2013

Annual Report and Accounts

The Nottingham

Bringing your finances closer to home

Contents

Executive summary

2013 was a significant year for your Society, one in which the hard work and focus of recent years to build a strong regional franchise based on service, value, advice and choice was rewarded as more and more people chose The Nottingham to help them achieve their financial ambitions.

Below are some of the key achievements and financial highlights of 2013:

- Group underlying profit up by 41% to £14.2m;
- Group pre-tax profit at £12.8m up from £8.1m in 2012;
- Asset growth of 10.4%;
- Gross mortgage lending up by 24% to £693m, resulting in mortgage book growth of 17%;
- Net interest margin at 1.33%;
- Strong capital ratios with Tier 1 ratio at 16.2% and gross capital at 6.7%;
- The mortgage book is 100% matched by a combination of capital and retail savings;
- Strong retail franchise – total branch balances up by 20% in the year and 42% over the last three years;
- Arrears levels remain very low at around a third of the industry average;
- Successful merger with Shepshed Building Society; and
- Acquisition of Harrison Murray estate agency to build capability and increase Heartland branch footprint.

Chairman's statement

"At The Nottingham we are determined to ensure that our proposition and offering is one which is valued by an increasing number of customers."

David Thompson

Market and economic background

After a number of years commenting upon the fragility and weakness of the UK, Eurozone and global economies, it is a welcome change to be starting my annual statement with some relatively positive comments about economic conditions, particularly in the UK.

Throughout 2013 the general economic environment, here at home, has been more positive. GDP growth of 1.9% has risen closer to the long term sustainable level that our economy needs. Productivity indices – a good marker to underlying business confidence – in construction, manufacturing and services are up markedly over the past 12 months and all ended 2013 in positive territory. Over the year retail sales figures have continued to grow, but performances between retailers are beginning to show a large degree of diversity. Whilst traditional heavyweights such as Tesco and Marks and Spencer disappointed, John Lewis and Next demonstrated that if you get your proposition right and stick to your strategy, good performance can be achieved. This is a topic to which I shall return later.

As inflation has reduced throughout 2013 and is now within the Bank of England target range and unemployment falls, interest rates have remained at all-time lows and, with the forward guidance now provided by the Bank, are set to remain at current levels for some time. Although there is more to be confident about in 2014, headwinds remain. Whilst the government is making some progress in reducing the deficit, it is still much larger than forecast in 2010-11. This means that tax revenues will need to increase and expenditure cut further, as recently outlined by the chancellor.

Further afield, whilst it has been a quieter year in both the Eurozone and Global markets the fundamental imbalances and threats remain. We continue to be extremely cautious and vigilant to the potential impacts that events, in Europe particularly, could have on the UK economy.

Closer to our core markets the combination of government stimulus in the shape of the Funding for Lending Scheme (FLS), Help to Buy and increasing consumer confidence have finally begun to see some improvement in the housing market, with overall transactions expected to be 1.1 million, 15.6% up on 2012 and the highest level of activity seen since 2007.

Whilst this is welcome, it has been accompanied by a larger than expected increase in house prices. In fact the Halifax House Price Index has shown that prices have risen by 7.5% overall in 2013. We believe that for the recovery to be sustainable, home ownership must be affordable and therefore excessive house price increases taking hold before transaction levels reach the long term average are not necessarily positive for the health of the market. If prices are to be stable in the face of increasing demand, we will need to ensure that supply rises to meet it. Currently new house building is only just half of the level required. The increase of the rental sector has also led to a lower number of houses coming to the market for sale than we have traditionally seen. The market is likely to look very different in the next 10 years – maintaining affordable levels of home ownership, we believe, will remain key.

2013 has also seen the rapid evolution of our regulatory environment. The twin peak approach to Prudential and Conduct regulation is now firmly in place with both regulators taking strong action to make their presence and new approaches felt.

The Prudential Regulatory Authority (PRA) has had a strong focus on capital adequacy with a number of large firms in both the publically owned and mutual sectors being told to raise their levels of capital. In the mutual sector this has resulted in very different outcomes. Whilst the Nationwide ended the year by successfully carrying out an issue of Profit Participating Deferred Shares – a first for the sector, the Co-op, facing a much larger shortfall and a number of internal issues, effectively collapsed into public ownership with debt holders becoming equity holders in a reconstituted firm.

It is noteworthy that The Nottingham remains a very strong business with one of the highest tier one capital ratios in its peer group at 16.2%. In fact our leverage ratio at 5.5% provides us both with good security and headroom for further growth without having to consider any additional capital raising activity. A position which has been endorsed by the PRA in our dealings with them in 2013.

In its first few months of existence the Financial Conduct Authority (FCA) has been very active ensuring that it makes an immediate impact. To the fore of this has been a series of high profile enforcement actions. In 2013 fines levied by the new regulator totalled £472m, with firms such as JP Morgan, RBS, Lloyds Bank, Barclays, Prudential and UBS all facing multi-million pound fines. In addition to the mortgage market review a number of thematic reviews have also got underway covering a wide range of activity.

Whilst remaining in the early stages we do expect the conduct regulator to continue to adopt an intrusive, judgement based approach to the regulation of conduct in the years ahead.

Strategy & progress

As I stated in my speech at our last AGM, The Nottingham is very well placed to grow and develop as a strong regional mutual, whilst offering security and protection for its members and I am delighted to report that we have continued to make excellent progress in 2013.

In his review, David Marlow our Chief Executive will highlight the excellent financial results we have achieved in 2013. However, we will also remember 2013 for the progress we achieved towards the delivery of our strategy.

"As a local business firmly rooted in its communities, it is very important that we support worthwhile causes that make our communities better places to live"

In January we acquired leading independent estate agency, Harrison Murray, which operates in 18 locations throughout Leicestershire, Cambridgeshire, Northamptonshire, Bedfordshire and Hertfordshire. The acquisition was targeted not only to build our capability as an estate agency but also to provide an opportunity to increase our high street footprint, as we plan to add building society services to a number of these new locations now and in the years ahead.

In July we completed the successful merger with the Shepshed Building Society and were delighted to welcome their almost 7,000 members who were served through branches in Shepshed, Loughborough and Ruddington.

These two significant steps have enabled us to increase our high street presence from 31 locations in four counties to 52 locations in 10 counties, 36 offering building society services. We believe that this provides us with a stronger regional profile and significantly enhanced opportunities to grow our customer base in the years ahead.

Board changes

As the Society evolves so too does our Board of Directors; Bob Marchant our Senior Independent Director and Board Audit Chairman retired on 31 December, after 10 very successful years as a Board member – he has also been Vice-Chairman since 2008. I would personally like to thank Bob for his outstanding contribution and wise counsel over many years, particularly through the challenges of the financial crisis. He will be missed by us all.

Mary Phibbs, who joined the Board in January 2013, will succeed Bob as the Chair of our Board Audit Committee.

I shall retire at the end of April and will be succeeded by John Edwards as Chairman. Since joining the Board in early 2012 John has brought his vast experience in financial services to the Board, making a strong contribution to our development over that period. John is the ideal person as Chairman to continue our progress and strategic development in the years ahead. I wish him every success and trust that he will gain as much satisfaction in his stewardship of the Society as I have enjoyed.

Supporting local communities

As a local business firmly rooted in its communities, it is very important that we support worthwhile causes that make our communities better places to live. Through our 'Doing Good Together' initiative we aim to support local causes that improve financial literacy, boost employability, and support the battle against homelessness.

I am pleased to report that we have continued to develop our partnership with Nottinghamshire Community Foundation, The Nottingham Post, radio station Gem106, a number of local newspapers, and our chosen charity partner Framework, to undertake a range of activities and fundraising in support of these causes.

In addition to providing in excess of £80,000 in grants and fundraising, we have launched an innovative philanthropic savings bond with Framework, enabling investors to accept lower rates of interest on their savings in return for reduced interest rate payments on a loan made to Framework by the Society to develop much needed follow-on accommodation. This unique initiative was welcomed with broad national press coverage at its launch. We have also entered an arrangement with Framework to convert one of our branch locations on Friar Lane in Nottingham into a drop-in advice centre, providing a much needed city centre location for service users seeking help. These are two examples of our commitment to developing innovative solutions to long term issues for the benefit of our communities.

The whole team at The Nottingham gain immense satisfaction from working so closely with all these groups. I would like to thank our staff for their enthusiastic commitment to this activity which makes it all possible.

Looking ahead

As I mentioned earlier, as the economy recovers there are businesses that are set to thrive in the new market conditions, whilst those that fail to offer customers a compelling proposition they value, will find life difficult.

At The Nottingham we are determined to ensure that our proposition and offering is one which is valued by an increasing number of customers. Whilst we have been busy making our popular offering available to more people, especially in our heartland, we are also consistently looking at what our customers need and value most. It is one of our strategic objectives to be seen as a leading provider of expert advice and as such for a number of years have offered our customers access to whole of market advice for their financial planning needs.

In his review, David Marlow will outline our plans to further develop and improve this unique proposition offered by The Nottingham in 2014.

We believe that the progress we have made in recent years and the plans we have in place will ensure that we continue to deliver good value, choice, and expert advice backed by high levels of service to our customers whilst remaining a strong, successful and independent mutual society.

Thank you

I would like to thank all the members of the team at The Nottingham and my colleagues on the Board. They continue to deliver a performance and service to our members to be proud of.

Finally I would also like to thank our business partners, intermediaries and suppliers who equally share our commitment to deliver security and value to our members, and to express my personal thanks to our members for trusting us with their financial ambitions.

David Thompson

David Thompson
Chairman

19 February 2014

Chief Executive's review

"It is important for us to generate an appropriate amount of profit to build our capital buffers to allow us to grow and provide protection from shocks, to reinvest in the business to improve our products and services to customers, as well as to cover the on-going costs of depositor guarantee protection."

David Marlow

2013 was a significant year for your Society, one in which the hard work and focus of recent years to build a strong regional franchise based on service, value, advice and choice was rewarded as more and more people chose The Nottingham to help them achieve their financial ambitions.

Your Society

In my review last year I highlighted a number of initiatives that we were planning to build the profile and capability of the Society.

Following an overwhelming vote by their members we were delighted to merge with the Shepshed Building Society on 1 July 2013. Due to the hard work of those involved, we opened at Shepshed, Loughborough and Ruddington on the same day having completed the successful transfer of all Shepshed customers onto The Nottingham's system, enabling from the outset all our customers the ability to transact at any branch of their choice in our extended network. We have also fully refurbished two of the offices and moved the Ruddington branch to new, larger premises right in the centre of the town. In the months since the merger, we have introduced existing and new customers to our wider range of products, services and branch based savings accounts paying higher rates of interest than prior to the merger. Overall this has enabled us to increase balances and raise activity levels in these new sites, demonstrating to members the value that such a merger can bring.

Another significant initiative in 2013 was the acquisition of East Midlands estate agency Harrison Murray. During 2013 we have been working hard on developing our capability as an estate agency. This has focussed on integrating the best of the Harrison Murray approach with the best of The Nottingham estate agency, to create one best practice operating model. Whilst the work will continue into 2014, we have made excellent progress, for example introducing lettings to some customers of The Nottingham estate agency for the first time. In fact the estate agency produced its best performance in terms of profit for many years. We were also delighted to introduce building society services to our Leicester office in December at our new premises on Halford Street, welcoming our first account holder within three minutes of opening our doors. This is the first in a number of steps planned over the next couple of years to maximize the opportunities created by this exciting acquisition.

We are aware that our members greatly value the branch network and see it as a cornerstone of our proposition. A branch is seen as a place to receive great service and advice from people they can trust. We have therefore continued to invest in the network, spending over £1m on improving a number of our branches. Where we have done so previously we have seen strong uplifts in activity levels, attracting new customers. This has been the case again in 2013 in locations such as Brigg and Chesterfield, with more planned for 2014.

Also in 2013, to support all of our activity, we have begun to increase our marketing spend to ensure that more people in our heartland hear about and understand our proposition. Although it still remains early in this process, we have achieved good progress in 2013, with unprompted awareness amongst non-customers almost doubling and recall of our advertising in our heartland ranking only behind Halifax, Nationwide, Santander and Lloyds and encouragingly ahead of NatWest, Barclays and HSBC.

We continue to invest in our infrastructure to gain service improvements and efficiencies – this has included a new society-wide customer relationship system, which enables staff across the Society to better track customer activity ensuring increasing consistency and speed of response to queries. We have also installed new printers across the Society to improve the speed of delivery and quality of documents and upgraded all the PCs in our branches.

We seek to continually develop our range of products and services. We are particularly proud of the launch of our Young Savers offering, which combines excellent interest rates with strong incentives for our youngsters to get into the savings habit. The introduction of the Robin Hood family of locally handmade pottery money boxes underpins our pride in our local heritage but also brings back some traditions of the past, which were successful in helping the younger generation understand the importance of saving.

Our performance

When undertaking a period of investment, it is important that the results of this come through in your performance and I am delighted to report that this has been the case in 2013.

During the year we have begun to see some more encouraging activity in the housing market and this has been reflected in our lending. In fact in 2013 our mortgage lending increased by 24% to £693m – equal to our record for lending in one year for the Society. In addition we continued to see an increasing number of customers choosing to stay with us at the end of their product term. This strong performance, in terms of both gross lending and retention, led to an increase in our mortgage book of 17%.

As we have said previously, one of the biggest challenges we face in this low interest rate environment is to balance the competing needs of borrowers and savers. Savers especially have found the past four years challenging in terms of returns on their savings. Despite the reduction of funding costs as a consequence of the introduction of the Funding for Lending Scheme (FLS) we have done all we can to continue to offer a range of good value accounts, particularly in our heartland. Whilst in 2013 the government backed funding, made available through the FLS, has led to fewer offers being made to savers online, we have maintained the attraction of our branch-based offering. This has been well received by members, with branch based balances up by 20% in the year, demonstrating the strength and popularity of our account offering. In fact our branch balances have now risen by 42% in the past three years, underscoring the strength and attractiveness of our branch network.

Whilst doing all we can to help savers we have carefully managed our product mix and pricing over the year and, supported by the availability of the Funding for Lending Scheme, we have seen our interest margin rise from 1.17% to 1.33%. This is due largely to the funding conditions we see at present but is much closer to the level of profit needed by the industry in the long run to meet its capital needs.

As I have said previously, following the acquisition of Harrison Murray earlier in the year both of the Society's subsidiaries combined, have delivered the best level of profitability for a number of years and are now well positioned for future growth and success. In fact our non-interest income increased in the year by 129% and now represents 19% of the total bringing more balance in the way we derive our income.

It is very important that we continue to demonstrate to members that we operate efficiently. It is pleasing to report therefore the Society's underlying cost income ratio continued to fall reaching 61.6% in 2013. Whilst direct comparisons on like for like costs is more difficult this year, owing to the marked change in the structure of the business; our business review section (page 11) provides further detail on the reasons for changes to our underlying management expense ratio from last year.

Overall this adds up to a very successful year for the Society with the balance sheet increasing by 10.4% to reach £3.0bn, putting us back where we were before the financial crisis hit in 2008. Profit before tax too saw a very good improvement up 58% to £12.8m, a record for the Group. This figure is after the deduction of a further £1.8m for on-going financial services compensation scheme costs - this takes our total levy cost over the past six years for FSCS to £8.3m – a sum equivalent to 29% of our total profit over the same period.

Quality and strength

The financial crisis has graphically demonstrated the importance of running the Society in a safe, secure and prudent fashion.

It is important for us to generate an appropriate amount of profit to build our capital buffers to allow us to grow and provide protection from shocks, to reinvest in the business to improve our products and services to customers, as well as to cover the on-going cost of depositor guarantee protection.

The importance of being well capitalised is now a key focus for the Prudential Regulatory

"From April all customers coming to The Nottingham will be offered a whole of market mortgage advice service."

Authority (PRA). As the Chairman has noted in his statement we are strongly capitalised as measured by all the key indicators and are well positioned for the future.

We must also exercise prudence when lending our members money to prospective mortgage customers. I am pleased to report that despite record lending activity our lending quality continues to improve:

- Our arrears performance is now at sector leading levels with only 114 cases out of a mortgage book of 22,675 three months or more in arrears. This is down from already extremely low levels last year at 135 cases and includes a number of cases in arrears inherited as a consequence of our merger with the Shepshed Building Society. Our arrears are about a third of the industry average;
- Repossession at 30 cases remains very low, although we will reluctantly take the ultimate step if we believe it is in all parties best interest to do so;
- We always seek to support our customers who do encounter financial difficulties. Each customer's individual circumstances are reviewed and once a forbearance option has been implemented it is subject to regular monitoring and review. At the end of 2013 there were 237 customers receiving some form of forbearance from the Society, compared with 242 at the end of 2012. This represents 1% of the total number of mortgage customer accounts and includes the cases reported in our arrears figures;
- We have continued to support local homebuyers with small deposits to take their first step on the housing ladder. In fact in 2013 22% of our lending was for loans with a 15% deposit or less. We have done this without any loss in asset quality. Our book LTV currently stands at 58%, well within our risk appetite;
- In addition to residential lending, we also undertake some Buy-to-Let lending and a small amount of commercial lending (3.5% of our total book). Lending quality here too is excellent with 8 and 9 cases three months or more in arrears out of total lending of 4,891 and 627 cases; comparing extremely favourably with our residential lending;
- Our funding and liquidity profiles also contribute to our strength and resilience. As market conditions have improved we have adjusted our liquidity levels closer to the long run average. The levels of liquidity held by the Society remains well in excess of that which we are required to hold by the regulator and remain of the highest quality with a large majority in UK Gilts and Treasury bills. Our retail funding and capital balances continue to fully cover our mortgage assets. And whilst our non-retail funding ratio has increased to 17.2% this year due to our participation in the FLS, it remains well within our Board risk appetite;
- All this serves to underpin the prudent approach to how we manage your Society.

Customer relationships

The heart of our strategy remains focused on providing our customers with value, choice and expert advice, backed by great service and providing this to more and more customers is what drives us.

In an era when trust in the big banks is at an all-time low and they continue to retreat from the high street, for example providing whole of market advice only to their wealthiest customers, we believe that this provides unique opportunities for strong regional mutuals like The Nottingham.

In recent years, in addition to our core business of deposit taking and mortgage lending, we have developed a unique proposition which includes access to expert advice on estate planning, access to financial planning products which are available across the whole market and a range of home buying services, as well as the financial protection of your home and loved ones.

The success we have seen so far has given us the confidence to take our developing proposition to more customers in new locations across the East Midlands.

As we have done so the feedback and response from customers has been excellent. Our customer satisfaction based on independently run telephone conversations held with customers, regarding a specific transaction or activity, continues to provide us with a strong level of feedback for activity across the Society. The results also remain at industry leading levels with 65% of customers surveyed over the year rating us as excellent and achieving a net promoter score over 2013 of 66.9% - a performance maintaining our position in the top 10% of all firms in all sectors. It is crucial to us that we maintain very strong levels of customer service.

Customers also let us know what they think in other ways. For example, in today's world it is important that we engage with our customers and communities in the most up to date ways. Our Facebook page offers an insight into our personality and since its launch in 2012 has attracted almost 9,000 likes; this is second only to The Nationwide in the building society sector, with the third placed society back on 3,000+.

We have picked up a number of awards during the year covering our community activities, customer service and technical capability. However, we were most delighted to win the "What Mortgage" Regional Building Society of the Year for the third year in a row in 2013 – an award voted for in each of the years by their readers.

Maintaining and building our reputation for great service and building relationships that enable customers to achieve their financial ambitions will remain key to our purpose.

Looking ahead

As you will see from this review, we began a number of developments in 2013 which should serve the Society well in the years ahead. In 2014 we will be seeking to build on our progress:

- During the course of the year we expect to add building society services to at least five further Harrison Murray locations. This will include a new branch location in Melton Mowbray which is scheduled to open in the first quarter;
- We will continue our work to integrate our estate agency operations – including the rollout of a single system platform across all estate agency offices scheduled for the first three months of the year;
- April will bring further regulatory change in the form of the mortgage market review. Following a detailed review of the market place, our business model and the regulatory environment, we have decided to fundamentally change our mortgage advice proposition. From April all customers coming to The Nottingham will be offered a whole of market mortgage advice service. With our strategy to provide value, choice, advice and service, and acknowledging that we cannot provide everybody who comes to us with a Nottingham mortgage, we have decided to introduce this enhancement. We believe that this will be unique amongst building societies but give consumers dealing with The Nottingham, whether in branch or on the phone, the confidence that we will consider all market-wide available products and recommend the one that is most suitable for them. This is an important step in the development of our proposition, one which we have undertaken in our estate agency for a number of years. We will be offering, for the first time, whole of market advice for mortgage and financial planning from a trusted high street based mutual;
- Despite this new offering we will remain a strong manufacturer of mortgage loans and expect 2014 to be a record year for our mortgage lending, driven by strong support from our intermediary partners;
- We will continue to invest in our infrastructure to make us more efficient and ensure that we can continue to grow without increasing costs significantly, as well as continue our branch investment programme, with a number of branches set to be refurbished this year;
- We will also continue to raise our profile through increased levels of marketing and community involvement under our Doing Good Together initiative – which encompasses fundraising and grant giving to local groups, our continued partnership with Framework, and further sponsorship with SportsAid of promising local young sports stars hoping to follow in the footsteps of the 2012 Olympians.

Thank You

It has been another busy but successful year with a number of records achieved and the delivery of strong growth and excellent financial performance.

This has only been possible due to the extraordinary commitment, enthusiasm and hard work of all team members within The Nottingham family, who as always strive hard to serve customers in a way which they themselves would wish to be served.

I would also like to highlight the contribution of our Chairman David Thompson who will be stepping down after our AGM later this year. David has been a member of the Board since 2002 and Chairman for almost 10 years. During that period of significant change and challenge he has led the Society and its Board with great skill and wisdom, continually focusing on ensuring that we serve the best interests of members now and in the future. The Nottingham has emerged from the maelstrom of recent years stronger and more capable; this is in large part due to David's leadership over that period. On behalf of the Board, staff and members, I would like to offer David our heartfelt thanks and gratitude for his wise stewardship and service to the Society over that period.

It has been a particular privilege to lead our team in 2013 and to have witnessed the great achievements that their focus and commitment has delivered.

As always I would like to thank our loyal members who place their trust and confidence in us to help them achieve their financial ambitions.

David Marlow
Chief Executive

19 February 2014

Business review

The following section provides a detailed review of the Group's performance in 2013 in the context of its key performance indicators (KPIs). The Business Review should be read in conjunction with the information provided in the Chairman's statement and Chief Executive's review, the Director's report, Income statements and Statement of financial position.

