# 2019 ANNUAL REPORT

AND ACCOUNTS


The Nottingham

# Contents

# KEY HIGHLIGHTS



The Society has continued to focus on the development of its strategy of rewarding our members for planning, protecting and saving for their future. We continue to deliver our 'all under one roof' advice and service offering through enthusiastic and expert team members. We strive to be easy to deal with and to be known as a force for good in our heartland.

Below are some of the key achievements and financial highlights of 2019:

**We strive to help and support our members to save, plan for and protect their financial futures**

- Capital strength improved with Tier 1 ratio at 15.6% and leverage ratio of 5.3%
- Total assets of £3.8 billion and gross mortgage lending of over £350 million in 2019
- Successful completion of the project to replace all of our online/ digital member facing activity
- Strong retail franchise – total branch balances of £2.4 billion – up 2% in 2019
- The Society welcomed over 20,000 new customers and is present in over 60 locations across nine counties
- Over 3,000 customers used our whole-of-market mortgage advice services in 2019; an increase of over 11% against 2018
- Net Promoter Score of 77%
- Arrears levels remain very low at less than a quarter of industry average
- Underlying profit before tax of £10.0 million

# CHAIRMAN'S STATEMENT

## Market and economic background

Reflecting back on my statement in our 2018 Annual Report & Accounts, there were three key themes I highlighted:

- Uncertainty around our path to Brexit;
- The increasing influence of digital and the rise of consumers being mobile-led; and
- Irrational pricing and intense competition in the mortgage market.

As we enter 2020, the key influences on our thinking and strategy remain the same. In terms of Brexit we had to wait until 12 December to get any real sense of direction and certainty. The general election result cleared the UK stalemate and has led to us leaving the EU on 31 January and entering the transition period. Despite a large government majority and a resolve to achieve an independent future in Europe, there is very little time remaining in the agreed transition period in which to agree a comprehensive approach to life outside the EU. The threat of a no deal Brexit has abated but not gone away completely. We will all be monitoring matters very closely to cover all possible eventualities as we head towards the end of 2020.

The continued emergence of digital and mobile-led activity has, as expected, continued apace in 2019, with almost all elements of our daily lives now being influenced or supported by an app of one style or another. David Marlow, our Chief Executive, will report further on our progress in this area, but overall the Board remains comfortable that decisions made almost four years ago and our investment and development since then, places your Society in a very strong position to serve our members today and attract the members of the future in a mobile-led world.

In terms of mortgage market competition and irrational pricing, this has continued throughout 2019. It is now apparent that this situation is set to continue for some time yet. The beginning of 2019 saw the creation of the new UK ring-fenced banks – a sensible regulatory requirement in response to the financial crisis. Put simply, major UK banks have been ordered to reorganise themselves, separating their UK based retail banking operations from their global market and trading entities. The result is that UK retail banks have large savings balances, on a large part of which they pay no interest or very small rates of return and which must now be used for UK based lending, of which UK residential mortgage forms a significant part. This has brought the big banks to our core market in a more significant way than ever before. Furthermore, their cost of funding enables them to offer ultra-low interest rates for mortgages. A good time to be a UK mortgage borrower but less attractive to be a saver. As a member owned building society we have a responsibility to find a fairer balance between our savings and mortgage members and we have continued to try to achieve this in 2019. This has led us not to grow our levels of lending as we have done for most of the past decade, but to manage our balance sheet carefully. David highlights the outcomes of this in his Chief Executive review.

With uncertainty still prevalent, albeit less intense than through most of 2019 we expect the next year to be characterised by continued low to modest GDP growth, low inflation and interest rates remaining low for the foreseeable future. In fact markets reacted starkly in early January to economic signals increasing the likelihood of bank base rate reductions in 2020 – something we believe is not necessary and would have minimal impact on stimulating sustainable economic growth.

## Regulation

As I have consistently stated in the past, the pace of regulatory change continues unabated and whilst fully supporting the need for a robust, resilient and safe financial services industry, almost all regulatory change requires us to respond and adapt. The list of items we are dealing with and expect to have to change in the next 12 months covers a wide range of activity.

We fully support the on-going work around operational resilience being progressed by the Bank of England, PRA and FCA. As the world we live in develops as an eco-system connecting firms, individuals and government agencies in a digital world, we all increasingly become reliant on each other. For example, to open a LISA account online we require authentication from HMRC. If their system is down or not available, we cannot offer that instant service. This will become increasingly unacceptable for customers and regulators in the future. Managing that eco-system and relying on external parties, is already a feature of the world we live in and we support steps to make this more resilient.

Other regulatory change priorities revolve around a response to climate change, GDPR, a transition away from the primary market reference interest rate for the past 30 years, namely LIBOR, to a new methodology, embedding accounting changes related to loan provisions and impairments, continuing changes in requirements around mortgage advice and a consultation paper from the FCA regarding the introduction of a Single Easy Access Rate (SEAR) or instant access savings account. The latter is something we hope may support the requirement for big banks to pay their savers a consistent minimum amount of return on their savings.

We continue to support the work of both our two key regulators, the PRA and FCA, and continue to work hard to develop strong relationships between us, anchored in the shared view of the importance of a safe and secure financial services industry that serves the best interests of customers.

## Strategy and progress

The Board remains committed to the pursuit of our unique 'all under one roof' member proposition designed to support our members to save, plan for and protect their financial futures. But at the same time, we fully acknowledge that we must remain relevant and operate in a sustainable manner to thrive. This requires us to be alive to changing consumer needs and market conditions and be responsive in adapting our approach and operating model to emerging conditions.

Through our continued investment in the Society, we are well placed to do this and in turn have been building and developing our capability to execute consistently and strongly, so that we can serve our growing membership in the manner in which we would want to be served ourselves.

Alongside building our digital capability, we will seek to strengthen and grow the core areas of our business, ensuring that we continue to support our members in saving, planning for and protecting their financial future. We will also continue to work closely with our carefully chosen partners who share our passion for looking after their customers to deliver this.

In addition, as David highlights, the Board believes that with the changes we are seeing in some of our core markets, particularly mortgages, it is prudent to adjust our balance sheet and write off some accounting assets, as we do not believe that they reflect the way that markets will operate in the years ahead.

The Board continues to encourage the management team to take a long-term view and to develop the Society to remain financially strong, relevant and deliver a vibrant proposition. Not just in today's world, but the rapidly emerging new digital world also.

## Board

Following a busy year of changes for the Board in 2018, 2019 was a relatively quiet period of stability. Following Jane Kibbey's retirement as a Non-Executive Director and Senior Independent Director we were delighted to appoint Simon Linares to our Board to replace the valuable skills we lost when Jane retired.

Simon has just completed a successful career across Fast Moving Consumer Goods, telecoms and financial services. His final executive position was Group HR Director at Direct Line where he led HR, communications, public affairs and corporate social responsibility. Prior to that Simon had senior experience at O2, Telefonica Digital and Diageo. He brings a wealth of people, development and commercial experience to the Board which will be highly valuable to us.

At the beginning of 2020, our Chief Risk Officer, Charles Roe, resigned to pursue new opportunities. We recruited Charles two years ago to use his career experience to build and develop our risk management framework and second line capability. This work has now substantively been completed and the Society is now served by a strong capable second line. On behalf of the Board, I would like to thank Charles for his work and commitment over that period and wish him all the very best for the future.

Finally, following Jane's retirement, we have appointed Andrew Neden as our Senior Independent Director. Andrew, who joined the Board in 2014, is ideally suited to support me in the effective running of your Board and providing my Board colleagues with experience and wise counsel on a wide range of matters.

## Supporting our communities

As one of our four key pillars, it remains as important as ever to support the communities we serve. Through our corporate responsibility programme, we commit to 'doing the right thing for our communities' by working with a wide range of charities and projects that seek to tackle homelessness and improve employability and financial awareness. In 2019, the programme reached a milestone as we surpassed £1m of contributions to local causes.

We have continued to support our charity partners Young Enterprise – supporting schools across the East Midlands to deliver their company programme and Framework – an East Midlands based homeless charity through support of their Off the Streets campaign.

We are also proud to have worked with the National Literacy Trust where we have donated over 2,500 books as part of their Better World Books campaign to raise literacy levels across our heartland.

My particular favourite in 2019, was our partnership work with Nottingham City Council in delivering their StoryParks initiative. Inspired by the first Chairman of the Society, Samuel Fox who established the first UK adult school in Nottingham, we were delighted to have our teams spending time in the summer across all the city's major parks working with park rangers on raising numeracy and literacy skills amongst the less privileged children who live in our inner city. The initiative saw us give over 7,000 children a real summer holiday treat and learning experience in our parks.

I remain overawed at the commitment and skill our team members continue to demonstrate in all the volunteering and fundraising they do for such deserving causes.

## Summary

The Society continues to operate in and adapt successfully to changing and challenging market conditions. Our results this year reflect these challenges, but also how we are ensuring that we take a long lens view of the development of our strategy, whilst not compromising our financial strength.

We believe that to be successful in the longer run, we will need to keep members at the heart of our core purpose which is to help and support them to save, plan for and protect their financial futures, adapt and develop new mobile-led, digital capabilities; and have the scale and financial efficiency to successfully grow membership in a market where a 0.8% to a 1.0% net interest margin is seen as the norm. We continue to challenge our management team to deliver these three key principle outcomes, acknowledging the uncertain environment in which we operate.

As I stated last year, our mutual status and ethos serve us well in times like these, enabling us to utilise and leverage the financial strength that we have built up over more than 150 years and to adapt to a newly emerging world whilst continuing to serve our members with a proposition that is relevant and delivers value to them. We firmly believe that we remained well placed to do this.

As always, I would like to thank all of our team members, our partners and suppliers who have continued to support us strongly over the past 12 months and to wish them every success in 2020.

Finally, I would like to thank you, our members, for your continued loyalty and support in 2019.

John Edwards
Chairman

5 March 2020

# CHIEF EXECUTIVE'S REVIEW

As the Chairman highlighted, there are a number of market and societal changes that we have had to face into over the past year and I am pleased to report good progress across a range of our activities.

## Staying relevant in a changing world to serve our members today and in the future

One of the biggest challenges of 2019 has been to effectively balance the conflicting needs of our savings and mortgage members, in the face of a continued ultra-low interest rate environment and intense mortgage price competition as the UK ring-fenced banks exerted their influence on the market. The challenge for us here was to respond to falling rates for new mortgages whilst protecting the average rate we pay to our savers. This has meant that we have reduced our new mortgage lending which is down almost 60% from £834m in 2018 to £353m in 2019, whilst continuing to be successful in raising the number of existing borrowers choosing to stay with us when they get to the end of their promotional period. This is something we have achieved well this year, with over 70% of members choosing to stay with us at the end of their initial product term.

This is in contrast to our savers, where we continue to work hard to hold up savings rates in the face of falling mortgage yields. Again, we are pleased with the outcome whereby our average rate payable on our savings at the end of 2019 is 1.00% compared to 1.02% at the end of 2018.

How we have strived to strike this balance is best demonstrated at the income statement level. In 2019, our interest receivable from mortgages was down 2% or £1.4m whereas our interest payable to savers actually increased by 7.7% or £2.7m. This £4.1m swing could be viewed as a further mutual dividend and strong evidence of our commitment and track record in doing all that we can to protect saving rates in these market conditions.

A vital component of our membership are those savers that use our branches. Despite our balance sheet overall undertaking a controlled contraction in 2019, we have seen the number of members and saving balances in our branches continuing to grow, with membership in branches up 2% in the year. We also continue to see an increasing number of members utilising our unique Member Rewards Scheme, which has been designed to reward members for planning for their financial future, in the form of a range of discounts and cashbacks. In 2019, members enjoyed rewards benefits of £0.6m.

Whilst continuing to grow our branch based membership and aiming to serve them brilliantly, we have been consistent in stressing the importance of building a strong digital capability, to ensure that we can serve the increasing number of existing and potential members who expect to deal with us not just digitally but mobile-led. 2019 has been a year of significant progress for us on this front, as we have implemented the Salesforce platform across all our online/digital member activity and in the process delivered significant benefits in terms of access, convenience and ease to our members.

Following the successful launch of Beehive Money in December 2018, we followed that with the launch of our member portal offering Lifetime ISAs (LISA) online for the first time in April. Then in November, we launched our Mortgage Broker Portal, which has significantly improved our online mortgage desicioning and processing capability for the thousands of brokers that deal with us over the course of a year. Both these initiatives have delivered material benefits to members, supporting us to offer improved service at a lower cost to serve. A LISA can now be opened, fully validated for ID by HMRC, as per the LISA rules and ready to fund in under four minutes, with the large majority of applications not requiring the submission or uploading of any additional documents.

In fact, in November, following a popular money advice TV programme, we opened almost 500 accounts within an hour of the programme finishing at 9pm on a Tuesday evening. In one week alone we have opened savings accounts online equivalent to 1% of the membership in our new portal.

On the mortgage side, we have radically reduced the time and effort for mortgages brokers to deal with us. Previously the lapsed time to register with us as a broker was 72 hours, with approximately 2 hours needed to get a full decision in principle and submit a mortgage application. Registration now takes 4 minutes and decision in principle and application submission under 20 minutes.

These fundamental improvements in how we provide our service in a digital world signal a strong beginning to the continuing digital transformation of the Society and one which we are committed to continuing in the years ahead. We believe that not only will it make us more relevant to a broader and younger set of potential members, but also serve our need to deliver quick, easy access to our services at lower cost.

Another element of our proposition, which continues to develop well is our whole-of-market mortgage advice service which is increasingly attractive to members (who can qualify for free advice) and fee paying non-members. We have continued to grow this part of our offering, with the number of mortgage completed in 2019, up 15% on 2018. This is particularly important when considered against the context of our own current reduced appetite for lending. Our approach ensures that we can always offer our members the best the mortgage market has to offer in all conditions, ensuring that we are always relevant.

Whatever we do to support our members to save, plan for and protect their financial futures, it is important that we do that well and deliver a level of service that we could expect to receive ourselves. I am delighted that we have continued to achieve this and to report that our Net Promoter Score remains at the high level of 77%; this continues to place us amongst the very best global service providers. My gratitude goes to our team members across the Society, who strive to look after and serve our members in a way that they would wish to be served every day.

## Our performance

As we trailed last year, our objectives in 2019 were to undertake a planned contraction of the balance sheet, do all we can to protect savings rates and continue to invest strongly in our digital future. Inevitably this has led us to operating at a reduced level of profit in 2019.

The ability to do so, without compromising our financial strength, is one of the attributes of the mutual model, as the Board can look through short term turbulence and continue to focus on the medium and longer term.

I have already outlined our actions on accepting lower interest receivable; whilst boosting interest payable creating a £4.1m reduction in net interest income taking overall income down by 9% in the year.

In times such as this, it is very important that management ensure that the money we spend running the Society on a day to day basis is well controlled and proportionate to the income we derive. I am pleased therefore to report that in 2019, due to strong management action and the benefits of new digital delivery, we reduced our underlying administration expenses by just over 10% to £35.2m.

But as you might expect our costs related to investment in the Society increased; when combining depreciation, strategic and project costs we invested a total of £6.8m over the course of the year; 70% up on 2018.

Overall, as our Annual Report & Accounts show, this has led us to deliver an underlying profit before tax of £10.0m. Although down on 2018, this is a strong return in the low interest rate, low profitability market environment we are in. A full reconciliation between the underlying profit and statutory loss for the year is included in the Strategic report.

## Financial strength and quality

As we approached the end of the year, we have reviewed how two of our core markets, mortgages and estate agency, have changed in the past couple of years and how we believe these changes will continue in the years ahead.

The Board has therefore elected to re-evaluate some of the assets we hold on our balance sheet and in doing so ensure that we are effectively positioning ourselves for the future. As we continue to increase the number of mortgage members we retain at the end of their product term, our change in accounting estimate and resulting write down of the mortgage EIR asset reflects our increasing conviction that no member should remain on our SVR for any meaningful period of time at the end of their product term. This prudent step also reflects our intention to begin to refine the way we charge for mortgages over the next two years or so, as we carry out work to develop the capability to individually price each member's mortgage, based on their own distinct characteristics.

We have benefitted overall as a Society from the expansion of building society services to branches facilitated by the acquisition of Harrison Murray, but the estate agency market has undertaken material structural changes over the past 2-3 years; in terms of the UK average annual transaction numbers, in the level of fees that agents are likely to be able to accrue from these transactions and in extra costs arising from new additional regulatory requirements. We have therefore deemed it prudent to write off the goodwill that sits on our balance sheet in relation to the historic acquisition of the estate agency.

Whilst both of these adjustments take us to an accounting loss for the year of £7.2m after tax, it is a strong affirmation of our financial strength, that despite these deductions totalling £16.3m, our core capital strength has improved over the period, with our CET 1 ratio increasing to 15.1%. Early in 2020 our regulator, the PRA, lowered the overall level of capital they require us to hold to demonstrate that we have adequate financial resources to withstand significant shocks.

In addition to capital, the core components of the financial strength of a building society are liquidity and credit risk and I am pleased to report that our performance in each of these two areas remains very strong.

Our liquidity position, as always, is strong and our liquidity coverage ratio ended the year at 229% which is significantly ahead of what we are required to hold. And finally our credit risk profile remains one of the strongest in our sector and across all the lending industry. We only had to make £0.4m of loan impairment provisions from a book totalling £3.2bn and only had 36 customers more than 3 months in arrears at the end of 2019.

## People and culture

We would not have been able to achieve and deliver all that we have during the year without our great team of enthusiastic experts. In 2019 we have continued to ensure that our people strategy is focused on supporting our team members to deliver our vision in line with our values and create a positive open culture focused on serving our membership.

Our People and Development team have continued to work very hard on this and this was reflected in our annual Your Voice Matters team engagement survey where we saw over 25% of responses to questions improving by 5 points or more.

Engaging our teams and creating an open culture that creates psychological safety for all to speak up and express themselves is a vital component of a high performing organisation. In the latter part of the year we have been carrying out some work across the Society to help us achieve that aim.

As always there remains a great deal to still achieve but we are committed to creating a positive contemporary workplace for all our people to thrive as they serve our members.

## Outlook

As we head into 2020 and life outside of the EU, the themes and priorities we have developed over the past 12 months will continue and in some cases pick up pace. As we expect the current market trading conditions to remain as they are today, we aim to continue to manage our balance sheet carefully and achieve on optimum balance between mortgage and savings members and in doing so create the right level of interest income.

We will continue to review our range of services to ensure our members receive the right blend of expert advice and service from us or our carefully selected range of partners, who play an important part in our 'all under one roof' proposition. We also expect to continue to grow and develop our increasingly popular whole-of-market mortgage advice offering (NMS).

We will continue to invest in digital, with a focus on doing even more to provide ease, access and convenience to our members, continue to attract younger members to the Society and reduce the cost to serve. It is clear that we will continue to challenge ourselves to spend our running costs wisely and look to reduce them further, without compromising the service and advice we deliver every day to members.

With the decisions we have taken during 2019, we believe we are doing all the right things to prepare your Society for a new world of financial services. As the nation grows older and the welfare state's role in individuals lives reduces, the younger generation particularly are going to have to be more financially independent than their parents and grandparents. We are building a Society that will be able to meet these needs and serve a new generation of members as well as we serve our members today, but in a digital first world. This will no doubt require us to continue to evolve the Society, introducing innovations in savings and mortgages, without compromising our service ethos or our financial strength and continuing to support the communities in which we serve.

As always, nothing would be possible without the commitment and support of our team members at The Nottingham who have been fantastic again this year. My gratitude also goes to my Board colleagues who provide constant challenge and counsel as we develop and deliver our strategy. Finally, I would like to thank our members for trusting us to help them save, plan and protect their financial futures.

David Marlow
Chief Executive

5 March 2020

# STRATEGIC REPORT


## Business model and Group strategy

The Nottingham is a top ten UK building society with £3.8bn of assets and a regional presence extending to over 60 branches across nine counties.

The essence of a building society is to provide a safe and secure home for members' savings and to use these funds to provide mortgages to members to purchase their homes.

To be successful, we believe a building society should offer more than this and at the heart of The Nottingham, we have a clear purpose, which is to build enduring membership in savers and borrowers who are looking to receive a proposition based on a combination of advice, price, service and convenience that helps them save, plan and protect for a secure financial future.

It is vital that we stay relevant to our members in a changing world, with the rising influence of digital and customers being mobile-led. At The Nottingham, we have made significant progress on our technology journey and are proud of where we stand.

During 2019, we successfully launched both our award winning Lifetime ISA, as well as our new mortgage broker portal on our new technology platform. We are now the only society to have both the mortgage and savings sides of the balance sheet using the new technology and this places us in a strong position going forward to successfully meet the expectation of current and future members, at a lower cost.

Wider sector competition from bank ring fencing activities has had a profound impact on the mortgage market, with current rates at near all-time lows and likely to stay at these levels for some time to come. To be successful in the longer term, with interest margins compressed, having a lower cost to serve our members will become increasingly important.

The intense mortgage competition also provides an excellent opportunity for The Nottingham to continue to develop its mortgage broking and whole-of-market mortgage advice subsidiary, Nottingham Mortgage Services. This is becoming increasingly popular and is an area we are looking to grow and develop over the coming years.

## Group structure and brands

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

## Business performance

The Chief Executive's review includes a summary of factors affecting our performance in 2019 and should be read in conjunction with this report.

The Society continues to move forward from its firm foundations, focusing on four key strategic pillars and, in 2019, we have delivered a strong performance in each. The Board is pleased with the overall performance of the Group in the context of its strategic objectives.

## OUR PLAN IS BUILT ON FOUR KEY & CONNECTED PILLARS

| 1 GROWING & REWARDING MEMBERSHIP | 2 PEOPLE, CULTURE & COMMUNITY | 3 SAFE & SECURE | 4 FINANCIAL ADEQUACY |
|---|---|---|---|
| • Grow sustainable membership based on service and advice not solely on price | • Have enthusiatic and expert team members | • What we must protect, on behalf of members and employees, to remain a secure, relevant and sustainable building society | • Protect and build capital on behalf of members (growth; margin; profit) |
| • Reward membership to make it meaningful | • Promote and embed our ARROWS culture | • Deliver a great service by protecting those things which matter most to our members | • Deliver optimal financial performance |
| • Be highly rated for delivering great advice and service | • Support home ownership and financial independence in our heartland (doing the right thing for our communities) | • To take responsibility as we can all make a difference | |

**Within each pillar there are a number of high level strategic objectives which will create focus.**

The following section focuses on the financial performance indicators that underpin our strategic pillars of financial adequacy and growing and rewarding membership.

| | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|
| **Underlying profit before tax** | **10.0** | **13.6** | **10.4** | **15.0** |
| Losses from derivative financial instruments | (0.6) | (0.7) | - | (1.2) |
| Other income | 0.2 | - | - | - |
| Strategic investment costs | (1.3) | (0.6) | (0.7) | (0.6) |
| Change in EIR accounting estimate | (12.3) | - | (12.3) | - |
| Impairment – goodwill | (4.0) | (0.5) | - | - |
| Fair value of intercompany | - | - | (2.0) | - |
| **Reported (loss)/profit before tax** | **(8.0)** | **11.8** | **(4.6)** | **13.2** |

The Board monitors both reported and underlying profit before tax. Reported profit before tax is a commonly used comparative measure of profit. However, it includes a number of items which the Board does not believe fully reflect underlying business performance and therefore underlying profit is also used to measure performance. Underlying profit before tax equates to reported results, adjusted to exclude charges in respect of fair value gains or losses from intercompany, derivatives and hedge accounting as well as one-off strategic investment costs, which are not ongoing in nature. During 2019, the goodwill generated from the acquisition of the Harrison Murray estate agency business was impaired. The Society also recognised a change in accounting estimate in respect of its mortgage EIR assets. Both of these items are one-off in nature and therefore excluded from underlying performance.

## 2019 Financial review and key performance indicators

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

### Underlying profit and profit after tax ratio

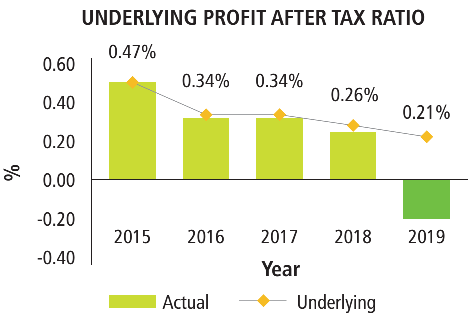
The Group's underlying profit before tax reduced to £10.0m in 2019. Whilst the Group did well to manage its cost base in the context of a significant investment programme, the reduction in net interest income is the primary driver of the fall in underlying profit. The holding of average savings rates for members against 2018, despite lower interest receivable, contributed to this.

Strategic investment costs of £1.3m, which are excluded from underlying profit, reflect one-off costs incurred in relation to the restructuring of the Member Services division and the retrenchment from some estate agency locations in this continued difficult trading environment. The Society has also invested heavily during the year into research for progressing its digital savings programme, which is one off in nature.

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

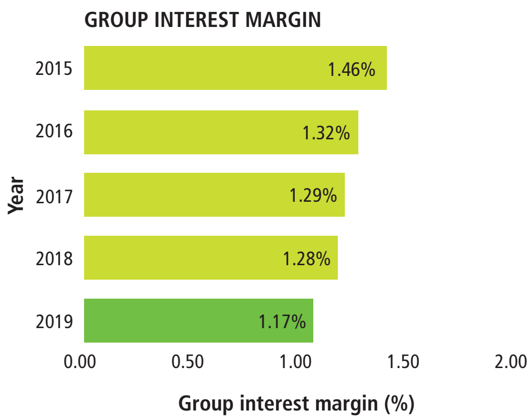
Another year of strong performance from the Group's whole-of-market mortgage advice business has contributed £0.3m of profit to the Group. This, however, has been offset by continued difficult trading conditions in the estate agency division, which has reported an underlying loss for the year of £0.6m. A further £0.4m one-off net cost has been recognised in the year in relation to the disposal of four of its locations, and has been excluded from underlying profit.

As a result of the above, the Group's profit after tax ratio has reduced significantly from 0.24% in 2018 to -0.18% in 2019. However this includes a number of one-off strategic items, and the Group's profit after tax ratio on an underlying basis, was 0.21%.




## Net interest income

Net interest income fell by £4.1m in the year to £46.1m as we delivered a net interest margin of 1.17%, a reduction of 9 basis points against 2018.




Asset yields continue to remain suppressed, driven by the continued low interest rate environment. The ring fencing activities that have taken place with some of the larger financial services institutions is also continuing to suppress mortgage rates by driving surplus liquidity into the mortgage market. Both low cost central bank funding facilities, namely Term Funding Scheme (TFS) and Funding for Lending Scheme (FLS) are now closed, with the Society fully paying down its FLS liabilities in the year and repayment of the TFS balance commencing during 2020.

However, we continue to try and protect our savings members from the low interest rate environment as much as possible. Our average savings rate in 2019 and our average rate payable at the end of the year stood at 1.0%. As a result, our branch savings balances stand at £2.4bn, increased by 2% against 2018.

## Fee income

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

| | 2019 £m | 2018 £m |
|---|---|---|
| Building society | 2.2 | 2.9 |
| Estate agency | 2.0 | 2.8 |
| Mortgage broking | 2.0 | 1.8 |
| **Total** | **6.2** | **7.5** |

The total Group fee income has fallen by 17% in 2019 to £6.2m. The fall in estate agency and mortgage related fees has been partially offset by an increase in mortgage broking fees.

The overall fee income for the Society has also fallen against the prior year. Levels of fee income continue to be impacted by intense competition in the mortgage market which has seen mortgage arrangement fees fall or disappear altogether on new mortgage lending. Third party estate planning income, through provision of financial planning and protection products, has continued to perform well and is in line with our expectations and the Society's £0.6m contribution towards rewarding members has also increased against the prior year.

Income from the estate agency business reduced by 28% to £2.0m, driven by the downturn and lack of supply in the housing market, which continues to be particularly impacted by the uncertainty following the EU referendum as well as a reduced number of locations.

The success of the Group's whole-of-market mortgage advice proposition continues with income up by 11% to £2.0m in the year.

## Derivatives

The Nottingham predominately uses derivative instruments to manage exposure to changes in interest rates that arise from fixed rate mortgage lending and fixed rate retail savings products, as well as in its secured bilateral funding arrangement. This leads to volatility in results; such volatility would only be realised if we chose to sell the derivatives before they reach maturity. The Nottingham has no need, or intention, to sell these derivatives and so expects the £0.6m negative fair value adjustment to reverse out over the derivatives' remaining lives. As this volatility arises primarily due to timing differences, the Board excludes its impact from underlying performance.

## Management expenses

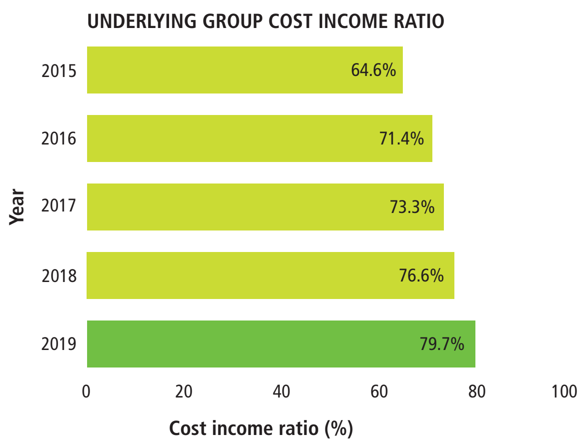
The Group's management expenses, including depreciation and amortisation, have reduced by 3% to £42.0m in 2019.

| | 2019 £m | 2018 £m |
|---|---|---|
| People related costs | 21.5 | 22.6 |
| Other administrative expenses | 13.7 | 16.8 |
| Underlying administrative expenses | 35.2 | 39.4 |
| Strategic investment costs | 1.3 | 0.6 |
| **Total administrative expenses** | **36.5** | **40.0** |
| Depreciation and amortisation | 5.5 | 3.4 |
| | **42.0** | **43.4** |

The Society has continued to invest significantly during 2019, particularly in the area of technology. The investment in digitalisation is already delivering improved accessibility to our services for members and the mortgage broker network and demonstrates that the Society continues to evolve and improve its IT capability and resilience. The Society has successfully launched its Lifetime ISA functionality as well as its new mortgage broker system during the year. This is seen in the increased depreciation charge compared to the prior year.

The redeployment of internal resource on strategic investment projects, alongside the careful management of costs, has ensured that administrative expenditure before strategic investment costs is down by 11% against 2018. This has led to there being an overall slight fall in the Group management expense ratio to 1.07% for the year (2018: 1.09%).

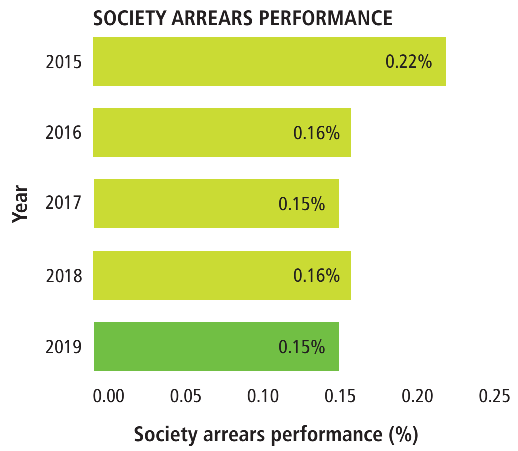
The Group's underlying cost income ratio is defined as total administrative expenses (excluding one-off strategic investment costs) as a percentage of total income (excluding the impact of fair value gains or losses from derivatives and one-off income).




The Group's underlying cost income ratio increased to 79.7% from 76.6% as the reduction in income outweighed the lower cost base.

## Impairment and provisions

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




The Society's arrears ratio has continued to stay at record low levels, with the ratio at the end of 2019 standing at 0.15%. This low level of arrears should be regarded as de minimis for a mortgage book of this size given that only 36 cases out of almost 24,000 mortgage accounts are three months or more in arrears. At the year-end, the Society had only five properties in possession.

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

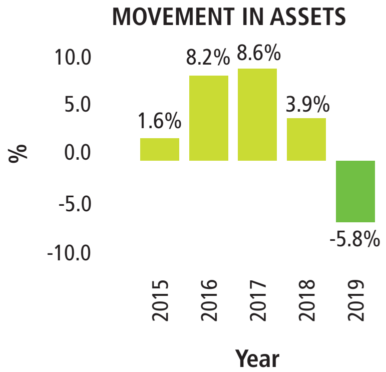
The Society's total overall impairment provisions as at 31 December 2019 is £1.6m (2018: £1.2m), which equates to 0.05% of the total book.

The Society is holding £0.2m in respect of PPI and customer redress provisions, and has recognised no further charge in the year (2018: £nil). This level of customer redress provision held is reflective of the FCA's time barring of PPI claims, which was effective from August 2019.

