lender has been made to modify the loan terms either as part of an on-going relationship or if the borrower is in financial difficulties. The renegotiated loan may no longer be treated as past due or impaired.
Residential loans	Loans that are loaned to individuals rather than institutions and are secured against residential property.
Risk appetite	The articulation of the level of risk that the Society is willing to accept (or not 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, under the relevant Basel III capital rules to reflect the degree of risk they represent.
Secured business lending (SBL)	Loans secured on commercial property which is only made available to Small and Medium sized Enterprises.
Shares	Funds deposited by a person in a retail savings account with the Society. Such funds are recorded as liabilities for the Society.
Shares and borrowings	The aggregate of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.
Special Purpose Vehicle (SPV)	A legal entity (usually a limited company) created to fulfil narrow, specific or temporary objectives. In the context of the Society, the SPV is used in relation to securitisation activities.
Standardised approach	The basic method used to calculate capital requirements for credit risk. In this approach the risk weighting used in the capital calculation are determined by specified percentages.
Term Funding Scheme (TFS)	A scheme launched by the Bank of England and HM Treasury, which provides funding to participating banks and building societies with the aim of stimulating lending within the economy.
Tier 1 capital	A component of regulatory capital, it comprises CET1 and AT1.
Tier 2 capital	Comprises the collective impairment allowance (for exposures treated on a Standardised basis), less certain regulatory deductions.
Tier 1 ratio	Tier 1 capital as a percentage of risk weighted assets.
Underlying profit	Profit before tax adjusted to exclude derivative fair value movements and the FSCS levy charge.
Wholesale funding	Amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.

Nottingham Building Society
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NG1 3DL
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YOUR HOME MAY BE REPOSSESSED IF YOU DO NOT KEEP UP REPAYMENTS ON YOUR MORTGAGE

Nottingham Building Society is a member of the Building Societies Association, the Council of Mortgage Lenders and Financial Ombudsman Service and is a participant in the Financial Services Compensation Scheme. Nottingham Building Society is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Registered under number 200785.

Financial planning is provided by Wren Sterling. Nottingham Building Society and Nottingham Property Services Limited are introducers to Wren Sterling for investments, pensions and protection. Wren Sterling is a trading name of Wren Sterling Financial Planning Limited, which is authorised and regulated by the Financial Conduct Authority. The Financial Services Register number is 665653. Registered office: Castle Marina Road, Castle Bridge Office Village, Nottingham NG7 1TN. Registered in England No 09157918.

Nottingham Property Services Limited, registered in England and Wales number 2272731. Harrison Murray Limited, registered in England and Wales number 3190376.

HM Lettings Limited, registered in England and Wales number 8333273. A wholly owned subsidiary of Nottingham Property Services.

Nottingham Building Society's home insurance is underwritten by Royal & Sun Alliance Insurance plc (no 93792). Registered in England and Wales at St Mark's Court, Chart Way, Horsham, West Sussex RH12 1XL. Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

Whole of market mortgage advice is provided by Nottingham Mortgage Services, an appointed representative of Intrinsic Mortgage Planning Limited, which is authorised and regulated by the Financial Conduct Authority. Registered in England and Wales No. 3089887. A wholly owned subsidiary of Nottingham Building Society.

Nottingham Building Society is an introducer to Dignity Pre Arrangement Limited who provide the Prepaid Funeral Plan. A company registered in England No. 1862158. VAT Reg. No. 486 6081 14. Registered Office: 4 King Edwards Court, King Edwards Square, Sutton Coldfield, West Midlands, B73 6AP. Telephone No. 0121 354 1557. Fax No. 0121 355 8081. Part of Dignity plc. A British company. Dignity Pre Arrangement Limited is regulated by the Funeral Planning Authority.

Nottingham Building Society acts as an introducer to The Will Writing Company Ltd for estate planning services. The Will Writing Company Ltd is authorised and regulated by the Solicitors Regulation Authority (SRA) in England and Wales as a licensed body (SRA number 626921).

Nottingham Building Society, Nottingham House, 3 Fulforth Street, Nottingham, NG1 3DL.

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