Our evolving operating model and prudent approach to business has enabled the Society to deliver strong financial performance over recent years.

The Society's key objective has been to maintain a strong level of capital through robust financial performance, underpinned by improving efficiency, to give long term protection to members.

We are strongly positioned to meet our customers' needs and deliver, through a carefully chosen range of products (mortgages, home sales, savings and investments, insurance and personal financial planning) value, service, advice and choice to customers. We deliver this through Nottingham Building Society, our estate agency services (Nottingham Property Services and Harrison Murray) and whole of market mortgage advice via Nottingham Mortgage Services. Investments and personal financial planning are offered through our partnership with an independent third party, Towergate Financial (East).

Principal risks and uncertainties

The Risk Management Report on pages 24 to 27 provides details of the main risks faced by the Group and how the Board looks to manage them. Strategically we continue to operate in an uncertain environment:

- The introduction of the Funding for Lending Scheme (FLS) and the introduction of the Help to Buy Scheme have provided strong stimulus to the mortgage market which has led to a fall in new business market rates for both mortgages and savings. As the Society must balance the needs of both savers and borrowers the level of uncertainty the introduction of FLS has brought to the mortgage and savings markets has had to be managed effectively. The continued impact of the FLS and ultimately its withdrawal will need to be managed closely;
- The Group's business model has very close links to the housing market and therefore any change in the level of activity in the market has a significant effect on the Group's performance. Management have a number of mitigating actions they could put in place to respond to any volatility or downturn in the market. For example the cost structure in the estate agency business has a high proportion of variable costs which could be reduced quickly if needed;
- As explained in the Chief Executive's review, during 2013 we made a significant investment to acquiring Harrison Murray which strengthens our estate agency business and more importantly provides us with an opportunity to offer building society services in the newly acquired locations. During 2014 we will look to roll out this service to a number of locations and continue to align working practices across the Group. The risks associated with both elements of integrating estate agency operations and adding building society services to existing Harrison Murray locations will require close management;
- The level of retail impairments has remained benign with the number of arrears cases falling from prior year. Although arrears are expected to remain stable while interest rates remain low the Society will need to remain vigilant over the medium term with any increases to unemployment and or interest rates potentially putting borrowers under additional financial duress.

The majority of the Society's customers are currently on fixed rate mortgages and would therefore not be immediately impacted by changes in interest rates;

- Whilst the Eurozone debt crisis has abated, for now, both the global recovery and the Eurozone remain fragile. Any further adverse development, such as a sovereign default, is likely to have an impact on the UK economy. Although the Society has no direct exposure to Eurozone countries, the risks to the UK economy and consumer confidence would impact the markets the Society operates in and would require the Society to respond effectively.

It is in this context that the Board assesses the Group's performance in 2013.

Business performance

The Chief Executives review includes a summary of factors affecting our performance in 2013 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 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 represent ongoing business performance and therefore underlying profit is also used to measure performance. Underlying profit before tax equates to reported results, adjusted to exclude derivative fair value movements, and exceptional costs relating to the Financial Services Compensation Scheme (FSCS). Exceptionally this year it also excludes the one off strategy costs of our acquisition of Harrison Murray and merger with the Shepshed Building Society. The comparative periods are disclosed on a similar basis.

Key performance indicators

The table to the right provides a summary of the Group's Key Performance Indicators.

	Group		Society	
	2013	2012	2013	2012
	£m	£m	£m	£m
Underlying profit before tax	14.2	10.1	14.4	10.4
FSCS costs	(1.8)	(2.0)	(1.8)	(2.0)
Derivative fair value movements	1.2	-	1.2	-
Merger and Acquisition costs	(0.8)	-	(0.5)	-
Reported profit before tax	12.8	8.1	13.3	8.4

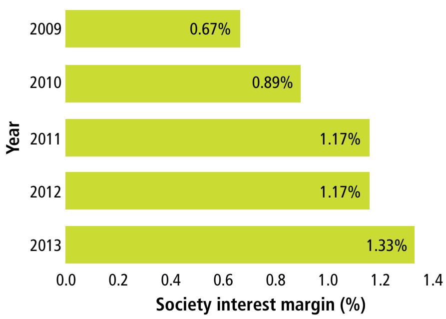
	2013	2012	2011	2010	2009
Profit after tax ratio					
Underlying	0.39%	0.30%	0.26%	0.13%	0.01%
Statutory	0.35%	0.25%	0.22%	0.10%	(0.06%)
Interest margins					
Statutory	1.33%	1.17%	1.17%	0.89%	0.67%
Society management expense ratio					
Statutory	0.88%	0.81%	0.84%	0.76%	0.67%
Group management expense ratio					
Statutory	1.13%	0.87%	0.89%	0.81%	0.73%
Society cost income ratio					
Underlying	61.6%	63.1%	65.9%	74.7%	88.5%
Group cost income ratio					
Underlying	68.1%	65.8%	66.6%	76.3%	90.1%
Statutory	66.4%	65.8%	66.6%	80.0%	101.0%
Society arrears performance	0.50%	0.64%	0.73%	0.85%	0.74%
Total assets	£3.0bn	£2.7bn	£2.5bn	£2.4bn	£2.6bn
Retail savings balances	£2.3bn	£2.3bn	£2.0bn	£1.8bn	£1.9bn
Liquid assets ratio	17.69%	22.08%	22.68%	22.76%	22.11%
Tier 1 capital	16.2%	16.9%	17.7%	17.5%	15.7%
Net promoter score	66.9%	76.5%	73.8%	47.9%	54.5%

Net interest income

The Society's interest income is a key component of its total income and is determined by our interest margin (the difference between interest received from members and liquid assets and interest paid to members and in the wholesale markets for funding) and in the main the size of our mortgage and savings books. The net interest margin represents net interest income divided by mean assets.

The objective is to optimise our net interest margin so that we balance the requirements of both mortgage and savings customers whilst ensuring sufficient profits are generated to maintain a strong capital position and continue to invest in the Society, as well as to pay the ongoing FSCS levy.

SOCIETY INTEREST MARGIN



The net interest margin increased from 1.17% in 2012 to 1.33% in 2013. The increase in net interest margin equates to an additional £7.5m of net interest income an increase of 25%. This has been achieved through focused and active management of the balance sheet including strong growth in mortgage lending.

The introduction of the government's Funding for Lending Scheme (FLS) has driven down both the new business mortgage rates and to a larger extent the overall cost of funding in both the retail savings and wholesale markets.

The reduction in mortgage lending yield, as a result of the more competitive mortgage market, has been more than offset by the reduced cost of funding which was partly achieved from the Society's drawings from the FLS.

Furthermore the margin has benefitted from a reduction in our core liquid asset holdings (explained in liquidity section) which has reduced from 22.1% to 17.7%.

Fee income

The main driver behind the overall increase to fee income has been our acquisition of Harrison Murray estate agents in the year. We see estate agency as being a core area of strategic focus in order to diversify our income stream and to build our geographic footprint.

	2013	2012
	£m	£m
Building society	3.0	3.0
Estate agency	6.7	1.2
Mortgage broking	0.6	0.2
Consolidation adjustments	(0.2)	(0.2)
Total	**10.1**	**4.2**

The fee income earned by the Society has remained relatively stable at £3.0m. Mortgage related fees have reduced in line with market activity but this shortfall has been offset by a one-off benefit of £0.5m from the sale of its old head office building and improvement in third party estate planning income, through provision of wills, financial planning and protection products.

Performance of the estate agency business has improved during the year as a result of an improvement in the housing market. The acquisition of Harrison Murray has added £5.6m to fee income and this has also been supported by increased activity in Nottingham Property Services which has seen income levels increase by 16% from £1.2m to £1.4m.

Mortgage broking activity has been assisted by the acquisition of Harrison Murray's broking arm – The Mortgage Advice Centre which has generated additional fee income of £0.3m in addition to the £0.3m generated from the existing subsidiary Nottingham Mortgage Services.

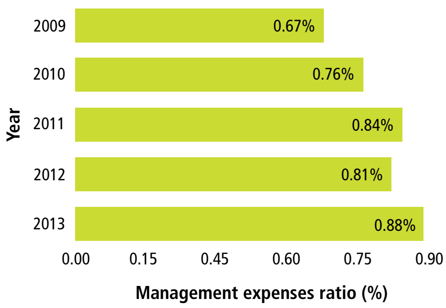
Derivatives

The Society 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 fair value volatility which could only be realised if the Society chooses to sell the derivatives before they reach maturity. The Society has no intention or need to sell these derivatives and so expects the £1.2m fair value adjustment to reverse out over the derivatives remaining lives. The board believes this fair value volatility arises due to the application of accounting rules which do not reflect the economic reality and therefore exclude their impact from underlying performance.

Management expenses

The ratio of management expenses to mean total assets is monitored closely and provides a guide to efficiency of the Society. The Society's management expenses ratio increased from 0.81% to 0.88%, equivalent to an absolute increase of £4.1m.

SOCIETY MANAGEMENT EXPENSES RATIO

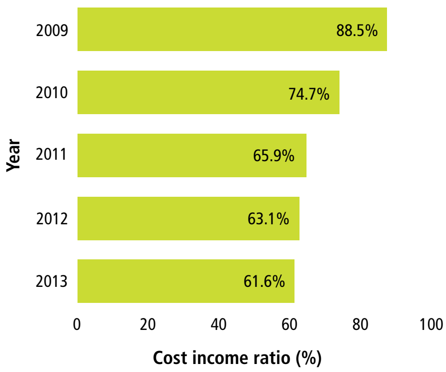


At the Society level, the cost of merging with the Shepshed Building Society contributed to an increase in management expenses of £0.9m both through the actual cost of merger and the addition of Shepshed's running costs.

Additionally the increase to the ratio also reflects strategic investment in marketing to increase local profile, increased investment in IT and higher staff bonus costs due to better performance compared with targets.

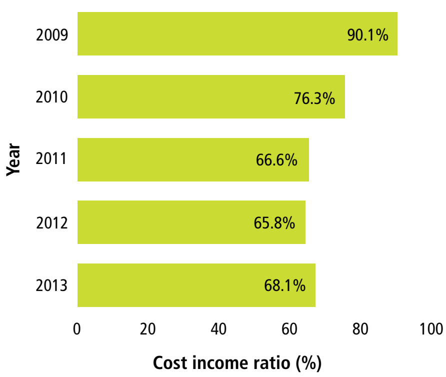
The benefits of this investment are seen in the Society's underlying cost income ratio which has improved to 61.6% during the year driven by the increased level of net interest income and continued focus on cost efficiency.

UNDERLYING SOCIETY COST INCOME RATIO



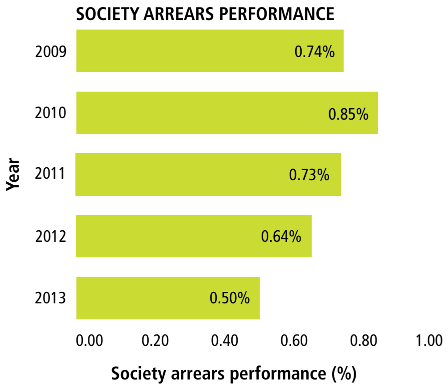
At a Group level the underlying cost income ratio increased from 65.8% to 68.1%. This is largely driven by the acquisition of Harrison Murray and the impact of a higher cost income ratio generally seen in the estate agency sector when compared to the building society sector. For this reason moving forward it is important that we clearly distinguish the differences between Group and Society indicators.

UNDERLYING GROUP COST INCOME RATIO



Impairment and provisions

The Society's arrears performance measures the number of loans three months and more in arrears as a percentage of the total loan book. This enables management to monitor how exposed we are to potential borrower defaults and therefore where losses may occur.



The Society's arrears ratio has continued to fall to 0.50% at the end of 2013, less than a third of the industry average.

The continued fall in the arrears ratio reflects our conservative business model which ensures customers can afford to meet their regular repayments from the outset. It is this approach that has ensured arrears levels have remained consistently low throughout the economic downturn.

The Society's total overall impairment provisions were £3.9m (£3.9m in 2012), this equates to 0.16% of the total book. The impairment charge for the year of £0.9m is £0.5m lower compared to 2012.

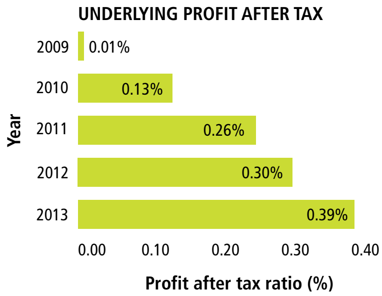
In common with all other UK regulated deposit takers the Society is required to pay levies under the Financial Services Compensation Scheme (FSCS) and has made provisions for the costs. This continues to form a significant cost to the Society - £1.8m in 2013 compared to £2.0m in 2012.

Acquisition and merger costs

These costs relate to expenditure incurred in the year associated with the merger with Shepshed Building Society and the acquisition of Harrison Murray estate agents and total £0.8m at Group level. These costs are by their very nature one-off and largely relate to professional fees and system integration costs.

Profit after tax

As a mutual the Society has no outside shareholders to whom we have to pay dividends and as such we do not have to maximise profit. However, we need to make sufficient profit for the Society to maintain its capital strength and to invest in the Society to improve services to members.



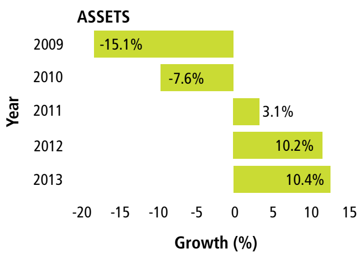
Underlying profit performance has continued on an upward trend with the underlying profit after tax ratio as a percentage of mean total assets up from 0.30% in 2012 to 0.39%. The reported profit after tax ratio has increased from 0.25% to 0.35% despite the exceptional merger and acquisition costs incurred during the year.

The primary driver behind the increase in underlying profit is the increase in net interest income from £30.6m to £38.1m, an increase of 25%. This is attributable to both the improvement to interest margin and the growth in the size of the Society's balance sheet (see section below).

The Society has also benefitted from consistently low arrears levels. This has contributed to a fall in the impairment charge by £0.5m to £0.9m.

Assets

The Group produced another strong year of asset growth, with the balance sheet increasing by 10.4% during the year. The Group balance sheet now stands at £3.0bn.



The balance sheet growth can be attributed to a number of factors:

- Mortgage balances grew by 17%, driven by a number of factors including the continued ability to offer competitively priced mortgage products. New lending increased by 24% to £693m. Book growth was also strongly supported by high retention levels at 68% continuing to demonstrate the Society's competitive range of mortgage products;
- The merger with Shepshed also contributed to a further £67.1m or 2.5% of asset growth;
- The mortgage growth was partially offset by a reduction in liquid assets in the year.

Liquid assets

The Group continues to maintain a prudent level of liquid resources in which to meet requests by investors for withdrawals from their accounts, to make new mortgage loans to borrowers and to fund its general business activities.

The Group's liquidity resources are made up from a combination of 'on balance sheet' liquid assets and contingent liquidity held with the Bank of England in the form of Treasury bills secured against certain assets. In times of stress the Group is able to exchange these assets for cash.

The Group's liquidity is made up as follows:

	2013	2012
	£m	£m
Bank of England	308.5	312.1
Multilateral Development Banks	20.7	31.9
UK Gilts & T'Bills	30.9	27.5
Certificate of deposit	26.2	32.8
Floating rate notes	47.7	65.1
Fixed rate notes	22.1	24.0
Other	39.6	62.9
Total	**495.7**	**556.3**

By holding liquidity of the highest quality, termed 'buffer' assets, the Group is able to reduce the total amount of liquidity it holds. This is because buffer assets are highly liquid and can be readily turned into cash. In fact over two thirds of the Group's liquidity is held in buffer assets.

At the end of the year the ratio of liquid assets to shares and deposits was 17.7% compared to 22.1% at the end of 2012. However, when contingent liquidity is taken into account as part of the Overall Liquidity Adequacy Rules (OLAR), this ratio increases to 21%.

The Society is also comfortably in excess of the minimum levels required under the forthcoming Liquidity Coverage Ratio.

Mortgages

Mortgage lending remains concentrated in prime high quality mortgage assets, with residential mortgages accounting for 98% of the total lending book.

	2013	2012
	£m	£m
Residential	2,397.6	2,043.3
SBL	79.5	71.6
Total	**2,477.1**	**2,114.9**

During the year the Society residential balances increased by 17%. The Secured Business Lending (SBL) book remained stable at £72m, with the small increase attributable to Shepshed mortgages.

The Society's lending is primarily focused in the 60% to 95% LTV category as we continue to provide products to support our heartland customers. The Society's LTV remained stable at 58% assisted by the growth in HPI.

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

	2013	2012
	%	%
Heartland	33.5	35.2
London & South East	25.8	24.6
North	11.4	11.4
Eastern	10.4	10.1
West Midlands	8.2	8.1
South West	7.9	7.8
Other	2.8	2.8
Total	**100**	**100**

The Society continues to fund its mortgages through a combination of retail savings and its own funds.

Retail and wholesale funding

The Group operates a diverse funding strategy. Retail savings continue to be the main stay of our funding requirement with the remainder obtained from the wholesale funding markets.

2013 has been dominated by the FLS and the impact this has had on the mortgage and savings market, with new business savings rates remaining relatively low throughout the year.

During the year retail balances have increased by £57m and now stand at £2,325m, with branch balances contributing £1,316m to this total. Our branch balances now represent 57% of all retail savings balances and have increased by 20% this year - which continues to indicate the strength of our branch network and strong evidence that customers have responded positively to our moves to maintain good rates for heartland savers. This is expected to increase further during 2014 as we look to add building society services to our Harrison Murray estate agency branches.

The group's wholesale funding ratio has increased from 8.1% in 2012 to 17.2% in 2013. The increase is predominantly driven by the drawing and subsequent realisation of Treasury Bills under FLS.

Capital

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

One measure of capital strength is the Society's Tier 1 ratio. Tier 1 capital is the strongest form of capital and comprises general reserves and 100% of our permanent interest bearing shares (PIBS). Under Basel III, the Society's PIBS will be phased out over a 10 year period commencing in 2014 which leaves retained profits as the only effective method of generating additional capital resources moving forward.

The table below sets out the Society's capital resources and ratios :

	2013	2012
	£m	£m
Core Tier 1 capital resources	148.5	141.4
Tier 1 capital resources	172.4	165.3
Risk Weighted Assets	1,066.7	975.9
Core Tier 1 Ratio	13.9%	14.5%
Tier 1 Ratio	16.2%	16.9%

The level of capital held throughout the year is comfortably in excess of regulatory requirements and the Society expects this to continue under the forthcoming Leverage Ratio regime. The Society's leverage ratio at the end of December 2013 was 5.5%.

The reduction in the Core Tier 1 ratio reflects the impact of growth in mortgage lending and the cost of acquisition of Harrison Murray. Both activities are expected to improve capital in the future.

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 Society. In 2013 we have maintained our industry leading levels of satisfaction, with 65% of our customers rating us as excellent or good.

The net promoter score measures the percentage of customers strongly prepared to recommend the Society to others less those who are not prepared to recommend the Society resulting in a net percentage of our customers who would recommend the Society's products and services.

The Society's net promoter score in 2013 was 66.9% compared to 76.5% in 2012. Whilst this has reduced in the year it remains at industry leading levels.

Your board of directors

David Thompson
FCA
Chairman

David joined the board in 2002 and was appointed Chairman in 2004. David is a chartered accountant and retired from The Boots Company Plc as Deputy Chief Executive and Finance Director in 2002, after 36 years with the business. He served as a director of Cadbury Schweppes Plc from 1998 to 2008. Today he is chairman of a charity supporting adults with learning difficulties.

John Edwards
Vice-Chairman

John joined the board in 2012, was appointed Vice-Chairman in 2013 and will become Chairman from May 2014. He has spent his entire career in the insurance and investment industry. His former senior executive roles include CEO of Clerical Medical Investment Group, CEO of HBOS Insurance and Investment Division and CEO of International Financial Services with Lloyds Banking Group, from which he retired in June 2009. He is currently a non-executive director of the LV Group and is also Chairman of their Investment Committee.

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, mainly in the financial services industry. Before joining The Nottingham, David held a number of senior posts in retail banking at Alliance & Leicester Plc. He is a director of Nottingham Property Services Ltd, Nottingham Mortgage Services Ltd, The Mortgage Advice Centre (East Midlands) Limited, Harrison Murray Ltd and HM Lettings Ltd.

Richard Fiddis
BSc (Hons), PhD

Richard joined the board in 2007. Richard has worked in the IT services sector for over 20 years and currently holds the position of Managing Director, Strategic Markets at Experian Plc. Prior to this he was Experian's Managing Director for the UK, Ireland and Northern Europe. Previously Richard held a number of general management positions at IBM.

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.

Bob Marchant
BSc (Social Sciences), FCA

Bob joined the board in 2003 and was appointed Vice-Chairman in 2008 until his retirement on 31 December 2013.

Mary Phibbs

BSc (Hons), FCA

Mary joined the board in 2013. She has over 30 years' experience in audit, advisory, banking, finance and insurance both here, in Australia and Asia Pacific. Mary has held key executive roles at Standard Chartered Bank, ANZ Banking Group, KPMG, National Australia Bank and Bankers Trust. Mary currently holds non-executive directorship posts at The Charity Bank Limited, Novae Group Plc, Stewart Title Limited, Morgan Stanley International Limited Group and Invicta Card Services Limited Group.

Mahomed Ashraf Piranie*

FCCA, MBA

Deputy Chief Executive & Finance Director

Ashraf joined the board in 2007 and is responsible for finance, treasury and credit risk. 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, The Mortgage Advice Centre (East Midlands) Limited, Harrison Murray Ltd and HM Lettings Ltd.

Simon Taylor*

ACIB, MBA

Chief Operating Officer

Simon joined the board in February 2011 and has responsibility for IT, the branch network, marketing, distribution and customer service. Before joining the Society he was Regional Director for the North of England with Lloyds Banking Group. Previous career experience includes roles with Barclays Bank and management consultancy with Unisys. Simon is also a director of Nottingham Property Services Ltd, Nottingham Mortgages Services Ltd, The Mortgage Advice Centre (East Midlands) Limited, Harrison Murray Ltd and HM Lettings Ltd.

Keith Whitesides

MBE, LLB, MPhil

Keith joined the board in 2004. He retired from his position as Director of Investor Relations at The Boots Company Plc in 2001, 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 Justice of the Peace in Nottinghamshire and was national Commissioner for Racial Equality.