STRATEGIC REPORT

## Assets

The Group balance sheet reduced by 5.8% in the year to £3.8bn and this was driven by the managed reduction of our mortgage book.




## Liquid assets

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

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

The Group's liquidity is made up as follows:

| | 2019 | 2018 |
|---|---|---|
| | £m | £m |
| Bank of England | 270.5 | 254.9 |
| Multilateral Development Banks | 67.0 | 63.9 |
| UK Gilts & T'Bills | 149.3 | 70.3 |
| Floating rate notes | - | 3.0 |
| Mortgage backed securities | 76.2 | 78.9 |
| Covered Bonds | 14.1 | - |
| Other | 38.0 | 35.9 |
| **Total** | **615.1** | **506.9** |

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

The Society supplements on-balance sheet liquidity with access to the Bank of England's Sterling Monetary Framework facilities supported by prepositioned collateral. When taking into account both on- and off-balance sheet liquidity, total liquid resources was 27.4% (2018: 20.4%), with prepositioned assets in addition.

The two key measures of liquidity introduced under CRD IV are the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). The final requirements for the NSFR have now been released, but are not yet in force. The Society is currently in excess of the minimum levels required for both measures, with the LCR at the end of year being 229% (2018: 219%).

## Mortgages

Gross lending totalled £353m for the year, of which £285m related to prime residential lending and £35m to buy-to-let. Mortgage lending remaining concentrated in prime high quality mortgage assets. Residential mortgages, excluding buy-to-let, account for 71% of the total lending book.

The Secured Business Lending (SBL) book increased to £95.2m, with £33m of gross lending for the year.

| | 2019 | 2018 |
|---|---|---|
| | £m | £m |
| Residential | 3,058.4 | 3,434.3 |
| SBL | 95.2 | 71.9 |
| **Total** | **3,153.6** | **3,506.2** |

Total mortgage balances fell by 10% during the year to £3.2bn, reflecting the conscious strategic decisions taken by the Board. Whilst gross lending fell against the prior year, the Society saw continued success on customer retention where we retained over 70% of customers who reached the end of their fixed or discounted product term in the year.

Residential mortgage lending is focused primarily in the 60% to 80% LTV category but performance continues to be underpinned by the low interest rate environment and levels of House Price Inflation (HPI). The Society's average LTV decreased marginally from 57% to 55% during the year.

| | 2019 | 2018 |
|---|---|---|
| | % | % |
| <60% | 42 | 36 |
| 60% - 80% | 43 | 43 |
| 80% - 90% | 12 | 16 |
| >90% | 3 | 5 |

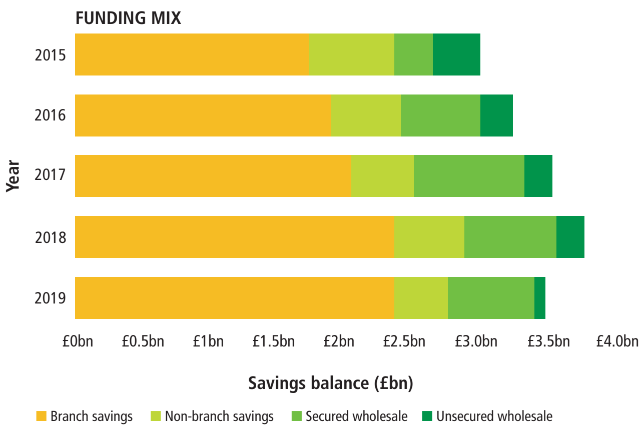
Geographic distribution continues to remain focused in two broad areas, our heartland of the East Midlands/Yorkshire and London/South East.

| | 2019 | 2018 |
|---|---|---|
| | % | % |
| East Midlands/Yorkshire | 31 | 31 |
| London & South East | 22 | 22 |
| North | 16 | 16 |
| Eastern | 10 | 10 |
| West Midlands | 10 | 10 |
| South West | 8 | 8 |
| Other | 3 | 3 |

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

## Retail and wholesale funding

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




Retail savings continue to be the cornerstone of our funding requirement, with the remainder obtained from the secured and unsecured wholesale funding markets. The Bank of England's Term Funding Scheme (TFS) has continued to provide access to secured funding, with £588m (2018: £588m) drawn down under the scheme as at 31 December 2019. The TFS scheme closed for further drawdowns during 2018 and repayment will commence later in 2020, for which the Society has robust plans in place to replace the funds. The outstanding balance due under the Funding For Lending (FLS) scheme has been fully repaid in the year (2018: £163m). The Society also has £62.6m (2018: £101.3m) outstanding as at 31 December 2019 borrowed through a secured bilateral funding agreement. Overall this has resulted in a higher proportion of secured wholesale funding than in previous years, however the repayment of FLS balances in the year has resulted in the wholesale funding ratio reducing from 24.2% to 21.7% in 2019.

Retail savings have fallen by £88m and stand at £2.8bn. We have continued to see inflows into our branch based retail accounts with branch balances having increased by £38m to £2.4bn by the end of the year, representing an increase of 2%. Branch balances represent almost 90% of total retail balances and this provides further support of the Group's combined operating model. It also continues to demonstrate the strength of our retail franchise and provides strong evidence that customers have responded positively to our moves to maintain good rates for savers, alongside our Member Rewards proposition.

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

## Customer satisfaction

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

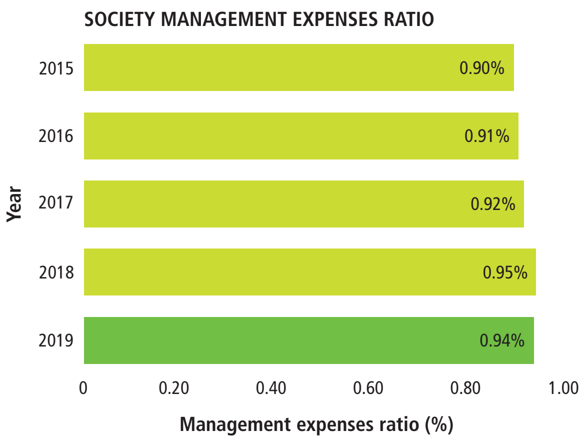
Our customer satisfaction survey is central to assessing how well we are delivering customer service and is based on customers' responses to actual transactions and activity with The Nottingham. In 2019 we have maintained our industry leading levels of satisfaction, with 84% of our customers rating us as excellent, an increase from 83% in 2018.

The Net Promoter Score measures the percentage of customers strongly prepared to recommend The Nottingham to others, less those who are not prepared to recommend The Nottingham, which results in a net percentage of our customers who would recommend our products and services. The Nottingham's Net Promoter Score also remained strong at 77%, and in line with 2018.

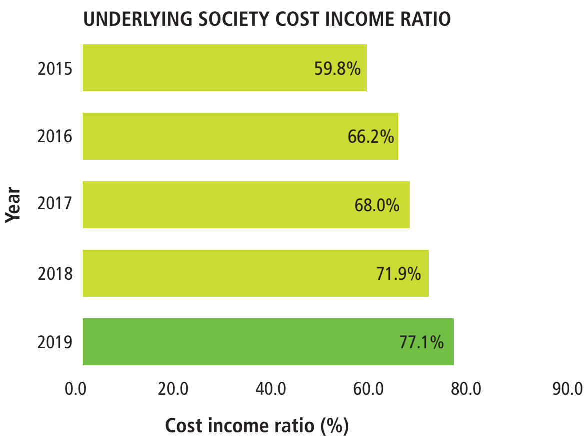
Our customer base continues to grow, with over 20,000 new customers welcomed to the Society during 2019. With strong customer satisfaction scores, a strong branch network and the Member Rewards programme in place, we anticipate that this growth will continue.

## Society performance

Overall, the Society has delivered an underlying profit before tax of £10.4m for 2019 (2018: £15.0m). When reported on a statutory basis, taking into account one-off items, the Society has reported a loss before tax of £4.6m (2018: profit of £13.2m). A smaller asset base and a reduced net interest margin of 1.17% (2018: 1.26%) has resulted in lower net income overall. This lower income and a higher depreciation charge has been offset by reduced administrative expenses, as previously outlined, resulting in a slight decrease of the Society management expense ratio to 0.94% (2018: 0.95%).




The Society's underlying cost income ratio (excluding fair value movement on derivatives and intercompany, change in accounting estimate and one-off strategic investment costs) has increased to 77.1%, in the main reflecting the fall in net interest margin and increase in costs as outlined above.




## Capital

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

Common Equity Tier 1 (CET1) capital is the strongest form of capital and comprises the Society's general reserves. Overall CET1 resources have decreased by £14.3m in the year. This is driven by the retained loss and other comprehensive income movements of the Society, as well as favourable changes in fair value reserves offset by a significant increase in regulatory adjustments for the higher level of intangible assets held as at 31 December 2019. However, alongside the fall in resources, there has been a reduction in risk weighted assets, reflecting the fall in mortgage assets.

Overall this resulted in a higher CET1 ratio of 15.1% compared against the 2018 position of 14.7%, emphasising our capital strength, despite the recognition of one-off items in the year.

The following tables show the composition of The Nottingham's regulatory capital as at 31 December 2019 under CRD IV final and transitional rules, and details of key ratios:

## CAPITAL RESOURCES

| | 2019 Final CRD IV £m | 2018 Final CRD IV £m | 2019 Transitional CRD IV £m | 2018 Transitional CRD IV £m |
|---|---|---|---|---|
| **COMMON EQUITY TIER 1 CAPITAL** | | | | |
| General reserves | 215.0 | 219.6 | 215.0 | 219.6 |
| Fair value reserves | (0.4) | (1.0) | (0.4) | (1.0) |
| Regulatory adjustments and deductions | (17.3) | (7.0) | (17.3) | (7.0) |
| **TOTAL COMMON EQUITY TIER 1 CAPITAL** | **197.3** | **211.6** | **197.3** | **211.6** |
| **ADDITIONAL TIER 1 CAPITAL** | | | | |
| Permanent Interest Bearing Shares | - | - | 7.1 | 9.5 |
| **TOTAL ADDITIONAL TIER 1 CAPITAL** | **-** | **-** | **7.1** | **9.5** |
| **TIER 2 CAPITAL** | | | | |
| Permanent Interest Bearing Shares | 23.8 | 23.8 | 16.7 | 14.3 |
| **TOTAL TIER 2 CAPITAL** | **23.8** | **23.8** | **16.7** | **14.3** |
| **TOTAL REGULATORY CAPITAL** | **221.1** | **235.4** | **221.1** | **235.4** |
| **RISK WEIGHTED ASSETS** | **1,309.2** | **1,442.4** | **1,309.2** | **1,442.4** |

## CAPITAL RATIOS

| | 2019 Final CRD IV % | 2018 Final CRD IV % | 2019 Transitional CRD IV % | 2018 Transitional CRD IV % |
|---|---|---|---|---|
| Common Equity Tier 1 (CET1) ratio | 15.1 | 14.7 | 15.1 | 14.7 |
| Total Tier 1 ratio | 15.1 | 14.7 | 15.6 | 15.3 |
| Total Capital ratio | 16.9 | 16.3 | 16.9 | 16.3 |
| Leverage ratio | 5.1 | 5.1 | 5.3 | 5.3 |

Regulatory adjustments include deductions for intangible assets and prudential valuations on fair value financial instruments.

At 15.6%, the Society's Tier 1 ratio – which compromises both CET1 and Additional Tier 1 capital – has increased in the year driven by the lower resources as well as reduced risk weighted assets and the transitional provisions applied to the Society's Permanent Interest Bearing Shares (PIBS).

The leverage ratio, which is calculated as Tier 1 capital divided by total balance sheet exposure, has remained in line with 2018 at 5.1% under the final rules basis. This is driven by the reduction in asset exposures from the smaller mortgage book.

The leverage ratio, excluding central bank deposits, would be 5.6% under the final rules basis.

The Regulator requires that the Society holds a certain amount of capital against the assets it holds. This is referred to as its Total Capital Requirement. At 31 December 2019, the Society's Total Capital Requirement was set at 9.95% of risk weighted assets or £130.3m. Subsequent to the year end, the Regulator set a new Total Capital Requirement for the Society. This would result in a fall of £15.5m if the December position were reported on the revised basis.

All the Society's capital ratios remained comfortably in excess of regulatory requirements throughout the year.

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

## Principal risks and uncertainties

In common with other financial institutions, the nature of our business results in a number of inherent risks which are continuously monitored and managed by the Board. These inherent risks, and how the Board manage them, are considered in the risk management report on pages 25 to 29.

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

Whilst we are a low-risk, UK-based organisation, we inevitably face challenges that pose risk to the delivery of our strategic objectives. We continue to operate in an uncertain global environment which creates risks and challenges for the mutual building society model. At the time of writing this report, uncertainties around Brexit and the UK's future trading relationship with the EU continue to permeate through all of the key risks faced by the Society. In particular, Brexit has the potential to create further economic uncertainty that will inevitably impact risks relating to the UK housing market (which affect both our estate agency business and the value of the security held against our mortgage lending) and the future path of interest rates (thus impacting our net interest margin). The highly competitive mortgage market also contributes to uncertainty over future earnings.

The key risks and uncertainties, and how we mitigate them, are summarised below.

### The mortgage trading environment

Since 2017, the UK ring-fenced banks have benefitted from large volumes of low cost deposits and are restricted in terms of the range of lending products that they can offer. This surplus funding has led many of the larger banks to significantly increase their volume of UK residential mortgage lending and this, in turn, has led to competition in the mortgage market increasing, which ultimately, has driven down mortgage interest rates. As a consequence, the Society has seen a sustained reduction in the rate of interest it has been able to achieve in all lending segments, including prime residential lending and buy-to-let, and across the loan-to-value spectrum.

Management expectations are that this situation is likely to persist for at least the next two to three years. As a result, the Society will explore new lending products and markets to ensure that it can continue to offer its savers an attractive rate of interest while earning an appropriate return on its lending activities.

### Compressed earnings

Alongside the structural market changes described above, UK interest rates have continued at historically low levels with no obvious sign of future increases. In order to provide our savers with acceptable returns, the net margin that the Society has been able to earn on its lending has become increasingly hard to maintain.

In order to meet its risk-adjusted return thresholds, the Society reduced its growth plans to ensure it delivers a long-term, sustainable return on its lending, whilst delivering good value products to savers relative to market conditions. Additionally, management continues to focus on ensuring its cost base remains proportionate to the size of the balance sheet.

### The housing market and economic uncertainty

The Group's business model has very close links to the state of the UK housing market and, therefore, a downturn in the domestic economy, accompanied by challenging housing market conditions, would have an adverse impact on the Group's performance. Unexpected rises in domestic interest rates could also affect our mortgage customers' ability to service their debts in the future.

The data on changes to house prices during 2019 has been mixed with wide differences across different geographical regions. Low levels of transaction volumes continue to impact the earnings of most estate agents, both on the high street and online.

The future path of house prices remains unclear, fuelled by the UK's ongoing EU exit negotiations and wider global market volatility.

Regional analysis of the Society's lending portfolio is undertaken regularly to ensure that changes in house prices are appropriately reflected. The Board remains vigilant to trends in the housing market and actively monitors performance of the estate agency and lending activity.

The level of retail lending impairments has continued to remain benign with the Society experiencing a very low number of arrears cases. Although arrears are expected to continue to be stable while interest rates remain low, any future increases in interest rates may potentially put borrowers under additional financial pressure. Additionally, a disorderly or unfavourable Brexit could cause economic dislocation resulting in increased unemployment and thus affect our borrowers' ability to repay their loans.

The majority of the Society's mortgage customers are currently on fixed rate products and would therefore not be immediately impacted by changes in interest rates, although many of our borrowers have never experienced significant interest rate rises or periods of economic downturn. Management regularly conducts stress testing on the mortgage book to gauge possible impacts of higher interest rate costs, reductions in house prices or increased unemployment on our borrowers and, as a result, has confidence that our customers are well placed to manage rising costs.

### Cyber risk

Organisations across both financial and non-financial sectors continue to experience high-profile cyber events attracting significant attention from both media and regulators. Cyber risk is the subject of increased regulatory focus, particularly the relationship between cyber security and operational resilience. Increasingly sophisticated cyber attacks can result in financial crime, services being rendered unavailable or theft of customer data. The Society's exposure to cyber risk is also influenced by an increasing online profile.

In view of our increased digital presence, managing cyber risk remains a key focus of Society management to safeguard the business and protect its members' data and savings. The Society continues to invest in technology to prevent and detect cyber-attacks, whilst specialists maintain an awareness of prevailing threats and are able to respond proactively to events. Technical expertise is complemented with education and awareness activities to ensure that our employees are equipped to recognise and manage the risks associated with cyber security. The capability to respond and recover from cyber events is kept under continuous review including contingency planning, crisis management and disaster recovery plans.

## Delivery of change agenda

To enable the Society to continue to grow, remain innovative and improve existing ways of working, we continue to pursue and implement a digital change agenda. The volume of activity and level of financial investment related to this programme will see a reduction in future years as we scale back our investment programme having satisfactorily implemented the development changes identified at the start of the transformation journey. However this level of development investment will remain high against our historic position, as the Society seeks to extend its range of digital offerings.

2019 has seen significant progress in this development area and new digital infrastructure now underpins our online savings capability, as well as the origination of mortgages through our broker network. This has required the Society to develop its relationships with new third parties, as the Society looks to expand technological capability with a view to embrace new ways of working in order to maximise operational effectiveness and support our members.

The change investment activity is underpinned by a clear attribution of responsibilities, regular and transparent status reporting and a high level of oversight and scrutiny by members of the Executive team and the Board.

## Third party delivery of key services

The Nottingham works closely with key suppliers who provide services to members on our behalf. The Society closely manages such relationships by rigorous contractual requirements and strict service delivery standards. All suppliers are monitored to ensure that their services meet the Society's high standards at all times and, where applicable, ensuring that they meet defined financial adequacy requirements. Metrics on service delivery are regularly reviewed at management committees. The Nottingham is committed to ensuring that its trusted suppliers provide the highest level of service to our members and, on the rare occasions where this doesn't happen, the Society acts in the best interests of our customers to ensure good, regulatory compliant customer outcomes are achieved.

Daniel Mundy
Chief Financial Officer

5 March 2020

DOING THE RIGHT THING for our communities

## Doing the right thing for our communities

Our commitment to doing the right thing for the communities we serve has remained an integral part of our ethos in 2019.

We have continued to focus our approach to community support around the key themes of tackling homelessness, promoting financial education and employability. These themes directly support our mission to help our members to plan for, save and protect their financial future.

Since 2011, we have contributed over £1m to local communities through fundraising, volunteering and financial donations. In 2019, we are proud to have raised funds and volunteered time for a number of worthy causes.

Our Young Enterprise volunteers have helped hundreds of young people understand what is involved in running a business and we have, once again, donated to support the organisation.


We have continued our partnership with local homelessness charity Framework, and this year contributed to their Off the Streets campaign, which goes towards supporting the Charity's Outreach team who respond to calls for help around-the-clock. Since the beginning of our partnership with Framework we have donated over £100,000.

In 2019, we were proud to begin a new partnership with Nottingham City Council in support of their StoryParks project - an interactive outdoor pop-up reading and numeracy camp of stories, activities and games aimed at helping young families develop their literacy and numeracy skills. We were hugely proud to be part of this initiative which aligns so closely to the work of our founder Samuel Fox and his commitment to improve the education and employability prospects of the people of Nottingham.

We made a donation towards the StoryParks initiative and employees committed almost 70 hours of volunteering; from reading stories with young children to supporting activities such as hunting down mini-beasts and setting up nature hunts. The parks were visited by around 15,000 people during the summer.

2019 also saw us link up with the National Literacy Trust (NLT) to support their initiatives in areas with lower literacy levels. We teamed up with NLT and Better World Books to create 'book drops' in all of our branches and head office with around 2,500 books collected so far. All profits from the sale of the books will be donated to NLT.

Our network of over 60 branches continue to raise hundreds of pounds each year for worthy local causes in their communities.

We have a proud history of supporting our communities, with every team member being given two days a year paid leave for volunteering. In 2019, our team members donated their time to a number of local causes; from sharing social media expertise with a local social enterprise café to mentoring students at Nottingham Girls Academy to help improve their employability prospects.

## Sports sponsorship

Our sports partnerships and associated community support has also been a prominent feature of 2019.

We have continued to leverage the benefits of the collaboration with the Nottingham Panthers ice hockey club throughout 2019. The Panthers have the highest average attendance of any ice hockey club in the UK and a very loyal and local fan base. Our partnership has enabled us to extend our reach and engage directly with a fan base of over 63,000 people. We are proud to support such a prestigious club.

We are now in our fourth year as the Official Building Society of Leicester Tigers rugby club. Through our partnership with the club, the TAG rugby scheme has been delivered to over 7,500 year 3 and 4 pupils in over 150 schools throughout Leicestershire. We also co-sponsor the Junior Tigers club which engages with around 50,000 children each year.

## Our people strategy

The Nottingham's success continues to be fundamentally linked to our people and their ability to thrive and lead in an ever-evolving Society.

Under our People, Culture & Community strategic pillar, our people strategy is to attract, grow and engage expert team members and to foster a culture that encourages our team members to do the right thing. To support this, we focused extensively on our leadership this year. We widened the scope of accountability and responsibility for leading the Society by creating a wider Leadership Team that is involved in key decision-making. We also partnered with a corporate philosopher to support our leaders to reach their full potential and have launched a new leadership development programme for current and future talent.

Another focus for this year was delivering on our commitment to doing the right thing for our team members. We continued to actively promote an inclusive workplace where diversity is valued, sought feedback from our teams through our annual engagement survey to enhance the employee experience and rolled out our Wellbeing strategy to promote happy, healthy people who feel valued and proud to work here.

## Organisational alignment

To ensure our sustainability in a challenging market, we re-shaped our branch network to focus our estate agency services on locations where we have the greatest opportunities to trade and grow. This included the sale of two dedicated estate agency branches, the closure of two locations and reduction of estate agency services in 21 branches. While we took every effort to find alternative opportunities for our team members, this was not always possible and a number of individuals left the business.

We also flattened our hierarchy in our Member Services function to ensure clear lines of responsibility as part of our drive to deliver a member-centric strategy.

## Engagement

Our doing the right thing culture frames how we think and act in our Society towards our members, team members and our communities. This year, we continued to embed this ethos in our teams. We measure our culture on a bi-annual basis and discuss progress against this with our Executive Committee and Board.

We received valuable feedback from team members in our annual employee survey Your Voice Matters which ran for a second year; we were able to benchmark this against the 2018 feedback and were pleased to see progress against the majority of themes on the back of actions taken the previous year.

We also launched our new Wellbeing strategy, focusing on supporting the social, physical, financial and emotional wellbeing of our people. Included in this was the introduction of mental health first aiders, trained volunteers who can help signpost team members to the support available.

## Talent Development

In 2019, we reviewed our approach to identifying and developing talent. We introduced a Talent forum to support in objectively identifying people with talent. We also launched our "Elevate" leadership programme encompassing four levels of leadership development. The programme supports individuals aspiring to be leaders, right through to senior managers mastering their leadership capability. Formal accreditation is gained through the Chartered Management Institute with the final level of the programme leading to a MSc in leadership and management. We continue to offer our team members learning and development opportunities to enhance their skills and grow their careers at The Nottingham and have created a tool, Your Career Matters, to highlight all the varied opportunities and routes available.

## Talent Acquisition

Attracting the best, diverse talent in an increasingly competitive market has been a focus area for us this year. We refreshed our employer brand through our careers website and through different social media platforms. We also introduced an efficient on-line portal to improve the candidate application process, as well as releasing an e-booklet, Your Reward Matters, to highlight the benefits of working for The Nottingham. We have enhanced our talent pipeline through the recruitment of apprentices in different areas of the business. To help us gain insight into how we can shape our future approach to recruitment, and to identify any potential barriers to working in our regional building society sector, we worked with a focus group of students from a local university.

## Equality, Diversity & Inclusion

Our doing the right thing ethos continues to provide a framework to drive an inclusive culture, valuing diversity and providing a safe environment to speak up. This year, we delivered on a broad range of actions in our Diversity & Inclusion agenda to attract and grow a diverse group of people.

We continue to be a proud signatory to the Women in Finance Charter. Since its inception in 2016, we committed to a 30% diversity floor for senior management, which we have comfortably exceeded. This year, we increased the floor to 35% and despite our senior management population more than doubling as a result of the creation of the Leadership Team, our diversity level increased slightly over last year, which truly demonstrates the depth of diversity in our Society.

Our Gender Pay Gap report was published for the second year and, in line with the challenges faced by our sector, our differences continue to be due to distribution of men and women across the Society, with a higher proportion of women in our branch network. Our ongoing work to create a truly diverse and inclusive culture will continue to support our focus in this area.

# Environment

Protection of the environment in which we live and operate is part of The Nottingham's values and principles and we consider it sound business practice. Care for the environment is one of our key responsibilities and an important part of the way in which we do business.

One of the biggest risks to our wider environment is the risk of climate change. The Nottingham is committed to doing all it can to reduce its impact on climate change, both by considering our environmental impact, as outlined below, and looking at ways to become greener, more sustainable and less carbon reliant across our footprint.

We are committed to reducing the environmental impact of The Nottingham by:

- Maximising the reuse, recycling and sustainable disposal of waste. Waste paper, cardboard and plastics are recycled, including shredding of all sensitive documentation.
- Minimising unnecessary paper and ink usage.
- Minimising unnecessary water and energy usage and waste, and reducing travel impacts wherever possible.
- Sourcing and buying locally to save fuel costs wherever possible and working with like-minded suppliers who take steps to minimise their environmental impact.
- Installing sustainable materials and environmentally friendly solutions, such as LED lighting, as part of our branch refurbishment and maintenance processes.
- Regularly reviewing our energy consumption in branches in partnership with independent evalulation via our facilities management partner.

The Nottingham is also committed to procuring its goods and services in an ethically and environmentally sensitive way, yet with proper regard to its commercial obligations.

The Society also acknowledges the broader impact of climate change on its business operations, with the increased risk of serious weather events such as flooding potentially impacting mortgage securities. The Society is working through the requirements of the Taskforce on Climate-related Financial Disclosures guidance and has set up a working group to review and consider the impacts of implementation. As part of this, the Society has included climate change within its risk management framework and Senior Manager accountability has been given to this area.

# YOUR BOARD OF DIRECTORS

## Non-Executive Directors

### John Edwards

**Chairman**

John joined the Board in February 2012 and was appointed Chairman in May 2014. In his executive career, he held a number of roles at a CEO level in the insurance and investment sector, retiring in 2009 from Lloyds Banking Group where he was CEO of their international financial services division. He was the senior independent Non-Executive Director of the LV Group until September 2015 and has also served on the Board of Saga Services Ltd as a Non-Executive Director. He is also currently a Non-Executive Director of GreyCastle Life Reinsurance (SAC) Ltd.

### Andrew Neden

**Vice-Chairman & Senior Independent Director**

Andrew joined the Board in 2014. He is a Chartered Accountant with over 35 years' experience in financial services in the UK and overseas. After a number of years running KPMG's UK financial sector transaction services team, he was the global Chief Operating Officer for KPMG's financial services business. Current directorships include the Wesleyan Assurance Society and ABC International Bank plc; he chairs the Audit committee for both organisations. He also chairs Aetna Insurance Company Ltd, and a couple of small charities.

### Simon Baum

Simon joined the Board in June 2018. Simon has spent over 30 years specialising in risk management within the financial services arena, holding several senior positions at Experian, Alliance & Leicester and Santander, both within the UK and overseas. His previous roles include Director of Mortgage Risk at Santander.

### Simon Linares

Simon joined the Board in 2019. He brings a wealth of people and development experience spanning a range of sectors, including Fast Moving Consumer Goods, telecommunications and insurance. His most recent position was Group HR Director at Direct Line plc, where he led the HR, communications, public affairs and corporate social responsibility strategies and in 2018 was ranked amongst the top five most influential HR practitioners. Prior to Direct Line, Simon headed up human resources for O2, Telefonica Digital and Diageo, covering different geographies and cultures, including Africa, Spain and Portugal.

### Kavita Patel

Kavita joined the Board at the beginning of 2017. She is a partner and Head of Investment Funds at the law firm, Shakespeare Martineau. Kavita has a wealth of experience advising clients in the financial services arena both in the retail and institutional space on corporate, regulatory and governance matters.

### Kerry Spooner

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

## Executive Directors

### David Marlow

**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. He has over 30 years' experience drawn from a number of senior roles in the financial services industry. Before joining The Nottingham, David held a number of senior posts in retail banking at Alliance & Leicester Plc, including Director of Current Accounts & Savings and Managing Director Alliance & Leicester Direct. David represents building societies on the FCA's Small Business Practitioners Panel and has previously held the posts of Deputy Chair of the Building Societies Association (BSA) and Chair of The Midlands and West Regional Association of the BSA. He is a director of Nottingham Property Services Ltd, Nottingham Mortgage Services Ltd, Harrison Murray Ltd and HM Lettings Ltd.

### Daniel Mundy

**Chief Financial Officer**

Daniel joined the Board in April 2017 as Finance Director and became Chief Financial Officer in January 2020. He has over 20 years' experience in the financial services industry and prior to joining The Nottingham, held a number of senior roles in retail banking organisations, which include Co-operative Bank, Nationwide, Santander, Yorkshire Building Society and the Financial Services Authority. Daniel is responsible for Finance, Treasury, Credit Risk and IT & Change, along with delivery of the Group strategy and business planning activities. He is a director of Nottingham Property Services Ltd, Nottingham Mortgage Services Ltd, Harrison Murray Ltd and HM Lettings Ltd.

### Charles Roe

**Chief Risk Officer**

Charles joined The Nottingham in April 2018 and became a member of the Board in January 2019. Prior to joining The Nottingham he was a director in the Regulatory Financial Services Practice at Grant Thornton LLP and worked for the FCA/FSA for 11 years, undertaking a number of senior supervisory roles including Head of Department for the mortgage sector. His early financial career began in the East Midlands with Standard Chartered Bank. As Chief Risk Officer, he is responsible for the design and implementation of the Society's risk management framework, ensuring it correctly controls, identifies and provides assurance over key risks across the organisation.



## Changes to the Board in the year to 31 December 2019

Charles Roe was appointed to the Board as an Executive Director in January 2019.
Simon Linares was appointed to the Board as a Non-Executive Director in December 2019.

## Changes to the Board post 31 December 2019 and up to the date of signing the accounts

Charles Roe resigned from the Board as an Executive Director in January 2020, effective from 31 March 2020.

## Board Committees

**Risk**

Simon Baum – Chair
John Edwards
Simon Linares
Andrew Neden
Kavita Patel
Kerry Spooner

**Audit**

Andrew Neden – Chair
Kavita Patel
Kerry Spooner

**Nominations**

John Edwards – Chair
David Marlow
Andrew Neden

**Remuneration**

Kerry Spooner – Chair
John Edwards
Andrew Neden
Kavita Patel

# DIRECTORS' REPORT

## The Directors' report should be read in conjunction with the Chairman's statement, Chief Executive's review and Strategic report on pages 4 to 17.

## Business objectives and activities

The Nottingham is a strong and successful mutual building society, which builds upon its strong regional foundations, and has a track record of serving members for over 170 years. At The Nottingham we aim to serve the needs of our members, offering a safe and secure place for their savings, helping them own their own home and supporting them through the complex challenges they face in planning for the future.

Information on the Group's business objectives and activities are provided in the Strategic report on pages 8 to 17.

## Business review, future developments and key performance indicators

The Group's business activities and future plans are reviewed in the Strategic report section of the Annual Report and Accounts on pages 8 to 17. Additionally within the Strategic report, we comment upon the financial (and other) key performance indicators used by the Board during the year to assist its control, direction and drive for business results.

## Principal risks and uncertainties

The principal risks and uncertainties faced by the Group are outlined on pages 16 and 17, and our approach to managing these risks can be found in the Risk management report on pages 25 to 29.

## Financial risk management objectives and policies

As a result of its normal business activities, the Group is exposed to a variety of risks, including credit, market and liquidity. The Group's objective is to minimise the impact of these risks, as well as financial risk, upon its performance. The risk management report on pages 25 to 29 considers this in detail. A further explanation of the financial risks and the controls in place to manage them (including the use of derivatives) is given in note 31 to the Annual Report and Accounts.

## Results

Group reported loss before tax for the year was £8.0 million (2018: profit of £11.8 million). The Group loss after tax for the year transferred from general reserves was £7.2 million (2018: profit of £9.4 million). As at 31 December 2019, total Group reserves and equity were £216.2 million (2018: £222.8 million).

## Capital

Group gross capital at 31 December 2019 was £240.9 million, (2018: £247.9 million) being 6.78% (2018: 6.55%) of total shares and borrowings. Free capital, as at the same date, amounted to £206.5 million (2018: £223.9 million) and 5.81% (2018: 5.91%) of total shares and borrowings.

The annual business statement on page 102 gives the explanation of these ratios. The Board of directors remains committed to maintaining a strong capital position.

## Loans and advances

During 2019, total lending was £353 million (2018: £834 million) and the average advance made was £149,489 (2018: £162,162), with the average debt at the end of the year being £132,406 (2018: £133,778). As at 31 December 2019, there were five cases (2018: five cases) of properties being 12 or more months in arrears or in possession. The total amount of balances outstanding in those cases was £368,643, with arrears of £19,931.

No mortgage losses were realised during the year from existing provisions. Provisions for potential mortgage losses total £1.6 million (0.05% of mortgage balances).

The Group offers a number of different forbearance options to customers including reduced payment concessions, payment plans, capitalisations and mortgage term extensions. As at 31 December 2019, the Group had 94 loans (2018: 104) subject to some form of forbearance. Note 31 to the Annual Report and Accounts on pages 89 and 91 provides further details.

## Property, plant and equipment

Freehold premises owned by the Group are shown in the Annual Report and Accounts at cost less depreciation. An estimate of the value of those properties, prepared in late 2019 by the Group's professional services team, indicates that market value is £2.1 million (2018: £2.2 million) higher than book value.

## Supplier payment policy

The Group is committed to deal responsibly with suppliers. The 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.

As at 31 December 2019, the total amount owed to suppliers was equivalent to 5 days' credit (2018: 12 days).

## Charitable and political donations

During the year, the Group made charitable donations of £30,000 (2018: £95,000). No contributions were made for political purposes.

## Country-by-country reporting

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 place certain reporting obligations on financial institutions within scope of the Capital Requirements Directive (CRD IV).

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

## Environmental policy

The environmental policy is set out in the corporate responsibility report on page 19.

## Our people

Our doing the right thing culture has become part of our common language at the Society. It frames how we engage with our members, team members and the communities we serve. Inherent to our culture is providing a diverse and inclusive working environment where our team members feel valued and free to express their views, knowing that their opinion counts. Key to this is an inclusive leadership and this year, we have focused extensively on growing our leadership capabilities. This includes work with a corporate philosopher and our new 'Elevate' leadership programme for current and future talent. We have also created a wider Leadership Team that is involved in key decision-making for the Society.

Engaging with and growing our people continues to be a priority for us. We actively seek out the views of our people through our annual engagement survey, Your Voice Matters. This year, our engagement rate increased to 77% and is in line with the financial services sector. We benchmarked this against the 2018 feedback and were pleased to see progress against the majority of themes on the back of actions taken the previous year. We also continue to work in partnership with our Your Voice Matters employee forum, which is held on a quarterly basis and attended by a member of the Board, Executive team or senior management.

We have also introduced a number of tools to support the wellbeing and engagement of our teams as well as the attraction of talent: Your Career Matters e-booklet to highlight all the opportunities available at The Nottingham to grow; Your Rewards Matters to highlight all the benefits of working for The Nottingham and our Health & Wellbeing Strategy, which includes the introduction of Mental Health first aiders and a monthly e-booklet to raise awareness.

We are proud to continue with our community support, a tradition that started with the work of our founder, Samuel Fox. Our team members have actively participated in a number of charity and community initiatives, including the StoryParks project with the Nottingham City Council to encourage young families to develop their mathematical and numeracy skills. To encourage further participation in volunteer work, we also held our first volunteering fair to give our community partners an opportunity to share how people can be involved.

## 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 1986 ('the Act') requires the directors to prepare Group and Society annual accounts for each financial year. Under that law they are required to prepare the Group annual accounts in accordance with 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 Act provides in relation to such annual accounts that references in the relevant part of that Act to annual accounts giving a true and fair view are references to their achieving a fair presentation.

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

- select suitable accounting policies in accordance with International Accounting Standard 8: Accounting Polices, Changes in Accounting Estimates and Errors and apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the annual accounts on the going concern basis unless it is inappropriate to presume that the Group and Society will continue in business.

In addition to the annual accounts, the Act requires the directors to prepare, for each financial year, an annual business statement and a directors' report, each containing prescribed information relating to the business of the Group.

## Directors' responsibilities for accounting records and internal control

The Directors are responsible for ensuring that the Group:

- keeps proper accounting records that disclose with reasonable accuracy, at any time, the financial position of the Group and Society, in accordance with the Act; and
- takes reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business in accordance with the rules made by the Financial Conduct Authority and the Prudential Regulation Authority under the Financial Services and Markets Act 2000.

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

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

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

## 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 they face.

## Directors' statement pursuant to the UK Corporate Governance Code

As required by the UK Corporate Governance Code, the directors confirm their opinion that the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for members to assess the performance, strategy and business model of the Society. Details of the governance procedures which have been implemented to support this can be found in the Board Audit Committee report on page 34.

## Going concern and viability

### Going concern

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

The directors have considered the risks and uncertainties discussed on pages 16 to 17 and 25 to 29, 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 7. In addition, note 31 to the Annual Report and Accounts includes the Group's policies and processes for managing financial instrument risk such as liquidity risk, interest rate risk and credit risk.

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

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

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

### Viability statement

In accordance with the 2018 revision of the UK Corporate Governance Code, the Board has also assessed the prospects of the Society over a period longer than the 12 months required by the going concern provision. The Board has conducted this review for a period of four years, which has been selected to align it to the Group's corporate planning period; however the Board has less certainty over the last year of the planning period.

The four year corporate plan considers the Group's profitability, cash flows, liquidity and capital requirements as well as other key financial ratios over the period. These ratios are subject to sensitivity analysis and stress testing, which involves varying a number of the main assumptions underlying the forecast both individually and in unison. Where appropriate, this stress testing is carried out to evaluate the potential impact of the Group's principal risks, as outlined on pages 16 to 17 of the Strategic report and the Risk management report on page 25, actually occurring. Based on the reviews completed, the Board considers that the Society is viable over the medium term.

## Directors

The names of the Directors of the Society who served during the year and up to the date of signing the accounts, their roles and membership of Board committees are detailed in the governance section on pages 20 to 21. 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, as at 31 December 2019.

In accordance with the agreement made by the Board and in line with the rules for re-election outlined on page 32, all Directors will stand for re-election at the 2020 Annual General Meeting. In addition, Simon Linares, who joined the Board in December 2019, will seek election at the 2020 Annual General Meeting. Charles Roe resigned as a director in January 2020 and will depart the business in March 2020.

## Auditor

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

On behalf of the Board,

John Edwards
Chairman

5 March 2020

# RISK MANAGEMENT REPORT

## For the year ended 31 December 2019

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

The Board is responsible for ensuring that an effective framework is in place to promote and embed a 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 reviews and approves a risk appetite statement annually, as part of its overarching Board Risk Policy.

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 both remain at an acceptable level.

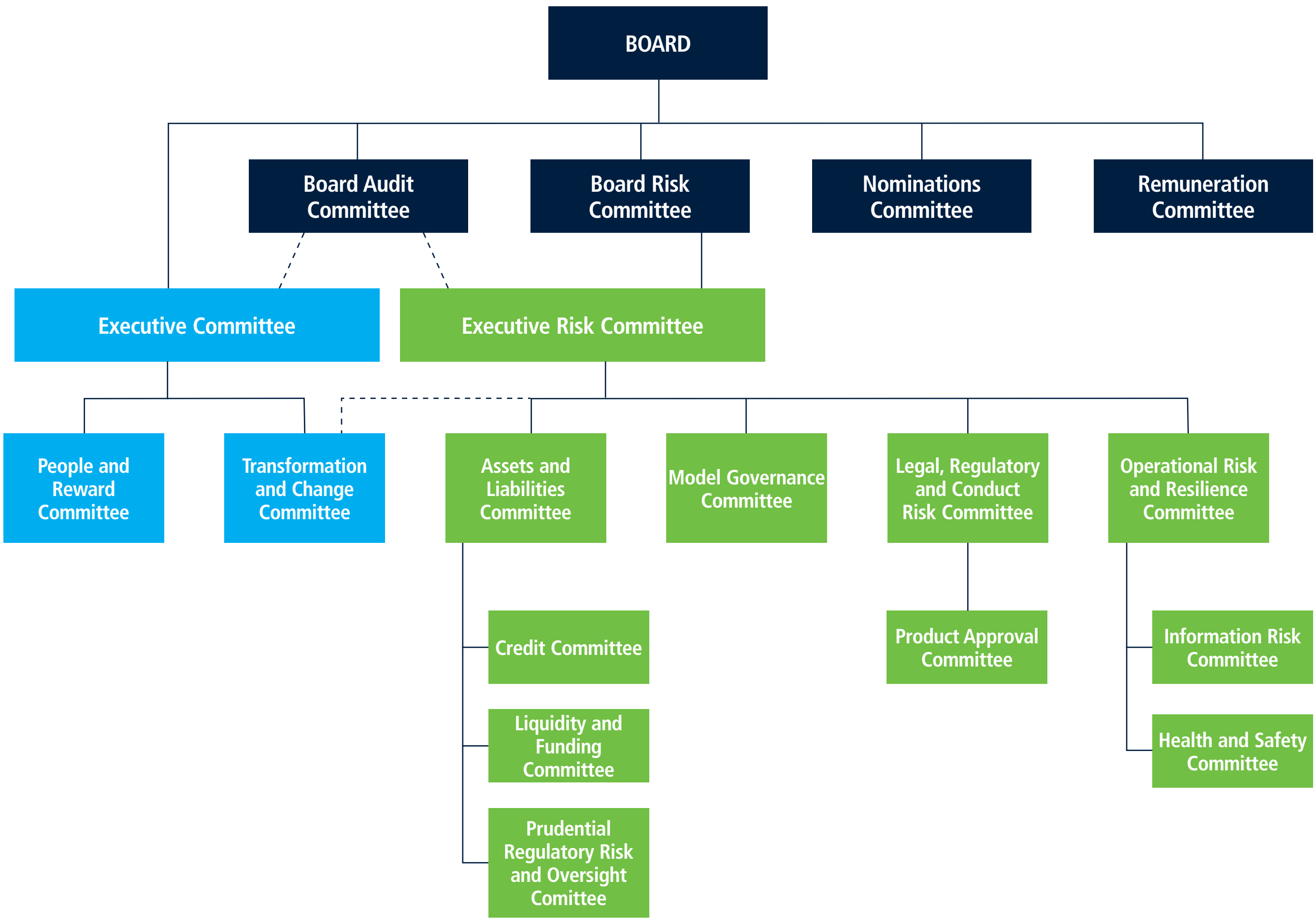
## The Board Risk Framework

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

The risk management framework is based on the three lines of defence model (described on page 32) 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.

Day-to-day risk management is the responsibility of the Executive Risk Committee (see below), which oversees the Society's risk and governance committees, as detailed in the diagram below.




GOVERNANCE

### Changes to risk committees during 2019

The Executive Risk Committee (ERC), which is chaired by the Chief Risk Officer (CRO) and focuses on the day-to-day oversight of risk within The Nottingham, was formed and assumed its responsibilities in February 2019. The Society's main risk management committees report into this new body. The implementation of the enhanced committee structure in 2019 enables the Executive Committee to focus on the delivery of The Nottingham's strategy and its performance against strategic goals, whilst the Executive Risk Committee focuses on risk.

In order to further enhance the governance structure, the Model Governance Committee (MGC) was promoted to a level three committee in the second half of 2019. This committee oversees, on behalf of ERC, the use of all significant financial models within The Nottingham in order to ensure that they are managed in line with relevant policies, that they are compliant with applicable regulation and remain fit for purpose.

## Board Risk Committee

As detailed on page 21, the Board Risk Committee comprises all non-executive directors. It is responsible for:

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

The Board Risk Committee meets at least four times per year to review risk management activities and consolidated management information regarding existing and emerging areas of risk.

The scope of the Board Risk Committee extends to all types of risk faced by the Group with the management of certain risks delegated to the Executive Risk Committee, Executive Committee and relevant management committees. The responsibilities of these committees are described below.

## Executive Committee

The Executive Committee is responsible for acting on behalf of the Board in formulating strategy, the business plan and for organising the Society's assets and resources to deliver value to members in a fair and appropriate manner.

The Committee is chaired by the Chief Executive and comprises all Executive Directors and certain senior Leadership Team members.

### Strategic risk

When discussing future strategy, the Committee, and ultimately the Board, takes care to ensure that risks such as system enhancements, long term funding approaches, acquisitions and changes in the external economy are evaluated and that plans are in place to effect any required risk mitigation. The Executive Committee oversees the detailed evaluation of these risks.

The Committee also oversees the management of risks relating to changes in the external environment, which have the potential to affect the Group's business model either through the level of demand for products and services and/or its ability to meet that demand.

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

## Executive Risk Committee

The Executive Risk Committee is responsible for acting on behalf of the Board and the Board Risk Committee in the management and oversight of The Nottingham's principal risks and the review of relevant policies to ensure that The Society acts in such a way as to organise, manage and protect the Society's assets to deliver value to members through the provision of savings and mortgages, whilst remaining within law, regulation and clear, agreed Board risk appetites.

The Committee enables the Board Risk Committee to fulfil its role by ensuring that:

- there is executive level oversight of the risk management framework;
- the accountability and responsibility for managing risk is clearly defined;
- the risk culture of The Society is defined and embedded;
- the nature and extent of the top risks of The Nottingham are determined and understood;
- appropriate risk appetites are defined and documented;
- The Nottingham, at all times, operates within stated risk appetites;
- processes are in place to consistently identify, measure, assess, monitor and control risks;
- The Nottingham is compliant with regulatory requirements, including ICAAP and ILAAP; and
- The Nottingham maintains an up to date and adequate Recovery & Resolution Plan which fully reflects the requirements of the Board and Financial Regulators.

The Committee also invites the principal risk category owners to present the first line overview of risk in their respective risk categories.

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

The Committee is chaired by the Chief Risk Officer and comprises all Executive Directors and certain members of the Executive Committee.

## Assets and Liabilities Committee

The Assets and Liabilities Committee (ALCO) is responsible for overseeing The Nottingham's liquidity risk, market and interest rate risk, credit risk and its capital sustainability risk. In addition, ALCO reviews treasury activity for compliance with approved treasury policies and procedures. The ALCO is supported by three sub-committees:

- Credit Committee;
- Liquidity and Funding Committee (LAF); and
- Prudential Regulatory Risk & Oversight Committee (POC).

The Committee is chaired by the Chief Financial Officer and comprises at least one Executive Director and relevant senior managers.

## Market and interest rate risk

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

The economy continues to be dominated by low interest rates and an uncertain economic environment, largely driven by uncertainties over the UK's future relationship with Europe. Current market expectations indicate that this will remain the case for some months to come. The Society actively monitors its position against its basis risk appetite to ensure any future change to interest rates does not adversely affect the Society's interest margin.

The Society's limits for the management of market and interest rate risk are documented in the Market and Interest Rate Risk Policy, which is developed, defined and recommended by ALCO and its sub committees and considered and approved ultimately by the Board.

Basis risk, which arises from changes in the relationship between different types of interest rates, is included within this risk category as a subset of interest rate risk.

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

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

Following the direction from the FCA regarding the sustainability of LIBOR as a benchmark market rate, the Society began the transition away from LIBOR to SONIA in 2019. All LIBOR-linked exposures are related to Treasury activities with no retail products attached to the benchmark rate. The Society is working to ensure it has a robust plan to manage its remaining derivative position post the end of 2021 when the LIBOR benchmark will be discontinued.

ALCO and its sub-committee LAF, is responsible for reviewing Treasury activity, performance and compliance with the approved policy and risk.

## Liquidity risk

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

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

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

The Society is required to be compliant with the Liquidity Coverage Ratio (LCR), which measures the amount of high quality liquid assets relative to modelled net stressed cash outflows within a 30 day period.

The Society also maintains a funding profile in line with a longer term funding measure, the Net Stable Funding Ratio (NSFR), which requires financial institutions to hold sufficient stable funding to cover the duration of their long term assets.

Based on our current and forecast liquidity positions, the liquidity portfolio held by the Society comfortably exceeds the minimum requirements of the LCR. Similarly the funding profile exceeds the requirements under the NSFR.

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

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

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

A detailed analysis of the Society's liquidity profile can be found in note 31 to the annual accounts.

## Credit risk

# Credit Committee

As discussed in the previous section, the Credit Committee is a sub-committee of ALCO, which is comprised of relevant senior managers and chaired by the CFO. It is responsible for oversight of the Society's retail credit and wholesale credit risks, which includes exposures to residential and buy-to-let (BTL) mortgages, Secured Business Loans (SBL) and those wholesale assets managed by the Society's Treasury function.

## Retail credit risk

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

A Retail Credit Risk Policy (incorporating the credit risk appetite) is developed and proposed by the Credit Committee, reviewed by ERC and considered and approved by the Board. 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 approved risk appetite. The Board ultimately receives monthly information on key risk appetite limits.

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

The Society regularly stress tests the mortgage portfolio to detect any signs of potential payment stress or sensitivity for our borrowers to the impact of future rate rises. The mortgage portfolio shows resilience to the impact of rate rises, but we ensure adequate monitoring and analysis is in place to detect any signs of deterioration. In light of recent regulatory developments, the Society is also in the process of designing a stress testing framework for the potential effects of climate change on property prices. This will be an area of increased focus in 2020 and beyond for the Society, the wider sector and the PRA.

The Society remains committed to promoting home ownership and its risk appetite allows lending to first time buyers, but it restricts the overall level of high loan-to-value lending to ensure the risk is managed sufficiently. Similarly, we continue to follow our long term policy of offering interest-only products to a small number of borrowers, which are covered by strict policies and monitoring procedures.

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 as part of our responsible lending requirements. The Society also shares account performance data with the selected bureau.

The Society's lending has become increasingly diversified throughout England and Wales over the last few years with no one area dominating the portfolio.

The Society continues to be a responsible lender and its approach to lending is based on making sure that customers can afford to meet their mortgage repayments from the outset, through the use of a prudent affordability calculator, as well as our manual underwriting processes. Should customers find themselves in financial difficulty, we respond with appropriate forbearance activities to ensure fair customer outcomes. The purpose of forbearance is to support customers who experience temporary financial difficulties by providing the assistance they require to enable them to regularise their financial arrangements. Only as a matter of last resort does the Society take the property into possession.

Residential, BTL and SBL loans are granted only against the 'bricks and mortar' value (i.e. loans are provided only for the purchase or re-mortgaging of a property and not for working capital or machinery etc.) An SBL policy is used to manage levels of business lending risk with loans manually underwritten. 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. The regulatory limit for SBL lending is set at 10% and the Society was comfortably within this limit at 3% as at 31 December 2019.

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

### 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.

The Society's risk of counterparty default is relatively low due to the high proportion of total liquidity held in UK Sovereign debt securities and the Bank of England reserve account. The composition of the treasury loans can be found on page 85.

The Society's liquidity policy sets out the amounts, products and counterparties under which Treasury liquid assets can be held. Credit worthiness of counterparties is assessed using a number of factors including minimum acceptable credit ratings approved by the Board Risk Committee, together with lending limits. The policy also allows for investments in multi-lateral development banks, and also in Covered Bonds and Residential Mortgage Backed Securities subject to criteria set by the Board Risk Committee. The Board does not permit any lending directly to sovereign states, other than the UK, and all lending is in sterling.

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

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

### Capital sustainability risk

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

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

The PRA uses the ICAAP during its Supervisory Review and Evaluation Process (SREP) through which it determines the amount of capital it requires The Nottingham to hold against its Total Capital Requirement (TCR).

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

## Model Governance Committee

The Model Governance Committee (MGC) assists the Executive Risk Committee in the oversight of computer-based models and End User Computing (EUC) applications that are used throughout The Nottingham's strategic and operational activities. A model is defined as "a quantitative method (including the complex manipulations of expert judgements) or system that applies theories to process input data into quantitative estimates, repeatedly used for decision making".

The Committee, which is made up of relevant senior managers and is chaired by a senior manager from within the Risk function, oversees the management of risks related to models to ensure that models are included within the Society's governance framework, and are robustly designed, developed, documented and reviewed.

The Committee provides oversight ensuring that models and EUC applications are managed in line with the Model Governance Risk Policy, both on an ongoing basis and during model development. It ensures that models and EUC applications are compliant with applicable regulation and remain fit for purpose.

## Legal, Regulatory & Conduct Risk Committee

The Society, being a provider of mortgage, savings and insurance products, is regulated by both the FCA and the PRA.

The Legal, Regulatory & Conduct Risk Committee (LRC) is responsible for overseeing how The Nottingham conducts its business, ensuring that all customer-impacting activities are conducted in a clear, transparent and fair manner, delivering fair outcomes for customers.

The Committee is chaired by the General Counsel, supported by relevant senior managers.

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

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

The Committee is supported by one sub-committee, the Product Approval Committee.

### Operational Risk

## Operational Risk and Resilience Committee

The Operational Risk and Resilience Committee (ORRC) is responsible for actively overseeing the management of operational risk across The Nottingham. It is also responsible for ensuring that the Society maintains sufficient operational resilience to ensure the ongoing delivery of key services to customers.

The Committee is chaired by the Director of Member Services supported by relevant senior managers.

The Committee is supported by two sub-committees:

- Information Risk Committee; and
- Health and Safety Committee.

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

To ensure that The Nottingham's services are operationally resilient, the Committee is also responsible for ensuring that processes are in place to prevent, adapt, respond to, recover and learn from operational disruptions. The Committee oversees the process by which the Society identifies its key business services, understands and remediates any potential weaknesses in the supporting processes, ensures that appropriate business continuity plans are in place and verifies that third party suppliers are able to meet our customers' needs at all times.

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

As outlined in the credit risk section above, the Society is in the process of designing a stress testing framework for the potential effects of climate change. This will incorporate impacts on operational risk (such as flood risk for our branch network) and will be an area of increased focus in 2020 and beyond. The Committee also continues to work on developing and embedding the Society's approach to operational resilience, in response to the Regulator's increased focus in this area.

## Information Risk Committee

Due to the importance of protecting the Society against the risk of loss of customer data through events such as a cyber-attack, the Operational Risk and Resilience Committee is supported by the Information Risk Committee. The Committee is chaired by the Head of IT & Change and supported by relevant senior managers. The Nottingham mitigates cyber risk by:

- having a Board approved Cyber Security Strategy that is reviewed annually;
- having a specialist governance committee with responsibility for cyber risk;
- keeping aware of prevailing threats and acting proactively to minimise exposure;
- continued investment in technology to prevent and detect cyber-attacks;
- education and awareness initiatives to ensure that our staff are equipped to manage cyber-attacks and consider the risks associated with cyber security during the course of day-to-day activities;
- developing the capability to respond and recover from cyber events, e.g. contingency measures, crisis management and disaster recovery plans:
- collaborating with relevant authorities; and
- ensuring relevant cyber risk insurance policies are in place.

## Transformation and Change Committee

The Transformation and Change Committee ultimately supports the Board in ensuring the optimum use of resources when delivering The Nottingham's programme of projects. It performs this role through the approval and prioritisation of all requests to initiate or materially change a project and ensures their status is monitored. The Committee is chaired by the Head of IT & Change, supported by relevant senior managers.

The Nottingham's change activity is underpinned by an evolving project risk management framework, which champions clear attribution of responsibilities, regular and transparent status reporting and a high level of oversight and scrutiny by members of the Executive team and the Board. All significant projects must be approved by the Executive Committee and the Board.

The Transformation and Change Committee is primarily overseen by the Executive Committee, to ensure that its activities are in line with the Society's strategic aims. The committee also reports to ERC, to ensure that any potential changes to the Society's risk outlook are appropriately governed.

## Risk Oversight

The risk management framework is supported by a series of control documents and risk reporting and is overseen by both the second and third lines of defence working through the committee structure detailed above.

This framework enables the Board and senior management to maintain effective oversight of the level of risk within The Nottingham and to ensure that appropriate controls and mitigating activities are in place.

On behalf of the Board,

Simon Baum
Chairman of the Board Risk Committee

5 March 2020

# CORPORATE GOVERNANCE REPORT

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

The Board has reviewed the Society's corporate governance practices against the revised UK Corporate Governance Code (July 2018) (the 'Code'), which is intended to apply to listed companies, to the extent that it is relevant to a building society. In the interest of transparency, each building society is encouraged to explain in its Annual Report and Accounts whether, and to what extent, it adheres to the Code. The Board is committed to complying with best practice in corporate governance.

This report sets out how the Board has operated in 2019 and complied with the provisions of the Code and specifies where the Society is not compliant with the Code, which the Board has identified as being in three different areas:

The Code requires that there should be enhanced engagement with the workforce. Whilst this has not been the case in 2019, the Remuneration Committee has approved the attendance of a member of the Board or Executive team at each meeting of the Your Voice Matters forum, which enables members of the workforce to raise issues directly with a Board or Executive team member in an open forum.

The Code also requires that there is alignment between pension contributions for the Executive Directors with those of the workforce. This has been considered by the Remuneration Committee and it has been agreed that the the pension arrangements for any future executive director would be reviewed for alignment with those of all employees.

Finally, the Code requires the Remuneration Committee to use internal and external measures, including pay ratios and pay gaps, in reviewing the appropriateness of remuneration.  The Remuneration Committee is considering the use of such measures across the Group in informing remuneration decisions.

## Leadership

### The Board

As at 31 December 2019, the Board consisted of six Non-Executive Directors (including the Chairman) and three Executive Directors, providing a complementary balance of skills and expertise.

The Board held eight meetings, one strategy review meeting and two business planning meetings during 2019.

In addition the Non-Executive Directors meet regularly, without the Executive Directors present, and consider all aspects of Board responsibilities, governance and performance.

In line with Code principles, the Board operates effectively and is collectively responsible for the long term success of the Group and ensuring that the necessary resources are in place for the Group to meet this objective. It has a schedule of reserved matters and its principal function is to focus on how it has considered and addressed the opportunities and risks to the future success of the Group, the sustainability of the Group's business model and how its governance contributes to the delivery of its strategy. 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 Executive and Non-Executive Directors are able to obtain independent professional advice, at the Society's expense, should that be necessary in the fulfilment of their duties, and have access to the services and advice of both the General Counsel and the Company Secretary.

### Division of responsibilities

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

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

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

### The Chairman

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

### Non-Executive Directors

Independent Non-Executive Directors play a vital role in challenging and helping develop strategy, whilst providing independent judgement, knowledge and experience.

The Board considers all Non-Executive Directors to be independent in character and judgement and free of any relationship or circumstances that could interfere with the exercise of their independent judgement.

One of the independent Non-Executive Directors is appointed as the senior independent director, to provide a sounding board for the Chairman and to serve as an intermediary for the other directors as necessary. The senior independent director is identified on page 20.

# Effectiveness

## Composition of the Board

The names of the directors together with brief biographical details are set out on pages 20 and 21.

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 21.

The table below shows the attendance of each Director at the relevant Board and Board committee meetings. The number to the left is the number of meetings actually attended; the number to the right is the number of meetings the Director was eligible to attend during 2019.

| Director | Board | Risk | Nominations | Remuneration | Audit |
|---|---|---|---|---|---|
| S. Baum | 8/8 | 5/5 | - | - | - |
| J. Edwards | 7/8 | 5/5 | 2/3 | 4/4 | - |
| J. Kibbey | 3/3 | 2/2 | - | - | - |
| S Linares | 1/1 | - | - | - | - |
| D. Marlow | 8/8 | 2/2 | 3/3 | - | - |
| D. Mundy | 8/8 | 2/2 | - | - | - |
| A. Neden | 8/8 | 5/5 | 2/2 | 4/4 | 5/5 |
| K. Patel | 8/8 | 5/5 | - | 1/1 | 5/5 |
| C Roe | 8/8 | 2/2 | - | - | - |
| K Spooner | 8/8 | 5/5 | - | 4/4 | 5/5 |

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

In addition to the four Board committees identified above, the Board has the Executive and Executive Risk Committees to support the Board in managing the day-to-day operations of the Group. The Executive and Executive Risk committees meet at least once a month and the membership of both committees is made up of both Executive Directors and senior leaders. Together, both committees are responsible for acting on behalf of the Board in organising, managing and protecting the Society's assets to deliver value to members, whilst ensuring the Society operates within the law, regulation and clear, agreed Board risk appetites. Together they are therefore, responsible for ensuring the management and delivery of four key areas on behalf of the Board: Strategy; Risk Management; Business Planning; and Operational Oversight. The Risk Management Report on page 25 covers these committees in further detail.

## Appointments to the Board

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

The Committee meets at least twice a year. Additional meetings may be convened if necessary.

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

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

## Commitment

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

## Development

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

## Information and support

The Chairman ensures that all directors receive accurate, timely and clear information.

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

## Evaluation

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

The Board and each of the committees formally evaluate their own performance and effectiveness each year. These evaluations take into consideration the balance of skills, experience, independence and knowledge, and consider the diversity of the Group and its ability to work together. The process is co-ordinated by the Senior Independent Director and the outcome of each evaluation is presented to the Nominations Committee who assesses 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 Code requires the Board to conduct an external evaluation every three years. The last review was performed in 2019. The Board will keep under review and consider the Code requirement to conduct an external evaluation every three years.

### Re-election

In 2020, all Directors will submit themselves for election at the annual general meeting (the 'AGM') in accordance with the Code.

Non-Executive Directors can serve up to a maximum of three three-year terms. Any extension must be approved annually, subject to rigorous review, and be explained giving due consideration to the continuing independence and objectivity of the Non-Executive Director.

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

## Accountability and audit

### Financial and business reporting

The Directors' report on pages 22 to 24 details the responsibilities of the directors in preparing the Group's accounts.

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

The Board has responsibility to present a fair, balanced and understandable assessment of the Group's performance and financial position, business model and strategy, consideration of which is contained within the Chief Executive's review on pages 6 to 7, the Strategic report on pages 8 to 17 and within the report and accounts taken as a whole.

### Viability statement

In accordance with the requirements of the Code, the Board has assessed the prospects of the Society over a period longer than the 12 months required by the going concern provision. The viability statement is considered on page 24 within the Directors' report.

### Risk management and internal control

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

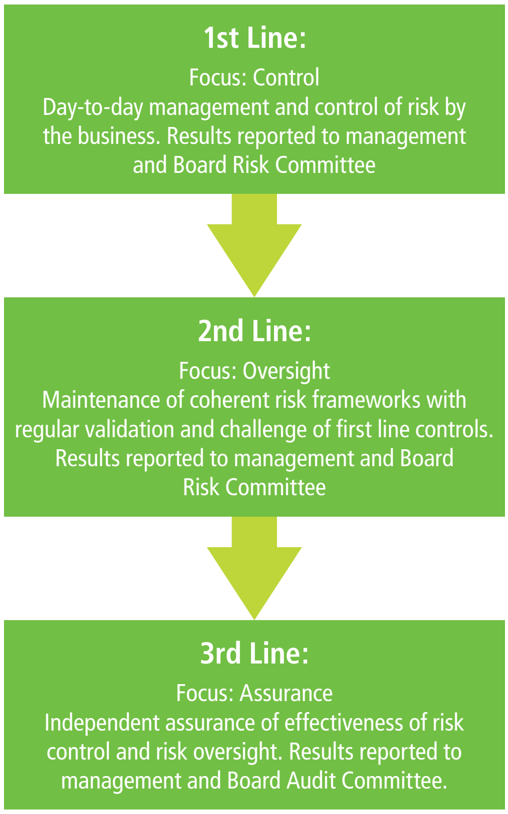
The second approach involves the Committee focusing its attention on the risks within the Group's strategy and the management of these risks.

To assist in monitoring the risk management framework, the Assets and Liabilities, Legal, Regulatory & Conduct Risk, Operational Risk & Resilience, Transformation & Change and Model Governance Committees report into the Executive Risk Committee, which in turn reports into the Board Risk Committee. The Board Risk Committee meets at least four times a year.

The Executive Committee, which reports into the Board, is supported by the Transformation & Change and People & Reward Committees

The Board has carried out a robust assessment of the principal risks facing the Group, including those that would threaten the business model, future performance, solvency and liquidity. These principal risks are detailed on pages 16 to 17 of the Strategic report and further information on risk management is given in the report commencing on page 25.

In accordance with the Code, the Board is committed to maintaining a sound system of internal controls to safeguard both its own assets and those of its members and there is an annual review of risk management and internal control systems. Over recent years, the Board invested to enhance the governance and risk management and to formalise the lines of risk identification and acceptance. These governance improvements have been fully operational throughout 2019.




The operation of these three lines of defence is embodied in the terms of reference of the Society's risk committees (Executive Risk, Legal, Regulatory & Conduct, Operational Risk & Resilience, Assets & Liabilities, Model Governance and Transformation & Change) who are informed by sub-committees (Information Risk, Credit, Prudential Oversight, Product Approval, Liquidity & Funding and Health & Safety). The Board Risk Committee has 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 2019 there were no material breaches of control or regulatory standards and that the Society maintained an adequate system of internal control. Where weaknesses in controls are identified by the three lines of defence, the Board monitors the steps taken to remedy the issues and to ensure that the Society responds to changing external threats and economic circumstances and to the changing regulatory environment.