Board Committees

Audit

Mary Phibbs – Chairman
Richard Fiddis
Jane Kibbey
Keith Whitesides

Nominations

David Thompson – Chairman
Bob Marchant
David Marlow

Remuneration

Keith Whitesides – Chairman
John Edwards
Richard Fiddis
Jane Kibbey
David Thompson

Risk

David Thompson – Chairman
John Edwards
Richard Fiddis
Jane Kibbey
David Marlow
Mary Phibbs
Ashraf Piranie
Simon Taylor
Keith Whitesides

* Executive Director

Directors' report

The Directors' report should be read in conjunction with the Chairman's statement and Chief Executive's review on pages 4 to 10.

Business objectives and activities

The Nottingham is a strong and successful mutual which builds upon its strong regional foundations, with a track record of serving our members for over 160 years. At The Nottingham we aim to build strong, 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 Business review on pages 11 to 15.

Business review

The Group's business activities are reviewed in the Business review. Additionally, we comment upon the financial (and other) key performance indicators used by the board during 2013 to assist its control, direction and drive for business results. These can be found on pages 11 to 15.

Principal risks and uncertainties

The principal risks and uncertainties faced by the Group and our approach to managing them can be found in the Risk management section on pages 24 to 27.

Financial risk management objective and policies

The Group's objective is to minimise the impact of financial risk upon its performance. An explanation of the financial risks and the controls in place to manage them (including the use of derivatives) is given in note 32 to the annual accounts.

"At The Nottingham we aim to build strong, lasting relationships with our customers."

Results

Group underlying profit before derivative fair value movements and Financial Services Compensation Scheme (FSCS) costs was £14.2m (2012: £10.1m). Group reported profit before tax was £12.8m (2012: £8.1m).

The profit after tax for the year transferred to general reserves was £10.2m (2012: £6.4m). Of the total profit for the year, the Society's subsidiaries delivered results of: Nottingham Property Services a loss of £0.2m, Harrison Murray Ltd a profit of £0.2m, HM Lettings a loss of £0.1m, Nottingham Mortgage Services £nil and TMAC a loss of £0.1m.

Loans and advances

During 2013, total lending was £693m (2012: £559m) and the average advance made was £157,999 (2012: £141,697), with the average debt at the end of the year being £109,221 (2012: £99,325).

At 31 December 2013 there were 20 cases (2012: 18 cases) of properties being 12 or more months in arrears or in possession. The total amount of balances outstanding in those cases was £2,312,106 (0.09% of the total mortgage book), with arrears of £224,565.

Mortgage losses of £0.9m were realised during the year from existing provisions. Provisions for potential mortgage losses total £3.9m, (0.16% of mortgage balances).

The Group offers a number of different forbearance options to customers including interest only concessions, reduced payment concessions, payment plans, capitalisations and mortgage term extensions. At 31 December 2013 the Group had 237 loans (2012: 242) subject to some form of forbearance. Note 32 to the accounts on page 74 provides further details.

Capital

Group gross capital at 31 December 2013 was £188.5m, being 6.73% of total shares and borrowings. Free capital, at the same date, amounted to £166.0m and 5.92% of total shares and borrowings.

The definitions of gross capital, free capital and total shares and borrowings are given in the annual business statement on page 86.

The directors remain committed to maintaining a strong capital position.

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 2013 by the Group's professional services team, indicates that market value is £1.6m 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 2013, the total amount owed to suppliers was equivalent to 4 days' credit.

Charitable and political donations

During the year the Group made charitable donations of £61,285 (2012: £60,533).

No contributions were made for political purposes.

Our people

A key focus for 2013 was to ensure that the strategic changes being implemented by the business were realised successfully through our teams. A summary of the key achievements appear below.

- **Achievement of Investors in People.** After independent assessment, silver award achieved in recognition of both the quality and investment in our people.
- **ILM** (Institute of Leadership and Management) is progressing well with Managers getting ready to submit their final assessments for ILM Level 5.

> "Accreditations for Level 3 have risen from 17% of branches (2012) to 71% of branches at the end of 2013."

- **Customer Review Management System.** Providing skills and technical knowledge through workshops and e-learning to enable the transition to our new Customer Review Management System (CRMS).
- **Winning Ways.** Accreditation process developed to focus more upon management skill enhancement. Accreditations for Level 3 have risen from 17% of branches (2012) to 71% of branches at the end of 2013 and 4% of branches at Level 4.
- **Performance Review.** Rollout into Harrison Murray Estate Agency. We achieved the successful introduction through workshops and e-learning of The Nottingham's performance management framework to enable a common performance measurement process.
- **Talent Programme –'High Potential'.** Launched initially as a pilot. Three employees were identified with a view to providing bespoke development to identify future senior leaders from within the Business. Programme designed and key elements sourced.
- **Leadership Landmarks.** A series of specialist, roundtable discussions, where managers debate and discuss particular issues related to leadership. These sessions enable a sharing of good practice, getting advice on challenges being faced and discussing topical business issues.
- Continued to provide a programme of skills development to support both our team members to further enhance the service we provide for our internal and external customers.

We are particularly pleased to have achieved all this whilst continuing to provide a cohesive programme of skills development to support both our team members to further enhance the service we provide for our internal and external customers.

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, an online training session 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.

"Open and clear communication amongst all our team members is vital to the success of The Nottingham."

To help gather team member views and opinions, we hold regular meetings with our Staff Council and our Team Survey is distributed annually to all team members. We were pleased with the results of our 2013 team survey which showed positive shifts in the majority of key measures and that 95% of our staff are 'proud to say they work at The Nottingham'. As we move into 2014 we will continue to take action to further improve the areas that our staff told us we could be better at.

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 and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- 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 Regulatory 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.

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 page 11 and pages 24 to 27, and the extent to which they might affect the preparation of the annual report and accounts on a going concern basis.

The Group's business activities and future plans are reviewed in the Chairman's statement and Chief Executive's review on pages 4 to 10. In addition note 32 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.

Directors

Information on the directors is given in the annual business statement on pages 87 and 88. Richard Fiddis and David Marlow retire by rotation at the annual general meeting and, being eligible, seek re-election under Rule 26(1).

Keith Whitesides retires under rule 24(1)(j) and has, having reached the age of 70, been approved as eligible for re-election by resolution of the board. The board has taken into account his vast experience and continued contribution as a non-executive in coming to that decision.

Further information on the directors who have served during the year can be found in the directors' report on remuneration (page 34).

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 2013.

Auditor

Our auditor, KPMG Audit Plc, has instigated an orderly wind down of business. The board has decided to put KPMG LLP forward to be appointed as auditor and resolution concerning their appointment will be put to the forthcoming annual general meeting of the Society.

On behalf of the board of directors,

David Thompson
Chairman

19 February 2014

Corporate and social responsibility

As a mutual organisation we've always believed in doing good together and three years ago we launched a new community programme. We called it Doing Good Together because it means exactly that – joining in and helping to support valuable work being done in our community.

Just like our original founders back in 1849, our desire is to truly make a difference to people and communities local to us, helping them thrive and become more prosperous.

In 2013 the Group's community investment programme 'Doing Good Together' continued to develop its community work around three key elements, namely; fundraising, community grants and volunteering, with activity continuing to be primarily focused on the themes of homelessness, financial education and employability.

With the assistance from Nottinghamshire Community Foundation and East Midlands radio station Gem 106, the Group gave community grants of £26,649 to several charitable groups in its heartland. In addition, in collaboration with The Nottingham Post £35,000 (of which The Nottingham contributed £25,000) was given to 140 worthy groups in the Nottinghamshire area.

Just like our original founders back in 1849, our desire is to truly make a difference to people and communities local to us.

As well as giving grants, our staff for the third year running continued to raise funds for our fundraising partner Framework. Framework is based in Nottingham and work throughout the East Midlands in supporting and preventing homelessness and offering routes to employment. The charity supports over 8,000 clients a year through accommodation services, housing support, 'walk in' services and its Education, Volunteering and Employment service (EVE).

During 2013, the relationship with Framework, our charity partner, further developed and saw three significant pieces of work:

- Believed to be the first of its kind in the UK, The Nottingham agreed to lend Framework £800,000 on commercial terms to assist in building 14 units of crucial move-on accommodation. The cost of the loan is partly offset by savers' investment in special Framework savings accounts provided by The Nottingham.
- The Nottingham has signed a five year contract with Framework to lease its former branch in central Nottingham on Friar Lane, providing an emergency city centre service for homeless and vulnerable people. The Nottingham has leased the property at a heavily discounted rate.
- The Nottingham supported Framework with the launch of its £10m investment plan for homeless housing. The launch was held at the House of Commons and attended by MPs, Politicians, charity groups, charity banks, the media and many others. Nick Hurd MP, Minister for Civil Society at the Cabinet Office was the keynote speaker.

In addition to Framework The Nottingham pledged to support the charity SportsAid. SportsAid is a charity that helps the sports stars of tomorrow by providing funding and recognition during the defining early years of their careers. These include some of Britain's brightest hopes for future Olympic and Paralympic success. Some famous British sportsmen and women have been helped by SportsAid in the past and these include Jessica Ennis, Bradley Wiggins, Tom Daley and Mo Farah. The Nottingham is delighted to be involved with this initiative and is sponsoring 13 athletes, involved in a variety of sports, who are based in communities near our branches.

Further information on the Group's community investment programme can be found on our website at **www.thenottingham.com**.

The Nottingham DOING GOOD TOGETHER

framework opening doors to homeless and vulnerable people

What have we done in 2013?

	FUNDRAISING	VOLUNTEERING	GRANT GIVING/ INITIATIVES
January	Recycling of unwanted mobile phones.		Dragons Den - £9,000 awarded to two entrepreneurs.
February	Sale of Valentine's cakes and cards.		
March	A member of staff donates a days' wages to Framework.		
April	A team of seven from our branch network raised over £600 by climbing Kinder Scout. A raffle to win Easter eggs at Head Office together with an egg hunt at our Sherwood branch raised over £120.		Cash For Your Community Grants 2013, in association with the Nottingham Post, was launched, encouraging groups to apply for a share of £35,000. The Nottingham awarded some £25,000 in grants to worthy causes supporting its themes.
May	Our Chief Operating Officer, Simon Taylor, took part in a Jail and Bail and raised over £1,000. And a book sale at Head Office saw just over £20 donated to Framework.		
June	Customers sponsored some of our branch managers to build 300 sandcastles in 30 minutes. They actually managed 409 sandcastles and raised £455 for SportsAid and Framework.		Regional launch of Framework Accounts was held at Nottinghamshire Golf Course. National launch of Framework Accounts at House of Commons as well as supporting Framework with their national investment campaign.
July			Cash for your Community finished - £35,000 awarded to 140 local groups.
August	Members of the public gave almost £200 when we held fundraising events outside seven of our branches to raise awareness of our BIKE IT challenge. Members of our North Hykeham branch and Marketing team completed a mile long cold water swim to raise over £1,000 for SportsAid and members of the Head Office team raised a further £60 for SportsAid by taking part in a sports day.		
September	September was a busy month for fundraising. 29 members of staff took part in our sponsored five day bike ride clocking up over 230 miles and raising nearly £4,440 in the process. A Macmillan Coffee morning at Head Office raised £500 for Macmillan Cancer Care. Some branch managers dressed up as Maid Marian and completed a 5 mile walk in Sherwood Forest and raised £345 for SportsAid and Framework.	Volunteers from a number of our branches wanted to gain a greater understanding of some of the facilities that Framework offer so took on the challenge to decorate the Sherwood Street Day Centre in Mansfield for rough sleepers of any age.	
October	The Nottingham's Head Office together with six branches held harvest festival collections for Framework and gathered £400 worth of food, toiletries and household goods.		The Nottingham awarded a 'Match Funding Grant' of £500 to Framework during their Autumn campaign encouraging other public donations.
November	The Nottingham's branches raffled off bouquets made of chocolate flowers and raised over £500.		
December		A team of volunteers from across the business renovated a room at Waterloo Crescent a home for homeless and vulnerable people.	The Nottingham awarded a grant of £2,500 to Nottinghamshire Fire & Rescue Prince's Trust Team Programme.

Risk management

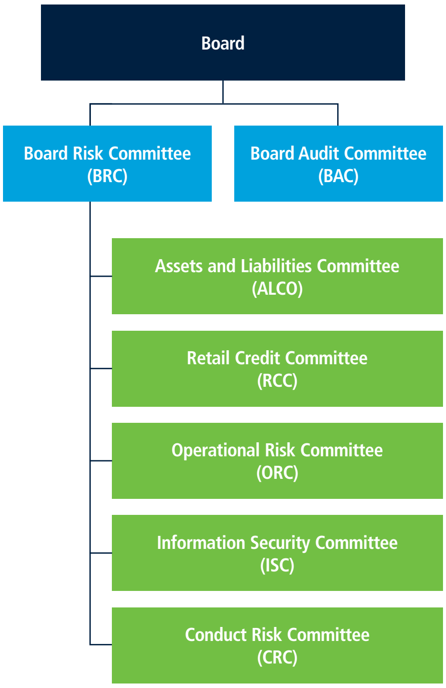
For the year ended
31 December 2013

The Nottingham recognises risk as a natural consequence of its business environment, as with any organisation. Through prudent management it aims to manage risk in a manner that supports the achievement of its strategic objectives, 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.

The Board Risk Framework

The board risk committee is an integral part of the Group's formal structure, overseeing all aspects of risk management. It regularly reviews and approves policy statements, risk limits, risk frameworks, mandates, retail and wholesale credit risk appetites and other control procedures.



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.

The risk committee framework (shown left) has been designed to support a wide ranging approach to the identification and management of risk. In so doing, each of the five 'management level' risk committees report to the board risk committee, whose responsibility it is to take a Group-wide view of the overall exposure to risk.

Board Risk Committee

The composition of the board risk committee can be found on page 17. It is responsible for:

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

The board risk committee regularly reviews risk management activities to ensure focus on managing not only existing risks but also identifying emerging risk areas such as the impact to net interest income following the end of the Funding for Lending Scheme (FLS) and the impact of integrating new business streams.

Business risk

Business risk is the risk of unexpected changes in the external environment that have the potential to affect the Society's business model either through the level of demand for the Society's products and services and/or its ability to meet it. The Society looks to mitigate its exposure by having a diverse range of products and services so that its income source is not reliant on one product or one area of its business.

Following its acquisition of Harrison Murray estate agents in January 2013 the Society continues to integrate the companies into its existing business and extend its building society services into a number of the newly acquired locations. Although the project is being managed in accordance with the Society's controlled project governance framework there remains a number of risks such as the perceived benefits identified fail to materialise and/or there is an adverse impact on customer service.

Strategic risk

Strategic risk is the risk that the Group pursues an inappropriate strategy or that risks associated with its implementation are not fully recognised. When discussing strategy 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 to mitigate them. The board risk committee oversees the detailed evaluation of these risks.

Capital management

The Society 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 the Society's strategic plan. This process is known as the Internal Capital Adequacy Assessment Process (ICAAP).

The ICAAP assesses the Society's future capital requirements by considering changes to business volumes, type and mix of assets and business activities within the context of current and future anticipated risks and stress scenarios.

The PRA use the ICAAP during their Supervisory Review and Evaluation Process (SREP) through which it determines the Society's Internal 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 capital levels remain well in excess of the PRA requirements. An analysis of the components of the Group's capital position under Basel II can be found in note 33 to the accounts.

From 1 January 2014, capital management will fall under a new regime, Capital Requirement Directive IV. This will seek to implement the Basel III framework.

The objective of the new regulation is to improve the banking sector's ability to absorb shocks arising from financial and/or economic stress. This will be achieved through increasing both the quality and quantity of regulatory capital firms will be required to hold.

To enhance the quality of regulatory capital, Core Tier 1 capital will only comprise retained earnings and those instruments that replicate ordinary shares and in particular that absorb losses.

The main impact on the Society is that its £25m of permanent interest bearing shares (PIBS) will no longer count as regulatory capital and will be phased out from the calculation of Tier 1 capital over a 10 year period, ending in 2022.

The changes have all been factored into the Society's capital management plan and when coupled with the Society's strong capital foundation, result in the Society continuing to hold capital comfortably in excess of the regulatory minimum.

Regulatory risk

The Society is regulated by the Prudential Regulatory Authority (PRA) for all prudential matters. The PRA requires the Society to comply with various external laws, regulations and codes. Failure to comply with relevant regulations could lead to sanctions, fines or other actions from the regulator.

Each business area is responsible for ensuring that all regulatory and statutory requirements are complied with on a day-to-day basis. Oversight of the business is undertaken by the Compliance function supported by the Society's Secretary.

Recent and upcoming changes to prudential related regulation include the Capital Requirements Directive (CRD IV).

Assets and Liabilities Committee

The Assets and Liabilities Committee (ALCO) comprises two executive directors and relevant senior managers. It is responsible for reviewing treasury activity, performance and compliance with approved treasury policy.

It is responsible for overseeing the Group's wholesale credit risk, liquidity risk and market risk.

Wholesale credit risk

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

On a day to day basis the Society's treasury team is responsible for the management of wholesale credit risk. The treasury risk team performs a daily oversight role to ensure the Society's exposures are within acceptable limits.

ALCO members receive updates on a monthly basis.

The risk of a counterparty failure both within the UK and Eurozone remain due to constraints on capital from new regulations. This risk has been managed through treasury policy which only permits sterling denominated lending to UK and other central governments, UK local authorities, banks and building societies. During the year lending has been permitted to selected European based Multilateral Development Banks in instances where it qualifies as High Quality Liquidity Buffer (HQLB) eligible assets, the Society has not permitted any lending directly to sovereign states, other than the UK.

Risk of counterparty default has been further reduced by the proportion of total liquidity held in UK Sovereign debt securities and the Bank of England reserve account which has remained significantly above the level required to be held by the PRA.

In addition, every bank must have a minimum 'A' rating from an external credit assessment institution.

A board approved policy statement 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, geographical regions etc.

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 managed through holding cash and other readily realisable liquid assets. The base level and composition of the Society's liquidity is subject to PRA guidance and regular stress testing. This forms part of the Society's Individual Liquidity Adequacy Assessment (ILAA) as required by the PRA's liquidity regime. A separate board approved policy statement, which is aligned to the ILAA, ensures day-to-day activities of the treasury team are conducted within a prudent framework.

During the year, the Society was able to benefit from confirmation that the Bank of England would count assets pre-positioned under the Funding for Lending Scheme (FLS) as eligible collateral in the Liquid Asset Buffer (LAB). This potentially enables the Society to reduce the level of liquid assets held on balance sheet at any one point in time.

The ALCO assists the board and executive in the prudent management of the treasury function. It is responsible for developing and defining the treasury risk appetite of the Society and for ensuring that the activities of the treasury function support the corporate plan, whilst remaining compliant with all applicable regulatory requirements. Responsibility for the day-to-day operational management of the risk lies with the Society's treasury team. Daily compliance with the limits is undertaken by the treasury risk team which reports to ALCO on a monthly basis.

The balance sheet is stress tested at least monthly to confirm that the Society is able to withstand extreme cash outflows.

A detailed analysis of the Society's liquidity profile can be found in note 32 to the annual accounts.

Market risk

Market risk is the risk of changes to the Society's financial condition caused by market variables in particular interest rates and property prices.

The economy is still dominated by the low interest rate environment although longer term LIBOR and Gilt yields have risen slightly following the Governor of the Bank of England's forward guidance. The Society has a greater proportion of LIBOR earning assets than liabilities which is being actively monitored to ensure any future change to interest rates does not adversely affect the Society's interest margin.

The introduction of the FLS has seen reductions to market rates for both retail lending and savings products. The Society is maintaining a watching brief on future market rate changes and the impact of the FLS extension to ensure it does not adversely affect the Society's position.

The Society manages market risk through a board approved policy statement which defines the maximum acceptable level of risk and what steps may be taken to reduce it. The treasury team is responsible for day-to-day management and for producing the Society's interest rate view and economic forecast. This is then overseen by the Society's treasury risk team.

Typically interest rate risk is managed through the use of appropriate hedging instruments or by taking advantage of natural hedging opportunities within the Society's balance sheet. The treasury risk team subject the balance sheet to monthly stress tests designed to measure the likely impact of a sudden change in interest rates.

The ALCO is responsible for reviewing treasury activity, performance and compliance with the approved policy statements. A detailed analysis of the Society's interest rate sensitivity exposure can be found in note 32 to the annual accounts.

Retail Credit Committee

The Retail Credit Committee (RCC) comprises two executive directors and a number of senior managers. It has responsibility for oversight of the Group's retail assets which includes Residential and Buy-to-Let mortgages and Secured Business Loans.

Retail credit risk is 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 their mortgage. The Society 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 stated risk appetite.

The level of retail credit risk continues to remain low compared to industry benchmarks. This is characterised by the low interest rate environment which is expected to extend beyond the end of 2014. The funding for lending scheme has also supported a more competitive mortgage market with mortgage rates significantly lower than they were 24 months ago.

The composition of the Society's new lending has generally been at lower average Loan-to-Value (LTV) levels than last year. However, the Society remains actively engaged in the higher LTV and Buy-to-Let (BTL) markets. Although the BTL market is perceived to be higher risk and has a greater concentration in London and the South East than the prime residential lending market, average new lending margins and arrears performance remains strong.

The Society has continued to follow its long term policy of offering interest only products however, there are strict policies and monitoring procedures around any new loans to ensure an appropriate repayment vehicle is in place.

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, which is reviewed and approved annually by the board. The board receives monthly information on key risk appetite limits.

This ongoing monitoring ensures that current and future exposures, such as LTV levels, geographic concentration and probability of default are managed within the risk appetite limits set by the board.

Exposure to retail credit risk is limited to the provision of loans secured on property within the UK. 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 Society also shares account performance data with the selected bureau.

Buy-to-Let lending is required to go through a comprehensive anti-fraud process to ensure the Group minimises its exposure to fraud risk.

The Society is 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. Should customers find themselves in financial difficulty, it responds with appropriate forbearance activities. 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 Society take the property into possession. In addition the Society continues to work within best practice guidelines to ensure customers with interest only loans have appropriate repayment vehicles in place.

The Society 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.

Loans are only granted against the 'bricks and mortar' value (i.e. loans are only provided for the purchase or re-mortgaging of a property and not for working capital or machinery etc.).

Secured Business Lending (SBL) policy is used to manage levels of business lending risk.

To ensure appropriate management of lending risk the Society 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.