## Remuneration

### Policy and procedures

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

The Remuneration Committee's work and the Society's compliance with the Code principles relating to remuneration is covered in the directors' remuneration report on pages 36 to 40.

### Membership

The Committee consists of Non-Executive Directors only and met on four occasions during the year. Additional meetings may be convened if necessary.

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

## Relations with members

### Dialogue with members

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

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

Furthermore, each year, the Society produces a Members' Newsletter, including the summary financial statement, which provides an abridged version of information contained within the Annual Report and Accounts alongside news about the Society. The Members' Newsletter is provided to all members as part of its annual AGM documentation.

### Constructive use of the AGM

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

All postal and proxy votes are counted using independent scrutineers.

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

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

On behalf of the Board of directors,

John Edwards
Chairman

5 March 2020

# BOARD AUDIT COMMITTEE REPORT

## Board Audit Committee

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

- to monitor the integrity of the financial statements of the Society and any formal announcements relating to the Society's financial performance;
- to review the Society's internal controls and risk management systems working with the Board Risk Committee;
- to monitor and review the effectiveness of the Society's internal audit function, agree and review progress of the annual Internal Audit Plan;
- prior to the members vote at the Annual General Meeting, make recommendations to the Board for appointment, re-appointment and removal of the external auditors;
- to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;
- to develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and to report to the Board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken; and
- to investigate any other relevant matter at the request of the Board.

## Membership and attendance

The Board Audit Committee consists of three Non-Executive Directors. The members of the Committee are Andrew Neden (Chairman), Kavita Patel and Kerry Spooner, who as a whole have competence relevant to the building society sector.

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

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

## Meeting frequency and reporting

The Committee met five times during 2019 and the main activities during the year were:

- reviewed the results and draft annual report and accounts for the year ending 31 December 2018;
- reviewed the going concern assumptions and all key issues and areas of judgement relating to the financial statement reporting;
- considered reports by the external auditor on its audit and review of the financial statement reporting;
- reviewed the year end and interim financial statements and draft press releases, with consideration of the fair, balanced and understandable requirements of the UK Corporate Governance Code;
- considered the internal audit strategy for 2019;
- reviewed and approved the Society's risk-based internal audit plan for the next year;
- received and reviewed reports from internal audit;
- reviewed the adequacy and effectiveness of the Society's internal financial controls, internal control and risk management systems; and
- carried out a review of the Committee's own effectiveness.

## Significant matters in relation to the financial statements

The Committee considers a wide range of matters in relation to the financial statements, which relate mainly to judgements and estimates which management have to make during the preparation of the statements. During 2019, the significant issues considered by the Committee included:

- **Loan loss provisioning – residential & SBL mortgages**
  The Society reviews the IFRS 9 model outputs to estimate the level of impairment required in the residential and commercial book, which uses historical default and loss experience as well as applying judgement. The Committee reviewed and challenged the approach to calculating the provisions and confirmed that the assumptions made are appropriate. The Committee is satisfied with the approach adopted to calculate the provision for impairment and the overall level of provision recognised.
- **Carrying value of consolidated goodwill**
  The Society purchased the Harrison Murray estate agency business in 2013 and the Committee considered the approach to supporting the carrying value of the consolidated goodwill recognised at a Group level. The Committee concluded that the carrying value should be fully written down in the year.
- **Accounting for intercompany balances under IFRS 9**
  The Society considered the fair value of its intercompany balances under IFRS 9 and resulting fair value adjustments recognised in the financial statements.
- **Effective Interest Rate ('EIR') methodology**
  The Society recognises interest income using a constant level of interest over the expected behavioural life of the loan. The Committee reviewed the basis of the EIR calculations, as well as the results from the testing performed by the external auditor, and concluded it was appropriate. During the year, the Committee also considered the potential impact on the carrying value of EIR assets, should strategic mortgage initiatives be implemented.
- **Calculation of the defined benefit pension plan position**
  The Society has a defined benefit pension scheme which was closed to new entrants in 1997 and closed to future service accrual from 31 January 2009. The Committee reviewed the methodologies and acceptable ranges from which assumptions had been selected in calculating the latest estimate of the scheme's assets and liabilities. This review was supported by a report provided by the Society's pension advisors. Noting that the assumptions adopted by management were consistent with this report, the Committee is satisfied with the position reported in the accounts.
- **Carrying value of intangible assets**
  The Society has an increased intangible asset balance as a result of its investment in new technology and digitalisation. The Committee therefore reviewed the carrying value of intangible assets and confirmed that they were satisfied with the position.

- **Other provisions**
  The Committee reviewed and challenged the estimates and assumptions made by management when calculating the level of provisions at the reporting period and concluded it was appropriate.

- **Fair value of derivative financial instruments**
  In light of the significant market volatility seen in the external markets in the year and resulting impact on derivative fair values, the Committee considered the income statement position. The Committee also considered the LIBOR-SONIA transition and impacts on hedge accounting.

- **Going concern assumption**
  The Committee evaluated whether the going concern basis of accounting was appropriate by considering forecast profitability, liquidity position, funding availability and regulatory capital positions. The review also took into account the detailed stress testing scenarios completed as part of the annual liquidity and capital adequacy assessments.

- **Fair, balanced and understandable**
  The Committee reviewed the integrity of the financial statements and any formal announcements. The content of the Annual Report and Accounts was reviewed and the Committee advised the Board that, in its view, and taken as a whole, it is fair, balanced and understandable and provides the information necessary for members to assess the Society's performance, business model and strategy. The Committee therefore recommended that the Board approve the Annual Report and Accounts.

- **Viability statement**
  The Committee reviewed the requirements of the UK Corporate Governance Code to provide the medium term viability statement in the Annual Report and Accounts and agreed the definition of the medium term period.

- **Revised Corporate Governance Code**
  The Committee reviewed the impacts on the 2019 financial statements of the revised Corporate Governance Code, effective from 1 January 2019.

- **New accounting standards**
  Regular updates on financial reporting developments were presented to the Committee during the year to enable it to provide effective oversight of the financial reporting within the interim and full year accounts, including the implementation of IFRS 16.

- **External audit findings**
  The external auditor did not highlight any material control weaknesses arising from their review of key financial reporting processes and systems.

## Internal controls

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

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

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

Further details on the risk management framework are provided in the corporate governance report on pages 30 to 33.

## Independence and effectiveness of external auditor

In 2014, the Society tendered its external audit relationship in line with best practice and Ernst & Young LLP were engaged during 2015 and have therefore been in post for five years at 31 December 2019.

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

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

The Committee considered the performance of Ernst & Young LLP as external auditor for 2019, and is satisfied with their objectivity, independence and effectiveness and therefore recommended that they be re-appointed at the AGM for the current year.

## Oversight and effectiveness of internal audit

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

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

## Audit committee performance and effectiveness

As outlined in the corporate governance report on page 31, the Board and each of the committees formally evaluate their own performance and effectiveness annually. The Committee therefore considers itself to be effective.

On behalf of the Board,

Andrew Neden
Chairman of the Board Audit Committee

5 March 2020

# DIRECTORS' REMUNERATION REPORT

## For the year ended 31 December 2019

### Statement by the Chair of the Remuneration Committee

On behalf of the Committee, I am pleased to present the annual directors' remuneration report, which sets out the remuneration policy and details of the directors' remuneration in the year to 31 December 2019.

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

- The Remuneration Policy, which sets out the Society's remuneration policy for directors; and
- The Annual Remuneration Report which outlines how the policy was implemented in 2019.

In 2019, the Remuneration Committee membership was made up as follows:

| | |
|---|---|
| **Kerry Spooner** | Non-Executive Director and Chair of the Committee |
| **John Edwards** | Chairman of the Board |
| **Andrew Neden** | Non-Executive Director and Chair of the Audit Committee |
| **Kavita Patel** | Non-Executive Director |

Kavita Patel took up her position on the Committee in December 2019.

### 2019 performance and awards

The Chairman's statement, Chief Executive's review and Strategic report on pages 4 to 17 describe 2019 as a period of continued strategic progress in a very competitive and uncertain environment. The Nottingham is a top ten building society with total assets of £3.8 billion. The year has seen conscious subdued trading performance with regard to mortgage lending and fee income. The strategic investment programme has successfully delivered new digital technology and system functionality to plan and costs are being managed. This new digital capability places the Society in a strong position to continue progressing its longer term strategic aims. Therefore, we have ensured that sufficient underlying profit has been generated to maintain our regulatory capital requirements and continue to invest in the Society, whilst maintaining competitive levels of return for our savers.

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

The Directors variable pay is through the Annual Bonus Plan only – the Directors received 50% of the total bonus payment for 2019 following the end of the performance year with 50% being deferred for three years and subject to malus[1] and clawback rules in line with Regulatory best practice. This is a change from the previous bonus plan where 40% of the bonus was paid at the end of the performance year, and 60% was deferred for a three year period.

The deferred bonus for the 2015 performance year was also paid out in full in March 2019 with all conditions met.

### Remuneration Committee

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

The Committee met four times in 2019 and is made up of a minimum of three Non-Executive Directors, as detailed on page 21. The Chief Executive, Head of People & Development, Senior Legal Counsel & Company Secretary attend the meetings.

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

During 2019, the Remuneration Committee reviewed the pension arrangements of Executive Directors in line with the changes to the Corporate Governance Code. The Committee agreed that pension arrangements for any future Executive Directors would be reviewed for alignment with those of all employees and to retain the existing arrangements for current Executive Directors as detailed on page 30.

In light of the revised requirements in the Corporate Governance Code, the Committee is also considering the use of pay ratios and pay gap data across the Group in informing remuneration decisions.

The Remuneration Committee also reviewed and approved the Terms and Conditions of the newly created Leadership Team. Roles were evaluated using the Willis Towers Watson global grading framework and changes were made in February 2019. The Nottingham now uses the Willis Towers Watson global grading and compensation framework to undertake job evaluation and salary benchmarking for all roles across the Group. This is in line with our commitment to fair and transparent pay practices.

The Remuneration Committee's activities in 2019 also included:

- reviewing regulatory updates and assessing the impact on The Nottingham;
- reviewing of the Remuneration Policy for 2019 and recommendation to the Board for approval;
- reviewing and approving the Remuneration Policy Statement ensuring its compliance with the Remuneration Code;
- oversight of the activities undertaken by the Executive Committee and People & Reward Committee in relation to reward;
- agreeing the appointment, salary and benefits for any new executive level roles and Leadership Team members;
- consideration of the annual pay review and bonus scheme approval and payments for all employees;
- reviewing and approving of executive variable pay for the 2019 financial year;

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

- reviewing and approving the terms & conditions and benefits of the Leadership Team;
- set the direction and principles for all variable pay schemes for 2019; and
- agreeing the remuneration aspects required to support an operational restructure within the Society.

## Remuneration policy

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

The policy is there to ensure that:

- Remuneration should be sufficient to attract, reward, retain and motivate high quality leaders and employees to run The Nottingham successfully, delivering value for our members whilst avoiding paying more than is necessary for this purpose in line with our mutual ethos; and
- Remuneration is structured to strike the right balance between fixed and variable pay. Variable pay schemes are designed to incentivise and reward appropriate behaviour and performance, aligned with The Nottingham's position on risk; rewards are only attributed to the delivery of success and achievement of objectives.

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

### Recruitment policy for Executive Directors

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

### Service contracts

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

### Payment for loss of office of Executive Directors

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

### Other directorships

None of the Executive Directors currently hold any paid external directorships. David Marlow is a member of the FCA Small Business Practitioners Panel for which he receives a fee of £10,000 per annum.

### Executive Director's total remuneration

Executive Directors' emoluments comprise a basic salary, variable pay, pension entitlement and other taxable benefits as outlined on page 38.

The total remuneration received by Executive Directors is detailed on page 39. The information has been audited and shows remuneration for the years ending 31 December 2018 and 31 December 2019 as required under the Building Societies (Accounts and Related Provisions) Regulations 1998.

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

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

### Non-Executive Directors

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

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

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

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

### Remuneration Code staff (Material Risk Takers)

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

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

## Executive Directors

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

| Component | Purpose | Operation | Performance measures | Opportunity |
|---|---|---|---|---|
| **Basic salary** | Fixed remuneration set to attract and retain executives of appropriate calibre and experience. Basic salary is assessed by reference to roles carrying similar responsibilities in comparable organisations. A comparator group is used that consists of executive director positions within building societies of a similar size and complexity. | Reviewed annually and linked to personal performance and market sector benchmarking. | Increases based on:<br>• Overall employee pay increases in the Group;<br>• Benchmarking comparisons;<br>• Personal performance; and<br>• Role and experience. | The base salaries of Executive Directors are reviewed as for any other employee in accordance with the reward matrix, except in circumstances where:<br>• Market peer benchmarking indicates that remuneration is moving out of line of the appropriate peer group; and/or<br>• There has been a material increase in scope or responsibility to the Executive Director's role. |
| **Variable pay**<br>Group Annual Bonus Scheme | Linked to the delivery of the Society and personal objectives. Used to reward Executive Directors within the context of achieving the Society's goals and objectives.<br>Payments under the variable pay schemes are not pensionable. | The bonus will only be awarded if the threshold criteria and Society and individual performance targets are met and a payment is triggered in the Group Bonus Scheme.<br>50% (60% for 2018 financial year and earlier) of the bonus is deferred for three years and payment is subject to meeting Society and individual performance threshold criteria in each of the years from award to payment.<br>The Committee has the discretion to reduce or withhold the deferred element if it becomes apparent that the basis on which the variable pay award was made was wrong or that financial performance has deteriorated materially since the award.<br>The deferred payment is also subject to clawback for a period of three years after payment. | The scheme is based upon three elements:<br>• **The Building Society Core Scheme Balanced Scorecard** measures Society performance against four strategic pillars:<br>- Financial adequacy;<br>- Growing & rewarding membership;<br>- People, Culture & Community; and<br>- Safe & Secure.<br>• **Individual performance** including achievement of strategic objectives.<br>Personal performance objectives, appropriate to the responsibilities of the Director, including the achievement of appropriate strategic progress are set at the start of each year. Objectives are set within board risk appetite and regulatory requirements. | On target of 21% and maximum of 35% of basic salary payable with 50% of the award deferred over a three year period. |
| **Pension or pension allowance** | A part of fixed remuneration to attract and retain executives of appropriate calibre and experience. | Executive Directors are invited to join the Society's defined contribution pension plan, or, as an alternative, be provided with an equivalent cash allowance. | Not applicable | Contribution of 15% of base salary or paid as cash allowance. |
| **Benefits** | A part of fixed remuneration to attract and retain executives of appropriate calibre and experience. | The benefits received by Executive Directors are private medical insurance and a car allowance. | Not applicable | Set at a level considered appropriate for each Executive Director by the Committee in line with market practice. |

## Annual report on remuneration

### Executive Director remuneration

| Audited Society | 2019 David Marlow £000 | 2019 Daniel Mundy £000 | 2019 Charles Roe £000 | 2019 Simon Taylor £000 | 2019 Total £000 | 2018 David Marlow £000 | 2018 Daniel Mundy £000 | 2018 Charles Roe £000 | 2018 Simon Taylor £000 | 2018 Total £000 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Fixed remuneration** | | | | | | | | | | |
| Salary[1] | 313 | 241 | 184 | - | **738** | 306 | 236 | - | 493 | **1,035** |
| Benefits | 10 | 9 | 10 | - | **30** | 10 | 9 | - | 8 | **27** |
| **Variable remuneration** | | | | | | | | | | |
| Annual bonus[2] | 91 | 30 | - | - | **121** | 37 | 28 | - | - | **65** |
| Long term incentive plans[3] | - | - | - | - | **-** | 58 | - | - | 43 | **101** |
| | 414 | 281 | 194 | - | **889** | 411 | 273 | - | 544 | **1,228** |
| Pension contribution | 47 | 36 | 26 | - | **109** | 46 | 35 | - | 32 | **113** |
| | **461** | **317** | **220** | **-** | **998** | **457** | **308** | **-** | **576** | **1,341** |

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

[1] Charles Roe became an Executive Director on 16 January 2019.

Simon Taylor left the Society on 30 November 2018. His 2018 salary includes £232,000 for contractual payment in lieu of notice and an ex-gratia payment of £80,000 made in lieu of the 2018 annual bonus, holiday pay and in recognition of his commitment and service to the Society.

[2] The annual bonus figure reflects the amount awarded in the year, which is not subject to deferral, and the deferred amount from the 2015 financial year, which was paid in year. The remaining element, which is subject to deferral and the achievement of threshold criteria, will be disclosed in the year of payment.

[3] Legacy LTI Scheme now fully paid out.

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

| Executive Directors | Performance Year | Due 2020 2016 | Due 2021 2017 | Due 2022 2018 | Due 2023 2019 | Total Deferred |
|---|---|---|---|---|---|---|
| | | **£000** | **£000** | **£000** | **£000** | **£000** |
| David Marlow | | 47 | 64 | 56 | 37 | 204 |
| Daniel Mundy | | - | 32 | 42 | 30 | 104 |
| | | **47** | **96** | **98** | **67** | **308** |

Simon Taylor (who left the Society on 30 November 2018), received an outstanding deferred bonus of £38,000 in 2019 in line with the terms of the annual bonus scheme. Two further deferred payments of £33,000 in 2020 and £47,000 in 2021 remain outstanding. This is subject to the achievement of the threshold criteria and Remuneration Committee approval.

GOVERNANCE

## Annual report on remuneration (continued)

### Non-Executive Director remuneration

| Audited<br>Society | | 2019<br>£000 | 2018<br>£000 |
|---|---|---|---|
| Simon Baum | | 57 | 35 |
| John Edwards (Chairman) | | 74 | 71 |
| Jane Kibbey (Vice-Chairman until retirement) | (retired 24 April 2019) | 15 | 45 |
| Simon Linares | (appointed 1 December 2019) | 4 | - |
| Andrew Neden (Vice-Chairman from 18 June 2019) | | 59 | 50 |
| Kavita Patel | | 42 | 39 |
| Kerry Spooner | | 51 | 47 |
| **TOTAL EMOLUMENTS FOR SERVICES AS DIRECTORS** | | **302** | **287** |

On behalf of the Board,

Kerry Spooner
Chair of the Remuneration Committee

5 March 2020

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

### Opinion

In our opinion, the financial statements:

- Give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's and the Society's affairs as at 31 December 2019 and of the Group's and the Society's income and expenditure for the year then ended; and
- Have been prepared in accordance with the requirements of the Building Societies Act 1986, and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements of Nottingham Building Society which comprise:

| Group | Society |
|---|---|
| Consolidated statement of financial position as at 31 December 2019 | Statement of financial position as at 31 December 2019 |
| Consolidated income statement for the year ended 31 December 2019 | Income statement for the year ended 31 December 2019 |
| Consolidated statement of comprehensive income for the year ended 31 December 2019 | Statement of comprehensive income for the year ended 31 December 2019 |
| Consolidated statement of changes in members' interests for the year ended 31 December 2019 | Statement of changes in members' interests for the year ended 31 December 2019 |
| Consolidated cash flow statement for the year ended 31 December 2019 | Cash flow statement for the year ended 31 December 2019 |
| Related notes 1 to 37 to the accounts, including a summary of principle accounting policies | Related notes 1 to 37 to the accounts, including a summary of principle accounting policies |

The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Group and Society in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### Conclusions relating to principal risks, going concern and viability statement

The directors have voluntarily complied with the UK Corporate Governance Code (the "Code") and Listing Rule 9.8.6(R)(3)(a) of the FCA and provided a statement in relation to going concern, required for companies with a premium listing on the London Stock Exchange. As a result, we have nothing to report in respect of the following information in the annual report, in relation to which the ISAs (UK) require us to report to you whether we have anything material to add or draw attention to:

- the disclosures in the annual report set out on pages 16 to 17 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation set out on page 24 in the annual report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity;
- the directors' statement set out on page 24 in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements;
- whether the directors' statement in relation to going concern required under the Listing Rules in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit; or
- the directors' explanation set out on page 24 in the annual report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

## Overview of our audit approach

| | |
|---|---|
| Key audit matters | • Revenue recognition in relation to effective interest rate (EIR) accounting;<br>• Valuation of loan impairment; |
| Audit scope | • We performed an audit of the complete financial information of the Group and Society.<br>• Our audit did not involve any component teams. |
| Materiality | • Overall Group materiality of £0.35m which equates to 3.5% of the Group's 2019 adjusted profit before tax. |

## Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

| **Risk** | **Our response to the risk** | **Key observations communicated to the Audit Committee** |
|---|---|---|
| **Risk of fraud in revenue recognition in relation to effective interest rate (EIR) accounting** | | |
| Refer to the Audit Committee report (page 34) and Accounting policies (pages 52 to 53) of the Consolidated financial statements.<br><br>Effective interest rate accounting is a judgemental area driven by customer payment behaviours and management's assumptions regarding future interest rates and expected behavioural lives of mortgages.<br><br>Changes in these assumptions could have a material impact on income recognition and could be subject to manipulation and therefore we classified this as a key audit matter. | We assessed the design effectiveness of internal controls operated by the Group over the EIR process. Our audit approach did not seek to rely on the controls identified.<br><br>We tested the completeness and accuracy of data on a sample basis, from the Society's source system to the EIR models.<br><br>We challenged assumptions regarding the expected lives of loans by comparing them to recent actual redemption behaviours, and wider industry trends. We also challenged these assumptions with reference to planned changes in operational processes that are expected to reduce Standard Variable Rate income in future periods.<br><br>We verified the logic and accuracy of the EIR calculation across products and agreed EIR balance to the general ledger.<br><br>We performed testing of journals recorded throughout the year and at the year-end using an approach based on risk of management override of controls. In each case we substantiated journals recorded to supporting evidence. | We concluded to the Audit Committee that the effective interest rate adjustments made to the Group's loan portfolios were materially correct at 31 December 2019.<br><br>We gained assurance of the completeness and accuracy of data used within EIR models.<br><br>We found that key assumptions in relation to behavioural lives of assets and future customer interest rates were materially consistent with the underlying data and the forecast effects of operational changes planned for implementation in 2020.<br><br>We found that the models were operating effectively in the calculation of EIR adjustments and that the results were accurately reflected in the general ledger.<br><br>We found no significant errors or evidence of management override of controls from testing of journal entries. |

| Risk | Our response to the risk | Key observations communicated to the Audit Committee |
|---|---|---|
| **Valuation of loan impairment** | | |
| Refer to Audit Committee report (page 34); Accounting policies (pages 53 to 55) and Note 15 of the Consolidated financial statements.<br><br>Valuation of loan impairment is an area of estimation that requires management judgement. Whilst the vast majority of the Society's portfolio is high quality with low arrears rates, impairment estimates applied are inherently a subjective area and involve a number of assumptions.<br><br>Such assumptions include exposure at default, the definition of a significant increase in credit risk, the probability of default rate, loss given default and multiple economic scenarios.<br><br>Given the amount of estimation involved and the value of the loan impairment provisions compared to audit materiality, we have classified this as a key audit matter. | We assessed the design effectiveness of internal controls operated by the Group over the loan impairment process. Our audit approach did not seek to rely on the controls identified.<br><br>We tested the completeness and accuracy of data on a sample basis over key data inputs to loan impairment models to source documentation.<br><br>We engaged modelling specialists to test the models including independent replication of the models with comparison to management's outputs and testing of the model code.<br><br>We utilised a specialist economist team to test the multiple economic scenarios for appropriateness.<br><br>We validated the output of the model through to the relevant account balances included within the financial statements and tested that the loan impairment disclosures are accurate.<br><br>We challenged management over the appropriateness of overlays outside the model process.<br><br>We performed testing of journals recorded throughout the year and at the year-end using an approach based on risk of management override of controls. In each case we substantiated journals recorded to supporting evidence. | We concluded to the Audit Committee that the provision levels held by the Group in relation to mortgages loan impairment were conservative when compared to a reasonable range using historical data and industry benchmarks.<br><br>We gained assurance of the completeness and accuracy of data used within the loan impairment models.<br><br>We found that the models were operating effectively in the calculation of loan impairment balances and that the results were accurately reflected in the general ledger.<br><br>We found no significant errors or evidence of management override of controls from testing of journal entries. |

In the prior year, our auditor's report included a key audit matter in relation to valuation of goodwill. In the current year, the goodwill balance has been fully impaired. We concur with the Directors' assessment that the carrying value of goodwill is fully written down at 31 December 2019.

## Our application of materiality

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

## Materiality

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

We determined materiality for the Group to be £0.35 million (2018: £1.07 million), which is 3.5% of the Group's 2019 profit before tax adjusted to account for items considered not to be part of normal business operations, including goodwill impairment, strategic costs and fair value movements of derivative instruments.

| | |
|---|---|
| **Standing basis** | • **Statutory loss before tax – £8.00m** |
| **Adjustments** | • **Add back non-underlying items - £17.90m** |
| **Materiality** | • **Adjusted profit before tax - £9.90m**<br>• **Materiality of £0.35m (3.5% of adjusted profit before tax)** |

## Performance materiality

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

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 75% (2018: 75%) of our planning materiality, namely £0.25 million (2018: £0.8 million). We have set performance materiality at this percentage based upon our recent experience of auditing the Group, from which we concluded that there is a lower expectation of undetected misstatement due to the effective control environment and only minor audit differences resulting from our work. As a result, we determined that the higher of our permissible thresholds for our performance materiality was appropriate.

We used a proportion of this value for performing the audit work on the subsidiaries, taking into consideration account size, risk profile, the organisation of the group and effectiveness of Group-wide controls, changes in the business environment and other factors, such as recent Internal audit results, when assessing the level of work to be performed at each entity. The performance materiality set for each subsidiary is based on the relative scale and risk of the subsidiary to the Group as a whole and our assessment of the risk of misstatement at that subsidiary. Our objective in adopting this approach was to ensure that total uncorrected and undetected audit differences in the financial statements did not exceed our materiality level. Our Group audit scope included all of the Society's subsidiaries. Our audit did not involve any component teams.

## Reporting threshold

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

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.02 million (2018: £0.06 million), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

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

## Other information

The other information comprises the information included in the annual report set out on pages 4 to 40, including Chairman's statement set out on pages 4 to 5, Chief Executive's statement set out on pages 6 to 7, Strategic report set out on pages 8 to 17, Corporate responsibility report set out on pages 18 to 19, Directors' report as set out on pages 22 to 24, Risk management report as set out on pages 25 to 29, Corporate governance report as set out on pages 30 to 33, and the Board Audit Committee report as set out on pages 34 to 35, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact. We have nothing to report in this regard.

The directors have voluntarily complied with the UK Corporate Governance Code (the "Code") and prepares a Corporate Governance Statement in accordance with the Disclosure Guidance and Transparency Rules of the Financial Conduct Authority (FCA).

The directors have requested that we review the parts of the Corporate Governance Statement relating to the Society's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) as if the Society were a premium listed company.

In this context, we also have nothing to report in regard to our responsibility to specifically address the following items in the other information and to report as uncorrected material misstatements of the other information where we conclude that those items meet the following conditions:

- **Fair, balanced and understandable set out on page 24** – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or

- **Audit committee reporting set out on pages 34 to 35** – the section describing the work of the audit committee does not appropriately address matters communicated by us to the audit committee; or
- **Directors' statement of compliance with the UK Corporate Governance Code set out on page 24** – the parts of the directors' statement required under the Listing Rules relating to the Society's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

## Opinion on other matters prescribed by the Building Societies Act 1986

In our opinion:

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

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

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 Society financial statements are not in agreement with the accounting records; or
- We have not received all the information and explanations and access to documents we require for our audit.

## Other voluntary reporting matters

### Directors' remuneration report

The Society voluntarily prepares a Report of the directors on remuneration in accordance with the provisions of the Companies Act 2006. The directors have requested that we audit the part of the Report of the directors on remuneration specified by the Companies Act 2006 to be audited as if the Society were a quoted company.

In our opinion, the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

## Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 23, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

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

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

## Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

The objectives of our audit, in respect to fraud, are: to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Group and determined that the most significant were the regulations, licence conditions and supervisory requirements of the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).

# INDEPENDENT AUDITOR'S REPORT (continued)

- We understood how the Group is complying with those frameworks by making enquiries of management, internal audit, and those responsible for legal and compliance matters. We also performed a review of regulatory correspondence and reviewed minutes of the Board and Board Risk Committee meetings held, and gained an understanding of the Group's approach to governance and internal control processes.
- We assessed the susceptibility of the Group and Society's financial statements to material misstatement, including how fraud might occur, by considering the entity level controls that the Group has established to address risks identified by the entity, or that otherwise seek to prevent, deter or detect fraud. We also considered performance and incentive plan targets and their potential to influence management to manage earnings.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations identified in the paragraphs above. Our procedures involved inquiries of legal counsel, executive management, internal audit, and focused testing, as referred to in the Key Audit Matters section above.
- The Group operates in the financial services industry which is a highly regulated environment. As such the Senior Statutory Auditor considered the experience and expertise of the engagement team to ensure that the team had the appropriate competence and capabilities, which included the use of specialists where appropriate.

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

## Other matters we are required to address

Following the recommendation of the audit committee we were appointed by the Society at its annual general meeting on 24 March 2015 to audit the financial statements of the Society for the period ending 31 December 2015 and subsequent financial periods. Our total uninterrupted period of engagement is five years, covering periods from our appointment through to the period ending 31 December 2019.

The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Society and we remain independent of the Group and the Society in conducting the audit.

The audit opinion is consistent with the Audit Results Report provided to the audit committee.

## Use of our report

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.

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

5 March 2020

Notes:

1. The maintenance and integrity of the Nottingham Building Society web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

# INCOME STATEMENTS
## for the year ended 31 December 2019

| | Notes | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|---|
| Interest receivable and similar income | 3 | 84.0 | 85.4 | 84.9 | 86.8 |
| Interest payable and similar charges | 4 | (37.9) | (35.2) | (38.8) | (36.6) |
| **NET INTEREST INCOME** | | **46.1** | **50.2** | **46.1** | **50.2** |
| Fees and commissions receivable | | 6.2 | 7.5 | 2.2 | 2.9 |
| Fees and commissions payable | | (1.1) | (1.4) | (1.1) | (1.4) |
| Other income | | 0.2 | - | - | 0.3 |
| Net losses from derivative financial instruments | 5 | (0.6) | (0.7) | - | (1.2) |
| **TOTAL NET INCOME** | | **50.8** | **55.6** | **47.2** | **50.8** |
| Administrative expenses | 6 | (36.5) | (40.0) | (31.8) | (34.4) |
| Depreciation and amortisation | 17,18 ,19 | (5.5) | (3.4) | (5.2) | (3.3) |
| Pension finance cost | 28 | (0.1) | (0.3) | (0.1) | (0.3) |
| Operating profit before impairment, change in EIR accounting estimate, fair value movement and provisions | | 8.7 | 11.9 | 10.1 | 12.8 |
| Impairment (charge)/ release - loans and advances | 15 | (0.4) | 0.3 | (0.4) | 0.3 |
| Impairment charge - goodwill | 18 | (4.0) | (0.5) | - | - |
| Change in EIR accounting estimate | 3 | (12.3) | - | (12.3) | - |
| Fair value movement of intercompany balances | 16 | - | - | (2.0) | - |
| Provisions release – FSCS levy and other | 27 | - | 0.1 | - | 0.1 |
| **(LOSS)/PROFIT BEFORE TAX** | | **(8.0)** | **11.8** | **(4.6)** | **13.2** |
| Tax credit/(expense) | 8 | 0.8 | (2.4) | 0.7 | (2.5) |
| **(LOSS)/PROFIT AFTER TAX FOR THE FINANCIAL YEAR** | | **(7.2)** | **9.4** | **(3.9)** | **10.7** |

The loss for the financial year arises from continuing operations.

A reconciliation from (loss)/profit before tax for the financial year to underlying profit used by management can be found on page 9.

The notes on pages 52 to 101 form part of these accounts.

# STATEMENTS OF COMPREHENSIVE INCOME
## for the year ended 31 December 2019

| | Notes | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|---|
| **(Loss)/profit for the financial year** | | (7.2) | 9.4 | (3.9) | 10.7 |
| **Items that will not be re-classified to the income statement** | | | | | |
| Remeasurements of defined benefit obligation | 28 | - | 0.4 | - | 0.4 |
| Tax on items that will not be re-classified | 8 | - | (0.1) | - | (0.1) |
| **Items that may subsequently be re-classified to the income statement** | | | | | |
| FVOCI reserve | | | | | |
| Valuation gains/(losses) taken to reserves | 12 | 0.7 | (1.2) | 0.7 | (1.2) |
| Tax on items that may subsequently be re-classified | 8 | (0.1) | 0.2 | (0.1) | 0.2 |
| **Other comprehensive income/(expense) for the period net of income tax** | | **0.6** | **(0.7)** | **0.6** | **(0.7)** |
| **TOTAL COMPREHENSIVE (EXPENSE)/INCOME FOR THE YEAR** | | **(6.6)** | **8.7** | **(3.3)** | **10.0** |

Both the (loss)/profit for the financial year and total comprehensive (expense)/income for the period are attributable to the members of the Society.

The notes on pages 52 to 101 form part of these accounts.

# STATEMENTS OF FINANCIAL POSITION
## as at 31 December 2019

| | Notes | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash in hand and balances with the Bank of England | 9 | 272.4 | 256.3 | 272.4 | 256.3 |
| Loans and advances to credit institutions | 10 | 36.1 | 34.5 | 29.9 | 19.0 |
| Debt securities | 12 | 306.6 | 216.1 | 306.6 | 216.1 |
| Derivative financial instruments | 13 | 2.0 | 8.2 | 2.0 | 7.8 |
| Loans and advances to customers | 14 | 3,161.4 | 3,502.9 | 3,161.4 | 3,502.9 |
| Amounts due from subsidiary undertakings | 16 | - | - | 20.3 | 21.2 |
| Other assets | | 3.5 | 10.2 | 3.3 | 10.0 |
| Property, plant and equipment | 17 | 12.1 | 13.8 | 11.2 | 12.8 |
| Right of use assets | 19 | 5.3 | - | 4.4 | - |
| Intangible assets | 18 | 17.0 | 10.2 | 17.0 | 6.2 |
| Current tax asset | | 1.5 | - | 1.5 | - |
| Deferred tax assets | 20 | 1.1 | 1.4 | 0.9 | 1.4 |
| **TOTAL ASSETS** | | **3,819.0** | **4,053.6** | **3,830.9** | **4,053.7** |
| **LIABILITIES** | | | | | |
| Shares | 21 | 2,781.1 | 2,869.2 | 2,781.1 | 2,869.2 |
| Amounts owed to credit institutions | 22 | 611.3 | 685.0 | 611.3 | 685.0 |
| Amounts owed to other customers | 23 | 91.9 | 126.2 | 91.9 | 126.2 |
| Amounts owed to subsidiary undertakings | 24 | - | - | 77.2 | 106.1 |
| Debt securities in issue | 25 | 68.1 | 106.8 | 5.5 | 5.5 |
| Derivative financial instruments | 13 | 12.8 | 5.9 | 12.6 | 5.9 |
| Other liabilities and accruals | 26 | 4.0 | 6.2 | 3.5 | 5.8 |
| Lease liabilities | 19 | 5.3 | - | 4.3 | - |
| Current tax liabilities | | - | 1.0 | - | 1.0 |
| Provisions for liabilities | 27 | 0.2 | 0.6 | 0.2 | 0.6 |
| Retirement benefit obligations | 28 | 3.4 | 4.8 | 3.4 | 4.8 |
| Subscribed capital | 29 | 24.7 | 25.1 | 24.7 | 25.1 |
| **TOTAL LIABILITIES** | | **3,602.8** | **3,830.8** | **3,615.7** | **3,835.2** |
| **RESERVES** | | | | | |
| General reserves | | 216.6 | 223.8 | 215.6 | 219.5 |
| Fair value reserves | 30 | (0.4) | (1.0) | (0.4) | (1.0) |
| **Total reserves attributable to members of the Society** | | **216.2** | **222.8** | **215.2** | **218.5** |
| **TOTAL RESERVES AND LIABILITIES** | | **3,819.0** | **4,053.6** | **3,830.9** | **4,053.7** |

The notes on pages 52 to 101 form part of these accounts.

These accounts were approved by the Board of directors on 5 March 2020 and signed on its behalf:

**John Edwards**
Chairman

**David Marlow**
Chief Executive

**Daniel Mundy**
Chief Financial Officer

# STATEMENTS OF CHANGES IN MEMBERS' INTERESTS
## for the year ended 31 December 2019

| | General reserves £m | FVOCI reserve £m | Total £m |
|---|---|---|---|
| **GROUP 2019** | | | |
| Balance as at 1 January 2019 | 223.8 | (1.0) | 222.8 |
| Loss for the year | (7.2) | - | (7.2) |
| Other comprehensive income for the period (net of tax) | | | |
| Net gains from changes in fair value | - | 0.6 | 0.6 |
| Total other comprehensive income | - | 0.6 | 0.6 |
| Total comprehensive (expense)/income for the period | (7.2) | 0.6 | (6.6) |
| **BALANCE AS AT 31 DECEMBER 2019** | **216.6** | **(0.4)** | **216.2** |
| **GROUP 2018** | | | |
| Balance as at 1 January 2018 | 212.7 | - | 212.7 |
| Change on initial recognition of IFRS 9 | 1.4 | - | 1.4 |
| Profit for the year | 9.4 | - | 9.4 |
| Other comprehensive income for the period (net of tax) | | | |
| Net losses from changes in fair value | - | (1.0) | (1.0) |
| Remeasurement of defined benefit obligation | 0.3 | - | 0.3 |
| Total other comprehensive income/(expense) | 0.3 | (1.0) | (0.7) |
| Total comprehensive income/(expense) for the period | 9.7 | (1.0) | 8.7 |
| **BALANCE AS AT 31 DECEMBER 2018** | **223.8** | **(1.0)** | **222.8** |

| | General reserves £m | FVOCI reserve £m | Total £m |
|---|---|---|---|
| **SOCIETY 2019** | | | |
| Balance as at 1 January 2019 | 219.5 | (1.0) | 218.5 |
| Loss for the year | (3.9) | - | (3.9) |
| Other comprehensive income for the period (net of tax) | | | |
| Net gains from changes in fair value | - | 0.6 | 0.6 |
| Total other comprehensive income/(expense) | - | 0.6 | 0.6 |
| Total comprehensive (expense)/income for the period | (3.9) | 0.6 | (3.3) |
| **BALANCE AS AT 31 DECEMBER 2019** | **215.6** | **(0.4)** | **215.2** |
| **SOCIETY 2018** | | | |
| Balance as at 1 January 2018 | 215.7 | - | 215.7 |
| Change on initial recognition under IFRS 9 | (7.2) | - | (7.2) |
| Profit for the year | 10.7 | - | 10.7 |
| Other comprehensive income for the period (net of tax) | | | |
| Net losses from changes in fair value | - | (1.0) | (1.0) |
| Remeasurement of defined benefit obligation | 0.3 | - | 0.3 |
| Total other comprehensive income/(expense) | 0.3 | (1.0) | (0.7) |
| Total comprehensive income/(expense) for the period | **11.0** | **(1.0)** | **10.0** |
| **BALANCE AS AT 31 DECEMBER 2018** | **219.5** | **(1.0)** | **218.5** |

The notes on pages 52 to 101 form part of these accounts.

# CASH FLOW STATEMENTS
## for the year ended 31 December 2019

| | Notes | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | | | |
| (Loss)/profit before tax | | (8.0) | 11.8 | (4.6) | 13.2 |
| Depreciation and amortisation | | 5.5 | 3.4 | 5.2 | 3.3 |
| Interest on subscribed capital | | 2.0 | 2.0 | 2.0 | 2.0 |
| Interest on lease payments | | 0.1 | - | 0.1 | - |
| Net gains on disposal and amortisation of debt securities | | 0.5 | 0.6 | 0.5 | 0.6 |
| Increase/(decrease) in impairment | | 4.4 | 0.2 | 0.4 | (0.3) |
| | | **4.5** | **18.0** | **3.6** | **18.8** |
| **CHANGES IN OPERATING ASSETS AND LIABILITIES** | | | | | |
| Decrease/(increase) in prepayments, accrued income and other assets | | 12.9 | (5.2) | (15.5) | (49.9) |
| Increase/(decrease) in accruals, deferred income and other liabilities | | 3.9 | (3.4) | 3.6 | (11.8) |
| Decrease/(increase) in loans and advances to customers | | 341.1 | (132.1) | 341.1 | (132.1) |
| (Decrease)/increase in shares | | (88.1) | 273.8 | (88.1) | 273.8 |
| Decrease in amounts owed to other credit institutions and other customers | | (108.0) | (77.6) | (108.0) | (77.6) |
| (Increase)/decrease in loans and advances to credit institutions | | (11.2) | 0.7 | (11.2) | 0.7 |
| Decrease in debt securities in issue | | (38.7) | (46.7) | - | (1.5) |
| Decrease in retirement benefit obligation | | (1.5) | (2.1) | (1.5) | (2.1) |
| Taxation paid | | (1.4) | (2.9) | (1.4) | (2.9) |
| **NET CASH GENERATED BY OPERATING ACTIVITIES** | | **113.5** | **22.5** | **122.6** | **15.4** |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | | | |
| Purchase of debt securities | | (334.8) | (135.7) | (334.8) | (135.7) |
| Disposal of debt securities | | 244.5 | 27.0 | 244.5 | 27.0 |
| Purchase of property, plant and equipment | | (0.4) | (1.4) | (0.4) | (1.3) |
| Purchase of intangible assets | | (13.3) | (4.7) | (13.3) | (4.7) |
| **NET CASH USED IN INVESTING ACTIVITIES** | | **(104.0)** | **(114.8)** | **(104.0)** | **(114.7)** |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | | | |
| Interest paid on subscribed capital | | (1.9) | (1.9) | (1.9) | (1.9) |
| Principal element of lease payments | | (1.1) | - | (0.9) | - |
| **NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS** | | **6.5** | **(94.2)** | **15.8** | **(101.2)** |
| Cash and cash equivalents at 1 January | | 266.1 | 360.3 | 250.6 | 351.8 |
| **CASH AND CASH EQUIVALENTS AT 31 DECEMBER** | 11 | **272.6** | **266.1** | **266.4** | **250.6** |

The notes on pages 52 to 101 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 FVOCI assets, intercompany balances and derivatives.

The accounts have been prepared on the going concern basis as outlined in the Directors' report on page 24.

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

With effect from 1 January 2019, the Group applies, for the first time, IFRS 16 'Leases' and the Group has therefore changed its accounting policies as a result of adopting this new standard. The impacts of IFRS 16 on the Group have been disclosed in note 37 to the Annual Report & Accounts.

There has been no restatement of comparative periods as a result of adopting the new standards.

### Future accounting developments

A number of amendments and improvements to accounting standards have been issued by the International Accounting Standards Board (IASB) with an effective date of 1 January 2019. They do not impact these financial statements.

### Basis of consolidation

Subsidiary companies are defined as those in which the Society has the power over relevant activities, has exposure to the rights of variable returns and has the influence to affect those returns.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group and de-consolidated from the date that control ceases. The Group accounts consolidate the assets, liabilities and results of the Society and all of its subsidiaries, eliminating intercompany balances and transactions. All entities have accounting periods ending on 31 December. The results of subsidiary undertakings acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date that ownership ceases.

### Special purpose funding vehicles

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

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

### Business combinations between mutual organisations

Identifiable assets and liabilities are measured at fair value. Intangible assets are amortised through the income statement over their estimated useful lives, being between one and ten years. A deemed purchase price is calculated by measuring the fair value of the acquired business. Goodwill is measured as the difference between the adjusted value of the acquired assets and liabilities and the deemed purchase price. Goodwill is recorded as an asset; negative goodwill is recognised in the income statement.

### Business combinations

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

### 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'.

During the year, the Group has recognised a non-recurring change in accounting estimate in respect of its mortgage EIR assets. As this adjustment is not reflective of the underlying yield of the related assets, it has been separately presented outside of interest income due to its size and to provide clear presentation for users of the financial statements.

The effective interest rate (EIR) method is applied for all financial assets or liabilities recorded at amortised cost, FVOCI, interest rate derivatives for which hedge accounting is applied and the related amortisation/recycling effect of hedge accounting. The effective interest rate is the rate that discounts the expected future cash flows, over the expected life of the financial instrument, to the net carrying amount of the financial asset or liability. This may include fees and commissions if they are an integral part of the effective interest rate of a financial instrument.

Interest income on financial assets is calculated by applying the EIR to the gross carrying amount of the financial asset, unless considered credit impaired. When a financial asset becomes credit impaired, and therefore considered as Stage 3, interest income is calculated by applying the EIR to the net amortised cost of the financial asset. If the financial asset cures and is no longer credit impaired, interest income is reverted to being calculated on a gross basis.

## 1. ACCOUNTING POLICIES (CONTINUED)

Interest income and expense also includes interest on derivatives measured at FVPL, where hedge accounting is not applied, using the contractual interest rate.

### Fees and commissions

Fees receivable are generally recognised when all performance obligations of the contract 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 performance obligations, that is the inception date of the product or on completion of a mortgage.

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

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

### Cash and cash equivalents

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

### Derivative financial instruments and hedge accounting

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

The Group has elected to continue to apply the hedge accounting requirements of IAS 39 on adoption of IFRS 9.

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

If derivatives are not designated as hedges, then changes in their fair values are recognised immediately in the income statement in the period in which they arise.

#### Fair value hedges

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

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

### Financial assets

#### Classification and Measurement

Financial assets comprise cash, loans and advances to credit institutions, debt securities, derivative financial instruments and loans and advances to customers. The Group classifies non-derivative financial assets as either amortised cost, FVOCI or FVPL depending on the business model for managing the assets and the contractual cash flow characteristics. The Group determines its business model at the level that best reflects how it manages groups of assets to achieve its business objective. In making this assessment it considers how the performance of the business model is evaluated and reported within the Group, how the risks of the business model are managed and the expected frequency, value and timing of sales of assets. The contractual terms of the financial assets are assessed to determine whether their cash flows represent solely payments of principal and interest or expose the Group to other risks. Management determines the classification of financial assets under IFRS 9 at the earlier of 1 January 2018 or initial recognition.

#### Amortised cost

Financial assets whose business model is to hold for collection of contractual cash flows where those cash flows represent solely payments of principal and interest (SPPI) are measured at amortised cost. Interest income from these financial assets is included in net interest income using the effective interest rate method. Any gain or loss arising on derecognition is recognised directly in profit or loss. The carrying value of these assets is adjusted by any expected credit loss allowance recognised. The Society classifies the following financial instruments as amortised cost:

- cash in hand and balances with the Bank of England;
- loans and advances to credit institutions; and
- loans and advances to customers.

#### Loans and advances to customers

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

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

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

## 1. ACCOUNTING POLICIES (CONTINUED)

***Fair value through other comprehensive income (FVOCI)***
The Society recognises its debt securities as FVOCI assets. The business model for these financial assets is to hold for collection of contractual cash flows and for selling the financial assets, where the assets' cash flows represent solely payments of principal and interest and are measured at FVOCI. Movements in the carrying amount are taken through Other Comprehensive Income (OCI). When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from reserves to the income statement. Interest income from these financial assets is included in net interest income using the effective interest rate method. The expected credit loss for these assets does not reduce the carrying amount in the statement of financial position, which remains at fair value. Instead, an amount equal to the allowance that would arise if the assets were at amortised cost, is recognised in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss.

***Fair value through profit or loss (FVPL)***
Assets that do not meet the criteria for amortised cost or FVOCI are measured at FVPL. Interest income from these financial assets is included in net interest income. The Society recognises its derivative financial instruments and some of its balances with subsidiary entities as FVPL assets.

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

Under IFRS 9, the Group assesses on a forward-looking basis the expected credit losses (ECL) associated with its financial assets carried at amortised cost and FVOCI and with the exposure arising from loan commitments. The allowance is based on the ECLs associated with the probability of default in the next 12 months unless there has been a significant increase in credit risk since origination and the measurement of ECL reflects:

- An unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes;
- The time value of money; and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

IFRS 9 outlines a 'three-stage' model for impairment based on changes in credit quality since initial recognition as summarised below:

- **Stage 1**: A financial instrument that is not credit-impaired on initial recognition and has its credit risk continuously monitored by the Group. ECL is measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months.
- **Stage 2**: If a significant increase in credit risk (SICR) since initial recognition is identified, the financial asset is moved to 'Stage 2' but is not yet deemed to be credit impaired. The definition of a significant increase in credit risk is detailed below. ECL for stage 2 assets are measured based on expected credit losses on a lifetime basis.
- **Stage 3**: If the financial asset is credit-impaired, it is moved to 'Stage 3'. The definition of credit-impaired and default is outlined below. ECL for stage 3 assets is also measured on expected credit losses on a lifetime basis.

Forward-looking information is taken into account in the measurement of ECL with its use of economic assumptions such as inflation, unemployment rates, house price indices and Gross Domestic Product.

The Group has no purchased or originated credit impaired assets and has not applied any simplified approaches.

***Significant increase in credit risk (SICR)***

The Group considers a financial instrument to have experienced a significant increase in credit risk when one of more of the following criteria has been met:

| Financial instrument | Definition of significant increase in credit risk |
|---|---|
| Loans and advances to customers – Retail | • Over 30 days past due on contractual repayments;<br>• In forbearance;<br>• Lifetime probability of default doubled since origination; and<br>• Lifetime probability of default greater than 1%. |
| Loans and advances to customers – SBL | • Over 30 days past due on contractual repayments;<br>• On management watch list;<br>• Lifetime probability of default doubled since origination; or<br>• In forbearance. |
| Wholesale liquidity instruments | • Any arrears or receipt of adverse information |

***Definition of default and credit-impaired***

The Group defines a financial asset as in default, which is fully aligned with the definition of credit-impaired, when it is more than 90 days past due on contractual repayments.

It is the Society's policy to consider a financial instrument as 'cured' and therefore reclassified out of Stage 3 when none of the default criteria have been present for at least six consecutive months. The decision whether to classify an asset as Stage 2 or Stage 1 once cured depends on the updated position, at the time of the cure, and whether there has been a significant increase in credit risk compared to initial recognition.

### Loans and advances to customers

***Forward-looking information incorporated in the ECL models***

The assessment of SICR and the calculation of ECL both incorporate forward-looking information. Forecasts of these economic variables are provided by a reputable third party on a quarterly basis and provide the best estimate view of the economy over the next five years. After five years, to project the economic variables out for the full remaining lifetime, a mean reversion approach is used, i.e. long-run averages.

In addition to the base economic scenario forecast, other possible scenarios along with scenario weightings are obtained, of which management have applied three scenarios in the model calculations.

## 1. ACCOUNTING POLICIES (CONTINUED)

***ECL models***

The ECL models are driven by three key components:

- **Probability of Default (PD):** The PD model takes attributes of the mortgage accounts on the portfolio (for example, origination vintage and time on book) and adjusts for the impacts of a range of independently sourced forward-looking macroeconomic scenarios to produce a vector detailing the likelihood of an account defaulting in a given month within the expected behavioural lifetime. The model outputs are scaled against a number of internal risk grades which are determined using the Society's behavioural scoring models. These behavioural scoring models contain a combination of internal and externally derived data to rank the mortgage accounts by risk and pool the accounts into groups of comparable expected performance.
- **Exposure at Default (EAD):** The EAD model predicts the loan exposure of each mortgage account at a future default date. The model takes into account balance amortisation and accrued interest from missed payments given expected changes in the repayment terms of the mortgage; for example interest rates may move in a manner consistent with the macroeconomic scenarios. The calculation produces a vector to represent 'expected' EAD at each potential point of default along the vector from the reporting date up to the expected behavioural lifetime; and
- **Loss Given Default (LGD):** The LGD model calculates the likely loss on asset disposal that the Society would suffer if a default were to occur in any given month over the expected behavioural lifetime of the mortgage account. LGD takes into account the EAD in comparison to the value expected to be recovered through the sale of an asset, given the macroeconomic scenario specific trend in property price indices. The expectation of loss is then scaled to reflect the likelihood of a mortgage account reaching default, progressing on to sale of the asset.

### Forbearance strategies and renegotiated loans

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

The main options offered by the Society include:

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

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

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

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

### Modifications

The Society may on occasion modify the contractual terms of loans provided to customers. When this is solely for commercial reasons and considered part of the ordinary course of business, there is no impact on the impairment approach. Generally, forbearance at the Society, whether retail or SBL lending, does not result in the terms of the loan being modified so significantly that it becomes substantially a different financial asset, and therefore, the original loan remains and does not result in derecognition.

### Write off of financial assets

Financial assets are written off either partially or in their entirety only when the Group has stopped pursuing the recovery. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the loss allowance, which is then applied to the gross carrying amount. Any subsequent recoveries are credited to the income statement on settlement receipt.

**Cash in hand and balances with the Bank of England, Loans and advances to credit institutions and Debt securities**

The Group reviews the external credit ratings of its liquid assets at each reporting date. Those assets, which are of investment grade or higher, are considered to have low credit risk and therefore are assumed to have not had a significant increase in credit risk since initial recognition. This includes the Society's debt security portfolio. The Society's policy to allow only high quality, senior secured exposures to Residential Mortgage Backed Securities (RMBS) and Covered Bonds ensures continued Society receipt of contractual cash flows in stressed scenarios. For all other wholesale liquidity balances, a simple model calculates the ECL allowance, based on externally provided 12 month PD rates for individual counterparties.

### Derecognition of financial assets and liabilities

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

## 1. ACCOUNTING POLICIES (CONTINUED)

### Financial liabilities

All non-derivative financial liabilities, that include shares and wholesale funds, held by the Group are measured at amortised cost with interest recognised using the effective interest rate method. Discounts and other costs incurred in the raising of wholesale funds are amortised over the period to maturity using the effective interest rate method.

### Fair value of financial assets and liabilities

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

#### Level 1 – Valuation using quoted market prices

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

#### Level 2 – Valuation technique using observable inputs

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

#### Level 3 – Valuation technique using significant unobservable inputs

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

### Subscribed capital

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

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

### Intangible assets

#### Computer Software

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

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

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

#### Goodwill

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

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

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

#### Other intangibles

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

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

## 1. ACCOUNTING POLICIES (CONTINUED)

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

### Property, plant and equipment

Additions and improvements to office premises and equipment, including costs directly attributable to the acquisition of the asset, are capitalised at cost. The property, plant and equipment value in the statement of financial position represents the original cost, less cumulative depreciation. The costs, less estimated residual values of assets, are depreciated on a straight-line basis over their estimated useful economic lives as follows:

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

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

### Employee benefits

#### Long term incentive schemes

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

#### Pensions

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

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

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

### Leases (effective from 1 January 2019)

The Group assesses at contract inception whether a contract is, or contains, a lease. That is, if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

#### Group as a lessee

The Group applies a single recognition and measurement approach for all leases, except for short-term leases and leases of low value assets. The Group recognises lease liabilities, as the current value of future lease payments, and right-of-use assets representing the right to use the underlying assets.

#### Right-of-use assets

The Group recognises right-of-use assets at the commencement date of the lease (i.e. the date the underlying asset is available for use). Right-of-use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any remeasurement of lease liabilities. The cost of right-of-use assets includes the amount of lease liabilities recognised, initial direct costs incurred, and lease payments made at or before the commencement date less any lease incentives received. Right-of-use assets are depreciated on a straight line basis over the lease term, adjusted to take account of any expected break or extension options.

- Leasehold premises over 10 to 15 years;
- Equipment, fixtures, fittings and vehicles over 3 to 5 years;
- Motor vehicles over 3 to 5 years;

Right-of-use 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.

#### Lease liabilities

At the commencement date of the lease, the Group recognises lease liabilities measured at the present value of lease payments to be made over the lease term, discounted using the incremental borrowing rate. The lease payments include fixed payments less any lease incentive receivable, variable lease payments that depend on an index or a rate, and amounts expected to be paid under any residual value guarantees.

In calculating the present value of lease payments, the Group uses its incremental borrowing rate at the lease commencement date as the interest rate implicit in the lease is not readily determinable. The incremental borrowing rate is determined based on the cost of funding to the Group. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for lease payments made.

In addition, the carrying amount of lease liabilities is remeasured if there is a modification, a change in the lease term or a change in the lease payments.

## 1. ACCOUNTING POLICIES (CONTINUED)

The Group does not have an option to purchase the underlying asset in its lease agreements.

### Short-term leases and leases of low-value assets

The Group applies the short-term lease recognition exemption to its short-term leases (i.e. those leases that have a lease term of 12 months or less from the commencement date). It also applies the lease of low-value assets recognition exemption to assets that are considered be of low value. Lease payments on short-term leases and leases of low-value assets are recognised as an expense on a straight-line basis over the term of the lease.

### Leases (effective until 31 December 2018)

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

### Taxation

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

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

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

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

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

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

### Provisions and contingent liabilities

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

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

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

### Accounting estimates and judgements

In the course of preparing the financial statements, no judgements have been made in the process of applying the Group's accounting policies, other than those involving estimations, which have had a significant effect on the amounts recognised in the financial statements. The Group's significant estimates, including judgements involving estimations, are shown below.

### 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, in particular, the estimation of the amount and timing of future cash flows and collateral values and the assessment of significant increase in credit risk. The Society's ECL calculations under IFRS 9 are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies, which individually are not possible to isolate. Note 1 on pages 54 to 55 outline the accounting policies and key definitions for IFRS 9.

Key elements of the ECL models that are considered accounting judgements, including estimation, include:

- The internal credit grading model, which assigns PDs to individual accounts;
- The criteria for assessing if there has been a significant increase in credit risk;
- Determination of associations between macroeconomic scenarios, economic inputs and the effect on PDs, EADs and LGDs; and
- Selection of forward-looking macroeconomic scenarios and their probability weightings to derive economic inputs to the ECL models.

Applying a 100% weighting to the Society's pessimistic economic scenario results in further impairment losses of £1.1 million as at 31 December 2019.

### Expected mortgage life

In determining the expected life of mortgage assets, which is used as part of the effective interest rate calculation, 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.

During the year, the Group has reviewed its approach to delivering an enduring member-centric lending proposition and is increasingly convinced that no member should remain on a Standard Variable Rate (SVR) for any meaningful period of time at the end of their product term. A two week extension of the time spent on SVR would result in an increase in the value of loans on the statement of financial position by approximately £0.1 million.

### Employee benefits

The Group operates a defined benefit pension scheme. Significant judgements (on such areas as future interest and inflation rates and mortality rates) have to be exercised in estimating the value of the assets and liabilities of the scheme, and hence of its net deficit. The assumptions are outlined in note 28 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 £1.1 million.

## 2. SEGMENTAL REPORTING

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

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

The Group reports through three operating segments:

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

| 2019 | Retail financial services £m | Estate Agency £m | Mortgage Broking £m | Consolidation adjustments £m | Total £m |
|---|---|---|---|---|---|
| Net interest income | 46.1 | - | - | - | 46.1 |
| Fees and commission receivable | 2.2 | 2.0 | 2.0 | - | 6.2 |
| Fees and commission payable | (1.1) | - | - | - | (1.1) |
| **TOTAL INCOME** | **47.1** | **2.0** | **2.0** | **-** | **51.2** |
| Administrative expenses | (31.2) | (2.3) | (1.7) | - | (35.2) |
| Depreciation and amortisation | (5.2) | (0.3) | - | - | (5.5) |
| Finance cost | (0.1) | - | - | - | (0.1) |
| Impairment losses on loans and advances | (0.4) | - | - | - | (0.4) |
| Provisions for liabilities – FSCS and other | - | - | - | - | - |
| **UNDERLYING PROFIT/(LOSS)** | **10.3** | **(0.6)** | **0.3** | **-** | **10.0** |
| Net losses from derivative financial instruments | (0.6) | - | - | - | (0.6) |
| Other income | - | 0.2 | - | - | 0.2 |
| Strategic investment costs | (0.7) | (0.6) | - | - | (1.3) |
| Impairment charge – goodwill | - | - | - | (4.0) | (4.0) |
| Change in EIR accounting estimate | (12.3) | - | - | - | (12.3) |
| Fair value movement of intercompany balances | (2.0) | 2.0 | - | - | - |
| **(LOSS)/PROFIT BEFORE TAX** | **(5.3)** | **1.0** | **0.3** | **(4.0)** | **(8.0)** |
| Tax credit | 0.7 | 0.1 | - | - | 0.8 |
| **(LOSS)/PROFIT AFTER TAX** | **(4.6)** | **1.1** | **0.3** | **(4.0)** | **(7.2)** |
| Total assets | 3,816.0 | 2.5 | 0.7 | (0.2) | 3,819.0 |
| Total liabilities | 3,601.4 | 1.4 | 0.2 | (0.2) | 3,602.8 |
| Capital expenditure | 13.7 | - | - | - | 13.7 |

## 2. SEGMENTAL REPORTING (CONTINUED)

| 2018 | Retail financial services £m | Estate Agency £m | Mortgage Broking £m | Consolidation adjustments £m | Total £m |
|---|---|---|---|---|---|
| Net interest income | 50.2 | - | - | - | 50.2 |
| Net fees and commission receivable | 2.9 | 2.8 | 1.8 | - | 7.5 |
| Fees and commission payable | (1.4) | - | - | - | (1.4) |
| Other income | 0.3 | - | - | (0.3) | - |
| **TOTAL INCOME** | **52.0** | **2.8** | **1.8** | **(0.3)** | **56.3** |
| Administrative expenses | (34.0) | (4.0) | (1.4) | - | (39.4) |
| Depreciation and amortisation | (3.3) | (0.1) | - | - | (3.4) |
| Finance cost | (0.3) | - | - | - | (0.3) |
| Impairment losses on loans and advances | 0.3 | - | - | - | 0.3 |
| Provisions for liabilities – FSCS and other | 0.1 | - | - | - | 0.1 |
| **UNDERLYING PROFIT/(LOSS)** | **14.8** | **(1.3)** | **0.4** | **(0.3)** | **13.6** |
| Net losses from derivative financial instruments | (0.7) | - | - | - | (0.7) |
| Strategic investment costs | (0.6) | - | - | - | (0.6) |
| Impairment charge - goodwill | - | (0.5) | - | - | (0.5) |
| **PROFIT/(LOSS) BEFORE TAX** | **13.5** | **(1.8)** | **0.4** | **(0.3)** | **11.8** |
| Tax (expense)/credit | (2.5) | 0.2 | (0.1) | - | (2.4) |
| **PROFIT/(LOSS) AFTER TAX** | **11.0** | **(1.6)** | **0.3** | **(0.3)** | **9.4** |
| Total assets | 4,048.8 | 1.6 | 0.4 | 2.8 | 4,053.6 |
| Total liabilities | 3,830.2 | 1.5 | 0.3 | (1.2) | 3,830.8 |
| Capital expenditure | 6.1 | - | - | - | 6.1 |

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 47 to 51.

## 3. INTEREST RECEIVABLE AND SIMILAR INCOME

| | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|
| On loans fully secured on residential property | 80.4 | 84.6 | 80.4 | 84.6 |
| On other loans | 3.6 | 2.8 | 3.6 | 2.8 |
| On amounts due from group undertakings | - | - | 0.8 | 1.0 |
| On liquid assets | 2.3 | 1.7 | 2.3 | 1.7 |
| On instruments held at amortised cost | 86.3 | 89.1 | 87.1 | 90.1 |
| On debt securities | 2.3 | 1.3 | 2.3 | 1.3 |
| On derivative hedging of financial assets | (4.4) | (5.6) | (4.4) | (4.9) |
| On instruments calculated on an EIR basis | 84.2 | 84.8 | 85.0 | 86.5 |
| On derivatives not in a hedge accounting relationship | (0.2) | 0.6 | (0.1) | 0.3 |
| | **84.0** | **85.4** | **84.9** | **86.8** |

Interest on debt securities includes £1.4 million (2018: £1.1 million) arising from fixed income investment securities.

Included within interest income is £0.1 million (2018: £0.1 million) in respect of interest income accrued on impaired loans three or more months in arrears.

## 3. INTEREST RECEIVABLE AND SIMILAR INCOME (CONTINUED)

### Change in EIR accounting estimate

The Society applies the effective interest rate (EIR) method to its financial instruments recorded at amortised cost, which includes its loans and advances to customers. In order to calculate the effective interest rate on these assets, a number of estimates are taken into account. These include the behavioural life of the customer, period of time spent on a standard variable rate (SVR), underlying SVR payable and expected early redemption charges. As a consequence of the Society's review of its approach to delivering an enduring member-centric lending proposition and its increasing conviction that no member should remain on SVR for any meaningful period of time at the end of their product term, changes to the underlying estimates used in determining SVR and expected early redemption charges have arisen in the year. Therefore, a charge of £12.3m has been recognised in the Society's income statement in the year to reflect this change in accounting estimate. This non-recurring item has been presented separately, outside of net interest margin, due to its size, and to provide clear presentation for users of the financial statements.