Operational Risk Committee

The Operational Risk Committee (ORC) comprises two executive directors and relevant senior managers. It has responsibility for actively overseeing the management of operational risk and adherence to policy.

Operational risk is the risk of loss arising from inadequate or failed internal processes, the actions of people, the Society's systems, or from external physical events such as wars, terrorism or an 'Act of God'.

To ensure the effective monitoring and reporting of risk, the Group has in place various risk registers, this includes an Executive risk register as well as individual departmental and project risk registers. These risk registers assist the Group to track the probability and impact of the risks identified.

Furthermore as part of the risk management framework all business areas are required to complete an Objectives, Risks and Control Assessment (ORCA) and review it on an annual basis. Documented within the ORCA are the business area's objectives, inherent risk (without specific controls) and residual risk where specific controls have been identified and evaluated. The ORCA is a living document and is used by management to ensure that both risks and controls within their business area are managed effectively. The ORCA forms a key component of any reviews undertaken by the internal audit function.

Information Security Committee

The Information Security Committee (ISC) supports the board in ensuring the security of the Society's information is managed effectively. It performs this role through the approval of appropriate frameworks and policy and oversight of policy implementation. The committee is chaired by the Chief Executive and comprises business area representatives from across the Society.

Given the nature of our business the Society places significant focus on managing information security, data protection and fraud risks whilst also ensuring appropriate staff awareness. Although the level of cyber-crime is on the increase and financial criminals continue to innovate, the Society aims 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.

Conduct Risk Committee

The Conduct Risk Committee (CRC) comprises one executive director and a number of senior managers. The Society, being a retailer of mortgage, savings and insurance products, is regulated by the Financial Conduct Authority (FCA). The CRC has responsibility for overseeing the manner in which the Group conducts business ensuring it is conducted in a clear, transparent and fair manner and is compliant with conduct rules set by the FCA, both in letter and in spirit.

The FCA requires the Society to comply with various external laws, regulations and codes including areas such as training and authorisation of staff, documentation, systems and processes. Failure to comply with relevant regulations could lead to sanctions, fines or other actions from the regulator.

Recent and upcoming changes to conduct related regulation include:

- Retail Distribution Review (RDR);
- Mortgage Market Review (MMR)

On behalf of the board of directors,

David Thompson.

David Thompson
Chairman

19 February 2014

Report of the directors on corporate governance

Nottingham Building Society supports the principles of good corporate governance. This report explains how the Society has regard to the principles of the UK Corporate Governance Code.

During the year the board again reviewed the Society's corporate governance practices against the current UK Corporate Governance Code that is applicable for all listed companies. Whilst the Society does not have to comply with the Corporate Code, as it is not a listed company, where appropriate the board has given regard to its principles.

Leadership

The Board

At 31 December 2013, the board comprised seven non-executive directors (including the Chairman) all of whom are considered to be independent, and three executive directors, providing a complementary balance of skills and expertise.

The board held 10 meetings and two strategy review meetings during 2013.

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. The board's principal role 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.

Division of responsibilities

The role of the Chairman of the board and the Chief Executive are held by different people and are distinct in their purpose.

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 annually 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.

The Vice-Chairman of the board is the Senior Independent Director who is also the main point of contact for members should the normal channels of communication with the Chairman, Chief Executive or other executive directors fail or be inappropriate.

Effectiveness

Composition of the Board

The names of the directors together with brief biographical details are set out on pages 16 and 17. 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 17.

The table to the right 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 2013.

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 or 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 annually considers 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. 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 selected by the nominations committee, with the assistance of external consultants.

All directors must meet the tests of fitness and propriety prescribed by the Regulator and are required to be registered with the Regulator as an Approved Person in order to fulfil their Controlled Function as a director.

Director	Board	Risk	Nominations	Remuneration	Audit
J. Edwards	10/10	4/4	-	3/3	-
R. Fiddis	10/10	4/4	-	3/3	5/5
J. Kibbey	10/10	4/4	-	3/3	5/5
R. Marchant	10/10	4/4	1/1	-	5/5
D. Marlow	10/10	4/4	1/1	-	-
M. Phibbs	10/10	3/4	-	-	4/5
M. Piranie	10/10	4/4	-	-	-
S. Taylor	10/10	4/4	-	-	-
D. Thompson	10/10	4/4	1/1	-	-
K. Whitesides	10/10	4/4	-	3/3	5/5

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.

Development

Upon appointment and throughout their tenure all directors receive timely and appropriate training to enable them properly to 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 advisors 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 and, for remuneration purposes, by the remuneration committee. 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 annually. 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.

The board is satisfied that the evaluation process meets the needs of the Society and its members, but is mindful of the Code requirement to conduct an external evaluation every three years, and will keep this under review.

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 a continuity of experience and knowledge. However the issue 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, and be explained giving due consideration to the continuing independence and objectivity of the non-executive director. Keith Whitesides was first elected in 2005 and has been assessed by the Board as continuing to be independent in character and judgement and has, having reached the age of 70, been approved as eligible for re-election by resolution of the Board. The Board considers that his independence is in no way affected or compromised by his length of service. The Board has taken into account his vast experience and continued contribution in coming to that decision. Being eligible, he offers himself for re-election this year.

The nominations committee makes recommendations to 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

Financial and business reporting

The directors' report on pages 18 to 21 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 Chief Executive's review on pages 7 to 10 and Business review on pages 11 to 15 provide an extensive review of the Group's performance and financial position.

Risk management and internal control

The board risk committee oversees the entire risk management framework of the Group. 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 in line 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 and information security committees report into the board risk committee. The committee meets at least quarterly.

More information on risk management is given in the report commencing on page 24.

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.

The Society's system follows industry good practice through the establishment of three lines of defence, as illustrated in the diagram below:

The operation of these three lines of defence is embodied in the terms of reference of the Society's six risk committees (assets and liabilities, retail credit, conduct, operational and information security risks 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 2013 there were no material breaches of control or regulatory standards and that the Society maintained an adequate system of internal control.

Audit committee and auditors

The role of the audit committee covers a number of responsibilities which are delegated by the board.

- **Financial reporting**

  The committee reviews the Group's accounting policies at least annually and on a quarterly basis receives updates on any key judgemental areas. In addition the committee reviews the integrity of the financial statements and any formal announcements, including review of significant financial reporting judgements contained within them. Judgemental issues which have been reviewed by the committee include impairment provisions, conduct and regulatory provisions, fair values on the merger with Shepshed Building Society, treatment of intangible assets upon the acquisition of Harrison Murray, hedge accounting and the effective interest rates used in calculating income and expenses.

- **Systems of internal financial controls**

  The committee receives reports and monitors the systems of internal control. This includes review of internal financial controls and taxation risks.

- **External auditors**

  The committee reviews the effectiveness of the external auditors and recommends to the board annually their re-appointment/appointment. The committee is mindful that the code requires companies to put the external audit contract out to tender every ten years. The committee will take a view on the frequency of the tender once the competition commission and the European Union proposed rules on audit tendering and auditor rotation come into force.

The committee also examines the external auditors' independence and approves their terms of engagement and remuneration. This includes any decisions on the engagement of the external auditors for non-audit services. Such engagements are subject to pre-approval to ensure that there is no threat to the independence and objectivity of the external audit firm.

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.

- **Internal auditors**

  The committee monitors and reviews the performance of the internal audit function. This is achieved through approval of the annual audit plan and monitoring of progress against this plan. In 2013 a formal external review was also undertaken on the effectiveness of internal audit taking into account the increasing requirements from the function. In addition, the committee reviews the results of audits undertaken, conclusions on the effectiveness of the control environment and progress made by management in addressing any concerns raised.

- **Report to the Board**

  The committee reports to the main board on how it has discharged its responsibilities.

The committee consists of non-executive directors only and met on five occasions during 2013. The board is satisfied that at least one member of the committee has recent and relevant financial experience.

The internal and external auditors both have direct access to this committee and to its chairman. The committee also holds independent meetings with the Chief Executive, the Finance Director, internal auditors and external auditors.

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 code principles relating to remuneration, is covered in the report of the directors on remuneration on pages 32 to 35.

Membership

The Committee consists of non-executive directors only and met on three 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.

More information on remuneration is given in the report commencing on page 32.

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 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 Member's 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.

On behalf of the board of directors,

David Thompson

David Thompson
Chairman

19 February 2014

Report of the directors on remuneration

Nottingham Building Society is committed to best practice in its remuneration of directors.

This report explains how the Society applies the principles in the UK Corporate Governance Code relating to remuneration and the regulators Remuneration Code.

Introduction

The board believes remuneration should be sufficient to attract, retain and motivate directors to run the Society successfully, whilst avoiding paying more than is necessary for this purpose. Incentives are structured to strike the right balance between fixed and variable pay. To incentivise appropriate behaviour, rewards are only attributed to the delivery of success. The remuneration of all directors is reviewed annually.

The Chairman and other non-executive directors each receive an annual fee. Executive directors' emoluments comprise a basic salary, pension entitlement and other taxable benefits.

Additionally, the executive directors participate in an annual bonus scheme and a medium/long term incentive scheme (renamed long term incentive scheme from 2013) which is designed to incentivise individuals to produce successful, sustainable business results.

Remuneration matters are considered for the board by a remuneration committee whose membership is shown on page 17.

The Nottingham adheres to the requirements of the Remuneration Code. The non-executive directors do not receive variable remuneration. Information on the Society's other Remuneration Code Staff is set out in the Pillar 3 disclosures published on our website **www.thenottingham.com**.

Executive directors

The remuneration of executive directors is considered annually by the remuneration committee attended by the Society's Chief Executive, who (except in respect of his own remuneration) makes recommendations regarding executive pay. All agreed recommendations are referred to the board.

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.

The Society operates a HMRC approved pension salary sacrifice scheme for all staff. The executive directors are eligible to participate in the scheme, however their gross salaries and pension contributions (before salary sacrifice is applied) are shown in the table on page 34.

Performance related awards are in two parts; an annual scheme and a medium/long term incentive scheme. Payments under these schemes are not pensionable.

a) The annual bonus scheme is a multiple of the percentage rate paid under the Group annual bonus scheme (which covers all staff) and is based on the achievement of specific financial performance objectives. The multiple is determined by individual performance, based on appraisal. The maximum amount payable being 25% of eligible salary.

   If the Group bonus scheme is not triggered, no payment is made to the executive directors. In 2013 the Group bonus scheme was triggered.

b) The three year Medium Term Incentive (MTI) scheme maturing at the end of 2012, and paid in 2013 focused primarily on the Group's cost income ratio, and was dependent on the Group's relative performance to a comparator group of societies for the period 2010-2012.

   The scheme paid a total of 40% of eligible salary to directors employed for the period of the scheme with pro rata payments made as appropriate.

The schemes currently in operation mature at the end of 2013, 2014 and 2015 respectively and all require achievement of a minimum level of:

- operating profit;
- solvency, in line with capital requirements and the Group's capital plan;
- liquidity levels, maintained within planned parameters;
- individual performance, based on appraisal; and
- the individual must have performed their duties at all times within board risk appetite.

Payments for the schemes maturing in 2013 and 2014 are determined by the cumulative level of operating profit compared to the Group's three year plan and are dependent on relative performance to a comparator group of societies.

Payments under the scheme maturing in 2015 are determined using a balanced scorecard and require achievement of:

- Group cost income ratio targets;
- successful implementation of strategic initiatives; and
- the Society's profit after tax ratio relative to a comparator group of societies.

Any payment under the 2011 – 2013 scheme cannot be confirmed until later in 2014 when all comparator societies' annual accounts are available. The maximum bonus achievable under each scheme is 40% of annual salary.

Pensions are provided to all executive directors who are members of the Society's defined contribution scheme.

Executive directors receive other taxable benefits including a car allowance.

Total remuneration policy

The total remuneration received by executive directors is detailed on page 34. The information has been audited and shows remuneration for the years ending 31 December 2012 and 31 December 2013 as required under the Building Society's (Accounts and Related Provisions) Regulations 1998.

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

Other directorships

None of the executive directors currently hold any paid external directorships.

Non-executive directors

Fees for non-executive directors are set by reference to benchmark information from a building society comparator group.

The 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, with a recommendation being referred to the board.

There are no bonus schemes or incentive schemes for any non-executive director including the Chairman. Similarly, non-executive directors have no pension scheme entitlements or other benefits.

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.

Non-executive directors are appointed for an initial term of three years. They will generally be expected to serve more than one three year term.

Remuneration of directors

Audited	Society	2013	2012
		£000	£000
(A) TOTAL DIRECTORS' REMUNERATION		1,249	1,091
(B) NON-EXECUTIVE DIRECTORS' REMUNERATION			
J.S. Edwards		41	30
R. W. Fiddis		33	33
J. C. Kibbey		33	33
R. P. Marchant (Vice-Chairman)		47	46
M. C. Phibbs (appointed 01 February 2013)		31	-
D. A. R. Thompson (Chairman)		62	60
K. R. Whitesides		39	38
Total emoluments for services as directors		**286**	**240**

Audited	Society						
	Salary[1]	Annual[2] bonus	Medium term[2] incentive scheme	Benefits	Sub-total	Society's[3] contribution to pension scheme	Total
(C) EXECUTIVE DIRECTORS' REMUNERATION	£000	£000	£000	£000	£000	£000	£000
2013							
D J Marlow	203	51	79	10	343	23	366
M A Piranie	187	47	72	9	315	19	334
S J Taylor	160	40	36	8	244	19	263
	550	**138**	**187**	**27**	**902**	**61**	**963**

[1] Basic salary pre-salary sacrifice

[2] The figures disclosed represent the total amount earned under the bonus arrangements. Under the rules of the schemes directors are eligible to participate in bonus sacrifice schemes. The schemes allow directors to sacrifice part or all of their bonus as pension contributions into a money purchase arrangement.

[3] The Society's contribution to the pension scheme does not include the additional contributions (paid through salary sacrifice) as they are effectively included in the pre-salary sacrifice basic salary figures.

Audited	Society						
	Salary[1]	Annual[2] bonus	Medium term[2] incentive scheme	Benefits	Sub-total	Society's[3] contribution to pension scheme	Total
2012	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
D J Marlow	196	31	76	10	313	24	337
M A Piranie	180	29	70	9	288	23	311
S J Taylor	139	22	16	8	185	18	203
	515	**82**	**162**	**27**	**786**	**65**	**851**

Former executive director I J Rowling received contractual payments of 2013: £37,000 (2012: £64,000) under the terms of the medium term incentive scheme.

On behalf of the board of directors,

Keith Whitesides
Chairman of the Remuneration Committee

19 February 2014

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

We have audited the group and society annual accounts of Nottingham Building Society for the year ended 31 December 2013 set out on pages 37 to 85. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU.

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

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 20, the directors are responsible for the preparation of annual accounts which give a true and fair view. Our responsibility is to audit, and express an opinion on, the annual accounts in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the annual accounts

A description of the scope of an audit of annual accounts is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on annual accounts

In our opinion the annual accounts:

- give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of affairs of the group and of the society as at 31 December 2013 and of the income and expenditure of the group and of the society for the year then ended; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and regulations made under it and, as regards the group annual accounts, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Building Societies Act 1986

In our opinion:

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

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Building Societies Act 1986 requires us to report to you if, in our opinion:

- proper accounting records have not been kept by the Society; or
- the annual accounts 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.

Richard Gabbertas (Senior Statutory Auditor) for and on behalf of KPMG Audit Plc, Statutory Auditor

Chartered Accountants,
1 The Embankment
Neville Street
Leeds
LS1 4DW

19 February 2014

Statements of comprehensive income

for the year ended 31 December 2013

	Notes	Group 2013 £m	Restated Group 2012 £m	Society 2013 £m	Restated Society 2012 £m
Interest receivable and similar income	3	98.6	97.1	98.6	97.1
Interest payable and similar charges	4	(60.5)	(66.5)	(60.5)	(66.5)
NET INTEREST INCOME		**38.1**	**30.6**	**38.1**	**30.6**
Fee and commissions receivable		10.1	4.6	3.0	3.4
Fees and commissions payable		(0.5)	(0.4)	(0.5)	(0.4)
Other Income		0.5	-	0.5	-
Net gains from derivative financial instruments	5	1.2	-	1.2	-
TOTAL NET INCOME		**49.4**	**34.8**	**42.3**	**33.6**
Administrative expenses	6	(28.7)	(19.7)	(21.8)	(18.3)
Acquisition & merger costs	6	(0.8)	-	(0.5)	-
Depreciation and amortisation	18,19	(3.8)	(2.9)	(3.4)	(2.9)
Finance cost	27	(0.2)	(0.3)	(0.2)	(0.3)
OPERATING PROFIT BEFORE IMPAIRMENT LOSSES AND PROVISIONS		**15.9**	**11.9**	**16.4**	**12.1**
Impairment losses on loans and advances	15	(0.9)	(1.4)	(0.9)	(1.4)
Provisions for liabilities – FSCS levy	26	(1.8)	(2.0)	(1.8)	(2.0)
Provisions for liabilities - Other	26	(0.3)	(0.4)	(0.3)	(0.3)
Loss on disposal of property, plant and equipment	18	(0.3)	-	(0.3)	-
Negative goodwill	36	0.2	-	0.2	-
PROFIT BEFORE TAX		**12.8**	**8.1**	**13.3**	**8.4**
Tax expense	9	(2.6)	(1.7)	(2.6)	(1.8)
PROFIT FOR THE FINANCIAL YEAR	**29**	**10.2**	**6.4**	**10.7**	**6.6**
Other comprehensive income:					
Items that will not be re-classified to the income statement					
Remeasurements of defined benefit obligation	27	0.1	(0.6)	0.1	(0.6)
Tax on items that will not be re-classified to the income statement	9	-	0.2	-	0.2
Items that may subsequently be re-classified to the income statement					
Available-for-sale reserve					
Valuation (losses) taken to reserves	12	(0.4)	(1.8)	(0.4)	(1.8)
Amount transferred to income statement	12	0.2	0.2	0.2	0.2
Tax on items that may subsequently be re-classified to the income statement	9	0.1	0.4	0.1	0.4
Other comprehensive (expense) for the period net of income tax		-	(1.6)	-	(1.6)
TOTAL COMPREHENSIVE INCOME FOR THE PERIOD		**10.2**	**4.8**	**10.7**	**5.0**

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 12.
The notes on pages 41 to 85 form part of these accounts.

Statements of financial position

as at 31 December 2013

	Notes	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
ASSETS					
Liquid assets					
Cash in hand	10	1.0	1.1	1.0	1.1
Loans and advances to credit institutions	11	347.1	374.2	345.7	374.2
Debt securities	12	147.6	181.0	147.6	181.0
Derivative financial instruments	13	20.1	23.3	20.1	23.3
Loans and advances to customers	14	2,471.4	2,129.9	2,471.4	2,129.9
Investments in subsidiary undertakings	16	-	-	9.1	1.6
Other assets	17	2.6	1.8	1.8	1.6
Property, plant and equipment	18	13.2	11.9	11.6	10.9
Intangible assets	19	11.0	7.3	6.1	7.3
Deferred tax assets	20	1.9	1.4	1.9	1.4
TOTAL ASSETS		**3,015.9**	**2,731.9**	**3,016.3**	**2,732.3**
LIABILITIES					
Shares	21	2,319.4	2,268.0	2,319.4	2,268.0
Amounts owed to credit institutions	22	253.7	55.7	253.7	55.7
Amounts owed to other customers	23	216.1	176.1	216.1	176.1
Debt securities in issue	24	13.5	19.7	13.5	19.7
Derivative financial instruments	13	8.9	21.8	8.9	21.8
Other liabilities and accruals	25	5.1	3.4	4.4	3.2
Current tax liabilities		1.2	0.3	1.2	0.3
Deferred tax liabilities	20	0.8	1.1	0.7	1.1
Provisions for liabilities	26	4.1	3.8	4.1	3.7
Retirement benefit obligations	27	4.6	5.1	4.6	5.1
Subscribed capital	28	26.2	27.4	26.2	27.4
TOTAL LIABILITIES		**2,853.6**	**2,582.4**	**2,852.8**	**2,582.1**
RESERVES					
General reserves	29	162.5	149.6	163.7	150.3
Available-for-sale reserves	30	(0.2)	(0.1)	(0.2)	(0.1)
Total reserves attributable to members of the Society		**162.3**	**149.5**	**163.5**	**150.2**
TOTAL RESERVES AND LIABILITIES		**3,015.9**	**2,731.9**	**3,016.3**	**2,732.3**

The notes on pages 41 to 85 form part of these accounts.
These accounts were approved by the board of directors on 19 February 2014 and signed on its behalf:

David Thompson
Chairman

David Marlow
Chief Executive

Ashraf Piranie
Deputy Chief Executive
and Finance Director

Statements of changes in members' interests

as at 31 December 2013

	Notes	General reserves £m	Available-for-sale reserves £m	Total £m
GROUP				
Balance as at 1 January 2013		149.6	(0.1)	149.5
Acquired on transfer of engagements		2.6	-	2.6
Profit for the year		10.2	-	10.2
Other comprehensive income for the period (net of tax)				
Net (losses) from changes in fair value		-	(0.1)	(0.1)
Remeasurement of defined benefit obligation		0.1	-	0.1
Total other comprehensive income/(expense)		0.1	(0.1)	-
Total comprehensive income/(expense) for the period		10.3	(0.1)	10.2
BALANCE AS AT 31 DECEMBER 2013	**29,30**	**162.5**	**(0.2)**	**162.3**
Balance as at 1 January 2012		143.6	1.1	144.7
Profit for the year		6.4	-	6.4
Other comprehensive income for the period (net of tax)				
Net (losses) from changes in fair value		-	(1.2)	(1.2)
Remeasurement of defined benefit obligation		(0.4)	-	(0.4)
Total other comprehensive (expense)		(0.4)	(1.2)	(1.6)
Total comprehensive income/(expense) for the period		6.0	(1.2)	4.8
BALANCE AS AT 31 DECEMBER 2012	**29,30**	**149.6**	**(0.1)**	**149.5**

	Notes	General reserves £m	Available-for-sale reserves £m	Total £m
SOCIETY				
Balance as at 1 January 2013		150.3	(0.1)	150.2
Acquired on transfer of engagements		2.6	-	2.6
Profit for the year		10.7	-	10.7
Other comprehensive income for the period (net of tax)				
Net (losses) from changes in fair value		-	(0.1)	(0.1)
Remeasurement of defined benefit obligation		0.1	-	0.1
Total other comprehensive income/(expense)		0.1	(0.1)	-
Total comprehensive income/(expense) for the period		10.8	(0.1)	10.7
BALANCE AS AT 31 DECEMBER 2013	**29,30**	**163.7**	**(0.2)**	**163.5**
Balance as at 1 January 2012		144.1	1.1	145.2
Profit for the year		6.6	-	6.6
Other comprehensive income for the period (net of tax)				
Net (losses) from changes in fair value		-	(1.2)	(1.2)
Remeasurement of defined benefit obligation		(0.4)	-	(0.4)
Total other comprehensive (expense)		(0.4)	(1.2)	(1.6)
Total comprehensive income/(expense) for the period		6.2	(1.2)	5.0
BALANCE AS AT 31 DECEMBER 2012	**29,30**	**150.3**	**(0.1)**	**150.2**

The notes on pages 41 to 85 form part of these accounts.