## 4. INTEREST PAYABLE AND SIMILAR CHARGES

| | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|
| On shares held by individuals | 29.1 | 25.9 | 29.1 | 25.9 |
| On amounts due to group undertakings | - | - | 2.1 | 3.1 |
| On deposits and other borrowings | 7.3 | 8.1 | 6.1 | 6.4 |
| On subscribed capital | 2.0 | 2.0 | 2.0 | 2.0 |
| On leases | 0.1 | - | 0.1 | - |
| On derivative hedging of financial liabilities | (0.6) | (0.8) | (0.6) | (0.8) |
| | **37.9** | **35.2** | **38.8** | **36.6** |

## 5. NET LOSSES FROM DERIVATIVE FINANCIAL INSTRUMENTS

| | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|
| Derivatives in designated fair value hedge relationships | (12.8) | 4.6 | (12.8) | 4.6 |
| Adjustments to hedged items in fair value hedge accounting relationships | 11.1 | (5.2) | 11.1 | (5.2) |
| Derivatives not in designated fair value hedge relationships | 1.1 | (0.1) | 1.7 | (0.6) |
| | **(0.6)** | **(0.7)** | **-** | **(1.2)** |

The net loss from derivative financial instruments of £0.6 million (2018: £0.7 million) 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.

Further information regarding the Group and Society's derivative financial instruments and fair value hedge accounting is presented in notes 13 and 31 of these financial statements.

## 6. ADMINISTRATIVE EXPENSES

| | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|
| Wages and salaries | 19.2 | 19.4 | 16.8 | 16.7 |
| Social security costs | 1.9 | 2.2 | 1.8 | 2.0 |
| Other pension costs | 1.1 | 1.0 | 1.0 | 0.9 |
| **Total staff costs** | **22.2** | **22.6** | **19.6** | **19.6** |
| Premises and facilities | 3.1 | 3.2 | 3.1 | 2.7 |
| IT | 4.0 | 4.3 | 4.0 | 4.3 |
| Marketing and advertising | 1.4 | 1.5 | 1.1 | 1.2 |
| Lease costs | 0.4 | 1.2 | 0.4 | 0.9 |
| Other administrative costs | 5.4 | 7.2 | 3.6 | 5.7 |
| | **36.5** | **40.0** | **31.8** | **34.4** |

Included in wages and salaries for the Group is £0.7m (2018: £0.4m) of restructuring costs. A further £0.6m of strategic investment costs are included in other administrative costs (2018: £0.2m). Of this, £0.4m (2018: £0.4m) in wages and salaries and £0.3m (2018: £0.2m) in other administrative costs relate to the Society.

| | Group 2019 £000 | Group 2018 £000 | Society 2019 £000 | Society 2018 £000 |
|---|---|---|---|---|
| **Other administrative costs include:** | | | | |
| Remuneration of auditors and associates (excluding VAT) | | | | |
| Audit of these financial statements | 220 | 246 | 220 | 246 |
| Audit of subsidiary undertakings | 32 | 45 | - | - |
| Audit of associated pension schemes | 11 | 11 | 11 | 11 |
| Other assurance services | 50 | 42 | 50 | 34 |

## 7. EMPLOYEES

| | Group 2019 Number | Group 2018 Number | Society 2019 Number | Society 2018 Number |
|---|---|---|---|---|
| The average number of persons employed during the year was: | | | | |
| Full time | 510 | 527 | 455 | 456 |
| Part time | 194 | 192 | 179 | 171 |
| | **704** | **719** | **634** | **627** |
| Building Society | | | | |
| Central Administration | 293 | 267 | 293 | 267 |
| Branches | 341 | 360 | 341 | 360 |
| Subsidiaries | 70 | 92 | - | - |
| | **704** | **719** | **634** | **627** |

The average number of employees on a full time equivalent basis in the Society was 557 (2018: 574) and all of these are employed within the United Kingdom.

## 8. TAX (CREDIT)/EXPENSE

| | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|
| Current tax (credit)/expense | (0.8) | 2.3 | (0.9) | 2.4 |
| Adjustments for prior years | (0.2) | - | (0.2) | - |
| **TOTAL CURRENT TAX** | **(1.0)** | **2.3** | **(1.1)** | **2.4** |
| Deferred tax | 0.1 | 0.1 | 0.3 | 0.1 |
| Adjustments for prior years | 0.1 | - | 0.1 | - |
| **TOTAL DEFERRED TAX** | **0.2** | **0.1** | **0.4** | **0.1** |
| 20 | **(0.8)** | **2.4** | **(0.7)** | **2.5** |

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

| | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|
| (Loss)/profit before taxation | (8.0) | 11.8 | (4.6) | 13.2 |
| Expected tax (credit)/charge at 19% (2018: 19%) | (1.5) | 2.2 | (0.9) | 2.5 |
| Expenses not deductible for corporation tax | 0.8 | 0.3 | 0.3 | 0.1 |
| Income not taxable | - | (0.2) | - | (0.1) |
| Effective securitisation | - | 0.1 | - | - |
| Adjustment for prior years | (0.1) | - | (0.1) | - |
| | **(0.8)** | **2.4** | **(0.7)** | **2.5** |

| | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|
| **Tax recognised directly in other comprehensive income** | | | | |
| Tax on FVOCI assets | 0.1 | (0.2) | 0.1 | (0.2) |
| Deferred tax on pension scheme | - | 0.1 | - | 0.1 |
| **TAX CHARGE/(CREDIT) FOR THE YEAR** | **0.1** | **(0.1)** | **0.1** | **(0.1)** |

### Factors affecting future tax charges

The Finance Act 2015 reduced the future rate of UK corporation tax from 20% to 19% with effect from 1 April 2017. Furthermore, the Finance Act 2016, following its enactment in September 2016, reduced the future rate further to 17% with effect from 1 April 2020. Deferred tax assets and liabilities are measured at whichever of these enacted tax rates are expected to apply when the related asset is realised or liability is settled.

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

| | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|
| Cash in hand | 1.9 | 1.5 | 1.9 | 1.5 |
| Balances with the Bank of England | 270.5 | 254.8 | 270.5 | 254.8 |
| | **272.4** | **256.3** | **272.4** | **256.3** |

Balances with the Bank of England includes cash ratio deposits of £6.1 million (2018: £5.7 million) which are not readily available for use in the Group's day-to-day operations and therefore are excluded from cash and cash equivalents.

## 10. LOANS AND ADVANCES TO CREDIT INSTITUTIONS

| | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|
| Repayable on call and short notice | 6.3 | 15.5 | 0.1 | - |
| Other loans and advances to credit institutions | 29.8 | 19.0 | 29.8 | 19.0 |
| | **36.1** | **34.5** | **29.9** | **19.0** |

As at 31 December 2019 £29.8 million (2018: £17.9 million) of cash has been deposited by the Group and Society as collateral against derivative contracts.

## 11. CASH AND CASH EQUIVALENTS

| | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|
| Cash in hand and balances with the Bank of England | 266.3 | 250.6 | 266.3 | 250.6 |
| Loans and advances to credit institutions | 6.3 | 15.5 | 0.1 | - |
| | **272.6** | **266.1** | **266.4** | **250.6** |

## 12. DEBT SECURITIES

| **Group and Society** | Notes | 2019 £m | 2018 £m |
|---|---|---|---|
| Debt securities | | | |
| Gilts | | 20.3 | 20.5 |
| Treasury bills | | 129.0 | 49.9 |
| Fixed rate notes | | 7.7 | 48.8 |
| Floating rate notes | | 59.3 | 18.0 |
| Mortgage backed securities | | 76.2 | 78.9 |
| Floating covered bonds | | 14.1 | - |
| | | **306.6** | **216.1** |
| Movements on debt securities during the year may be analysed as follows: | | | |
| As at 1 January | | 216.1 | 109.2 |
| Additions | | 334.3 | 135.0 |
| Disposals and maturities | | (244.4) | (27.1) |
| Net gains/(losses) from changes in fair value recognised in other comprehensive income | 30 | 0.6 | (1.0) |
| | | **306.6** | **216.1** |

Of this total £157.0 million (2018: £119.2 million) is attributable to fixed income debt securities.

Debt securities include items with a carrying value of £10.2 million (2018: £nil) which have been pledged as collateral under Bank of England facilities.

## 13. DERIVATIVE FINANCIAL INSTRUMENTS

| Group | 2019 Contract/ notional amount £m | 2019 Fair value of assets £m | 2019 Fair value of liabilities £m | 2018 Contract/ notional amount £m | 2018 Fair value of assets £m | 2018 Fair value of liabilities £m |
|---|---|---|---|---|---|---|
| Derivatives not in hedge accounting relationship | | | | | | |
| Interest rate swaps | 454.3 | 0.7 | (0.2) | 456.7 | 0.4 | (1.0) |
| Derivatives designated as fair value hedges | | | | | | |
| Interest rate swaps | 2,064.0 | 1.3 | (12.6) | 1,907.0 | 7.8 | (4.9) |
| | **2,518.3** | **2.0** | **(12.8)** | **2,363.7** | **8.2** | **(5.9)** |

| Society | 2019 Contract/ notional amount £m | 2019 Fair value of assets £m | 2019 Fair value of liabilities £m | 2018 Contract/ notional amount £m | 2018 Fair value of assets £m | 2018 Fair value of liabilities £m |
|---|---|---|---|---|---|---|
| Derivatives not in a hedge accounting relationship | | | | | | |
| Interest rate swaps | 374.6 | 0.7 | - | 343.4 | - | (1.0) |
| Derivatives designated as fair value hedges | | | | | | |
| Interest rate swaps | 2,064.0 | 1.3 | (12.6) | 1,907.0 | 7.8 | (4.9) |
| | **2,438.6** | **2.0** | **(12.6)** | **2,250.4** | **7.8** | **(5.9)** |

Further information regarding the Group's hedge accounting and fair value hedges is presented in note 31 'Financial Instruments' on page 95.

## 14. LOANS AND ADVANCES TO CUSTOMERS

| Group and Society | Notes | 2019 £m | 2018 £m |
|---|---|---|---|
| Loans fully secured on residential property | | 3,058.4 | 3,434.3 |
| Other loans fully secured on land | | 95.2 | 71.9 |
| | | 3,153.6 | 3,506.2 |
| Provision for impairment losses on loans and advances | 15 | (1.6) | (1.2) |
| | | 3,152.0 | 3,505.0 |
| Fair value adjustment for hedged risk | | 9.4 | (2.1) |
| | | **3,161.4** | **3,502.9** |

### Encumbrance

The Society pledges a proportion of its loans and advances to customers to enable it to access funding either through a secured funding arrangement or as whole mortgage loan pools with the Bank of England.

Loans and advances to customers used to support these funding activities are as follows:

| Group and Society 2019 | Mortgages pledged £m | Held by third parties £m | Held by the Group drawn £m | Held by the Group undrawn £m |
|---|---|---|---|---|
| Bank of England | 1,349.1 | - | 769.7 | 579.4 |
| Other secured funding | 78.0 | 78.0 | - | - |
| | **1,427.1** | **78.0** | **769.7** | **579.4** |

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## 14. LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

| Group and Society 2018 | Mortgages pledged £m | Held by third parties £m | Held by the Group drawn £m | Held by the Group undrawn £m |
|---|---|---|---|---|
| Bank of England | 1,347.8 | - | 1,097.9 | 249.9 |
| Other secured funding | 106.8 | 106.8 | - | - |
| | **1,454.6** | **106.8** | **1,097.9** | **249.9** |

### Other secured funding

As at 31 December 2019, loans and advances to customers also includes balances for both the Group and Society which have been used in secured funding arrangements, resulting in the beneficial interest of these loans being transferred to Arrow Mortgage Finance No.1 Limited, a special purpose vehicle consolidated into the Group Accounts. All of the loans pledged are retained within the Society's Statement of Financial Position as the Society retains substantially all the risk and rewards relating to the loans. These loans secure £62.6 million (2018: £101.3 million) of funding for the Group (note 25).

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

Impairment provisions have been deducted from the appropriate asset values on the Statement of Financial Position. The gross carrying amounts and impairment provisions are presented in detail below.

| Group and Society | Loans fully secured on residential property 2019 £m | Other loans fully secured on land 2019 £m | Total 2019 £m | Loans fully secured on residential property 2018 £m | Other loans fully secured on land 2018 £m | Total 2018 £m |
|---|---|---|---|---|---|---|
| **Gross carrying amount** | | | | | | |
| Stage 1 | 2,419.3 | 51.7 | 2,471.0 | 3,170.3 | 30.0 | 3,200.3 |
| Stage 2 | 634.6 | 42.2 | 676.8 | 258.3 | 40.3 | 298.6 |
| Stage 3 | 4.5 | 1.3 | 5.8 | 5.7 | 1.6 | 7.3 |
| | **3,058.4** | **95.2** | **3,153.6** | **3,434.3** | **71.9** | **3,506.2** |

| Group and Society | Loans fully secured on residential property 2019 £m | Other loans fully secured on land 2019 £m | Total 2019 £m | Loans fully secured on residential property 2018 £m | Other loans fully secured on land 2018 £m | Total 2018 £m |
|---|---|---|---|---|---|---|
| **Expected Credit Loss allowance** | | | | | | |
| Stage 1 | 0.1 | - | 0.1 | 0.1 | 0.1 | 0.2 |
| Stage 2 | 0.3 | 0.4 | 0.7 | 0.1 | 0.5 | 0.6 |
| Stage 3 | 0.1 | 0.7 | 0.8 | - | 0.4 | 0.4 |
| | **0.5** | **1.1** | **1.6** | **0.2** | **1.0** | **1.2** |

The ECL allowance recognised against the Society's loan commitment balance at 31 December 2019 and 2018 is immaterial to the financial statements and therefore has not been separately disclosed.

## 15. PROVISION FOR IMPAIRMENT LOSSES ON LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

### Forward-looking information incorporated in the ECL models

The assessment of SICR and the calculation of ECL both incorporate forward-looking information. The key economic variables impacting credit risk and expected credit loss for the portfolios have been determined by management, as outlined below, but expert judgement is also applied in the process. Forecasts of these economic variables are provided by a reputable third party on a quarterly basis and provide the best estimate view of the economy over the next five years. After five years, to project the economic variables out for the full remaining lifetime, a mean reversion approach is used, i.e. long-run averages.

In addition to the base economic scenario forecast, other possible scenarios along with scenario weightings are obtained, of which management have applied three scenarios in the model calculations, weighted 30% upside, 43% base and 27% downside.

The summary below outlines the most significant forward-looking assumptions under IFRS 9, over the five year planning period and their low and high points across the optimistic, base and pessimistic scenarios.

| | | 2019 | 2018 |
|---|---|---|---|
| Inflation | Base<br>Low to high | 1.6%<br>(0.8)% – 3.2% | 2.2%<br>(0.5)% – 3.4% |
| Unemployment rate | Base<br>Low to high | 4.0%<br>3.0% – 8.2% | 4.2%<br>3.4% - 8.5% |
| House price index | Base<br>Low to high | 1.3%<br>(11.8)% – 7.3% | 3.3%<br>(12.0)% - 6.9% |
| Gross Domestic Product | Base<br>Low to high | 0.9%<br>(5.8)% – 4.5% | 1.4%<br>(3.2)% - 3.7% |

Applying a 100% weighting to the pessimistic economic scenario would result in further impairment losses of £1.1 million as at 31 December 2019 (2018: £0.5 million).

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

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

| Group and Society | 2019 Loans fully secured on residential property £m | 2019 Other loans fully secured on land £m | 2019 Total £m | 2018 Loans fully secured on residential property £m | 2018 Other loans fully secured on land £m | 2018 Total £m |
|---|---|---|---|---|---|---|
| Charge/(release) of provision for impairment | 0.3 | 0.1 | 0.4 | (0.2) | (0.1) | (0.3) |
| Recoveries of debts previously written off | - | - | - | - | - | - |
| | **0.3** | **0.1** | **0.4** | **(0.2)** | **(0.1)** | **(0.3)** |

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## 16. AMOUNTS DUE FROM SUBSIDIARY UNDERTAKINGS

| Society | 2019 Shares £m | 2019 Amount due £m | 2018 Shares £m | 2018 Amount due £m |
|---|---|---|---|---|
| **As at 1 January under IAS 39** | - | - | - | 28.7 |
| Change in measurement basis on initial recognition of IFRS 9 | - | - | - | (8.6) |
| As at 1 January under IFRS 9 | - | 21.2 | - | 20.1 |
| Additions/(repayments) | - | 1.1 | | 1.1 |
| Change in fair value | - | (2.0) | - | - |
| | - | **20.3** | - | **21.2** |

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

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

The registered office of Arrow Mortgage Finance No. 1 Limited is 35 Great St. Helen's, London, EC3A 6AP. The registered office address for all other subsidiary companies listed above is detailed in note 36.

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

The amounts due from Arrow Mortgage Finance No. 1 Ltd have a contractual maturity of less than one year and are expected to be repaid within this period in line with the secured funding term. The amount due from Arrow is classed as Stage 1 for ECL calculation purposes under IFRS 9 and the ECL arising is immaterial to the financial statements.

All other intercompany balances have no fixed date of repayment and are recognised at fair value through profit or loss. The directors have reviewed the recoverability of outstanding balances with subsidiary undertakings and therefore the fair value as at 31 December 2019 and a change in fair value of £2.0m has been recognised in the year (2018: £nil).

Details of the balances outstanding with subsidiary undertakings are disclosed in the related party transactions note 34.

## 17. PROPERTY, PLANT AND EQUIPMENT

| 2019 | Group Land and buildings £m | Group Equipment, fixtures, fittings £m | Group Total £m | Society Land and buildings £m | Society Equipment, fixtures, fittings £m | Society Total £m |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| As at 1 January 2019 | 16.5 | 25.2 | 41.7 | 14.5 | 24.5 | 39.0 |
| Additions | - | 0.4 | 0.4 | - | 0.4 | 0.4 |
| Disposals | - | - | - | - | - | - |
| **As at 31 December 2019** | **16.5** | **25.6** | **42.1** | **14.5** | **24.9** | **39.4** |
| **Depreciation** | | | | | | |
| As at 1 January 2019 | 9.3 | 18.6 | 27.9 | 8.1 | 18.1 | 26.2 |
| Charge for the year | 0.3 | 1.8 | 2.1 | 0.3 | 1.7 | 2.0 |
| On disposals | - | - | - | - | - | - |
| **As at 31 December 2019** | **9.6** | **20.4** | **30.0** | **8.4** | **19.8** | **28.2** |
| **Net Book Value** | | | | | | |
| **As at 31 December 2019** | **6.9** | **5.2** | **12.1** | **6.1** | **5.1** | **11.2** |

| 2018 | Group Land and buildings £m | Group Equipment, fixtures, fittings £m | Group Total £m | Society Land and buildings £m | Society Equipment, fixtures, fittings £m | Society Total £m |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| As at 1 January 2018 | 16.4 | 23.9 | 40.3 | 14.4 | 23.3 | 37.7 |
| Additions | 0.1 | 1.3 | 1.4 | 0.1 | 1.2 | 1.3 |
| Disposals | - | - | - | - | - | - |
| **As at 31 December 2018** | **16.5** | **25.2** | **41.7** | **14.5** | **24.5** | **39.0** |
| **Depreciation** | | | | | | |
| As at 1 January 2018 | 8.9 | 16.8 | 25.7 | 7.8 | 16.3 | 24.1 |
| Charge for the year | 0.4 | 1.8 | 2.2 | 0.3 | 1.8 | 2.1 |
| On disposals | - | - | - | - | - | - |
| **As at 31 December 2018** | **9.3** | **18.6** | **27.9** | **8.1** | **18.1** | **26.2** |
| **Net Book Value** | | | | | | |
| **As at 31 December 2018** | **7.2** | **6.6** | **13.8** | **6.4** | **6.4** | **12.8** |

## 17. PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

| | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|
| The net book value of land and buildings comprises: | | | | |
| Freehold | 6.5 | 6.7 | 5.7 | 5.9 |
| Short Leasehold | 0.4 | 0.5 | 0.4 | 0.5 |
| | **6.9** | **7.2** | **6.1** | **6.4** |
| The net book value of land and buildings occupied for own use: | | | | |
| Building Society | 5.7 | 6.0 | 5.7 | 6.0 |
| Subsidiaries | 0.8 | 0.8 | - | - |
| Non - Group | 0.4 | 0.4 | 0.4 | 0.4 |
| | **6.9** | **7.2** | **6.1** | **6.4** |

## 18. INTANGIBLE ASSETS

| Group 2019 | Goodwill £m | Purchased Software £m | Developed Software £m | Other Intangibles £m | Total £m |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| As at 1 January 2019 | 4.5 | 7.9 | 17.4 | 0.7 | 30.5 |
| Additions | - | - | 13.3 | - | 13.3 |
| **As at 31 December 2019** | **4.5** | **7.9** | **30.7** | **0.7** | **43.8** |
| | | | | | |
| **Amortisation and impairment** | | | | | |
| As at 1 January 2019 | 0.5 | 7.3 | 11.8 | 0.7 | 20.3 |
| Charge for the year | - | 0.3 | 2.2 | - | 2.5 |
| Impairment in the year | 4.0 | - | - | - | 4.0 |
| **As at 31 December 2019** | **4.5** | **7.6** | **14.0** | **0.7** | **26.8** |
| **Net Book Value** | | | | | |
| **As at 31 December 2019** | **-** | **0.3** | **16.7** | **-** | **17.0** |

## 18. INTANGIBLE ASSETS (CONTINUED)

| Group 2018 | Goodwill £m | Purchased Software £m | Developed Software £m | Other Intangibles £m | Total £m |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| As at 1 January 2018 | 4.5 | 7.5 | 13.1 | 0.7 | 25.8 |
| Additions | - | 0.4 | 4.3 | - | 4.7 |
| **As at 31 December 2018** | **4.5** | **7.9** | **17.4** | **0.7** | **30.5** |
| **Amortisation** | | | | | |
| As at 1 January 2018 | - | 7.1 | 10.8 | 0.7 | 18.6 |
| Charge for the year | - | 0.2 | 1.0 | - | 1.2 |
| Impairment in the year | 0.5 | - | - | - | 0.5 |
| **As at 31 December 2018** | **0.5** | **7.3** | **11.8** | **0.7** | **20.3** |
| **Net Book Value** | | | | | |
| **As at 31 December 2018** | **4.0** | **0.6** | **5.6** | **-** | **10.2** |

The goodwill relates to the 2013 acquisition of 100% of the ordinary share capital of Harrison Murray Ltd (£4.0m) and 100% of the lettings trade and assets of Harrison Murray Commercial Ltd (£0.5m). The goodwill relating to the lettings trade and assets was impaired in full in previous years. In accordance with the requirements of IAS 36, the Group completed an impairment review of the carrying value for goodwill as at 31 December 2019 to ensure that the carrying value is stated at no more than its recoverable amount. Whilst the Group has benefitted overall from the expansion of building society services to branches facilitated by the acquisition of Harrison Murray, the estate agency market has undertaken material structural changes over the past 2-3 years; in terms of the UK average annual transaction numbers, in the level of fees that agents are likely to be able to accrue from these transactions and in extra costs arising from new additional regulatory requirements. As a result of this, the goodwill relating to the acquisition of the Harrison Murray estate agency business was written down in value by £4.0 million.

The discounted cash flow calculation used to complete the impairment review is based on the most recent corporate plan, which takes into account the risks inherent in the business areas. The cash flows are extrapolated for subsequent years based on a long term growth rate, and discounted at a rate of 12.5%.

| Society | 2019 Purchased Software £m | 2019 Developed Software £m | 2019 Total £m | 2018 Purchased Software £m | 2018 Developed Software £m | 2018 Total £m |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| As at 1 January | 7.8 | 17.4 | 25.2 | 7.4 | 13.1 | 20.5 |
| Additions | - | 13.3 | 13.3 | 0.4 | 4.3 | 4.7 |
| **As at 31 December** | **7.8** | **30.7** | **38.5** | **7.8** | **17.4** | **25.2** |
| **Amortisation** | | | | | | |
| As at 1 January | 7.2 | 11.8 | 19.0 | 7.0 | 10.8 | 17.8 |
| Charge for the year | 0.3 | 2.2 | 2.5 | 0.2 | 1.0 | 1.2 |
| **As at 31 December** | **7.5** | **14.0** | **21.5** | **7.2** | **11.8** | **19.0** |
| **Net Book Value** | | | | | | |
| **As at 31 December** | **0.3** | **16.7** | **17.0** | **0.6** | **5.6** | **6.2** |

## 19. LEASES

The statement of financial position shows the following amounts relating to leases:

| | Group | | | | Society | | | |
|---|---|---|---|---|---|---|---|---|
| | Property £m | Equipment £m | Motor Vehicles £m | Total £m | Property £m | Equipment £m | Motor Vehicles £m | Total £m |
| **Cost** | | | | | | | | |
| As at 1 January 2019 | - | - | - | - | - | - | - | - |
| On adoption of IFRS 16 | 4.7 | 0.3 | 0.3 | 5.3 | 3.8 | 0.3 | 0.3 | 4.4 |
| Additions | 1.0 | - | - | 1.0 | 0.7 | - | - | 0.7 |
| Disposals | (0.1) | - | - | (0.1) | - | - | - | - |
| **As at 31 December 2019** | **5.6** | **0.3** | **0.3** | **6.2** | **4.5** | **0.3** | **0.3** | **5.1** |
| **Depreciation** | | | | | | | | |
| As at 1 January 2019 | - | - | - | - | - | - | - | - |
| Charge for the year | 0.7 | 0.1 | 0.1 | 0.9 | 0.5 | 0.1 | 0.1 | 0.7 |
| On disposals | - | - | - | - | - | - | - | - |
| **As at 31 December 2019** | **0.7** | **0.1** | **0.1** | **0.9** | **0.5** | **0.1** | **0.1** | **0.7** |
| **Net Book Value** | | | | | | | | |
| **As at 31 December 2019** | **4.9** | **0.2** | **0.2** | **5.3** | **4.0** | **0.2** | **0.2** | **4.4** |

| | Group 31 December 2019 £m | Group 1 January 2019 £m | Society 31 December 2019 £m | Society 1 January 2019 £m |
|---|---|---|---|---|
| **Lease liabilities** | | | | |
| Current | 0.7 | 0.7 | 0.5 | 0.5 |
| Non-current | 4.6 | 4.7 | 3.8 | 3.9 |
| | 5.3 | 5.4 | 4.3 | 4.4 |

In the previous year, the Group recognised all of its leases as operating leases under IAS 17 and therefore there was no impact on the statement of financial position. For adjustments recognised on adoption of IFRS 16 on 1 January 2019, please refer to note 37.

The income statement shows the following amounts relating to leases:

| | Note | Group 2019 £m | Society 2019 £m |
|---|---|---|---|
| Depreciation charge for right-of-use assets | | **0.9** | **0.7** |
| Interest expense (included in interest payable and similar charges) | 4 | 0.1 | 0.1 |
| Expense relating to short-term leases (included in administritave expenses) | | 0.4 | 0.4 |

The total cash outflow for leases in 2019 was £1.1m for the Group, of which £0.9m related to the Society.

## 20. DEFERRED TAX

| | Notes | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|---|
| As at 1 January | | 1.4 | 1.7 | 1.4 | 1.7 |
| Charge on initial recognition of IFRS 9 | | - | (0.3) | - | (0.3) |
| Adjustments in respect of prior periods | | (0.1) | - | (0.1) | - |
| Charge to the income statement | | (0.1) | (0.1) | (0.3) | (0.1) |
| Recognised directly in other comprehensive income | | (0.1) | 0.1 | (0.1) | 0.1 |
| | | **1.1** | **1.4** | **0.9** | **1.4** |

The deferred tax charge in the income statement comprises the following temporary differences:

| | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|
| Pensions and other post tax retirement benefits | 0.4 | (0.1) | 0.4 | (0.1) |
| Intangible assets | - | 0.1 | - | 0.1 |
| Other provisions | (0.1) | (0.1) | (0.1) | (0.1) |
| Tax losses | (0.2) | - | - | - |
| | **0.1** | **(0.1)** | **0.3** | **(0.1)** |

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

| | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|
| **Deferred tax assets** | | | | |
| Pensions and other post-retirement benefits | 0.7 | 1.1 | 0.7 | 1.1 |
| Property, plant and equipment | 0.4 | 0.4 | 0.4 | 0.4 |
| Fair value reserves | 0.1 | 0.2 | 0.1 | 0.2 |
| Transfer of engagements – fair value adjustments | - | 0.1 | - | 0.1 |
| Tax losses | 0.2 | - | - | - |
| | **1.4** | **1.8** | **1.2** | **1.8** |
| **Deferred tax liabilities** | | | | |
| IFRS transitional adjustments | 0.2 | 0.3 | 0.2 | 0.3 |
| Intangibles | 0.1 | 0.1 | 0.1 | 0.1 |
| | **0.3** | **0.4** | **0.3** | **0.4** |
| **Net deferred tax asset** | **1.1** | **1.4** | **0.9** | **1.4** |

Deferred tax liabilities have been offset against deferred tax assets in the statement of financial position in the current year as it is deemed that there is a legal right of offset.

ACCOUNTS

## 21. SHARES

| Group and Society | 2019 £m | 2018 £m |
|---|---|---|
| Held by individuals | 2,781.4 | 2,869.2 |
| Fair Value Adjustment for hedged risk | (0.3) | - |
| | **2,781.1** | **2,869.2** |

## 22. AMOUNTS OWED TO CREDIT INSTITUTIONS

| Group and Society | 2019 £m | 2018 £m |
|---|---|---|
| Amounts owed to credit institutions | 611.3 | 685.0 |
| | **611.3** | **685.0** |

Amounts owed to credit institutions include £nil (2018: £9.8 million) secured against certain loans and advances to credit institutions and loans and advances to customers.

## 23. AMOUNTS OWED TO OTHER CUSTOMERS

| | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|
| **Demand accounts** | | | | |
| Retail customers | 1.2 | 1.0 | 1.2 | 1.0 |
| Other | 3.2 | 3.4 | 3.2 | 3.4 |
| | **4.4** | **4.4** | **4.4** | **4.4** |
| **Term deposits** | | | | |
| Local Authorities | 75.4 | 94.4 | 75.4 | 94.4 |
| Pension Funds/ Insurers | 2.0 | 10.0 | 2.0 | 10.0 |
| Other | 10.1 | 17.4 | 10.1 | 17.4 |
| | **87.5** | **121.8** | **87.5** | **121.8** |
| | **91.9** | **126.2** | **91.9** | **126.2** |

## 24. AMOUNTS OWED TO SUBSIDIARY UNDERTAKINGS

| Society | 2019 £m | 2018 £m |
|---|---|---|
| At 1 January | 106.1 | 158.5 |
| Repayment | (28.9) | (52.4) |
| | **77.2** | **106.1** |

The amounts owed to subsidiary undertakings represents a deemed loan as part of a secured funding balance. The repayment of the loan will follow the collection of the principal and interest of the underlying mortgage assets, which is contractually due to be settled within one year.

## 25. DEBT SECURITIES IN ISSUE

| | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|
| Senior secured debt | 62.6 | 101.3 | - | - |
| Certificates of deposit | 5.5 | 5.5 | 5.5 | 5.5 |
| | **68.1** | **106.8** | **5.5** | **5.5** |

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

## 26. OTHER LIABILITIES AND ACCRUALS

| | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|
| Trade creditors | 0.2 | 0.8 | 0.2 | 0.8 |
| Accruals and deferred income | 2.3 | 3.7 | 2.1 | 3.5 |
| Other creditors | 1.5 | 1.7 | 1.2 | 1.5 |
| | **4.0** | **6.2** | **3.5** | **5.8** |

## 27. PROVISIONS FOR LIABILITIES

| Group and Society | 2019 FSCS £m | 2019 Customer redress & other provisions £m | 2019 Total £m | 2018 FSCS £m | 2018 Customer redress & other provisions £m | 2018 Total £m |
|---|---|---|---|---|---|---|
| At 1 January | - | 0.6 | 0.6 | 0.2 | 0.9 | 1.1 |
| (Credit)/charge for the year | - | - | - | (0.1) | - | (0.1) |
| Provisions utilised | - | (0.4) | (0.4) | (0.1) | (0.3) | (0.4) |
| | **-** | **0.2** | **0.2** | **-** | **0.6** | **0.6** |

**FSCS levy**
Following the settlement of the loans outstanding from the 2008/09 banking failures, there are no further liabilities outstanding. Ongoing costs of the FSCS scheme are recognised in administrative expenses.

**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 months.

**Contingent liabilities**
As a deposit taker, the Society continues to have obligations to the FSCS, as well as other contractual obligations to third party suppliers, which may create a financial obligation in future accounting periods.

ACCOUNTS

## 28. RETIREMENT BENEFIT OBLIGATIONS

### a) Defined benefit obligations

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

The pension cost is assessed following the advice of a qualified independent actuary using the projected unit method. The latest funding review of the scheme was as at 31 March 2017. This review showed that the market value of the scheme assets as at 31 March 2017 was £50.3 million and that the actuarial value of those assets represented 88% of the benefits that had accrued to members after allowing for expected future increase in salaries.

An updated actuarial valuation at 31 December 2019 was carried out on a market value basis by a qualified independent actuary, as follows:

| Group and Society | 2019 % | 2018 % |
|---|---|---|
| The principal actuarial assumptions used were as follows: | | |
| Discount rate | 2.1 | 2.9 |
| Rate of increase in salaries | 3.1 | 3.3 |
| Rate of increase in pensions | 3.5 | 3.6 |
| Inflation | 3.1 | 3.3 |

The assumptions applied follow the requirements of IAS 19, which are different to the technical valuation approach. This requires the discount rate to be benchmarked against AA corporate rated bonds, which as at 31 December 2019 were lower than the rate of inflation.

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

| Group and Society | 2019 Male Years | 2019 Female Years | 2018 Male Years | 2018 Female Years |
|---|---|---|---|---|
| Expected life at retirement for a new pensioner | 24.7 | 26.9 | 24.7 | 26.8 |
| Expected life at retirement in 20 years' time | 26.6 | 28.8 | 26.5 | 28.7 |

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

| Group and Society | Change in assumption | 2019 £m | 2018 £m |
|---|---|---|---|
| **Principal actuarial assumption** | | | |
| Discount rate | +/- 0.25% | (2.7) | (2.4) |
| Rate of increase in salaries | +/- 0.25% | 0.2 | 0.1 |
| Rate of increase in pensions | +/- 0.25% | 0.8 | 0.7 |
| Mortality age adjustment | +/- 0.25% | 0.6 | 0.5 |
| Inflation | +/- 0.25% | 1.1 | 1.0 |

## 28. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

| Group and Society | 2019 £m | 2018 £m |
|---|---|---|
| **Fair value of scheme assets:** | | |
| As at 1 January | 49.9 | 53.5 |
| Interest on pension scheme assets | 1.4 | 1.3 |
| Contributions by employer | 1.5 | 2.1 |
| Benefits paid | (1.8) | (2.6) |
| Expenses paid by trustees | - | - |
| Gain/(loss) on asset returns | 9.1 | (4.4) |
| **As at 31 December** | **60.1** | **49.9** |
| **Present value of defined benefit obligations:** | | |
| As at 1 January | (54.1) | (58.3) |
| Past service cost | - | (0.2) |
| Interest on pension scheme liabilities | (1.5) | (1.4) |
| Benefits paid | 1.8 | 2.6 |
| Experience (loss) on liabilities | - | (0.2) |
| Gain on changes in financial assumptions | (6.2) | 3.4 |
| **As at 31 December** | **(60.0)** | **(54.1)** |
| **Surplus/(deficit) in scheme at 31 December** | **0.1** | **(4.2)** |
| Impact of asset ceiling | (3.5) | (0.6) |
| **LIABILITY IN THE STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER** | **(3.4)** | **(4.8)** |

In recognising the net surplus or deficit of the pension scheme, the funded status of the scheme is adjusted to reflect the funding requirement agreed by the sponsor alongside the rights of any return of surplus, with the recognition of an asset ceiling liability. The actual return on plan assets was a gain of £10.5 million (2018: £3.1 million loss).

Following the recent legal case ruling in 2018, the Society has recognised a past service cost of £nil (2018: £0.2 million) in the year, to reflect the estimate of liabilities for GMP equalisation.

The major categories of plan assets are as follows:

| Group and Society | 2019 £m | 2018 £m |
|---|---|---|
| Equities | 30.0 | 22.5 |
| Bonds | - | 17.8 |
| Liability driven investments | 16.0 | 8.4 |
| Cash | 13.0 | 0.1 |
| Secured pensioners | 1.1 | 1.1 |
| **Fair value of scheme assets** | **60.1** | **49.9** |

**The amounts recognised in finance cost in the income statement:**

| | 2019 £m | 2018 £m |
|---|---|---|
| Interest cost | (1.5) | (1.4) |
| Interest on pension scheme assets | 1.4 | 1.3 |
| | **(0.1)** | **(0.1)** |

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

| Group and Society | 2019 £m | 2018 £m |
|---|---|---|
| Opening defined benefit obligation at 1 January | (4.8) | (6.9) |
| Amount recognised in the income statement | (0.1) | (0.3) |
| Employer contributions | 1.5 | 2.0 |
| Remeasurement gains | - | 0.4 |
| **CLOSING DEFINED BENEFIT OBLIGATION AS AT 31 DECEMBER** | **(3.4)** | **(4.8)** |

## 28. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

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

| Group and Society | 2019 £m | 2018 £m |
|---|---|---|
| Actual return less expected return on plan assets | 9.1 | (4.4) |
| Experience loss arising on scheme liabilities | - | (0.2) |
| Changes in assumptions underlying the present value of the scheme liabilities | (6.2) | 3.4 |
| Change in impact of asset ceiling | (2.9) | 1.6 |
| **REMEASUREMENT OF DEFINED BENEFIT OBLIGATION** | **-** | **0.4** |

The average duration of the defined benefit obligation as at 31 December 2019 is 17 years (2018: 17 years). This number can be analysed as follows:

| Group and Society | 2019 Years | 2018 Years |
|---|---|---|
| Active members | 22 | 21 |
| Deferred members | 22 | 21 |
| Retired members | 13 | 13 |

During the year, the Group made additional contributions of £1.5 million (2018: £2.1 million) as part of its funding plan. The Group and Society have committed to contribute £1.5 million in 2020 under the agreed funding plan.

**b) Defined contribution obligations**

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

The pension charge for the period represents contributions payable by the Group and Society to the schemes and amounted for the Group to £1.0 million (2018: £0.9 million) and for the Society £0.9 million (2018: £0.8 million). There were no outstanding or prepaid contributions at either the beginning or end of the year.

## 29. SUBSCRIBED CAPITAL

| Group and Society | 2019 £m | 2018 £m |
|---|---|---|
| 7.875% sterling permanent interest bearing shares | 23.9 | 23.9 |
| Fair value adjustment for hedged risk | 0.8 | 1.2 |
| | **24.7** | **25.1** |

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.

## 30. FAIR VALUE RESERVES

| Group and Society | 2019 £m | 2018 £m |
|---|---|---|
| At 1 January | (1.0) | - |
| Transfer from available-for-sale on adoption of IFRS 9 | - | - |
| Net gain/(loss) from changes in fair value | 0.6 | (1.0) |
| | **(0.4)** | **(1.0)** |

## 31. FINANCIAL INSTRUMENTS

### Classification & Measurement

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

The Group has a formal structure for managing risk, including established risk limits, reporting lines, mandates, credit risk appetite and other control procedures. The Board Risk Committee (BRC) is tasked with monitoring the Group's overall exposure to risk, supported by the Executive Risk Committee (ERC). Five sub committees, the Assets and Liabilities Committee (ALCO), including its sub-committees Credit Committee (CC) and Liquidity and Funding Committee (LAF), Model Governance (MGC), Operational Risk & Resilience Committee (ORRC), Legal, Regulatory & Conduct Risk Committee (LRC), and the Transformation & Change Committee monitor the individual areas of risk and report to the Board Risk Committee quarterly.

The ALCO, supported by the CC and LAF, 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 and ensures that the management of credit risk is consistent with the credit risk appetite statement.

Key performance indicators are provided to the Executive Risk Committee and Board monthly by the ALCO and its sub-committees.

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

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

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

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

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

The fair values of these hedges as at 31 December 2019 are shown in note 13.

## 31. FINANCIAL INSTRUMENTS (CONTINUED)

### Classification & Measurement (continued)

Below are the summary terms and conditions and accounting policies of financial instruments held by the Group. These are the same for the Society, except for intercompany balances, which are accounted for at fair value through profit and loss.

| Financial instrument | Terms and conditions | Accounting policy: IFRS 9 |
|---|---|---|
| **Loans and advances to credit institutions** | Fixed or reference linked interest rate<br>Fixed term<br>Short to medium term maturity | Amortised cost<br>Accounted for at settlement date |
| **Debt securities** | Fixed or reference linked interest rate<br>Fixed term<br>Short to medium term maturity | Fair value through other comprehensive income<br>Accounted for at settlement date |
| **Loans and advances to customers** | Secured on residential property or land<br>Standard maximum contractual term of 25 years<br>Fixed or variable rate interest | Amortised cost<br>Accounted for at settlement date |
| **Shares** | Variable term<br>Fixed or variable interest rates | Amortised cost<br>Accounted for at settlement date |
| **Amounts owed to credit institutions** | Fixed or reference linked interest rate<br>Fixed term<br>Short to medium term maturity | Amortised cost<br>Accounted for at settlement date |
| **Amounts owed to other customers** | Fixed or reference linked interest rate<br>Fixed term<br>Short to medium term maturity | Amortised cost<br>Accounted for at settlement date |
| **Debt securities in issue** | Fixed or reference linked interest rate<br>Fixed term<br>Short to medium term maturity | Amortised cost<br>Accounted for at settlement date |
| **Subscribed capital** | Fixed interest rate<br>Issued for indeterminate period<br>Only repayable upon winding up of the Society | Amortised cost<br>Accounted for at settlement date |
| **Derivative financial instruments** | Fixed interest received/paid converted to variable interest paid/received<br>Based on notional value of the derivative | Fair value through profit and loss<br>Accounted for at trade date |

## 31. FINANCIAL INSTRUMENTS (CONTINUED)

### Classification & Measurement (continued)

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

| Carrying values by category | Held at amortised cost | Held at fair value | | | |
|---|---|---|---|---|---|
| Group<br>As at 31 December 2019 | Financial assets and liabilities at amortised cost<br>£m | Fair value through other comprehensive income<br>£m | Derivatives designated as fair value hedges<br>£m | Unmatched derivatives<br>£m | Total<br>£m |
| **Financial assets** | | | | | |
| Cash in hand and balances with the Bank of England | 272.4 | - | - | - | 272.4 |
| Loans and advances to credit institutions | 36.1 | - | - | - | 36.1 |
| Debt securities | - | 306.6 | - | - | 306.6 |
| Derivative financial instruments | - | - | 1.3 | 0.7 | 2.0 |
| Loans and advances to customers | 3,161.4 | - | - | - | 3,161.4 |
| **Other assets** | 40.5 | - | - | - | 40.5 |
| | **3,510.4** | **306.6** | **1.3** | **0.7** | **3,819.0** |
| **Financial liabilities** | | | | | |
| Shares | 2,781.1 | - | - | - | 2,781.1 |
| Amounts owed to credit institutions | 611.3 | - | - | - | 611.3 |
| Amounts owed to other customers | 91.9 | - | - | - | 91.9 |
| Debt securities in issue | 68.1 | - | - | - | 68.1 |
| Derivative financial instruments | - | - | 12.6 | 0.2 | 12.8 |
| Subscribed capital | 24.7 | - | - | - | 24.7 |
| **Other liabilities** | 12.9 | - | - | - | 12.9 |
| | **3,590.0** | **-** | **12.6** | **0.2** | **3,602.8** |

## 31. FINANCIAL INSTRUMENTS (CONTINUED)

### Classification & Measurement (continued)

| Carrying values by category | Held at amortised cost | Held at fair value | | | |
|---|---|---|---|---|---|
| **Group**<br>**As at 31 December 2018** | Financial assets and liabilities at amortised cost<br>**£m** | Fair value through other comprehensive income<br>**£m** | Derivatives designated as fair value hedges<br>**£m** | Unmatched derivatives<br>**£m** | Total<br>**£m** |
| **Financial assets** | | | | | |
| Cash in hand and balances with the Bank of England | 256.3 | - | - | - | 256.3 |
| Loans and advances to credit institutions | 34.5 | - | - | - | 34.5 |
| Debt securities | - | 216.1 | - | - | 216.1 |
| Derivative financial instruments | - | - | 7.8 | 0.4 | 8.2 |
| Loans and advances to customers | 3,502.9 | - | - | - | 3,502.9 |
| **Other assets** | 35.6 | - | - | - | 35.6 |
| | **3,829.3** | **216.1** | **7.8** | **0.4** | **4,053.6** |
| **Financial liabilities** | | | | | |
| Shares | 2,869.2 | - | - | - | 2,869.2 |
| Amounts owed to credit institutions | 685.0 | - | - | - | 685.0 |
| Amounts owed to other customers | 126.2 | - | - | - | 126.2 |
| Debt securities in issue | 106.8 | - | - | - | 106.8 |
| Derivative financial instruments | - | - | 4.9 | 1.0 | 5.9 |
| Subscribed capital | 25.1 | - | - | - | 25.1 |
| **Other liabilities** | 12.6 | - | - | - | 12.6 |
| | **3,824.9** | **-** | **4.9** | **1.0** | **3,830.8** |

## 31. 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 | | 2019 Book value £m | 2019 Fair value £m | 2018 Book value £m | 2018 Fair value £m |
|---|---|---|---|---|---|
| **Financial assets** | | | | | |
| Cash in hand and Balances with the Bank of Engand | a | 272.4 | 272.4 | 256.3 | 256.3 |
| Loans and advances to credit institutions | b | 36.1 | 36.1 | 34.5 | 34.5 |
| Loans and advances to customers | c | 3,161.4 | 3,175.4 | 3,502.9 | 3,507.6 |
| **Financial liabilities** | | | | | |
| Shares | d | 2,781.1 | 2,784.5 | 2,869.2 | 2,876.5 |
| Amounts owed to credit institutions | d | 611.3 | 611.3 | 685.0 | 685.0 |
| Amounts owed to other customers | d | 91.9 | 92.0 | 126.2 | 126.2 |
| Debt securities in issue | e | 68.1 | 68.2 | 106.8 | 106.8 |
| Subscribed capital | f | 23.9 | 31.9 | 23.9 | 29.0 |

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The estimated fair value of the financial assets and liabilities above has been calculated using the following valuation methodology:

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

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

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

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

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

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

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

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

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

## 31. FINANCIAL INSTRUMENTS (CONTINUED)

### Fair values of financial assets and liabilities carried at fair value

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

| Group | Notes | 2019 Level 1 £m | 2019 Level 2 £m | 2019 Total £m | 2018 Level 1 £m | 2018 Level 2 £m | 2018 Total £m |
|---|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | | |
| FVOCI - Debt securities | 12 | 306.6 | - | 306.6 | 216.1 | - | 216.1 |
| Derivative financial instruments – Interest rate swaps | 13 | - | 2.0 | 2.0 | - | 8.2 | 8.2 |
| | | **306.6** | **2.0** | **308.6** | **216.1** | **8.2** | **224.3** |
| **Financial liabilities** | | | | | | | |
| Derivative financial instruments – Interest rate swaps | 13 | - | (12.8) | (12.8) | - | (5.9) | (5.9) |
| | | **-** | **(12.8)** | **(12.8)** | **-** | **(5.9)** | **(5.9)** |

The Group has no level 3 financial instruments carried at fair value.

**Valuation techniques**

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

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

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

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

### Debt securities

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

### Interest rate swaps

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

### The Society's intercompany balances

The Society's intercompany balances are carried at fair value and are classed as level 3 instruments. They are measured based on a discounted cash flow calculation based on the most recent corporate plan, taking into account the risks inherent in the business areas and existing liquidity positions in the relevant entity.

### Transfers between fair value hierarchies

Transfers between fair value hierarchies occur when either it becomes possible to value a financial instrument using a method that is higher up the valuation hierarchy or it is no longer possible to value it using the current method and it must instead be valued using a method lower down the hierarchy. There have been no transfers during the current or previously reported periods.

## 31. 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 | 2019 £m | 2018 £m |
|---|---|---|
| **Credit risk exposure** | | |
| Cash in hand and Balances with the Bank of England | 272.4 | 256.3 |
| Loans and advances to credit institutions | 36.1 | 34.5 |
| Debt securities | 307.1 | 217.3 |
| Derivative financial instruments | 2.0 | 8.2 |
| Loans and advances to customers | 3,161.4 | 3,502.9 |
| **Total statement of financial position exposure** | **3,779.0** | **4,019.2** |
| Off balance sheet exposure – mortgage commitments | 93.8 | 79.2 |
| | **3,872.8** | **4,098.4** |

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

The Executive Risk Committee, supported by ALCO and CC, is responsible for approving treasury counterparties for both derivatives and investment purposes within the Board's risk appetite. 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 weekly by the Society's Treasury risk team and reviewed monthly by the ALCO and CC.

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 | 2019 £m | 2019 % | 2018 £m | 2018 % |
|---|---|---|---|---|
| **Industry sector** | | | | |
| Banks | 119.3 | 19.4 | 116.8 | 23.0 |
| Building Societies | 9.0 | 1.5 | 1.0 | 0.2 |
| Multilateral Development Banks | 67.0 | 10.9 | 63.9 | 12.6 |
| Central Government | 419.8 | 68.2 | 325.2 | 64.2 |
| | **615.1** | | **506.9** | |

| Group | 2019 £m | AAA % | AA % | A % | Other % | 2018 £m |
|---|---|---|---|---|---|---|
| **Geographic region** | | | | | | |
| United Kingdom | 548.1 | 15.4 | 76.6 | 8.0 | - | 440.0 |
| Multilateral Development banks | 67.0 | 100.0 | - | - | - | 63.9 |
| Australia | - | - | - | - | - | 3.0 |
| | **615.1** | | | | | **506.9** |

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## 31. FINANCIAL INSTRUMENTS (CONTINUED)

### Credit risk (continued)

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

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

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

All of the Group's treasury assets are classified as Stage 1 for ECL calculation purposes under IFRS 9 and there are no impairment charges against any of the Group's treasury assets as at 31 December 2019 (2018: £nil).

#### b) Loans and advances to customers

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

The lending portfolio is monitored by the CC 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. The continual assessment of customer risk of default is used to assess the customer's suitability for further lending as well as feed into strategic decision making processes, such as the corporate plan. Models used within the customer rating process are monitored in line with industry best practice and to provide insight into changes observed within the mortgage portfolios.

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

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

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

The maximum credit risk exposure is disclosed in the table on page 85.

Loans and advances to customers are predominantly made up of retail loans fully secured against UK residential property (£3,058.4 million), split between residential and buy-to-let loans with the remaining £95.2 million being secured on commercial property.

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

## 31. FINANCIAL INSTRUMENTS (CONTINUED)

### Credit risk (continued)

### b) Loans and advances to customers (continued)

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

| Group and Society | 2019 % | 2018 % |
|---|---|---|
| **Geographical analysis** | | |
| Eastern | 9.6 | 9.5 |
| East Midlands | 18.7 | 19.0 |
| London | 7.9 | 7.7 |
| North East | 5.0 | 5.1 |
| North West | 11.0 | 10.7 |
| South East | 14.1 | 14.2 |
| South West | 8.6 | 8.2 |
| Wales | 3.1 | 3.0 |
| West Midlands | 9.7 | 9.8 |
| Yorkshire & Humberside | 12.1 | 12.5 |
| Other | 0.2 | 0.3 |
| | **100.0** | **100.0** |

**Retail loans (Loans fully secured on residential properties)**

Loans fully secured on residential property are split between residential and buy-to-let. The average LTV is the mean LTV for the portfolio. Each individual LTV is calculated by comparing the value of the mortgage loan to the value of collateral held adjusted by a house price index. The simple average LTV of residential mortgages is 54% (2018: 56%). All residential loans above 80% LTV are insured against loss.

The indexed LTV analysis on the Group's residential mortgage portfolio is shown below:

| Group and Society | 2019 Residential % | 2019 Buy-to-let % | 2018 Residential % | 2018 Buy-to-let % |
|---|---|---|---|---|
| **Loan to Value analysis** | | | | |
| < 60% | 37.0 | 50.5 | 32.5 | 44.6 |
| 60% - 80% | 42.3 | 49.5 | 39.1 | 55.3 |
| 80% - 90% | 16.9 | - | 21.7 | 0.1 |
| > 90% | 3.8 | - | 6.7 | - |
| | **100.0** | **100.0** | **100.0** | **100.0** |
| | | | | |
| Average loan to value of loans | 53.8 | 56.9 | 56.4 | 58.8 |
| Average loan to value of new business | 68.5 | 59.9 | 74.5 | 66.4 |

The quality of the Group's retail mortgage book is reflected in the number and value of accounts in arrears. By volume 0.1% (2018: 0.2%) of loans are three months or more in arrears and by value it is 0.1% (2018: 0.1%).

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

## 31. FINANCIAL INSTRUMENTS (CONTINUED)

### Credit risk (continued)

### b) Loans and advances to customers (continued)

**Retail loans (continued)**

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

| Group and Society | 2019 Indexed £m | 2019 Unindexed £m | 2018 Indexed £m | 2018 Unindexed £m |
|---|---|---|---|---|
| **Value of collateral held:** | | | | |
| Stage 1: *12 month expected credit losses* | 4,908.1 | 4,125.3 | 5,832.6 | 4,998.7 |
| Stage 2: *Lifetime expected credit losses* | 970.1 | 866.3 | 408.6 | 357.3 |
| Stage 3: *Lifetime expected credit losses* | 10.8 | 7.8 | 13.2 | 9.4 |
| | **5,889.0** | **4,999.4** | **6,254.4** | **5,365.4** |

The collateral held consists of residential property. Collateral values are adjusted by the ONS Property Price Index 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 in stages 2 and 3 under IFRS 9 and which are in arrears, is £13.3 million as at 31 December (2018: £17.4 million).

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

The table below provides information on retail gross loans and Expected Credit Loss stages split by the number of days past due (DPD):

| Group and Society | 2019 Gross loans £m | 2019 Expected Credit Loss £m | 2018 Gross loans £m | 2018 Expected Credit Loss £m |
|---|---|---|---|---|
| **Stage 1:** 12 month expected credit losses | | | | |
| < 30 days past due | 2,419.3 | 0.1 | 3,170.3 | 0.1 |
| **Stage 2:** Lifetime expected credit losses | | | | |
| < 30 days past due | 625.0 | 0.3 | 245.0 | 0.1 |
| > 30 days past due | 9.6 | - | 13.3 | - |
| **Stage 3:** Lifetime expected credit losses | | | | |
| < 90 days past due | 2.4 | 0.1 | 2.9 | - |
| > 90 days past due | 2.1 | - | 2.8 | - |
| | **3,058.4** | **0.5** | **3,434.3** | **0.2** |

## 31. FINANCIAL INSTRUMENTS (CONTINUED)

### Credit risk (continued)

### b) Loans and advances to customers (continued)

**Forbearance**

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

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

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

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

The term of the mortgage is extended in order to reduce payments to a level that 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 CC on a monthly basis. In addition the Legal, Regulatory & 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 retail loans category:

| Group and Society | 2019 Number | 2018 Number |
|---|---|---|
| **Type of forbearance** | | |
| Interest only concessions | 2 | 3 |
| Reduced payment concessions | 1 | 1 |
| Payment plans | 23 | 24 |
| Capitalisations | 53 | 58 |
| Mortgage term extensions | 54 | 59 |
| Less: cases with more than one form of forbearance | (47) | (50) |
| | **86** | **95** |

These cases are covered by an IFRS 9 ECL allowance of £2,000 (2018: £3,000). In total, £5.2 million (2018: £5.7 million) of loans are subject to forbearance.

**Secured Business Loans (Other loans fully secured on land)**

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

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

| Group and Society | 2019 £m | 2019 % | 2018 £m | 2018 % |
|---|---|---|---|---|
| Owner occupied | 42.5 | 44.6 | 32.8 | 45.6 |
| Investment property | 52.7 | 55.4 | 39.1 | 54.4 |
| | **95.2** | **100.0** | **71.9** | **100.0** |

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## 31. FINANCIAL INSTRUMENTS (CONTINUED)

### Credit risk (continued)

### b) Loans and advances to customers (continued)

**Secured Business Loans (continued)**

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

| Group and Society | 2019 % | 2018 % |
|---|---|---|
| **Loan to Value analysis** | | |
| < 60% | 38.4 | 36.0 |
| 60% - 80% | 51.5 | 49.2 |
| 80% - 90% | 9.9 | 14.5 |
| > 90% | 0.2 | 0.3 |
| | **100.0** | **100.0** |
| Average loan to value of loans | 58.4 | 50.7 |
| Average loan to value of new business | 54.3 | 52.0 |

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

| Group and Society | 2019 Indexed £m | 2019 Unindexed £m | 2018 Indexed £m | 2018 Unindexed £m |
|---|---|---|---|---|
| **Value of collateral held:** | | | | |
| **Stage 1**: 12 month expected credit losses | 108.8 | 106.7 | 69.3 | 67.6 |
| **Stage 2:** Lifetime expected credit losses | 92.1 | 99.3 | 82.5 | 91.0 |
| **Stage 3:** Lifetime expected credit losses | 1.6 | 2.6 | 2.5 | 3.6 |
| | **202.5** | **208.6** | **154.3** | **162.2** |

Collateral reflects the latest valuation completed. If a property has had a desktop valuation since the latest full valuation, the collateral reflects the desktop valuation (58% of the SBL book has had a desktop valuation (2018: 70%)).

The table below provides information on SBL gross loans and Expected Credit Loss stages split by the number of days past due (DPD):

| Group and Society | 2019 Gross loans £m | 2019 Expected Credit Loss £m | 2018 Gross loans £m | 2018 Expected Credit Loss £m |
|---|---|---|---|---|
| **Stage 1:** 12 month expected credit losses | | | | |
| < 30 days past due | 51.7 | - | 30.0 | 0.1 |
| **Stage 2:** Lifetime expected credit losses | | | | |
| < 30 days past due | 41.2 | 0.4 | 39.1 | 0.5 |
| > 30 days past due | 1.0 | - | 1.2 | - |
| **Stage 3:** Lifetime expected credit losses | | | | |
| < 90 days past due | 0.4 | 0.3 | 1.3 | 0.3 |
| > 90 days past due | 0.9 | 0.4 | 0.3 | 0.1 |
| | **95.2** | **1.1** | **71.9** | **1.0** |

In terms of SBL risk, the single largest borrower represents less than 1.0% (2018: 1.5%) of the SBL mortgage book.

## 31. FINANCIAL INSTRUMENTS (CONTINUED)

### Credit risk (continued)

### b) Loans and advances to customers (continued)

**Secured Business Loans (continued)**

**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 within the SBL loans category:

| Group and Society | 2019 Number | 2018 Number |
|---|---|---|
| **Type of forbearance** | | |
| Interest only concessions | 1 | 1 |
| Re-negotiation of contractual payment | 6 | 5 |
| Active payment plan | 1 | 3 |
| | 8 | 9 |

These cases are covered by an IFRS 9 ECL allowance of £0.2 million (2018: £0.1 million). In total, £1.9 million (2018: £1.8 million) of loans are subject to forbearance.

### Liquidity risk

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

i) meet day-to-day business needs;

ii) meet any unexpected cash needs;

iii) maintain public confidence; and

iv) ensure maturity mismatches are provided for.

Monitoring of liquidity, in line with the Society's prudent policy framework, is performed daily. Compliance with these policies is reported to ALCO and LAF monthly and through to the Executive Risk and Board Risk Committees.

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

The Society's liquid resources comprise high quality liquid assets, including a Bank of England reserves account, Gilts, time deposits and investment grade fixed and floating rate notes issued by highly rated financial institutions, supplemented by unencumbered mortgage assets. At the end of the year the ratio of liquid assets to shares and deposits was 17.3% compared to 13.4% at the end of 2018. When also taking into account the off balance sheet liquid resources, the ratio of liquid resources to shares and deposits was 27.4% (2018: 20.4%).

The Society maintains a contingency funding plan, as part of its Recovery and Resolution Plan process, 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.

## 31. FINANCIAL INSTRUMENTS (CONTINUED)

### Liquidity risk (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 4.0 years (2018: 3.4 years). Conversely, retail deposits repayable on demand generally remain on the balance sheet much longer.

| **Group Residual maturity as at 31 December 2019** | On demand £m | Not more than three months £m | More than three months but not more than one year £m | More than one year but not more than five years £m | More than five years £m | Total £m |
|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | |
| Liquid assets | | | | | | |
| Cash in hand and balances with the Bank of England | 266.3 | - | 6.1 | - | - | 272.4 |
| Loans and advances to credit institutions | 6.2 | 29.9 | - | - | - | 36.1 |
| Debt securities | - | 58.9 | 98.8 | 148.9 | - | 306.6 |
| Total liquid assets | 272.5 | 88.8 | 104.9 | 148.9 | - | 615.1 |
| Derivative financial instruments | - | (0.1) | (0.4) | 2.0 | 0.5 | 2.0 |
| Loans and advances to customers | 2.4 | 27.4 | 78.8 | 472.1 | 2,580.7 | 3,161.4 |
| **Other assets** | - | 1.6 | 3.9 | 0.5 | 34.5 | 40.5 |
| | **274.9** | **117.7** | **187.2** | **623.5** | **2,615.7** | **3,819.0** |
| **Financial liabilities and reserves** | | | | | | |
| Shares | 1,303.5 | 488.7 | 454.8 | 533.0 | 1.1 | 2,781.1 |
| Amounts owed to credit institutions | 3.6 | 7.6 | 156.3 | 443.8 | - | 611.3 |
| Amounts owed to other customers | 6.4 | 42.3 | 43.2 | - | - | 91.9 |
| Debt securities in issue | - | - | 68.1 | - | - | 68.1 |
| Derivative financial instruments | - | 0.1 | 1.2 | 11.5 | - | 12.8 |
| Subscribed capital | - | 0.1 | - | - | 24.6 | 24.7 |
| Reserves | - | - | - | - | 216.2 | 216.2 |
| **Other liabilities** | 0.9 | 2.4 | 0.8 | 3.5 | 5.3 | 12.9 |
| | **1,314.4** | **541.2** | **724.4** | **991.8** | **247.2** | **3,819.0** |
| **NET LIQUIDITY GAP** | **(1,039.5)** | **(423.5)** | **(537.2)** | **(368.3)** | **2,368.5** | **-** |

## 31. FINANCIAL INSTRUMENTS (CONTINUED)

### Liquidity risk (continued)

| **Group**<br>**Residual maturity**<br>**as at 31 December 2018** | On demand<br>**£m** | Not more than three months<br>**£m** | More than three months but not more than one year<br>**£m** | More than one year but not more than five years<br>**£m** | More than five years<br>**£m** | Total<br>**£m** |
|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | |
| Liquid assets | | | | | | |
| Cash in hand and balances with the Bank of England | 250.6 | - | 5.7 | - | - | 256.3 |
| Loans and advances to credit institutions | 15.5 | 19.0 | - | - | - | 34.5 |
| Debt securities | - | 40.2 | 30.1 | 145.8 | - | 216.1 |
| Total liquid assets | 266.1 | 59.2 | 35.8 | 145.8 | - | 506.9 |
| Derivative financial instruments | 0.1 | - | 1.1 | 6.7 | 0.3 | 8.2 |
| Loans and advances to customers | 1.5 | 28.5 | 83.4 | 490.9 | 2,898.6 | 3,502.9 |
| **Other assets** | - | 0.3 | 9.7 | 1.1 | 24.5 | 35.6 |
| | **267.7** | **88.0** | **130.0** | **644.5** | **2,923.4** | **4,053.6** |
| **Financial liabilities and reserves** | | | | | | |
| Shares | 1,298.6 | 462.6 | 592.9 | 514.4 | 0.7 | 2,869.2 |
| Amounts owed to credit institutions | 2.1 | 79.2 | 14.6 | 589.1 | - | 685.0 |
| Amounts owed to other customers | 4.4 | 86.9 | 34.9 | - | - | 126.2 |
| Debt securities in issue | - | - | 5.5 | 101.3 | - | 106.8 |
| Derivative financial instruments | - | - | 0.7 | 5.1 | 0.1 | 5.9 |
| Subscribed capital | - | 0.1 | - | - | 25.0 | 25.1 |
| Reserves | - | - | - | - | 222.8 | 222.8 |
| **Other liabilities** | 1.7 | 3.3 | 1.6 | 1.2 | 4.8 | 12.6 |
| | **1,306.8** | **632.1** | **650.2** | **1,211.1** | **253.4** | **4,053.6** |
| **NET LIQUIDITY GAP** | **(1,039.1)** | **(544.1)** | **(520.2)** | **(566.6)** | **2,670.0** | **-** |

There is no material difference between the maturity profile for the Group and that for the Society. As at 31 December 2019, £887.7 million (2018: £1,245.2 million) of the Group's assets were encumbered. The 2018 table has been represented in the year to reclassify on demand maturities.