Cash flow statements

for the year ended 31 December 2013

	Notes	Group 2013 £m	Group 2012 £m	Society 2013 £m	Society 2012 £m
CASH FLOWS FROM OPERATING ACTIVITIES					
Profit before tax		12.8	8.1	13.3	8.4
Depreciation and amortisation		3.8	2.9	3.4	2.9
Loss on disposal of property, plant and equipment		0.3	-	0.3	-
Interest on subscribed capital		2.0	2.0	2.0	2.0
Net losses on disposal and amortisation of debt securities		0.1	0.8	0.1	0.8
Increase in impairment of loans and advances		0.9	1.4	0.9	1.4
TOTAL		**19.9**	**15.2**	**20.0**	**15.5**
CHANGES IN OPERATING ASSETS AND LIABILITIES					
Decrease/(increase) in prepayments, accrued income and other assets		23.2	(13.8)	22.8	(14.1)
(Decrease)/increase in accruals, deferred income and other liabilities		(20.8)	11.6	(22.2)	11.6
(Increase) in loans and advances to customers		(363.1)	(198.8)	(363.2)	(198.8)
Increase in shares		59.9	270.7	59.9	270.7
Increase/(decrease) in amounts owed to other credit institutions and other customers		238.6	(23.2)	238.6	(23.2)
Decrease in loans and advances to credit institutions		14.1	16.3	14.1	16.3
(Decrease) in debt securities in issue		(6.2)	(11.8)	(6.2)	(11.8)
(Decrease) in retirement benefit obligation		(0.4)	(0.3)	(0.4)	(0.3)
Taxation paid		(1.8)	(1.6)	(1.8)	(1.6)
NET CASH GENERATED BY OPERATING ACTIVITIES		**(36.6)**	**64.3**	**(38.4)**	**64.3**
CASH FLOWS FROM INVESTING ACTIVITIES					
Purchase of debt securities		(119.4)	(212.8)	(119.4)	(212.8)
Disposal of debt securities		152.6	315.3	152.6	315.3
Cash acquired on transfer of engagements		2.1	-	2.1	-
Purchase of property, plant and equipment		(3.9)	(2.1)	(2.5)	(2.1)
Disposal of property, plant and equipment		0.4	-	0.4	-
Purchase of intangible assets		(6.2)	(2.4)	(1.0)	(2.4)
Investment in subsidiary undertakings		-	-	(6.2)	-
NET CASH GENERATED BY/(USED IN) INVESTING ACTIVITIES		**25.6**	**98.0**	**26.0**	**98.0**
CASH FLOWS FROM FINANCING ACTIVITIES					
Interest paid on subscribed capital		(1.9)	(1.9)	(1.9)	(1.9)
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS		**(12.9)**	**160.4**	**(14.3)**	**160.4**
Cash and cash equivalents at 1 January		350.8	190.4	350.8	190.4
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	**31**	**337.9**	**350.8**	**336.5**	**350.8**

The notes on pages 41 to 85 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 18 and 21.

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

The following IFRS pronouncements, relevant to the Group, were adopted with effect from 1 January 2013

- Amendment to IAS 1 'Presentation of Financial Statements': Presentation of items of Other Comprehensive Income - this amendment requires entities to group items presented in the statements of other comprehensive income on the basis of whether they are potentially reclassifiable to profit or loss in subsequent periods;
- Amendment to IAS 19 'Employee Benefits - this amendment covers the standard's recognition, measurement and presentation criteria with regard to a pension scheme's expense contained within IAS 19's 'defined benefit' scope. The amendment eliminates the 'expected return on assets' from the measurement of a pension's expense and directs entities to instead charge a cost of finance against its net unfunded liability position. When determining a discount rate, that which calculates a pension obligation's present value, reference should be made to market yields. These yields should be matched to high quality corporate bonds, in terms of both the obligation's currency and maturity, ahead of any previously assumed government bond yield reference point. As a result of these amendments, the comparative financial information in the income statement and other comprehensive income has been restated for the year ending 31 December 2012. The effect of applying the above on profit or loss was to reduce net finance income by £0.4m and increase remeasurements of the net defined benefit liability in other comprehensive income by £0.4m. There was no impact on the Group's net assets or reserves;
- Amendment to IFRS 7, Offsetting Disclosures - the amendment requires additional disclosures to enable users to evaluate the effect of netting arrangements, including rights of set off, of financial assets and liabilities;
- IFRS 13 'Fair Value Measurement' - The standard defines fair value and acts as its single authority, dealing with both measurement and disclosure. It does not require fair value measurements in addition to those already required, or permitted by other IFRSs, and is not intended to establish valuation standards or affect valuation practices outside of financial reporting. The standard is unlikely to have a material impact to the Group.

Early adoption

The following IFRS pronouncements were early adopted by the Group with effect from 1 January 2013 (EU effective date 1 January 2014).

- Amendment to IFRS 10 'Consolidated Financial Statements' - the standard replaces IAS 27 'Consolidated and Separate Financial Statements' and SIC 12 'Consolidation-Special Purposes Entities' by introducing a single model to be applied in the control analysis for all investees;
- Amendment to IFRS 12 'Disclosure of Involvement with Other Entities' - the standard requires enhanced disclosures regarding consolidated and unconsolidated entities in which the entity has an involvement;
- Amendment to IAS 27 'Separate Financial Statements' – the amendment requires that subsidiaries are accounted for at cost or in accordance with IFRS 9.

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 2017 at the earliest but not yet endorsed by the EU. The standard will eventually replace all of IAS 39. Phase one of this process specifically requires financial assets to be classified at amortised cost or at fair value. Consequently, the available-for-sale category currently used will become void. Further development phases for IFRS 9 are scheduled to cover key areas such as impairment and hedge accounting. Early adoption is permitted once endorsed by the EU. The impact of IFRS 9 is likely to be material to the Group once it becomes effective;

Notes to the accounts

- Amendment to IAS 39 'Financial Instruments: Recognition and Measurement' – effective for accounting periods beginning on or after 1 January 2014. Under this amendment there would be no need to discontinue hedge accounting if a hedging transaction was novated, provided certain criteria are met. This is unlikely to have a material impact to the Group;
- IFRIC 21 'Levies' – effective from 1 January 2014 with the option for early adoption. The interpretation provides clarification for accounting for government imposed levies. The Group has not adopted IFRIC 21 early. The impact to the Group is currently being assessed but is expected to change the level of provisions held for government imposed levies;

Basis of consolidation

Subsidiary companies are defined as those in which the Society has the power to govern the financial and operating policies, 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 statement of comprehensive income from the effective date of acquisition or up to the effective.

Business combinations between mutual organisations

Identifiable assets and liabilities are measured at fair value. Intangible assets are amortised through the statement of comprehensive income 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 statement of comprehensive income.

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 and liabilities acquired. Acquisition related costs are recognised in the statement of comprehensive income as incurred.

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.

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 when policies go on risk 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 income/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 for risk management purposes. The Group 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 designates derivatives held for risk management purposes as hedging instruments in qualifying hedging relationships. On initial designation of the hedge, the Group formally documents the relationship between the hedging instruments and hedge 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.

Fair value hedges

When a derivative is designated as the hedging instrument in a hedge of the change in fair value of a recognised asset or liability or a firm commitment that could affect profit and loss, changes in the fair value of the derivative are recognised immediately in profit and loss 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 statement of comprehensive income 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 profit and loss as part of the recalculated effective interest rate of the item over its remaining life.

Notes to the accounts

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.

a) 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.

b) 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 32 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 statement of comprehensive income.

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

a) 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 statement of comprehensive income and a corresponding reduction in the value of the financial asset is recognised through the use of provisions.

b) 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 statement of comprehensive income; any loss previously recognised through other comprehensive income is reversed out and charged to the statement of comprehensive income 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:

- Temporary transfer to an interest only mortgage;
- Reduced monthly payment;
- An arrangement to clear outstanding arrears;
- Capitalisation of arrears; and
- Extension of mortgage term.

Notes to the accounts

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.

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.

Subscribed capital

Subscribed capital comprises Permanent Interest Bearing Shares (PIBS) which have no voting rights to residual interest and is 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 statement of comprehensive income as interest expense.

Intangible assets

a) 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 statement of comprehensive income 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.

b) 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, 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 statement of comprehensive income 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 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.

c) 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 acquired in a business combination are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to the statement of comprehensive income on a straight-line basis over the estimated useful life of the asset which is typically 1 to 20 years. The amortisation periods used are reviewed annually.

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.

Notes to the accounts

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 statement of financial position property, plant and equipment value 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

a) 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 statement of comprehensive income. 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 statement of comprehensive income as contributions become due.

b) 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. The long term incentive bonuses disclosed in the Directors remuneration report are included when paid.

Leases

The leases entered into by the group are operating leases. The rental charges payable under operating leases are charged to the statement of comprehensive income 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 statement of comprehensive income 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 provided using the statement of financial position liability method, providing for temporary differences between the carrying amount of assets and liabilities for accounting purposes and the amounts used for taxation purposes. Deferred tax assets and liabilities are recognised gross on the statement of financial position and 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 statement of comprehensive income when the deferred fair value gain or loss is recognised in the statement of comprehensive income.

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

Provisions

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 6. 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.

Financial guarantees

The Society has made an explicit assertion that it regards intra-group financial guarantees as insurance contracts. As such, financial guarantees are accounted for under IFRS 4 'Insurance Contracts'. Such insurance contracts are accounted for as a contingent liability until such time that it becomes probable that the Society will be required to make a payment.

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 are described overleaf:

Notes to the accounts

a) 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 cashflows. 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 £0.4 million.

b) 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 £0.4 million.

c) 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 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 £0.8 million.

d) Financial Services Compensation Scheme (FSCS)

The FSCS levy consists of three parts – a management expenses levy, a compensation levy and with effect from 31 December 2012 a capital loan repayment. The management expenses levy covers the costs of running the scheme and includes any interest payable on the borrowings made from H M Treasury.

The compensation levy covers the amount of compensation the scheme pays, net of any recoveries it makes using the rights that have been assigned to it.

The capital loan repayment, triggered by participation in the deposit market at 31 December, covers the FSCS estimated loan shortfall and is payable for three years commencing 31 December 2012.

The amount provided for future years is disclosed in note 26 of the accounts and is calculated in accordance with a prescribed formula.

The actual payments to be made may vary from that provided due to changes in the assumptions used. The key assumptions include:

- Future interest rates;
- The Society's share of protected deposits; and
- Estimate of the management expenses levy

A change to the Society's share of protected deposits by 1% would change the provision by £0.3 million. A 1% increase to 12mth LIBOR would increase the provision by £0.5 million.

e) Fair value of derivatives and financial assets

The Group employs the following techniques in determining the fair value of its derivatives and financial assets:

- Available for sale – measured at fair value using market prices or, where markets have become inactive or there is no readily available traded price, the present value of future cash flows is used.
- Derivative financial instruments - calculated by discounted cash flow models using yield curves that are based on observable market data.

A change in the yield curve of 1% would change the total net fair value of derivative financial instruments by £22.4 million.

The classification of these fair value techniques is in line with the fair value hierarchy detailed in IFRS 13: 'Fair Value Measurement' which 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.

Notes to the accounts

2 SEGMENTAL REPORTING

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:

- Building Society – Provides mortgages, savings, third party insurance and investments. Includes all income and costs associated with Nottingham Building Society.
- 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 and TMAC Ltd.

	Building Society	Estate Agency	Mortgage Broking	Consolidation adjustments	Total
2013	**£m**	**£m**	**£m**	**£m**	**£m**
Net interest income	38.1	-	-	-	38.1
Net fees and commission receivable	3.0	6.7	0.6	(0.2)	10.1
TOTAL INCOME	**41.1**	**6.7**	**0.6**	**(0.2)**	**48.2**
Administrative expenses	(21.8)	(6.5)	(0.6)	0.2	(28.7)
Depreciation and amortisation	(3.4)	(0.1)	-	(0.3)	(3.8)
Finance income	(0.2)	-	-	-	(0.2)
Impairment losses on loans and advances	(0.9)	-	-	-	(0.9)
Provisions for other liabilities	(0.3)	-	-	-	(0.3)
Loss on disposal of property, plant and equipment	(0.3)	-	-	-	(0.3)
UNDERLYING PROFIT	**14.2**	**0.1**	**-**	**(0.3)**	**14.0**
Net gains from derivative financial instruments	1.2	-	-	-	1.2
Merger & acquisition costs	(0.5)	(0.3)	-	-	(0.8)
Provisions for liabilities – FSCS levy	(1.8)	-	-	-	(1.8)
Negative goodwill	0.2	-	-	-	0.2
PROFIT/(LOSS) BEFORE TAX	**13.3**	**(0.2)**	**-**	**(0.3)**	**12.8**
Tax expense	(2.6)	-	-	-	(2.6)
PROFIT/(LOSS) AFTER TAX	**10.7**	**(0.2)**	**-**	**(0.3)**	**10.2**
Total assets	3,016.3	8.4	0.3	(9.1)	3,015.9
Total liabilities	2,852.8	9.6	0.3	(9.1)	2,853.6
Capital expenditure	2.9	0.1	-	-	3.0

Notes to the accounts

	Building Society	Estate Agency	Mortgage Broking	Consolidation adjustments	Total
2012	**£m**	**£m**	**£m**	**£m**	**£m**
Net interest income	30.6	-	-	-	30.6
Net fees and commission receivable	3.0	1.2	0.2	(0.2)	4.2
TOTAL INCOME	**33.6**	**1.2**	**0.2**	**(0.2)**	**34.8**
Administrative expenses	(18.3)	(1.4)	(0.2)	0.2	(19.7)
Depreciation and amortisation	(2.9)	-	-	-	(2.9)
Finance Income	(0.3)	-	-	-	(0.3)
Impairment losses on loans and advances	(1.4)	-	-	-	(1.4)
Provisions for other liabilities	(0.3)	(0.1)	-	-	(0.4)
UNDERLYING PROFIT/(LOSS)	**10.4**	**(0.3)**	**-**	**-**	**10.1**
Net gains/(losses) from derivative financial instruments	-	-	-	-	-
Provisions for liabilities – FSCS levy	(2.0)	-	-	-	(2.0)
PROFIT/(LOSS) BEFORE TAX	**8.4**	**(0.3)**	**-**	**-**	**8.1**
Tax expense	(1.8)	0.1	-	-	(1.7)
PROFIT/(LOSS) AFTER TAX	**6.6**	**(0.2)**	**-**	**-**	**6.4**
Total assets	2,732.3	1.1	0.1	(1.6)	2,731.9
Total liabilities	2,582.1	1.8	0.1	(1.6)	2,582.4
Capital expenditure	4.5	-	-	-	4.5

The Group operates throughout the UK therefore no geographical analysis has been presented.

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 37 to 40.

Notes to the accounts

Group and Society	2013	2012
3 INTEREST RECEIVABLE AND SIMILAR INCOME	**£m**	**£m**
On loans fully secured on residential property	102.4	99.1
On other loans	2.6	2.2
On debt securities	2.0	3.2
On liquid assets	1.6	2.2
Profit on sale of liquid assets	0.2	0.2
Net interest (expense) on derivatives	(10.2)	(9.8)
	98.6	**97.1**

Interest on debt securities includes £0.7 million (2012: £1.6 million) arising from fixed income investment securities.

Included within interest income is £0.8 million (2012: £1.0 million) in respect of interest income accrued on impaired loans two or more months in arrears.

Group and Society	2013	2012
4 INTEREST PAYABLE AND SIMILAR CHARGES	**£m**	**£m**
On shares held by individuals	56.7	61.0
On deposits and other borrowings	4.5	5.5
On subscribed capital	2.0	2.0
Net interest (income) on derivatives	(2.7)	(2.0)
	60.5	**66.5**

Group and Society	2013	2012
5 NET GAINS FROM DERIVATIVE FINANCIAL INSTRUMENTS	**£m**	**£m**
Derivatives in designated fair value hedge relationships	18.0	2.5
Adjustments to hedged items in fair value hedge accounting relationships	(17.4)	(2.7)
Derivatives not in designated fair value hedge relationships	0.6	0.2
	1.2	**-**

The net gains from derivative financial instruments of £1.2m (2012: £nil) 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

	Group 2013	Group 2012	Society 2013	Society 2012
6 ADMINISTRATIVE EXPENSES	**£m**	**£m**	**£m**	**£m**
Staff costs				
Wages and salaries	14.9	10.5	11.1	9.7
Social security costs	1.1	0.8	0.8	0.8
Other pension costs	0.6	0.6	0.6	0.5
	16.6	11.9	12.5	11.0
Capitalised staff costs	-	(0.5)	-	(0.5)
	16.6	11.4	12.5	10.5
Operating lease rentals	0.6	0.5	0.4	0.4
Other administrative costs	12.3	7.8	9.4	7.4
	29.5	19.7	22.3	18.3
Less: Merger & acquisition costs	(0.8)	-	(0.5)	-
	28.7	**19.7**	**21.8**	**18.3**

The 2013 wages and salaries costs include £0.1 million (2012: £nil) in respect of redundancy costs.
Merger and acquisition costs comprise professional fees, external project management resource and termination payments.

OTHER ADMINISTRATIVE COSTS INCLUDE:	**£000**	**£000**	**£000**	**£000**
Remuneration of auditors and associates (excluding VAT)				
Audit of these financial statements	87	80	87	80
Audit of subsidiary undertakings	36	12	-	-
Audit of associated pension schemes	5	5	5	5
Other assurance services	55	-	55	-
Other services related to taxation	53	70	53	70

	Group 2013	Group 2012	Society 2013	Society 2012
7 EMPLOYEES	**Number**	**Number**	**Number**	**Number**
The average number of persons employed during the year was:				
Full time	395	284	265	253
Part time	204	124	120	111
	599	**408**	**385**	**364**
Building Society				
Central Administration	190	183	190	183
Branches	195	181	195	181
Subsidiaries	214	44	-	-
	599	**408**	**385**	**364**

8 REMUNERATION OF DIRECTORS

Directors' emoluments are shown as part of the report of the directors on remuneration on page 34.

Total Directors' emoluments totalled £1.2 million (2012: £1.1m).

Notes to the accounts

	Group 2013	Group 2012	Society 2013	Society 2012
9 TAX EXPENSE	**£m**	**£m**	**£m**	**£m**
Current tax	3.6	2.5	3.6	2.6
Adjustments for prior years	(0.7)	(0.7)	(0.7)	(0.7)
	2.9	1.8	2.9	1.9
Deferred tax (note 20)	(0.5)	(0.4)	(0.5)	(0.4)
Adjustments for prior years	0.2	0.3	0.2	0.3
TOTAL TAX EXPENSE	**2.6**	**1.7**	**2.6**	**1.8**

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 2013	Group 2012	Society 2013	Society 2012
Profit before taxation	12.8	8.1	13.3	8.4
Expected tax at 23.25% (2012: 24.5%)	3.0	2.0	3.1	2.1
Expenses not deductible for corporation tax purposes	0.2	0.2	0.1	0.2
Effect of tax change in tax rate on deferred tax	(0.1)	(0.1)	(0.1)	(0.1)
Adjustment for prior years	(0.5)	(0.4)	(0.5)	(0.4)
TAX EXPENSE FOR THE YEAR	**2.6**	**1.7**	**2.6**	**1.8**
TAX RECOGNISED DIRECTLY IN OTHER COMPREHENSIVE INCOME				
Tax on available-for-sale assets	(0.1)	(0.4)	(0.1)	(0.4)
Deferred tax on pension scheme	0.1	-	0.1	-
Corporation tax on pension scheme	(0.1)	(0.2)	(0.1)	(0.2)
TAX (CREDIT) FOR THE YEAR	**(0.1)**	**(0.6)**	**(0.1)**	**(0.6)**

The Finance Act 2012, which was enacted in July 2012, reduced the rate of UK corporation tax to 24% with effect from 1 April 2012 and 23% with effect from 1 April 2013. This results in a weighted average rate of 23.25% for 2013 (2012: 24.5%). The Finance Act 2013 includes provisions to reduce the rate to 21% from 1 April 2014 and 20% from 1 April 2015. This will reduce the Group's future current tax charge accordingly.

	Group and Society	2013	2012
10 CASH IN HAND	**Note**	**£m**	**£m**
Cash in hand		1.0	1.1
Included in cash and cash equivalents	31	1.0	1.1

Notes to the accounts

	Group 2013	Group 2012	Society 2013	Society 2012
11 LOANS AND ADVANCES TO CREDIT INSTITUTIONS	**£m**	**£m**	**£m**	**£m**
Repayable on call and short notice	324.9	335.7	323.5	335.7
Placements with credit institutions	12.0	14.0	12.0	14.0
Included within cash and cash equivalents	336.9	349.7	335.5	349.7
Other loans and advances to credit institutions	10.2	24.5	10.2	24.5
	347.1	**374.2**	**345.7**	**374.2**

At 31 December 2013 £nil (2012: £7.7m) of cash has been pledged by the Group and Society against derivative contracts.

Group and Society	2013	2012
12 DEBT SECURITIES	**£m**	**£m**
Securities available-for-sale		
Gilts	30.9	27.0
Treasury bills	-	0.5
Certificate of deposit	26.2	32.8
Fixed rate notes	37.2	40.8
Floating rate notes	53.3	79.9
	147.6	**181.0**

Of this total £94.2 million (2012: £101.1 million) is attributable to fixed income debt securities.

All debt securities are unlisted.

Included within the certificates of deposit balance is £nil (2012: £nil) in respect of cash and cash equivalents.

Group and Society	2013	2012
Movements on debt securities during the year may be analysed as follows:	**£m**	**£m**
At 1 January	181.0	305.0
Acquired on transfer of engagements	24.9	-
Additions	94.4	212.8
Disposals and maturities	(152.5)	(335.2)
Net gains from changes in fair value recognised in other comprehensive income	(0.2)	(1.6)
AT 31 DECEMBER	**147.6**	**181.0**

Notes to the accounts

Group and Society			
13 DERIVATIVE FINANCIAL INSTRUMENTS AT 31 DECEMBER 2013	**Contract/notional amount £m**	**Fair values – Assets £m**	**Fair values – Liabilities £m**
a) Unmatched derivatives – Interest rate swaps	26.2	0.2	(0.2)
b) Derivatives designated as fair value hedges – Interest rate swaps	1,565.7	19.9	(8.7)
TOTAL RECOGNISED DERIVATIVE ASSETS/(LIABILITIES)	**1,591.9**	**20.1**	**(8.9)**
AT 31 DECEMBER 2012			
a) Unmatched derivatives – Interest rate swaps	24.7	-	(0.6)
b) Derivatives designated as fair value hedges – Interest rate swaps	1,350.1	23.3	(21.2)
TOTAL RECOGNISED DERIVATIVE ASSETS/(LIABILITIES)	**1,374.8**	**23.3**	**(21.8)**

Group and Society		2013	2012
14 LOANS AND ADVANCES TO CUSTOMERS	**Note**	**£m**	**£m**
Loans fully secured on residential property		2,397.6	2,043.3
Other loans – loans fully secured on land		79.5	71.6
		2,477.1	2,114.9
Provision for impairment losses on loans and advances	15	(3.9)	(3.9)
		2,473.2	2,111.0
Fair value adjustment for hedged risk		(1.8)	18.9
		2,471.4	**2,129.9**

The Group has encumbered £532m (2012: £nil) of mortgage assets through the Funding for Lending Scheme.

Notes to the accounts

	Group and Society		
15 PROVISION FOR IMPAIRMENT LOSSES ON LOANS AND ADVANCES Movement in provision for impairment losses on loans and advances may be analysed as follows:	**Loans fully secured on residential property £m**	**Other loans fully secured on land £m**	**Total £m**
Individual provision			
At 1 January 2013	1.1	1.6	2.7
Provision for loan impairment	0.2	0.3	0.5
Provision utilised	(0.5)	(0.4)	(0.9)
AT 31 DECEMBER 2013	**0.8**	**1.5**	**2.3**
Collective provision			
At 1 January 2013	0.5	0.7	1.2
Provision for loan impairment	0.1	0.3	0.4
AT 31 DECEMBER 2013	**0.6**	**1.0**	**1.6**
Individual provision			
At 1 January 2012	1.2	1.1	2.3
Provision for loan impairment	0.4	0.7	1.1
Provision utilised	(0.5)	(0.2)	(0.7)
AT 31 DECEMBER 2012	**1.1**	**1.6**	**2.7**
Collective provision			
At 1 January 2012	0.4	0.5	0.9
Provision for loan impairment	0.1	0.2	0.3
AT 31 DECEMBER 2012	**0.5**	**0.7**	**1.2**
The charge to the statement of comprehensive income comprises:			
Provision for loan impairment			
Recoveries of debts previously written off			
CHARGE TO THE STATEMENT OF COMPREHENSIVE INCOME IN 2013	**0.3**	**0.6**	**0.9**
CHARGE TO THE STATEMENT OF COMPREHENSIVE INCOME IN 2012	**0.5**	**0.9**	**1.4**

16 INVESTMENTS IN SUBSIDIARY UNDERTAKINGS

Investments in subsidiary undertakings represent the cost of ordinary shares £112 (2012: £112) and loans to subsidiary undertakings.

Group and Society	2013	2012
	£m	**£m**
a) Investments in subsidiary undertakings		
Shares held at cost	-	-
Loans to subsidiary undertakings *	9.1	1.6
	9.1	**1.6**

* The prior year comparative for Loans to subsidiary undertakings has been reclassified from Other debtors. There has been no change to total assets.

The Group has the following subsidiary undertakings which operated in the United Kingdom during the year and are included in the Group accounts:

Name of subsidiary undertaking	Principal business activity	Ownership interest
Harrison Murray Ltd	Estate Agency and related services	100%
HM Lettings Ltd	Lettings	100%
Nottingham Mortgage Services	Mortgage Broking	100%
Nottingham Property Services	Estate Agency and related services	100%
The Mortgage Advice Centre (East Midlands) Ltd	Mortgage Broking	100%

The Society also holds 100% of the ordinary share capital of a number of dormant subsidiaries which are all incorporated in England.

Notes to the accounts

16 INVESTMENTS IN SUBSIDIARY UNDERTAKINGS (CONTINUED)

Group and Society	2013	2012
b) Movement in investments in subsidiary undertakings	**£m**	**£m**
At 1 January	1.6	1.5
Additions	6.2	-
Loan Movement	1.3	0.1
AT 31 DECEMBER 2013	**9.1**	**1.6**

The 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.

c) Acquisition of subsidiary undertakings

On 31 January 2013, the Society provided, by way of an intercompany loan, funding for its subsidiary company Nottingham Property Services Ltd to acquire two companies, Harrison Murray Ltd and Harrison Murray Commercial Ltd (HMC) for cash consideration of £6.2 million. On the 18 February 2013 the trade and assets of a third company AMS were purchased for a nominal amount. In addition the trade and assets relating to the lettings business within HMC were hived across to an existing group subsidiary – HM Lettings Ltd. HMC (the surveying business) was then sold to a third party for a nominal amount.

Name of subsidiary undertaking	Principal business activity	Date of acquisition	Percentage of ownership interest	Cost £m	Goodwill arising £m
Harrison Murray Ltd	Estate Agents	31 January 2013	100%	5.7	4.0
Harrison Murray Commercial Ltd	Lettings & Surveying	31 January 2013	100%	0.5	0.5
				6.2	**4.5**

The acquisitions individually are not considered to be material to the Group and therefore the analysis below has not been set out for each individual subsidiary, instead the aggregate position is provided.

	Book values of assets acquired	Fair value adjustments	Total
	£m	**£m**	**£m**
Cash consideration			6.2
Property, plant and equipment	1.1	(0.5)	0.6
Intangible assets	-	0.7	0.7
Debtors	0.6	-	0.6
Cash	0.5	-	0.5
Liabilities	(0.7)	-	(0.7)
NET ASSETS	**1.5**	**0.2**	**1.7**
Goodwill			**4.5**

Intangible assets comprise brand £0.4m, stock £0.15m and debtors £0.15m.

Notes to the accounts

16 INVESTMENTS IN SUBSIDIARY UNDERTAKINGS (CONTINUED)

The acquisitions detailed above relate to companies within the estate agency and related sectors and the consideration paid for these businesses often exceeds the fair value of the net assets acquired. The premium arises as a result of the expected future economic benefit arising from the staff within those businesses.

The acquisition of Harrison Murray will complement the Group's core competencies, providing significant opportunities to extend the provision of building society services into a number of new locations as well as improve the overall performance as an estate agent.

The results of all subsidiaries have been consolidated using the acquisition method of accounting, and the net assets of subsidiaries acquired have been incorporated into the Group accounts at fair value. Goodwill acquired in a business combination is allocated at acquisition to the cash generating unit (operating segment) that is expected to benefit from that business combination.

Group	2013	2012
OPERATING SEGMENT	**£m**	**£m**
Estate Agency	4.5	-
Cost of goodwill	4.5	-

The Group assess goodwill for impairment by comparing the recoverable amount to the current carrying value. The recoverable amounts of the operating segments are determined from value in use calculations. The key assumptions for the value in use calculations are those regarding cash flows, discount rates and growth rates.

The Group prepares cash flow forecasts on the assumption that the subsidiary undertakings within the operating segment are held for long term investment. The cash flows are derived from the most recent financial budgets for the next three years and extrapolates cash flows for subsequent years (up to an additional 12 years) based on long term growth rates of 2%-4%. The cash flows are discounted at a rate of 12.5%. The table below details the amounts of revenue and profit or loss included within the consolidated statement of comprehensive income that relates to the acquired entities.

	Revenue	Profit/(loss)
OPERATING SEGMENT	**£m**	**£m**
Estate Agency	5.3	0.1
Mortgage broking	0.3	(0.1)
	5.6	**-**

The financial performance of the acquired entities for the full 12 months ending 31 December 2013 had the acquisition occurred on 1 January is as follows:

	Revenue	Profit/(loss)
OPERATING SEGMENT	**£m**	**£m**
Estate Agency	5.7	0.1
Mortgage broking	0.4	(0.1)
	6.1	**-**

	Group 2013	Group 2012	Society 2013	Society 2012
17 OTHER ASSETS	**£m**	**£m**	**£m**	**£m**
Prepayments	2.0	1.8	1.8	1.6
Other Debtors *	0.6	-	-	-
	2.6	**1.8**	**1.8**	**1.6**

* The prior year comparative for Other Debtors being amounts owed by subsidiary undertakings (£1.6m) has been reclassified to subsidiary undertakings. There has been no change to total assets.

Notes to the accounts

18 PROPERTY, PLANT AND EQUIPMENT	Group			Society		
	Land and buildings	Equipment, fixtures, fittings and vehicles	Total	Land and buildings	Equipment, fixtures, fittings and vehicles	Total
2013	£m	£m	£m	£m	£m	£m
Cost						
At 1 January 2013	14.3	14.4	28.7	12.3	14.2	26.5
Acquired on transfer of engagements	0.6	-	0.6	0.6	-	0.6
Acquisitions	0.6	0.7	1.3	-	-	-
Additions	0.5	1.5	2.0	0.4	1.5	1.9
Disposals	(0.1)	(0.1)	(0.2)	(0.1)	-	(0.1)
AT 31 DECEMBER 2013	**15.9**	**16.5**	**32.4**	**13.2**	**15.7**	**28.9**
Depreciation						
At 1 January 2013	7.0	9.8	16.8	6.0	9.6	15.6
Acquired on transfer of engagements	0.2	-	0.2	0.2	-	0.2
Acquisitions	0.2	0.5	0.7	-	-	-
Charge for the year	0.4	1.2	1.6	0.3	1.2	1.5
On disposals	-	(0.1)	(0.1)	-	-	-
AT 31 DECEMBER 2013	**7.8**	**11.4**	**19.2**	**6.5**	**10.8**	**17.3**
Net Book Value						
AT 31 DECEMBER 2013	**8.1**	**5.1**	**13.2**	**6.7**	**4.9**	**11.6**
2012						
Cost						
At 1 January 2012	13.8	12.8	26.6	11.9	12.5	24.4
Additions	0.5	1.6	2.1	0.5	1.6	2.1
AT 31 DECEMBER 2012	**14.3**	**14.4**	**28.7**	**12.4**	**14.1**	**26.5**
Depreciation						
At 1 January 2012	6.7	8.8	15.5	5.8	8.5	14.3
Charge for the year	0.4	0.9	1.3	0.4	0.9	1.3
AT 31 DECEMBER 2012	**7.1**	**9.7**	**16.8**	**6.2**	**9.4**	**15.6**
Net Book Value						
AT 31 DECEMBER 2012	**7.2**	**4.7**	**11.9**	**6.2**	**4.7**	**10.9**

	Group 2013	Group 2012	Society 2013	Society 2012
	£m	£m	£m	£m
The net book value of land and buildings comprises:				
Freehold	7.4	6.5	6.0	5.5
Short Leasehold	0.7	0.7	0.7	0.7
	8.1	**7.2**	**6.7**	**6.2**
The net book value of land and buildings occupied for own use:				
Building Society	6.4	5.8	6.4	5.8
Subsidiaries	1.4	1.0	-	-
Non - Group	0.3	0.4	0.3	0.4
	8.1	**7.2**	**6.7**	**6.2**

Notes to the accounts

19 INTANGIBLE ASSETS	Group				
	Goodwill £m	Purchased Software £m	Developed Software £m	Other Intangibles £m	Total £m
2013					
Cost					
At 1 January 2013	-	6.8	11.4	-	18.2
Acquired on business combinations	4.5	-	-	0.7	5.2
Additions	-	0.5	0.5	-	1.0
Written off in the year	-	-	(0.6)	-	(0.6)
AT 31 DECEMBER 2013	**4.5**	**7.3**	**11.3**	**0.7**	**23.8**
Amortisation					
At 1 January 2013	-	5.7	5.2	-	10.9
Charge for the year	-	0.5	1.4	0.3	2.2
Written off in the year	-	-	(0.3)	-	(0.3)
AT 31 DECEMBER 2013	**-**	**6.2**	**6.3**	**0.3**	**12.8**
Net Book Value					
AT 31 DECEMBER 2013	**4.5**	**1.1**	**5.0**	**0.4**	**11.0**
2012					
Cost					
At 1 January 2012	-	6.5	9.3	-	15.8
Additions	-	0.3	2.1	-	2.4
AT 31 DECEMBER 2012	**-**	**6.8**	**11.4**	**-**	**18.2**
Amortisation					
At 1 January 2012	-	5.3	4.0	-	9.3
Charge for the year	-	0.4	1.2	-	1.6
AT 31 DECEMBER 2012	**-**	**5.7**	**5.2**	**-**	**10.9**
Net Book Value					
AT 31 DECEMBER 2012	**-**	**1.1**	**6.2**	**-**	**7.3**

Notes to the accounts

	Society			
19 INTANGIBLE ASSETS (CONTINUED)	**Goodwill £m**	**Purchased Software £m**	**Developed Software £m**	**Total £m**
2013				
Cost				
At 1 January 2013	-	6.7	11.4	18.1
Additions	-	0.5	0.5	1.0
Written off in the year	-	-	(0.6)	(0.6)
AT 31 DECEMBER 2013	**-**	**7.2**	**11.3**	**18.5**
Amortisation				
At 1 January 2013	-	5.6	5.2	10.8
Charge for the year	-	0.5	1.4	1.9
On disposals		-	(0.3)	(0.3)
AT 31 DECEMBER 2013	**-**	**6.1**	**6.3**	**12.4**
Net Book Value				
AT 31 DECEMBER 2013	**-**	**1.1**	**5.0**	**6.1**
2012				
Cost				
At 1 January 2012	-	6.4	9.3	15.7
Additions	-	0.3	2.1	2.4
AT 31 DECEMBER 2012	**-**	**6.7**	**11.4**	**18.1**
Amortisation				
At 1 January 2012	-	5.2	4.0	9.2
Charge for the year	-	0.4	1.2	1.6
AT 31 DECEMBER 2012	**-**	**5.6**	**5.2**	**10.8**
Net Book Value				
AT 31 DECEMBER 2012	**-**	**1.1**	**6.2**	**7.3**

Notes to the accounts

	Group 2013	Group 2012	Society 2013	Society 2012
20 DEFERRED TAX	**£m**	**£m**	**£m**	**£m**
Movement on deferred tax				
At 1 January	0.3	0.2	0.3	0.2
Acquired on transfer of engagements	0.6	-	0.7	-
Statement of comprehensive income credit	0.3	0.1	0.3	0.1
Recognised directly in other comprehensive income	(0.1)	-	(0.1)	-
AT 31 DECEMBER	**1.1**	**0.3**	**1.2**	**0.3**
The deferred tax charge in the statement of comprehensive income comprises the following temporary differences:				
Property, plant and equipment	0.3	0.1	0.3	0.1
IFRS transitional adjustment	0.2	0.2	0.2	0.2
Pensions and other post tax retirement benefits	(0.1)	0.1	(0.1)	0.1
Adjustment for prior years	(0.2)	(0.3)	(0.2)	(0.3)
Intangible assets	(0.1)	-	-	-
Effect of change in tax rate	0.1	(0.1)	0.1	(0.1)
Other provisions	0.1	0.1	-	0.1
	0.3	**0.1**	**0.3**	**0.1**
Deferred income tax assets and liabilities are attributable to the following items:				
Deferred tax assets				
Pensions and other post retirement benefits	1.0	1.2	1.0	1.2
Other provisions	0.2	0.2	0.2	0.2
Transfer of engagements – fair value adjustments	0.7	-	0.7	-
	1.9	**1.4**	**1.9**	**1.4**
Deferred tax liabilities				
IFRS transitional adjustments	0.3	0.6	0.3	0.6
Property, plant and equipment	0.4	0.5	0.4	0.5
Acquired upon acquisition	0.1	-	-	-
	0.8	**1.1**	**0.7**	**1.1**

A reduction in the UK corporation tax rate from 24% to 23% (effective 1 April 2013) was substantively enacted on 3 July 2012. Further reductions to 21% (effective 1 April 2014) and 20% (effective 1 April 2015) were substantively enacted on 2 July 2013. This will reduce the Group's future tax charge accordingly. The deferred tax asset at 31 December 2013 has been calculated based on the rates 21% and 20% substantively enacted at the balance sheet date.

Group and Society	2013	2012
21 SHARES	**£m**	**£m**
Held by individuals	2,319.6	2,266.2
Fair value adjustment for hedged risk	(0.2)	1.8
	2,319.4	**2,268.0**

Group and Society	2013	2012
22 AMOUNTS OWED TO CREDIT INSTITUTIONS	**£m**	**£m**
Amounts owed to credit institutions	253.7	55.7
	253.7	**55.7**

At 31 December 2013 £9.8m (2012: £nil) of cash has been received by the Group and Society against derivative contracts.

Notes to the accounts

Group and Society	2013	2012
23 AMOUNTS OWED TO OTHER CUSTOMERS	£m	£m
Retail customers: Demand accounts	5.8	5.5
Local Authorities: Term deposits	112.6	68.0
Pension Funds/Insurers: Term deposits	2.8	13.4
Other		
Demand accounts	11.7	12.0
Term deposits	83.2	77.1
	216.1	176.0
Fair value adjustment for hedged risk	-	0.1
	216.1	**176.1**

Group and Society	2013	2012
24 DEBT SECURITIES IN ISSUE	£m	£m
Certificates of deposit	13.5	19.7
	13.5	**19.7**

	Group 2013	Group 2012	Society 2013	Society 2012
25 OTHER LIABILITIES AND ACCRUALS	£m	£m	£m	£m
Income tax	0.9	0.1	0.9	0.1
Accruals and deferred income	2.8	1.8	2.2	1.7
Other creditors	1.4	1.5	1.3	1.4
	5.1	**3.4**	**4.4**	**3.2**

	Group 2013	Group 2012	Society 2013	Society 2012
26 PROVISION FOR LIABILITIES	£m	£m	£m	£m
FSCS levy				
At 1 January	3.4	2.1	3.4	2.1
Acquired on transfer of engagements	0.1	-	0.1	-
Charge for the year	1.8	2.0	1.8	2.0
Provision utilised	(1.7)	(0.7)	(1.7)	(0.7)
AT 31 DECEMBER	**3.6**	**3.4**	**3.6**	**3.4**
Customer redress and other related provisions				
At 1 January	0.4	0.2	0.3	0.2
Acquired on transfer of engagements	0.1	-	0.1	-
Charge for the year	0.3	0.4	0.3	0.3
Provision utilised	(0.3)	(0.2)	(0.2)	(0.2)
AT 31 DECEMBER	**0.5**	**0.4**	**0.5**	**0.3**
TOTAL	**4.1**	**3.8**	**4.1**	**3.7**

Notes to the accounts

26 PROVISION FOR LIABILITIES – FSCS LEVY (CONTINUED)

In common with all regulated UK deposit takers, the Society pays levies to the FSCS to enable the FSCS to meet claims against it. The FSCS levy consists of two parts: a management expenses levy and a compensation levy. The management expenses levy covers the costs of running the scheme and the compensation levy covers the amount of compensation the scheme pays, net of any recoveries it makes using the rights that have been assigned to it.

The FSCS meets these current claims by way of loans received from HM Treasury. The terms of these loans were interest only for the first three years, and the FSCS seeks to recover the interest cost, together with ongoing management expenses, by way of annual management levies on members over this period. Interest on the loan from HM Treasury will be charged at LIBOR + 100bps subject to a floor, which is the relevant Gilt reference rate.

The FSCS provision reflects market participation up to the reporting date. The above provision includes the estimated management expense levy for the scheme years 2013/14 and 2014/15. This amount was calculated on the basis of the Society's current share of protected deposits taking into account the regulator's estimate of total management expense levies for each scheme year.

In addition to the management levies, from scheme year 2013/14, triggered by participation in the market at 31 December 2012, the FSCS is to levy over three years the current estimated shortfall on capital loans outstanding. In common with the management expenses levy, the capital loan repayment was calculated on the basis of the Society's current share of UK protected deposits.

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) 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 2011 and takes into account the closure of the scheme for future service accrual. This review showed that the market value of the scheme assets at 1 April 2011 was £35.4 million and that the actuarial value of those assets represented 90% of the benefits that had accrued to members after allowing for expected future increase in salaries.

An updated actuarial valuation at 31 December 2013 was carried out on a market value basis by a qualified independent actuary, as follows:

Group and Society	2013	2012
	%	%
Principal actuarial assumptions used were as follows:		
Discount rate	4.40	4.40
Expected return on plan assets	5.40	5.40
Rate of increase in salaries	3.75	3.25
Rate of increase in pensions	3.60	3.30
Inflation	3.25	3.00
The table below shows the assumptions used for expected life at 31 December (normal retirement age of 62).	**Years**	**Years**
Expected life at retirement for a new pensioner (yrs) - Male	26.8	27.0
Expected life at retirement for a new pensioner (yrs) - Female	28.4	28.7
Expected life at retirement in 20 years' time (yrs) – Male	29.6	29.9
Expected life at retirement in 20 years' time (yrs) - Female	30.5	30.8

Notes to the accounts

Group and Society	2013	2012
27 RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)	**£m**	**£m**
Fair value of scheme assets:		
As at 1 January	39.7	38.0
Expected return on pension scheme assets	1.8	2.1
Contributions by employer	0.7	0.6
Benefits paid	(1.2)	(2.3)
Decrease in secured pensioners value due to scheme experience	(0.2)	-
Gain on asset returns	1.2	1.3
AS AT 31 DECEMBER	**42.0**	**39.7**
Present value of defined benefit obligations:		
As at 1 January	(44.8)	(42.8)
Interest on pension scheme liabilities	(2.0)	(2.0)
Benefits paid	1.2	2.3
Decrease in secured pensioners value due to scheme experience	0.1	-
Experience (loss)/gain on liabilities	(0.1)	0.1
Loss on changes in assumptions	(1.0)	(2.4)
AS AT 31 DECEMBER	**(46.6)**	**(44.8)**
The amounts recognised in the statement of financial position are determined as follows:		
Present value of funded obligations	(46.6)	(44.8)
Fair value of plan assets	42.0	39.7
LIABILITY IN THE STATEMENT OF FINANCIAL POSITION	**(4.6)**	**(5.1)**
The actual return on plan assets was a gain of £3.0m (2012: £3.8m gain). The amounts recognised in the statement of comprehensive income are as follows:		Restated*
Amounts recognised in finance income		
Interest cost	(2.0)	(2.1)
Expected return on plan assets	1.8	1.8
TOTAL	**(0.2)**	**(0.3)**
Movement in the liability recognised in the statement of financial position:		Restated*
Opening defined benefit obligation	(5.1)	(4.8)
Total as above	(0.2)	(0.3)
Employer contributions	0.6	0.6
Remeasurement gains/(losses)	0.1	(0.6)
CLOSING DEFINED BENEFIT OBLIGATION	**(4.6)**	**(5.1)**
The amounts recognised in the statement of other comprehensive income are as follows:		Restated*
Actual return less expected return on plan assets	1.2	1.7
Experience (loss) arising on scheme liabilities	(0.1)	0.1
Changes in assumptions underlying the present value of the scheme liabilities	(1.0)	(2.4)
REMEASUREMENT OF DEFINED BENEFIT OBLIGATION	**0.1**	**(0.6)**

The cumulative amount recognised outside profit and loss at 31 December 2013 is an actuarial loss of £9.6m (2012: £9.7m).

* Restated according to amended IAS19.

Notes to the accounts

Group and Society	2013	2012
27 RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)	£m	£m
The major categories of plan assets are as follows:		
Equities	20.2	16.4
Bonds	19.7	20.6
Cash	0.7	0.6
Secured pensioners	1.4	1.5
Property	-	0.6
TOTAL	**42.0**	**39.7**

The average duration of the defined benefit obligation at 31 December 2013 is 18 years (2012: 18 years). This number can be analysed as follows:

Group and Society	2013	2012
	Years	Years
Active members	24	24
Deferred members	23	24
Retired members	14	14

During 2013 the Group made additional contributions of £0.6m (2012: £0.6m) as part of its funding plan. The Group and Society expect to contribute £0.7m to the fund during 2014.

History of experience gains and losses for the current and previous four years are as follows:

Group and Society	2013	2012	2011	2010	2009
	£m	£m	£m	£m	£m
Present value of defined benefit obligation	(46.6)	(44.8)	(42.8)	(39.6)	(38.2)
Fair value of plan assets	42.0	39.7	38.0	36.3	32.2
Plan (deficit)	(4.6)	(5.1)	(4.8)	(3.3)	(6.0)
Experience adjustments on plan liabilities	0.1	(0.1)	0.3	(0.9)	(0.1)
Percentage of scheme liabilities	0.2%	0.2%	0.7%	2.3%	0.3%

Following the Government announcement in July 2010 to link pension payments to the Consumer Price Index (CPI) rather than the Retail Prices Index (RPI) the Group has reviewed its position. At 31 December the Group continues to use RPI in assessing pension payments.

b) 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 £0.5m (2012: £0.5m) and for the Society £0.5m (2012: £0.5m. There were no outstanding or prepaid contributions at either the beginning or end of the year.

Group and Society	2013	2012
28 SUBSCRIBED CAPITAL	£m	£m
7.875% sterling permanent interest bearing shares	23.9	23.9
Fair value adjustment for hedged risk	2.3	3.5
	26.2	**27.4**

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 and as such they have been classified as a debt instrument rather than equity.

Notes to the accounts

	Group 2013	Group 2012	Society 2013	Society 2012
29 GENERAL RESERVES	**£m**	**£m**	**£m**	**£m**
At 1 January	149.6	143.6	150.3	144.1
Acquired on transfer of engagements	2.6	-	2.6	-
Profit for the financial year	10.2	6.4	10.7	6.6
Net gain/(loss) recognised directly in other comprehensive income	0.1	(0.4)	0.1	(0.4)
AT 31 DECEMBER	**162.5**	**149.6**	**163.7**	**150.3**

	Group and Society	2013	2012
30 AVAILABLE-FOR-SALE RESERVES		**£m**	**£m**
At 1 January		(0.1)	1.1
Net (loss) from changes in fair value		(0.1)	(1.2)
AT 31 DECEMBER		**(0.2)**	**(0.1)**

		Group 2013	Group 2012	Society 2013	Society 2012
31 CASH AND CASH EQUIVALENTS	**Note**	**£m**	**£m**	**£m**	**£m**
Cash in hand	10	1.0	1.1	1.0	1.1
Loans and advances to credit institutions	11	336.9	349.7	335.5	349.7
Debt securities	12	-	-	-	-
AT 31 DECEMBER		**337.9**	**350.8**	**336.5**	**350.8**

32 FINANCIAL INSTRUMENTS

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. Five sub committees, the assets and liabilities committee (ALCO), retail credit committee (RCC), operational risk committee (ORC), Information Security (ISC) and the conduct risk committee (CRC) 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 fair value hedging techniques to reduce its exposure to interest rate risk as follows:

Activity	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 2013 are shown in note 13.

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

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 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

Notes to the accounts

32 FINANCIAL INSTRUMENTS (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:

	Group					
Carrying values by category 31 December 2013	**Held at amortised cost**		**Held at fair value**			
	Loans and receivables	Financial assets and liabilities at amortised cost	Available-for-sale	Derivatives designated as fair value hedges	Unmatched derivatives	Total
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Financial assets						
Cash in hand	-	1.0	-	-	-	1.0
Loans and advances to credit institutions	347.1	-	-	-	-	347.1
Debt securities	-	-	147.6	-	-	147.6
Derivative financial instruments	-	-	-	19.9	0.2	20.1
Loans and advances to customers	2,471.4	-	-	-	-	2,471.4
Other assets	-	28.7	-	-	-	28.7
	2,818.5	**29.7**	**147.6**	**19.9**	**0.2**	**3,015.9**
Financial liabilities						
Shares	-	2,319.4	-	-	-	2,319.4
Amounts owed to credit institutions	-	253.7	-	-	-	253.7
Amounts owed to other customers	-	216.1	-	-	-	216.1
Debt securities in issue	-	13.5	-	-	-	13.5
Derivative financial instruments	-	-	-	8.7	0.2	8.9
Other liabilities	-	15.8	-	-	-	15.8
Subscribed capital	-	26.2	-	-	-	26.2
	-	**2,844.7**	**-**	**8.7**	**0.2**	**2,853.6**
Carrying values by category 31 December 2012						
Financial assets						
Cash in hand	-	1.1	-	-	-	1.1
Loans and advances to credit institutions	374.2	-	-	-	-	374.2
Debt securities	-	-	181.0	-	-	181.0
Derivative financial instruments	-	-	-	23.3	-	23.3
Loans and advances to customers	2,129.9	-	-	-	-	2,129.9
Other assets	-	22.4	-	-	-	22.4
	2,504.1	**23.5**	**181.0**	**23.3**	**-**	**2,731.9**
Financial liabilities						
Shares	-	2,268.0	-	-	-	2,268.0
Amounts owed to credit institutions	-	55.7	-	-	-	55.7
Amounts owed to other customers	-	176.1	-	-	-	176.1
Debt securities in issue	-	19.7	-	-	-	19.7
Derivative financial instruments	-	-	-	21.2	0.6	21.8
Other liabilities	-	13.7	-	-	-	13.7
Subscribed capital	-	27.4	-	-	-	27.4
	-	**2,560.6**	**-**	**21.2**	**0.6**	**2,582.4**

There have been no reclassifications during either year.

Notes to the accounts

32 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	2013 Book value £m	2013 Fair value £m	2012 Book value £m	2012 Fair value £m
Financial assets					
Cash in hand	a	1.0	1.0	1.1	1.1
Loans and advances to credit institutions	b	347.1	347.1	374.2	374.3
Loans and advances to customers	c	2,471.4	2,560.6	2,129.9	2,211.3
Financial liabilities					
Shares	d	2,319.4	2,336.5	2,268.0	2,300.5
Amounts owed to credit institutions	d	253.7	253.7	55.7	55.8
Amounts owed to other customers	d	216.1	218.0	176.1	178.4
Debt securities in issue	e	13.5	13.6	19.7	19.8
Subscribed capital	f	23.9	29.8	23.9	26.3

The difference between book value and fair value in the table above represents the surplus/deficit of fair value compared to the book amount of those financial instruments for which fair values have been estimated. The book value above of any financial assets and liabilities that are designated as hedged items in a portfolio fair value hedge relationship includes gains or losses attributable to the hedged risk.

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

a) **Cash in hand**
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**
The fair value of overnight deposits is the amount repayable on demand. The estimated fair value of loans and advances to credit institutions is calculated based on discounted expected future cash flows.

c) **Loans and advances to customers**
Loans and advances are recorded net of provisions for impairment together with the fair value adjustment for hedged items as required by IAS39. 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 money market rates for items of similar remaining maturity.

d) **Shares, deposits and borrowings**
The estimated fair value of shares and deposits and other borrowings with no stated maturity is the amount repayable on demand.
The estimated fair value of fixed interest bearing deposits and other borrowings without a quoted market price is based on discounted expected future cash flows. Expected cash flows are discounted at prevailing money market rates for items of similar remaining maturity.

e) **Debt securities in issue**
The estimated fair value is based on discounted expected future cash flows. Expected cash flows are discounted at prevailing money market rates for items of similar remaining maturity.

f) **Subscribed capital**
The estimated fair value of fixed interest bearing debt is based on its active market price as at 31 December.

Notes to the accounts

32 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		Level 1	Level 2	Level 3	Total
	Notes	£m	£m	£m	£m
31 December 2013					
Financial assets					
Available-for-sale					
Debt securities	12	121.4	26.2	-	147.6
Derivative financial instruments					
Interest rate swaps	13	-	20.1	-	20.1
		121.4	**46.3**	**-**	**167.7**
Financial liabilities					
Derivative financial instruments					
Interest rate swaps	13	-	(8.9)	-	(8.9)
		-	**(8.9)**	**-**	**(8.9)**
31 December 2012					
Financial assets					
Available-for-sale					
Debt securities	12	148.3	32.7	-	181.0
Derivative financial instruments					
Interest rate swaps	13	-	23.3	-	23.3
		148.3	**56.0**	**-**	**204.3**
Financial liabilities					
Derivative financial instruments					
Interest rate swaps	13	-	(21.8)	-	(21.8)
		-	**(21.8)**	**-**	**(21.8)**

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 – 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 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 interest cash flows and maturities of the instruments. The majority of swaps are collateralised and therefore no adjustment is required for credit risk in the fair value of derivatives.

Notes to the accounts

32 FINANCIAL INSTRUMENTS (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	2013	2012
Credit risk exposure	**£m**	**£m**
Cash in hand	1.0	1.1
Loans and advances to credit institutions	347.1	374.2
Debt securities	147.9	180.9
Derivative financial instruments	20.1	23.3
Loans and advances to customers	2,473.2	2,111.0
Total statement of financial position exposure	2,989.3	2,690.5
Off balance sheet exposure – mortgage commitments	98.7	64.4
TOTAL	**3,088.0**	**2,754.9**

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	2013	2013	2012	2012
Industry sector	**£m**	**%**	**£m**	**%**
Banks	118.5	23.9	152.3	27.4
Building Societies	15.0	3.0	31.2	5.6
Multilateral Development Banks	20.7	4.2	31.9	5.7
Central Government	341.5	68.9	340.9	61.3
TOTAL	**495.7**		**556.3**	

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

Group	2013	AAA	AA	A	Other	2012
Geographic region	**£m**	**%**	**%**	**%**	**%**	**£m**
United Kingdom	421.5	-	87.0	9.4	3.6	466.4
Multilateral Development banks	20.7	100	-	-	-	31.9
France	-	-	-	-	-	2.9
Canada	5.0	-	100	-	-	-
United States of America	-	-	-	-	-	5.2
Australia	38.4	-	64.5	35.5	-	44.8
Japan	10.1	-	-	100	-	5.1
TOTAL	**495.7**					**556.3**

'Other' relates to investments in unrated Building Societies.

The Group has no exposure to foreign exchange risk. All instruments are denominated in Sterling.

Given the continuing issues within the Eurozone and concerns with possible sovereign debt defaults, the Group has limited its risk exposure by ensuring it has no direct exposure to any sovereign states, other than the UK.

The Group's derivative financial instruments are analysed in the table below:

Group	2013	AAA	AA	A	2012
Geographic region	**£m**	**%**	**%**	**%**	**£m**
United Kingdom	1,589.9	-	-	100	1,372.8
Other Western Europe	2.0	-	-	100	2.0
TOTAL	**1,591.9**				**1,374.8**

a) 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 upon the overall risk appetite that the Group wishes to take, 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 creditworthiness 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 risk appetite.

It is the Group's policy to treat customers fairly 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 table on page 70.

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

Loans and advances to customers are predominately made up of retail loans fully secured against UK residential property (£2,397.6m), split between residential and buy-to-let loans with the remaining £79.5m being secured on commercial property.

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

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

Group and Society	2013	2012
Geographical analysis	**£m**	**£m**
Eastern	10.4	10.1
East Midlands	22.7	23.5
London	11.1	10.7
North East	3.1	2.9
North West	8.3	8.5
South East	14.7	13.9
South West	7.9	7.8
Wales	2.4	2.5
West Midlands	8.2	8.1
Yorkshire & Humberside	10.8	11.7
Other	0.4	0.3

Retail loans

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 average LTV of residential mortgages is 55% (2012: 55%). All residential loans above 80% LTV are insured with a Lloyds of London insurance firm.

Further LTV information on the Group's residential mortgage portfolio is shown below:

Group and Society	2013	2012
LTV analysis	**%**	**%**
Residential		
0% - 30%	7	8
30% - 60%	16	17
60% - 80%	51	33
80% - 90%	22	31
90% - 100%	4	9
> 100%	-	2
Average loan to value of residential mortgage loans	55	55
Average loan to value of new business	76	78
Buy-to-let		
0% - 30%	1	-
30% - 60%	9	8
60% - 80%	79	72
80% - 90%	7	12
90% - 100%	4	7
> 100%	-	1
Average loan to value of buy-to-let loans	70	74
Average loan to value of new business	71	72

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

The quality of the Group's retail mortgage book is reflected in the number and value of accounts in arrears. By volume 0.48% (2012: 0.60%) of loans are three months or more in arrears and by value it is 0.30% (2012: 0.48%).

The main factor for loans moving into arrears tends to be the condition of the general economic environment.

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

Group and Society	2013	2013	2012	2012
Arrears analysis	**£m**	**%**	**£m**	**%**
Not impaired:				
Neither past due or impaired	2,370.8	98.88	2,011.2	98.43
Past due up to 3 months but not impaired	16.3	0.68	17.3	0.85
Past due over 3 months but not impaired	2.4	0.10	3.6	0.17
Possessions	0.2	0.01	0.3	0.02
Impaired:				
Not past due	1.0	0.04	1.2	0.06
Past due up to 3 months	2.4	0.10	3.6	0.17
Past due 3 to 6 months	2.1	0.09	3.4	0.17
Past due 6 to 12 months	0.9	0.04	1.6	0.08
Past due over 12 months	0.3	0.01	0.3	0.01
Possessions	1.2	0.05	0.8	0.04
	2,397.6		**2,043.3**	
	Indexed	Unindexed	Indexed	Unindexed
Value of Collateral held:	**£m**	**£m**	**£m**	**£m**
Neither past due or impaired	4,123.4	3,879.2	3,523.6	3,440.7
Past due but not impaired	37.4	33.4	44.1	40.1
Impaired	9.1	9.3	12.4	13.6
	4,169.9	**3,921.9**	**3,580.1**	**3,494.4**

The collateral 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 £19.0m (2012: £21.2m) against outstanding debt of £19.0m (2012: £21.2m). In addition, the value of collateral held against 'Impaired' assets at 31 December is £7.6m (2012: £10.5m) against outstanding debt of £7.8m (2012: £10.9m).

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 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 'interest only' concessions, payment plans, capitalisations, term extensions and reduced payment concessions.

Notes to the accounts

32 FINANCIAL INSTRUMENTS (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 allows 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	2013	2012
Type of forbearance	**Number**	**Number**
Interest only concessions	28	37
Reduced payment concessions	3	18
Payment plans	96	102
Capitalisations	70	41
Mortgage term extensions	80	55
Less: cases with more than one form of forbearance	(73)	(55)
TOTAL	**204**	**198**

These are covered by an individual impairment provision of £0.4m (2012: £0.4m).

In total £4.1m (2012: £3.6m) of loans that would be past due are subject to forbearance.

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

Secured Business Loans

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	2013	2013	2012	2012
	£m	%	£m	%
Owner occupied	41.0	51.6	41.0	57.3
Investment property	38.5	48.4	30.6	42.7
	79.5		71.6	

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

Group and Society	2013	2012
SBL	%	%
LTV analysis		
0% - 30%	3	3
30% - 60%	25	23
60% - 80%	47	47
80% - 90%	24	27
90% - 100%	-	-
> 100%	1	-
Average loan to value of SBL	63	63
Average loan to value of new business	53	53

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

Group and Society	2013	2013	2012	2012
Arrears analysis	£m	%	£m	%
Not impaired:				
Neither past due or impaired	73.4	92.34	66.0	92.17
Past due up to 3 months but not impaired	1.1	1.38	1.3	1.81
Past due over 3 months but not impaired	0.4	0.50	-	-
Impaired:				
Not past due	1.4	1.76	0.5	0.72
Past due up to 3 months	1.8	2.26	3.1	4.32
Past due 3 to 6 months	0.8	1.01	0.2	0.28
Past due 6 to 12 months	-	-	0.4	0.56
Past due over 12 months	-	-	-	-
Possessions	0.6	0.75	0.1	0.14
	79.5		71.6	
Fair value of collateral held:				
Neither past due or impaired	133.0		115.4	
Past due but not impaired	2.5		2.0	
Impaired	5.6		4.3	
	141.1		121.7	

Collateral reflects the latest valuation. If a property has had a desktop valuation since the latest full valuation, the collateral reflects the desktop valuation (48% of the SBL book has had a desktop valuation). 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 £1.5m (2012: £1.3m) against outstanding debt of £1.5m (2012: £1.3m). In addition, the value of collateral held against 'Impaired' assets at 31 December is £4.5m (2012: £3.8m) against outstanding debt of £4.9m (2012: 4.3m).

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

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% (2012: 2.0%) of the SBL mortgage book. SBL assets totalling £9.0m (2012: £4.3m) 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	2013	2012
Type of forbearance	**Number**	**Number**
Interest only concessions	3	3
Re-negotiation of contractual payment	6	4
Payment plans	6	2
Capitalisations	2	1
TOTAL	**17**	**10**

These loans are covered by the £1.1m (2012: £0.7m) collective provision.

£2.8m (2012:£2.2m) of loans that would be past due or impaired are subject to forbearance.

Liquidity risk

Liquidity risk is the risk that the Group 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 Group'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 Group'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 Group'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 (ILAA) process. They include scenarios that fulfil the specific requirements of the FSA (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 Group'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 an amount of T-Bills issued to the Society under the Funding for Lending Scheme (FLS). At the end of the year the ratio of liquid assets to shares and deposits was 17.7% compared to 22.1% at the end of 2012. When the FLS T'bills are taken into account, the ratio of liquid resources to shares and deposits was 21%.

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.

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

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 3.3 years. Conversely, retail deposits repayable on demand generally remain on balance sheet much longer.

	Group					
Residual maturity as at 31 December 2013	On demand	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	More than five years	Total
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Financial assets						
Liquid assets						
Cash in hand	1.0	-	-	-	-	1.0
Loans and advances to credit institutions	324.9	16.0	6.2	-	-	347.1
Debt securities	-	31.3	40.3	76.0	-	147.6
Total liquid assets	325.9	47.3	46.5	76.0	-	495.7
Derivative financial instruments	-	-	7.2	10.6	2.3	20.1
Loans and advances to customers	6.0	15.5	53.0	331.1	2,065.8	2,471.4
Other assets	-	9.5	1.7	-	17.5	28.7
	331.9	**72.3**	**108.4**	**417.7**	**2,085.6**	**3,015.9**
Financial liabilities and reserves						
Shares	835.1	571.0	441.5	471.8	-	2,319.4
Amounts owed to credit institutions	1.7	159.6	90.4	2.0	-	253.7
Amounts owed to other customers	28.6	68.3	91.2	28.0	-	216.1
Debt securities in issue	-	5.0	8.5	-	-	13.5
Derivative financial instruments	-	0.2	1.6	7.1	-	8.9
Other liabilities	0.8	3.2	4.2	3.0	4.6	15.8
Subscribed capital	-	0.1	-	-	26.1	26.2
Reserves	-	-	-	-	162.3	162.3
	866.2	**807.4**	**637.4**	**511.9**	**193.0**	**3,015.9**
NET LIQUIDITY GAP	**(534.3)**	**(735.1)**	**(529.0)**	**(94.2)**	**1,892.6**	**-**

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

	Group					
Residual maturity as at 31 December 2012	On demand	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	More than five years	Total
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Financial assets						
Liquid assets						
Cash in hand	1.1	-	-	-	-	1.1
Loans and advances to credit institutions	335.8	29.7	8.7	-	-	374.2
Debt securities	-	22.2	53.3	105.5	-	181.0
Total liquid assets	336.9	51.9	62.0	105.5	-	556.3
Derivative financial instruments	-	0.3	14.8	4.7	3.5	23.3
Loans and advances to customers	5.3	12.9	47.2	302.2	1,762.3	2,129.9
Other assets	-	0.8	1.9	0.5	19.2	22.4
	342.2	**65.9**	**125.9**	**412.9**	**1,785.0**	**2,731.9**
Financial liabilities and reserves						
Shares	741.3	417.6	641.0	468.1	-	2,268.0
Amounts owed to credit institutions	1.2	48.0	5.5	1.0	-	55.7
Amounts owed to other customers	18.4	83.0	46.1	28.6	-	176.1
Debt securities in issue	-	5.1	14.6	-	-	19.7
Derivative financial instruments	-	0.1	1.0	20.7	-	21.8
Other liabilities	0.6	1.9	3.2	2.9	5.1	13.7
Subscribed capital	-	-	0.1	-	27.3	27.4
Reserves	-	-	-	-	149.5	149.5
	761.5	**555.7**	**711.5**	**521.3**	**181.9**	**2,731.9**
NET LIQUIDITY GAP	**(419.3)**	**(489.8)**	**(585.6)**	**(108.4)**	**1,603.1**	**-**

There is no material difference between the maturity profile for the Group and that for the Society.

All Group liquid assets are unencumbered as at the balance sheet date.

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

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

	Group					
31 December 2013	Repayable on demand	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	More than five years	Total
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Shares	859.9	588.6	447.3	472.2	-	2,368.0
Amounts owed to credit institutions	0.1	30.8	10.6	2.1	-	43.6
Amounts owed to other customers	28.6	68.4	91.9	28.8	-	217.7
Debt securities in issue	-	5.0	8.6	-	-	13.6
Derivative financial instruments	-	0.4	3.9	24.6	-	28.9
Subscribed capital	-	0.5	1.5	7.9	23.9	33.8
TOTAL LIABILITIES	**888.6**	**693.7**	**563.8**	**535.6**	**23.9**	**2,705.6**
31 December 2012						
Shares	772.8	432.2	640.2	467.2	-	2,312.4
Amounts owed to credit institutions	1.2	48.0	5.6	1.0	-	55.8
Amounts owed to other customers	18.4	84.6	47.7	30.8	-	181.5
Debt securities in issue	-	5.1	14.8	-	-	19.9
Derivative financial instruments	-	0.2	1.5	35.8	-	37.5
Subscribed capital	-	0.5	1.5	7.9	23.9	33.8
TOTAL LIABILITIES	**792.4**	**570.6**	**711.3**	**542.7**	**23.9**	**2,640.9**

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.

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

Market risk

Market risk is the risk of changes to the Group'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 5% 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 2013	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	More than five years	Non interest bearing	Total
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Financial assets						
Cash in hand	-	-	-	-	1.0	1.0
Loans and advances to credit institutions	340.0	4.0	-	-	3.1	347.1
Debt securities	79.1	25.1	40.7	-	2.7	147.6
Derivative financial instruments	-	-	-	-	20.1	20.1
Loans and advances to customers	790.8	312.2	1,371.8	1.7	(5.1)	2,471.4
Other assets	-	-	-	-	28.7	28.7
	1,209.9	**341.3**	**1,412.5**	**1.7**	**50.5**	**3,015.9**
Financial liabilities and reserves						
Shares	1,437.2	431.4	430.5	-	20.3	2,319.4
Amounts owed to credit institutions	164.9	88.3	-	-	0.5	253.7
Amounts owed to other customers	96.4	90.7	27.9	-	1.1	216.1
Debt securities in issue	5.0	8.5	-	-	-	13.5
Derivative financial instruments	-	-	-	-	8.9	8.9
Other liabilities	-	-	-	-	15.8	15.8
Subscribed capital	-	-	-	23.9	2.3	26.2
Reserves	-	-	-	-	162.3	162.3
	1,703.5	**618.9**	**458.4**	**23.9**	**211.2**	**3,015.9**
Impact of derivative instruments	814.9	123.4	(948.3)	10.0	-	-
Interest rate sensitivity gap	**321.3**	**(154.2)**	**5.8**	**(12.2)**	**(160.7)**	**-**
Sensitivity to profit and reserves						
Parallel shift of +1%	-	0.4	(1.2)	0.5	-	(0.3)
Parallel shift of +2%	(0.1)	0.9	(2.3)	1.0	-	(0.5)

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

	Group					
Interest rate risk as at 31 December 2012	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	More than five years	Non interest bearing	Total
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Financial assets						
Cash in hand	-	-	-	-	1.1	1.1
Loans and advances to credit institutions	367.3	5.5	-	-	1.4	374.2
Debt securities	101.9	33.8	44.1	-	1.2	181.0
Derivative financial instruments	-	-	-	-	23.3	23.3
Loans and advances to customers	754.5	350.9	1,002.4	3.0	19.1	2,129.9
Other assets	-	-	-	-	22.4	22.4
	1,223.7	**390.2**	**1,046.5**	**3.0**	**68.5**	**2,731.9**
Financial liabilities and reserves						
Shares	1,188.9	617.0	435.1	-	27.0	2,268.0
Amounts owed to credit institutions	47.8	6.5	-	-	1.4	55.7
Amounts owed to other customers	100.0	44.7	28.0	-	3.4	176.1
Debt securities in issue	5.0	14.5	-	-	0.2	19.7
Derivative financial instruments	-	-	-	-	21.8	21.8
Other liabilities	-	-	-	-	13.7	13.7
Subscribed capital	-	-	-	23.9	3.5	27.4
Reserves	-	-	-	-	149.5	149.5
	1,341.7	**682.7**	**463.1**	**23.9**	**220.5**	**2,731.9**
Impact of derivative instruments	409.2	(1.0)	203.9	(617.1)	5.0	-
Interest rate sensitivity gap	**291.2**	**(293.5)**	**787.3**	**(638.0)**	**(147.0)**	**-**
Sensitivity to profit and reserves						
Parallel shift of +1%	0.2	0.4	-	0.4	-	1.0
Parallel shift of +2%	0.4	0.8	(0.1)	0.8	-	1.9

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.

Notes to the accounts

33 CAPITAL STRUCTURE

The Group'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 ICAAP process (Internal Capital Adequacy Assessment Process) assists the Group with its management of capital. Through its quarterly business plan update the board monitors the Group's capital position to assess whether adequate capital is held to mitigate the risks it faces in the course of its business activities. The Group's actual and expected capital position is reviewed against stated risk appetite which aims to maintain capital at a specific level above its Internal Capital Guidance (ICG).

The Board manages the Group's capital and risk exposures to maintain capital in line with regulatory requirements which includes monitoring of:

a) **Lending and Business Decisions -** TThe Group 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 portfolios and individual customers. In addition, for residential and buy-to-let mortgages property values are updated on a quarterly basis.

b) **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.

c) **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.

d) **Counterparty risk -** Wholesale lending is only carried out with approved counterparties in line with the Group's lending criteria and is subject to a range of limits. The limits are monitored daily to ensure the Group remains within risk appetite.

This is subjected to regular stress tests to ensure the Group maintains sufficient capital for future possible events.

The Group's capital requirements are set and monitored by the Prudential Regulatory Authority (PRA). During 2013 the Group has continued to comply with the EU Capital Requirements Directive (Basel II). From 1 January 2014 the Group will be required to comply with Basel III. Further details of the Basel III requirements and their impact on the Group are provided in the Risk Management report on page 24.

Regulatory capital is analysed into two tiers:

a) **Tier 1 capital –** which includes retained earnings and subscribed capital

b) **Tier 2 capital –** which includes revaluation reserves and collective provisions

The level of capital is matched against risk-weighted assets which are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets.

There were no reported breaches of capital requirements during the year. There have been no material changes in the Group's management of capital during the year.

The Group's regulatory position as at 31 December under the standardised approach was as follows:

	Note	Group 2013	Group 2012	Society 2013	Society 2012
Tier 1 capital		**£m**	**£m**	**£m**	**£m**
General reserves	29	162.5	149.6	163.7	150.3
Subscribed capital	28	23.9	23.9	23.9	23.9
Less: Intangibles	19	(11.0)	(7.3)	(6.1)	(7.3)
TOTAL TIER 1 CAPITAL		**175.4**	**166.2**	**181.5**	**166.9**
Tier 2 Capital					
Collective provision		1.6	1.0	1.6	1.0
TOTAL TIER 2 CAPITAL		**1.6**	**1.0**	**1.6**	**1.0**
TOTAL TIER 1 AND TIER 2 CAPITAL		**177.0**	**167.2**	**183.1**	**167.9**
Less: Investments in subsidiary undertakings		-	-	(9.1)	(1.6)
TOTAL REGULATORY CAPITAL		**177.0**	**167.2**	**174.0**	**166.3**

Under Basel II 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**.

Notes to the accounts

34 GUARANTEES AND FINANCIAL COMMITMENTS

a) The Society guarantees its subsidiaries' bank overdrafts; at the year end this was £nil (2012: £nil).

	Group 2013	Group 2012	Society 2013	Society 2012
b) Capital commitments	**£m**	**£m**	**£m**	**£m**
Capital expenditure contracted for but not provided for in the accounts	0.6	-	0.6	-
c) Leasing commitments				
The total of future minimum lease payments under non-cancellable operating leases are payable as follows:				
Land and buildings:				
Commitments expiring:				
Less than one year	0.1	-	-	-
Between one year and five years	0.4	0.3	0.3	0.3
In more than five years	1.8	1.6	1.6	1.6
Other:				
Commitments expiring:				
Less than one year	-	-	-	-
Between one year and five years	0.2	0.2	0.1	0.1
	2.5	**2.1**	**2.0**	**2.0**

35 RELATED PARTY TRANSACTIONS

a) 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	2013	2012
	£m	**£m**
Management charges paid by NPS	0.3	0.3
Fees and commissions paid to NPS	(0.1)	(0.1)
	0.2	**0.2**

Details of the intercompany debtor are disclosed in note 16.
At the end of the year the following balances were outstanding with Group companies:

	2013	2012
Loans owed by subsidiaries	**£m**	**£m**
Harrison Murray Ltd	0.4	-
HM Lettings Ltd	0.3	-
Nottingham Property Services Ltd	8.2	1.6
TMAC Ltd	0.2	-
	9.1	**1.6**

Transactions and balances between Group companies are on normal commercial terms and conditions.

Notes to the accounts

35 RELATED PARTY TRANSACTIONS (CONTINUED)

b) Key management personnel compensation

The directors of the Society are considered to be the only key management personnel as defined by IAS 24.

Total compensation for key management personnel for the year by category of benefit was as follows:

Group and Society	2013	2012
	£m	£m
Short term employee benefits	1.2	1.1

c) Transactions with key management personnel, and their close family members with Nottingham Building Society.
The following transactions were undertaken through the normal course of business:

Group and Society	Number of key management personnel and their close family members	Amounts in respect of key management personnel and their close family members	Number of key management personnel and their close family members	Amounts in respect of key management personnel and their close family members
	2013	2013	2012	2012
Loans and advances		£m		£m
Net movements in the year		0.2		-
Balances outstanding 31 December	2	0.2	-	-
Deposits, share accounts and investments				
Net movement in the year		(0.1)		(0.3)
Balances outstanding 31 December	10	0.3	13	0.4

Key management personnel and members of close family paid interest totalling £4,767 (2012: £nil), and received interest totalling £12,000 (2012: £19,000) during the year.

Secured loans made to key management personnel and members of their close family would be on the same terms and conditions that are applicable to all other employees and members of Nottingham Building Society.

Amounts deposited by key management personnel and members of their close family earn interest at the same rates and on the same terms and conditions as applicable to all other employees and members of Nottingham Building Society.

d) Directors' loans and transactions

At 31 December 2013 there was one outstanding secured mortgage loan of £220,911 (2012: £nil) 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 2013, will be available for inspection at the head office for a period of 15 days up to and including the annual general meeting.

36 TRANSFER OF ENGAGEMENTS

On the 1 July 2013 the Society acquired the business of Shepshed Building Society (Shepshed) following approval of the shareholders and borrowing members of Shepshed.

The assets and liabilities acquired and the associated accounting adjustments are set out below:

Assets	Notes	Cessation accounts £m	Adjustments £m	Take on balances £m
Cash in hand		0.1	-	0.1
Loans and advances to credit institutions		2.2	-	2.2
Debt securities		24.9	-	24.9
Loans and advances to customers	c)	70.4	(3.2)	67.2
Intangible assets	d)	-	0.1	0.1
Property, plant and equipment		0.4	-	0.4
Other assets and prepayments		0.1	-	0.1
Deferred tax	e)	-	0.7	0.7
TOTAL ASSETS		**98.1**	**(2.4)**	**95.7**

Notes to the accounts

36 TRANSFER OF ENGAGEMENTS (CONTINUED)

Liabilities	Notes	Cessation accounts £m	Adjustments £m	Take on balances £m
Shares	f)	88.4	0.2	88.6
Amounts owed to credit institutions		3.0	-	3.0
Amounts owed to other customers		0.8	-	0.8
Derivative financial instruments	g)	-	0.1	0.1
Other liabilities and accruals		0.3	-	0.3
Provisions for liabilities	h)	0.1	0.2	0.3
General reserves		5.5	(2.9)	2.6
TOTAL LIABILITIES		**98.1**	**(2.4)**	**95.7**
Goodwill				
Fair value of net assets				2.6
Less: deemed purchase consideration	i)			(2.4)
Negative Goodwill	j)			0.2

Notes to the adjustments

a) The income and expenditure account for Shepshed for the period to 30 June 2013 is reported in the table below for information only and is not included in these financial statements.

b) The cessation accounts of Shepshed have been prepared in accordance with UK Generally Accepted Accounting Principles (UK GAAP)

c) The mortgage balances have been adjusted to fair value by considering the rates at which new lending would be made in the market by comparison to the actual rates applicable in the acquired mortgage book. The acquisition fair value adjustment reflects both the credit and interest rate risks associated with these assets.

d) A £0.1m core deposit intangible has been recognised representing the intrinsic value of the retail savings book.

e) Corporation and deferred tax assets have been provided where subsequent tax benefits or charges will arise from the fair value adjustments.

f) The retail savings balances have been adjusted to fair value by considering the rates at which new retail savings would be obtained in the market by comparison to the actual rates applicable in the acquired retail savings book. The acquisition fair value adjustment reflects the interest rate risk associated with these liabilities.

g) Derivative financial instruments were previously carried at amortised costs and these are now included at fair value based on discounted future cashflows, with market inputs valued consistently across the Society.

h) The fair value adjustment aligns the Shepshed's provisioning for liabilities to that for the rest of the Group.

i) The combination of the two societies did not result in any transfer of consideration. The deemed purchase price has been calculated be measuring the fair value of the Shepshed's business. This calculation has been based on forward projections of cash flows generated by the business assuming modest growth in business assets and a saving in management expenses through achievement of cost efficiencies.

j) Negative goodwill results from the transaction and has been recognised in the income statement.

Income and expenditure account of the Shepshed Building Society
For the period 1 January 2013 to 30 June 2013

	£000
Net interest income	670
Net fee and commission income	5
Administration expenses	(1,172)
Depreciation	(60)
Impairment losses on loans and advances	12
Provision for FSCS Levy	(40)
Loss before tax	(585)
Tax	7
NET LOSS FOR THE PERIOD *	**(578)**

*The above income and expenditure account relates to the cessation accounts of Shepshed and these amounts have not been included in the Statements of comprehensive income of Nottingham Building Society or the Group. They are reported here for information only. It is not felt practicable to disclose what the results for the enlarged Society would have been for the period to 30 June 2013 if the merger had taken place on 1 January 2013.

Following the merger, Shepshed ceased to exist, being subsumed by Nottingham Building Society. It is impractical to separate its results post the transfer of engagements.

Annual business statement

for the year ended 31 December 2013

1. Statutory percentages	2013	Statutory limit
	%	%
Lending limit		
Proportion of business assets not in the form of loans fully secured on residential property	5.91	25
Funding limit		
Proportion of shares and borrowings not in the form of shares held by individuals	17.24	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 21.

2. Other percentages	2013	2012
	%	%
As a percentage of shares and borrowings		
Gross capital	6.73	7.02
Free capital	5.92	6.31
Liquid assets	17.69	22.08
As a percentage of mean total assets		
Profit after taxation	0.35	0.25
Management expenses (Group)	1.13	0.87
Management expenses (Society)	0.88	0.81

'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.

Annual business statement

for the year ended 31 December 2013

3. Information about the directors at 31 December 2013:

Director's name	Date of appointment	Date of birth	Business occupation	Other directorships (and offices)
D. A. R. Thompson FCA Chairman	22.05.02	04.09.42	Director	Boots Pensions Limited Southwell Care Project (Chairman) The Care Project Limited (Chairman)
R. P. Marchant BSc (Social Sciences), FCA Vice-Chairman	31.12.03	27.02.47	Director	Hummingbird Design Limited Pershore Riverside Youth Centre
J.S.Edwards	10.01.12	10.06.56	Director	Liverpool Victoria Friendly Society Limited
R. W. Fiddis BSc (Hons), PHD	24.09.07	08.11.52	Director	The Experian Group (and its subsidiaries)
J.C. Kibbey BSc, MCIPD	01.05.06	23.08.50	Director	Governor Oundle School
D.J. Marlow ACIB Chief Executive	16.01.06	18.10.65	Building Society Executive	Harrison Murray Limited HM Lettings Limited Nottingham Mortgage Services Ltd Nottingham Property Services Ltd The Mortgage Advice Centre (East Midlands) Limited
M.C. Phibbs FCA	01.02.13	06.07.57	Director	Edendiclare Limited Morgan Stanley International Limited Morgan Stanley & Co International PLC Morgan Stanley Bank International Limited Novae Group PLC Novae Syndicates Limited Stewart Title Limited The Charity Bank Limited
M. A. Piranie MBA, FCCA Deputy Chief Executive & Finance Director	16.04.07	13.04.63	Building Society Executive	Dubai Property Consortium Ltd Harrison Murray Limited HM Lettings Limited Nottingham Mortgage Services Ltd Nottingham Property Services Ltd The Mortgage Advice Centre (East Midlands) Limited
S. J. Taylor ACIB, MBA Chief Operating Officer	01.02.11	31.07.70	Building Society Executive	Harrison Murray Limited HM Lettings Limited Nottingham Mortgage Services Ltd Nottingham Property Services Ltd The Mortgage Advice Centre (East Midlands) Limited
K. R. Whitesides MBE, LLB, MPhil	18.08.04	06.09.43	Director	Christel House Europe Limited The Staff Pension Scheme of Nottingham Building Society (Trustee)

Correspondence to directors jointly or individually should be addressed 'Private and Confidential' and c/o KPMG Audit Plc, 1 The Embankment, Neville Street, Leeds LS1 4DW.

Annual business statement

For the year ended 31 December 2013

3. Information about the directors at 31 December 2013 (continued):

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. All the contracts are reviewed annually in June.

Officers:

D. R. Watts, LLB Group Secretary	**L. E. Giddings, DMS, MCMI** Head of Branch Network	**S. J. Owen, MBA** Head of Business Development
A. M. Bayes, BCom (Hons) Head of Marketing	**M. J. W. Griffin** Treasurer	**S. Y. Snaith** Head of Estate Agency
K. E. Coulson, DMS, MCMI Head of Risk	**T. M. Hayton-Banks MBA** Head of Central Sales & Service	
J. A. Cutts, MSc Head of Information Technology	**A. J. Lumby, BA (Hons), FCA** Head of Finance	

D.R. Watts holds directorships for:

Nottingham Ltd
Nottingham Insurance Services Ltd
Nottingham Life Assurance Ltd
Nottingham Direct Ltd
Nottingham Direct Mortgages Ltd
Nethergate School

Auditor:

KPMG Audit Plc, 1 The Embankment, Neville Street, Leeds, LS1 4DW

Bankers:

National Westminster Bank Plc, 148-149 Victoria Centre, Nottingham

Solicitors:

Nelsons Solicitors, 8 Stanford Street, Nottingham

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.
Basel II	Basel II is the second of the Basel Accords, issued by the Basel Committee on Banking Supervision, which defines the methods by which firms should calculate their regulatory capital requirements to retain sufficient capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive, and was implemented in the UK via the FSA Handbook.
Basel III	The Basel Committee on Banking Supervision issued the Basel III rules text in December 2010, which presents the details of strengthened global regulatory standards on bank capital adequacy and liquidity. It is expected that Basel III will be implemented progressively across the EU (and elsewhere) between 2013 and 2019.
Buy to let loans	Buy to let loans are those loans which are offered to customers buying residential property specifically to let out.
Contractual maturity	The date at which a loan or financial instrument expires, at which point all outstanding principal and interest has been paid.
Core Tier 1 capital	The FSA specifically defines what can be included as Core Tier 1 Capital. In respect of the Society this equates to its General Reserves.
Credit risk	This is the risk that a customer or counterparty fails to meet their contractual obligations.
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.
Deferred tax asset	Corporation tax recoverable (or payable) in future periods resulting from temporary or timing differences, between the accounting value of assets and liabilities and the tax base of those assets and liabilities.
Defined benefit obligation	The present value of expected future payments required to settle the obligations of a defined benefit plan resulting from employee service.
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 rates.
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 for 1 April 2013.
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 FSA 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.
General reserves	The accumulation of the Society's historic and current year profits which is the main component of 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 (ILAA)	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.

Glossary (continued)

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.
Lending limit	Measures the proportion of business assets not in the form of loans fully secured on residential property.
Liquid Assets	Total of cash in hand, loans and advances to credit institutions, and debt securities.
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 are past due when a loan payment that 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)	Unsecured, deferred shares of the Society that are a form of Tier 1 capital. PIBS rank behind the claims of all depositors, payables and investing members of the Society. PIBS are also known as subscribed capital.
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.
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 II capital rules to reflect the degree of risk they represent.
Residential loans	Loans that are loaned to individuals rather than institutions. Residential mortgage lending is secured against residential property.
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 from the 1 April 2013. The PRA is a subsidiary of the Bank of England.
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.
Standardised approach	The basic method used to calculate capital requirements for credit risk under Basel II. In this approach the risk weighting used in the capital calculation are determined by specified percentages.
Subscribed capital	See permanent interest bearing shares (PIBS)
Tier 1 capital	A measure of financial strength as defined by the FSA. Comprises general reserves from retained profits and permanent interest bearing shares (PIBS), less intangible assets and other regulatory adjustments.
Tier 2 capital	Comprises the collective impairment allowance (for exposures treated on a Basel II 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.
Wholesale funding	The total of amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.

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YOUR HOME MAY BE REPOSSESSED IF YOU DO NOT KEEP UP REPAYMENTS ON YOUR MORTGAGE

Nottingham Property Services Limited, registered in England and Wales number 2272731. Harrison Murray Limited, registered in England and Wales number 03190376. Registered address: Nottingham House, 3 Fulforth Street, Nottingham NG1 3DL. Nottingham Building Society is an introducer to Towergate Financial (East) Limited for investments, pensions and protection. Towergate Financial (East) Limited is authorised and regulated by the Financial Conduct Authority. Nottingham Building Society is an introducer to The Will Writing Company for estate planning services and is regulated by the Institute of Professional Will Writers. Nottingham Building Society is an introducer to Dignity Pre-Arrangement Limited who provide the Guaranteed Funeral Plan. Nottingham Mortgage Services Limited, registered in England and Wales number 3089887. Registered address: Nottingham House, 3 Fulforth Street, Nottingham, NG1 3DL. A wholly owned subsidiary of Nottingham Building Society. Nottingham Mortgage Services Limited is an appointed representative of Intrinsic Mortgage Planning Limited that is authorised and regulated by the Financial Conduct Authority. 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. Nottingham Building Society, Nottingham House, 3 Fulforth Street, Nottingham, NG1 3DL

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