## 31. FINANCIAL INSTRUMENTS (CONTINUED)

### Liquidity risk (continued)

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

| Group<br>31 December 2019 | Repayable on demand £m | Not more than three months £m | More than three months but not more than one year £m | More than one year but not more than five years £m | More than five years £m | Total £m |
|---|---|---|---|---|---|---|
| Shares | 1,358.9 | 488.7 | 454.8 | 532.7 | 1.1 | 2,836.2 |
| Amounts owed to credit institutions | 3.6 | 7.5 | 156.3 | 443.9 | - | 611.3 |
| Amounts owed to other customers | 6.4 | 42.3 | 43.5 | - | - | 92.2 |
| Debt securities in issue | - | 3.1 | 65.1 | - | - | 68.2 |
| Derivative financial instruments | - | 0.5 | 4.8 | 40.7 | - | 46.0 |
| Subscribed capital | - | 0.5 | 1.5 | 7.9 | 23.9 | 33.8 |
| **TOTAL LIABILITIES** | **1,368.9** | **542.6** | **726.0** | **1,025.2** | **25.0** | **3,687.7** |
| **Group<br>31 December 2018** | | | | | | |
| Shares | 1,356.8 | 462.6 | 593.1 | 514.4 | 0.7 | 2,927.6 |
| Amounts owed to credit institutions | 2.3 | 81.2 | 14.6 | 589.1 | - | 687.2 |
| Amounts owed to other customers | 4.4 | 87.0 | 35.1 | - | - | 126.5 |
| Debt securities in issue | - | 5.0 | 9.2 | 8.7 | 83.9 | 106.8 |
| Derivative financial instruments | - | 0.3 | 2.9 | 39.2 | - | 42.4 |
| Subscribed capital | - | 0.5 | 1.5 | 7.9 | 23.9 | 33.8 |
| **TOTAL LIABILITIES** | **1,363.5** | **636.6** | **656.4** | **1,159.3** | **108.5** | **3,924.3** |

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.

## 31. FINANCIAL INSTRUMENTS (CONTINUED)

### Market and interest rate risk

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

The Society has adopted the 'Extended' approach to interest rate risk, as defined by the PRA, which aims to undertake the hedging of individual transactions within an overall strategy for structural hedging, based on a detailed analysis of the statement of financial position.

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 range of stress tests, including a 2% rise in interest rates on a weekly basis. The results are measured against the risk appetite for market risk which is currently set at a maximum of 4.0% of capital. In addition, management review interest rate basis risk and its potential impact on earnings. Risk positions are reviewed monthly by the ALCO and LAF and reported through to the Executive Risk and Board Risk Committees.

The table below summarises the Group's exposure to interest rate risk.

| Group and Society | 2019 £m | 2018 £m |
|---|---|---|
| Changes in market value from a 2% parallel upward shift in interest rates | 4.3 | 3.5 |

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

The Group is not exposed to foreign currency risk.

The Society does not have any financial assets or liabilities that are offset with the net amount presented in the statement of financial position as IAS 32 'Financial Instruments – Presentation' requires both an enforceable right to set off and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously. Neither of these conditions are met by the Society.

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

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

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

| Group and Society | 2019 Gross Amounts £m | 2019 Financial collateral* £m | 2019 Net amounts £m | 2018 Gross Amounts £m | 2018 Financial collateral* £m | 2018 Net amounts £m |
|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | |
| Derivative financial instruments | 2.0 | (2.0) | - | 8.2 | (8.2) | - |
| **TOTAL FINANCIAL ASSETS** | **2.0** | **(2.0)** | **-** | **8.2** | **(8.2)** | **-** |
| **Financial liabilities** | | | | | | |
| Derivative financial instruments | 12.8 | (12.8) | - | 5.9 | (5.9) | - |
| Repurchase agreements | 9.9 | (9.9) | - | 59.8 | (59.8) | - |
| **TOTAL FINANCIAL LIABILITIES** | **22.7** | **(22.7)** | **-** | **65.7** | **(65.7)** | **-** |

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

## 31. FINANCIAL INSTRUMENTS (CONTINUED)

### Market and interest rate risk (continued)

**Fair value hedges**

The Group holds a portfolio of fixed rate mortgages and savings products as well as fixed rate PIBS and therefore is exposed to changes in fair value due to movements in market interest rates. The Group manages this risk exposure by entering into pay fixed/ receive floating interest rate swaps for its loans to customers and pay floating/receive fixed interest rate swaps to hedge its fixed rate liabilities.

Only the interest rate risk element is hedged and therefore other risks, such as credit risk, are managed separately but are not managed through hedged derivative financial instruments by the Group.The interest rate risk component is determined as the change in the fair value of the long term fixed rate mortgages arising solely from changes in the appropriate 3 month LIBOR or SONIA (the benchmark rate of interest). Such changes are usually the largest component of the overall change in fair value. This strategy is designated as a fair value hedge and its effectiveness is assessed by comparing changes in the fair value of the loans attributable to changes in the benchmark rate of interest with changes in the fair value of the loans attributable to changes in the benchmark rate of interest with changes in the fair value of the interest rate swaps. The Group establishes the hedging ratio by matching the notional of the derivatives with the principal of the portfolio being hedged. Possible sources of ineffectiveness are as follows:

- differences between the expected and actual volumes of prepayments, as the Group hedges to the expected repayment date taking into account expected prepayments based on past experience;
- difference in the discounting between the hedged item and the hedging instrument, as cash collateralised interest rate swaps are discounted using the relevant reference rate discount curves, which are not applied to the fixed rate mortgages; and
- hedging derivatives with a non-zero fair value at the date of initial designation as a hedging instrument.

The exposure from this portfolio frequently changes due to new loans originated, contractual repayments and early prepayments made by customers in each period. As a result, the Group adopts a dynamic hedging strategy (sometimes referred to as a 'macro' or 'portfolio' hedge) to hedge the exposure profile by closing and entering into new swap agreements at each month-end. The Group uses the portfolio fair value hedge of interest rate risk to recognise fair value changes related to changes in interest rate risk in the relevant portfolio, and therefore reduce the profit or loss volatility that would otherwise arise from changes in fair value of the interest rate swaps alone.

The following table details the hedging instruments included in the derivative financial instruments line of the Group's consolidated statement of financial position:

| Group and Society | 2019 Contract/notional amount £m | 2019 Fair value of assets £m | 2019 Fair value of liabilities £m | 2019 Changes in fair value used for calculating hedge ineffectiveness £m |
|---|---|---|---|---|
| Derivatives designated as fair value hedges for interest rate risk (note 13) | | | | |
| Fixed rate mortgages | 1,705.0 | 0.5 | (12.2) | (12.1) |
| Fixed rate savings | 349.0 | - | (0.4) | - |
| Subscribed capital | 10.0 | 0.8 | - | (0.7) |
| | **2,064.0** | **1.3** | **(12.6)** | **(12.8)** |

| Group and Society | 2018 Contract/notional amount £m | 2018 Fair value of assets £m | 2018 Fair value of liabilities £m | 2018 Changes in fair value used for calculating hedge ineffectiveness £m |
|---|---|---|---|---|
| Derivatives designated as fair value hedges for interest rate risk (note 13) | | | | |
| Fixed rate mortgages | 1,887.0 | 6.7 | (4.9) | 5.1 |
| Fixed rate savings | 10.0 | - | - | - |
| Subscribed capital | 10.0 | 1.1 | - | (0.5) |
| | **1,907.0** | **7.8** | **(4.9)** | **4.6** |

## 31. FINANCIAL INSTRUMENTS (CONTINUED)

### Market and interest rate risk (continued)

**Fair value hedges (continued)**

The following table details the hedge exposures covered by the Group's hedging strategies:

| Group and Society | 2019 Carrying amount of hedged item Assets £m | Liabilities £m | 2019 Accummulated amount of fair value adjustments on the hedged item Assets £m | Liabilities £m | 2019 Balance sheet line item | 2019 Change in fair value of hedged item for ineffectiveness assessment £m |
|---|---|---|---|---|---|---|
| Hedged items in fair value hedges for interest rate risk (note 13) | | | | | | |
| Fixed rate mortgages | 1,715.1 | - | 9.3 | - | Loans & advances to customers | 10.4 |
| Fixed rate savings | - | 344.7 | 0.3 | - | Shares | 0.3 |
| Subscribed capital | - | 10.0 | - | (0.7) | Subscribed capital | 0.4 |
| | **1,715.1** | **354.7** | **9.6** | **(0.7)** | | **11.1** |

| Group and Society | 2018 Carrying amount of hedged item Assets £m | Liabilities £m | 2018 Accummulated amount of fair value adjustments on the hedged item Assets £m | Liabilities £m | 2018 Balance sheet line item | 2018 Change in fair value of hedged item for ineffectiveness assessment £m |
|---|---|---|---|---|---|---|
| Hedged items in fair value hedges for interest rate risk (note 13) | | | | | | |
| Fixed rate mortgages | 1,904.7 | - | - | (2.1) | Loans & advances to customers | (5.7) |
| Fixed rate savings | - | 8.4 | - | - | Shares | - |
| Subscribed capital | - | 10.0 | - | (1.2) | Subscribed capital | 0.5 |
| | **1,904.7** | **18.4** | **-** | **(3.3)** | | **(5.2)** |

## 31. FINANCIAL INSTRUMENTS (CONTINUED)

### Market and interest rate risk (continued)

**Fair value hedges (continued)**

The following table contains information regarding the effectiveness of the hedging relationships designated by the Group, as well as the impacts on profit or loss.

| Group and Society | 2019 Hedge ineffectiveness recognised in income statement £m | 2019 Income statement line item that includes reclassified amount |
|---|---|---|
| **Fair value hedges** | | |
| Interest rate swaps | | |
| Fixed rate mortgages | (1.7) | Net losses from derivative financial instruments |
| Fixed rate savings | - | Net losses from derivative financial instruments |
| Subscribed capital | - | Net losses from derivative financial instruments |
| | **(1.7)** | |

| Group and Society | 2018 Hedge ineffectiveness recognised in income statement £m | 2018 Income statement line item that includes reclassified amount |
|---|---|---|
| **Fair value hedges** | | |
| Interest rate swaps | | |
| Fixed rate mortgages | (0.6) | Net losses from derivative financial instruments |
| Fixed rate savings | - | Net losses from derivative financial instruments |
| Subscribed capital | - | Net losses from derivative financial instruments |
| | **(0.6)** | |

## 32. CAPITAL STRUCTURE

The Society's policy is to maintain a strong capital base to maintain member, creditor and market confidence and to sustain future development of the business. The formal Internal Capital Adequacy Assessment Process (ICAAP) assists the Society with its management of capital. Through its quarterly business plan update the Board monitors the Society's capital position to assess whether adequate capital is held to mitigate the risks it faces in the course of its business activities. The Society's actual and expected capital position is reviewed against stated risk appetite which aims to maintain capital at a specific level above its Total Capital Requirement (TCR).

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

- **Lending and Business Decisions** – The Society uses application scorecards to help it assess whether mortgage applications fit within its appetite for credit risk. Once loan funds have been advanced, behavioural scorecards are used to review the ongoing risk profile of both the portfolios and individual customers. In addition, for residential and buy-to-let mortgages property values are updated on a quarterly basis.
- **Pricing** – Pricing models are utilised for all mortgage product launches. The models include expected loss estimates and capital utilisation enabling the calculation of a risk adjusted return on capital.
- **Concentration risk** – The design of retail products takes into account the overall mix of products to ensure that exposure to market risk remains within permitted parameters.
- **Counterparty risk** – Wholesale lending is only carried out with approved counterparties in line with the Society's lending criteria and is subject to a range of limits. The limits are monitored daily to ensure the Society remains within risk appetite.

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

The Group's capital requirements are set and monitored by the PRA. During 2019, the Society has complied with the requirements included within the EU Capital Requirements Directive IV (Basel III). Further details of these requirements and their impact on the Society are provided in the Strategic report on pages 14 and 15.

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

Under Basel III Pillar 3, the Society is required to publish further information regarding its capital position and exposures. The Society's Pillar 3 disclosures are available on our website **www.thenottingham.com**.

## 33. FINANCIAL COMMITMENTS

| | Group 2019 £m | Group 2018 £m | Society 2019 £m | Society 2018 £m |
|---|---|---|---|---|
| **Leasing commitments** | | | | |
| The total of future minimum lease payments under non-cancellable operating leases are payable as follows: | | | | |
| **Land and buildings:** | | | | |
| Commitments due: | | | | |
| Less than one year | - | 0.9 | - | 0.6 |
| Between one year and five years | - | 2.7 | - | 2.1 |
| In more than five years | - | 2.0 | - | 1.7 |
| | **-** | **5.6** | **-** | **4.4** |
| **Other:** | | | | |
| Commitments due: | | | | |
| Less than one year | - | 0.3 | - | 0.3 |
| Between one year and five years | - | 0.6 | - | 0.6 |
| | **-** | **6.5** | **-** | **5.3** |

At 31 December 2018, the Group and Society had ourstanding commitments for future minimum lease payments under non-cancellable operating leases. Following the adoption of IFRS 16 'Leases' on 1 January 2019, all lease commitments are now presented in the statement of financial position (notes 19 and 37).

## 34. RELATED PARTY TRANSACTIONS

### Transaction with Group companies

Details of the Society's shares in group undertakings are given in note 16.

During the normal course of business the following transactions were undertaken during the year:

| Society | 2019 Nottingham Mortgage Services £m | 2019 Nottingham Property Services £m | 2019 Harrison Murray £m | 2018 Nottingham Mortgage Services £m | 2018 Nottingham Property Services £m | 2018 Harrison Murray £m |
|---|---|---|---|---|---|---|
| Management charges paid | 0.1 | 0.1 | 0.1 | - | 0.2 | 0.2 |
| People related recharges | 0.4 | 0.2 | 0.3 | - | 0.2 | 0.3 |
| Fixed occupancy related recharges | - | 0.1 | - | - | 0.2 | 0.3 |

During the year, Nottingham Building Society has received £0.1 million (2018: £0.1 million) in fees for providing cash manager and mortgage servicer fees to Arrow Mortgage Finance No.1 Limited.

Movement on the intercompany balances are disclosed in note 16.

At the end of the year the following balances were outstanding between the Society and its subsidiaries:

| | 2019 Amount owed to subsidiaries £m | 2019 Amount owed by subsidiaries £m | 2018 Amount owed to subsidiaries £m | 2018 Amount owed by subsidiaries £m |
|---|---|---|---|---|
| Arrow Mortgage Finance No. 1 Limited | (77.2) | 20.1 | (106.1) | 20.1 |
| Estate Agency | - | 0.1 | - | 1.0 |
| Mortgage Broking | - | 0.1 | - | 0.1 |
| | **(77.2)** | **20.3** | **(106.1)** | **21.2** |

Interest accrues on the balances outstanding with Arrow Mortgage Finance at LIBOR plus a margin. The repayment of the loans will follow the collection of the principal and interest of the underlying mortgage assets, used as security and has a contractual maturity within one year.

No interest is charged on balances between the other Group companies.

## 34. RELATED PARTY TRANSACTIONS (CONTINUED)

### Transactions with key management personnel

Transactions with key management personnel are on the same terms and conditions applicable to members and other employees within the Group. The directors are considered to be the only key management personnel as defined by IAS 24, which includes Non-Executive Directors.

Compensation for key management personnel for the year totalled £1.0 million (2018: £1.3 million) and a breakdown is disclosed on page 39 in the Directors' remuneration report.

In addition, the following transactions were undertaken through the normal course of business:

| Group and Society | 2019 Number of key management personnel and their close family members Number | 2019 Amounts in respect of key management personnel and their close family members £000 | 2018 Number of key management personnel and their close family members Number | 2018 Amounts in respect of key management personnel and their close family members £000 |
|---|---|---|---|---|
| **Loans and advances** | | | | |
| Net movements in the year | - | (15) | - | (14) |
| Balances outstanding 31 December | 2 | 139 | 2 | 154 |
| **Share accounts** | | | | |
| Net movement in the year | - | - | 1 | 26 |
| Balances outstanding 31 December | 9 | 81 | 9 | 81 |
| Interest receivable on loans & advances | | 3 | | 4 |
| Interest payable on share accounts | | 1 | | - |

### Directors' loans and transactions

As at 31 December 2019 there was one (2018: one) outstanding secured mortgage loan made in the ordinary course of business at a normal commercial rate to directors and their connected persons. A register is maintained at the head office of the Society that 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 2019, will be available for inspection at the head office for a period of 15 days up to and including the annual general meeting.

## 35. NOTES TO THE CASH FLOW STATEMENTS

| **Group** | **Notes** | **2019 Subscribed capital £m** | **2018 Subscribed capital £m** |
|---|---|---|---|
| **Changes in liabilities arising from financing activities** | | | |
| Subscribed capital at 1 January | | 23.9 | 23.9 |
| Accrued interest | | 1.9 | 1.9 |
| Interest paid | | (1.9) | (1.9) |
| Balance at 31 December | 29 | **23.9** | **23.9** |

## 36. REGISTERED OFFICE

Nottingham Building Society is a building society, incorporated and domiciled in the United Kingdom. The address of its registered office is: Nottingham House, 3 Fulforth Street, Nottingham, NG1 3DL.

## 37. CHANGES TO ACCOUNTING POLICIES

This note explains the impact on the financial statements as a result of adopting the new accounting standard IFRS 16 'Leases' and also discloses the new accounting policies, that have been applied with effect from 1 January 2019, where they differ to those applied in prior periods. This policy affects the Group as a lessee.

The Group has lease contracts for various branches, and a small number of vehicles and IT equipment. Before the adoption of IFRS 16, the Group classified each of its leases (as a lessee) at the inception date as either a finance lease or an operating lease. Under IAS 17, all of the Group's leased assets at 31 December 2018 were classified as operating leases, as substantially all of the risks and rewards incidental to ownership of the leased assets were not transferred to the Group. Therefore, all lease payments were recognised as an expense in the income statement. Upon adoption of IFRS 16, the Group applied a single recognition and measurement approach for all leases, except short-term leases and low value leased assets. The standard provides specific transition requirements and practical expedients, which have been applied by the Group.

From 1 January 2019, the Group recognises right-of-use assets and lease liabilities for those leases previously classified as operating leases, except for short-term leases and low value leased assets. The Group has applied the modified approach of the standard, so for all leases already in place at 1 January 2019, it has applied IFRS 16 as if the lease started on this date, with the asset and liability being equal on day one and therefore there is no impact on opening reserves or prior year comparatives.

The lease liability is initially measured at the present value of future lease payments, discounted using the incremental borrowing rate.

The Group has applied the available practical expedients wherein it:

- Used a single discount rate to a portfolio of leases with reasonably similar characteristics;
- Relied on its assessment of whether leases are onerous immediately before the date of initial application;
- Applied the short-term leases exemption to leases with lease term that ends within 12 months at the date of initial application;
- Excluded the initial direct costs from the measurement of the right-of-use asset at the date of initial application; and
- Used hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

The financial impact for the Group of adopting this accounting standard has resulted in the recognition of a £5.3m asset at 1 January 2019. The corresponding lease liability includes a £0.1m transfer of existing onerous lease provision.

A reconciliation from the future operating lease commitments disclosed in the 2018 Annual Report and Accounts to the lease liability recognised on 1 January 2019 is shown below.

| | Group 1 January 2019 £m | Society 1 January 2019 £m |
|---|---|---|
| **Operating lease commitments disclosed as at 31 December 2018** | 6.5 | 5.3 |
| Weighted average incremental borrowing rate as at 1 January 2019 | 1.75% | 1.75% |
| Discounted operating lease commitments at 1 January 2019 | 5.7 | 4.7 |
| Less leases recognised as short-term under the practical expedient under IFRS 16 | (0.1) | (0.1) |
| Less contracts reassessed as service agreements | (0.2) | (0.2) |
| **Lease liability recognised at 1 January 2019** | **5.4** | **4.4** |

The recognised right-of-use assets relate to the following types of assets.

| | Group 31 December 2019 £m | Group 1 January 2019 £m | Society 31 December 2019 £m | Society 1 January 2019 £m |
|---|---|---|---|---|
| Properties | 5.0 | 4.7 | 4.1 | 3.8 |
| Equipment | 0.2 | 0.3 | 0.2 | 0.3 |
| Motor vehicles | 0.1 | 0.3 | 0.1 | 0.3 |
| **Total right-of-use assets** | **5.3** | **5.3** | **4.4** | **4.4** |

ACCOUNTS

# ANNUAL BUSINESS STATEMENT
## for the year ended 31 December 2019

| 1. Statutory percentages | 2019 % | Statutory limit % |
|---|---|---|
| **Lending limit** | | |
| Proportion of business assets not in the form of loans fully secured on residential property | 3.26 | 25 |
| **Funding limit** | | |
| Proportion of shares and borrowings not in the form of shares held by individuals | 21.71 | 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 | 2019 % | 2018 % |
|---|---|---|
| **As a percentage of shares and borrowings:** | | |
| Gross capital | 6.78 | 6.55 |
| Free capital | 5.81 | 5.91 |
| Liquid assets | 17.32 | 13.38 |
| **As a percentage of mean total assets:** | | |
| (Loss)/profit after taxation | (0.18) | 0.24 |
| Management expenses (Group) | 1.07 | 1.09 |
| Management expenses (Society) | 0.94 | 0.95 |
| **As a percentage of year end assets:** | | |
| Return on assets | (0.19) | 0.23 |

The above percentages have been calculated from the Group accounts.

'Shares and borrowings' are the aggregate of 'shares', 'amounts owed to credit institutions', 'amounts owed to other customers' and 'debt securities in issue' in the Group statement of financial position.

'Gross capital' is the aggregate of subscribed capital and aggregated reserves as shown in the Group statement of financial position.

'Free capital' is gross capital less property, plant and equipment, lease assets and intangible assets in the Group statement of financial position.

'Mean total assets' are calculated by halving the aggregate of total assets at the beginning and end of the financial year for the Group/Society.

'Liquid assets' are the first three items on the asset side of the Group statement of financial position.

'Management expenses' are the aggregate of administrative expenses (excluding acquisition and merger costs) and depreciation and amortisation taken from the Group/Society statements of comprehensive income.

**3. Information about the directors at 31 December 2019:**

| Director's name | Date of appointment | Age | Business occupation | Other directorships (and offices) |
|---|---|---|---|---|
| **Simon Baum** | 18.06.18 | 57 | Director | Baum Associates Ltd |
| **John Edwards**<br>Chairman | 10.01.12 | 64 | Director | GreyCastle Life Reinsurance (SAC) Ltd |
| **Simon Linares** | 01.12.19 | 55 | Director | Kids Out Trading Ltd<br>Kids Out UK Charity |
| **David Marlow**<br>Chief Executive | 16.01.06 | 54 | Building Society Executive | Harrison Murray Limited<br>HM Lettings Limited<br>Nottingham Mortgage Services Ltd<br>Nottingham Property Services Ltd<br>Member of FCA Smaller Business Practitioner Panel |
| **Daniel Mundy**<br>Chief Financial Officer | 19.04.17 | 43 | Building Society Executive | Harrison Murray Limited<br>HM Lettings Limited<br>Nottingham Mortgage Services Ltd<br>Nottingham Property Services Ltd |
| **Andrew Neden** | 17.09.14 | 57 | Director | ABC International Bank plc<br>Aetna Insurance Company Ltd<br>Ashmill Worcester Ltd<br>Eltham College Ltd<br>Grace Church Dulwich Ltd<br>Northgate (Warwick) Developments Ltd<br>The Great St Helen's Trust Ltd<br>St Peter's Canary Wharf Trust Ltd<br>Wesleyan Assurance Society<br>Wesleyan Unit Trust Managers Ltd |
| **Kavita Patel** | 01.01.17 | 43 | Director | Shakespeare Martineau LLP<br>Philsec Ltd<br>Meaujo Incorporations Ltd |
| **Charles Roe**<br>Chief Risk Officer | 16.01.19 | 54 | Building Society Executive | |
| **Kerry Spooner** | 01.09.16 | 58 | Director | Scotiabank Europe plc |

Correspondence to directors jointly or individually should be addressed 'Private and Confidential' and c/o Ernst & Young LLP, 1 Bridgewater Place, Water Lane, Leeds LS11 5QR.

**Directors' service contracts:**

David Marlow entered into his contract as Chief Executive on 21 February 2011; however, he has been a Director of the Society since 16 January 2006. Daniel Mundy entered into his contract as Finance Director on 19 April 2017, and became Chief Financial Officer in January 2019. Charles Roe entered into his contract as Chief Risk Officer on 9 April 2018, and became a Director of the Society on 16 January 2019.

All contracts are terminable at any time by the Society on 12 months' notice and by the individual on six months' notice. Unless notice to terminate is given by either party, the contracts continue automatically.

# GLOSSARY

Set out below are the definitions of the terms used within the Annual Report and Accounts to assist the reader and to facilitate comparison with other financial institutions:

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| **Additional Tier 1 capital (AT1)** | Capital that meets certain rules under CRD IV and which comprises the Society's PIBS but only under the transitional provisions. |
| **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 III** | Basel III became effective in the UK on 1 January 2014 through CRD IV and sets out the details of strengthened global regulatory standards on bank capital adequacy and liquidity. |
| **Buy-to-let loans (BTL)** | Buy-to-let loans are those loans which are offered to customers buying residential property specifically to let out and generate a rental income. |
| **Capital Requirements Directive (CRD IV)** | CRD IV is the European legislation which came into force from 1 January 2014 to implement Basel III. It is made up of the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD), outlining the capital requirements framework and introduced liquidity requirements, which regulators use when supervising firms. |
| **Common Equity Tier 1 capital (CET1)** | CET1 capital consists of internally generated capital generated from retained profits, other reserves less intangible assets and other regulatory deductions. CET1 capital is fully loss absorbing. |
| **Common Equity Tier 1 ratio** | Common Equity Tier 1 capital as a percentage of risk weighted assets. |
| **Contractual maturity** | The date at which a loan or financial instrument expires, at which point all outstanding principal and interest has been paid. |
| **Credit risk** | This is the risk that a customer or counterparty fails to meet their contractual obligations. |
| **Debt securities** | Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings excluding those issued by central banks. |
| **Debt securities in issue** | Transferable certificates of indebtedness of the Society to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit. |
| **Derivative financial instruments** | A derivative financial instrument is a contract between two parties whose value is based on an underlying price or index rate it is linked to, such as interest rates, exchange rates of stock market indices. The Society uses derivative financial instruments to hedge its exposure to interest rate risk. |
| **Effective interest rate method (EIR)** | The method used to measure the carrying value of a financial asset or liability and to allocate associated interest income or expense over the relevant period. The calculation includes all fees and penalties paid and received between parties which are integral to the contract. |
| **Expected Credit Loss (ECL)** | The present value of all cash shortfalls over the expected life of the financial instrument. The term is used for accounting for impairment provisions under the new IFRS 9 standard. |
| **Exposure** | The maximum loss a financial institution might suffer if a borrower, counterparty or group fails to meet their obligations. |
| **Exposure at Default (EAD)** | A component of the IFRS 9 expected credit loss calculation. The EAD model calculates the balance profile of each mortgage account over its expected behavioural lifetime. |
| **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. |
| **Fair value through other comprehensive income (FVOCI)** | Financial assets held at fair value on the balance sheet with changes in fair value being recognised through other comprehensive income. |
| **Fair value through profit or loss (FVPL)** | Financial assets held at fair value on the balance sheet with changes in fair value being recognised through the income statement. |
| **Financial Conduct Authority (FCA)** | The statutory body responsible for conduct of business regulation and supervision of UK authorised firms. |
| **Financial Services Compensation Scheme (FSCS)** | The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry.<br><br>Every firm authorised by the FCA is obliged to pay an annual levy, which goes towards its running costs and compensation payments. |

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| **Forbearance strategies** | Strategies to support borrowers in financial difficulty, such as agreeing a temporary reduction in the monthly payment, extending mortgage terms and a conversion to an interest-only basis. The aim of forbearance strategies is to avoid repossession. |
| **Free Capital** | The aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment and intangible assets. |
| **Funding Limit** | Measures the proportion of shares and borrowings (excluding the fair value adjustment for hedged risk) not in the form of shares held by individuals. The calculation of the funding limit is explained in the Annual Business Statement. |
| **Funding for Lending Scheme (FLS)** | A scheme launched by the Bank of England and HM Treasury, which provides funding to participating banks and building societies with the aim of stimulating lending within the economy. |
| **General reserves** | The accumulation of the Society's historic and current year profits which is the main component of Common Equity Tier 1 capital. |
| **Gross capital** | The aggregate of general reserves, fair value 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. |
| **Interest rate risk** | The risk of loss due to a change in market interest rates. Interest rate risk can have an impact on Society's mortgages and savings products. |
| **Internal Capital Adequacy Assessment Process (ICAAP)** | The Society's own assessment, as part of Basel III 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. |
| **Internal Liquidity Adequacy Assessment Process (ILAAP)** | The Society's own assessment of the liquidity resources it requires in order to remain within the risk tolerances it has set. This will include an evaluation of potential stresses based on multiple market environments. |
| **Lending limit** | Measures the proportion of business assets not in the form of loans fully secured on residential property. |
| **Leverage ratio** | The ratio of Tier 1 capital divided by the total exposures, which includes on and off balance sheet items. |
| **Liquid assets** | Total of cash in hand, loans and advances to credit institutions, and debt securities. |
| **Liquidity resources** | Assets held in order to manage liquidity risk. Liquidity resources comprises cash and balances with the Bank of England, UK Government securities and multilateral development banks, other securities and bank deposits and Bank of England approved mortgage portfolios. |
| **Liquidity risk** | Liquidity risk is the risk that the Society is unable to meet its financial obligations as they fall due, or can only secure them at excessive cost. This risk arises from timing mismatches of cash inflows and outflows. |
| **Loan to value ratio (LTV)** | LTV expresses the amount of a mortgage as a percentage of the value of the property. |
| **Loans past due** | Loans on which a payment has not been made as of its due date. |
| **Loss Given Default (LGD)** | A component of the IFRS 9 expected credit loss calculation. The LGD model calculates the likely loss on asset disposal that the Society would suffer if a default event were to occur in any given month over the expected behavioural lifetime of a mortgage account. |
| **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. |

# GLOSSARY (continued)

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| **Operational risk** | The risk of loss arising from inadequate or failed internal processes, people and systems, or from external events. |
| **Permanent interest bearing shares (PIBS) / Subscribed capital** | Unsecured, deferred shares of the Society that are a form of Additional Tier 1 capital under the transitional rules of CRD IV. PIBS rank behind the claims of all depositors, payables and investing members of the Society. PIBS are also known as subscribed capital. |
| **Probability of Default (PD)** | A component of the IFRS 9 expected credit loss calculation. An estimate of the probability that a borrower will default on their credit obligation over a fixed time period. A 12 month ECL uses a 12 month PD, whilst a lifetime ECL uses the estimated PD over the remaining contractual life of the loan. |
| **Prudential Regulation Authority (PRA)** | The statutory body responsible for the prudential supervision of banks, building societies, insurers and small number of significant investment firms in the UK. The PRA is a subsidiary of the Bank of England. |
| **Renegotiated loans** | Loans are classed as renegotiated where an agreement between a borrower and a lender has been made to modify the loan terms either as part of an on-going relationship or if the borrower is in financial difficulties. The renegotiated loan may no longer be treated as past due or impaired. |
| **Residential loans** | Loans that are loaned to individuals rather than institutions and are secured against residential property. |
| **Right-of-use assets** | A lessee's right to use an asset over the life of a lease. The cost of the asset is calculated as the amount of lease liabilities recognised, initial direct costs incurred, and lease payments made at or before the commencement date less any lease incentives received. |
| **Risk appetite** | The articulation of the level of risk that the Society is willing to accept (or not accept) in order to safeguard the interests of the Society's members whilst also achieving business objectives. |
| **Risk weighted assets (RWA)** | The value of assets, after adjustment, under the relevant Basel III capital rules to reflect the degree of risk they represent. |
| **Secured business lending (SBL)** | Loans secured on commercial property which is only made available to Small and Medium sized Enterprises. |
| **Shares** | Funds deposited by a person in a retail savings account with the Society. Such funds are recorded as liabilities for the Society. |
| **Shares and borrowings** | The aggregate of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue. |
| **Significant increase in credit risk (SICR)** | A significant increase in credit risk on a financial asset is judged to have occurred when an assessment, using quantitative and qualitative factors, identifies at a reporting date that the credit risk has moved significantly since the last asset was originally recognised. |
| **Special Purpose Vehicle (SPV)** | A legal entity (usually a limited company) created to fulfil narrow, specific or temporary objectives. In the context of the Society, the SPV is used in relation to securitisation activities. |
| **SPPI test** | An assessment of whether the contractual terms of the financial asset give rise to cash flows that are in substance solely payments of principal and interest. |
| **Stage 1** | A component of the IFRS 9 expected credit loss calculation. Stage 1 assets are assets which have not experienced a significant increase in credit risk since the asset was originally recognised on the balance sheet. 12 month ECL are recognised as the impairment provision for all financial assets on initial recognition. Interest revenue is the EIR on the gross carrying amount. |
| **Stage 2** | A component of the IFRS 9 expected credit loss calculation. Stage 2 assets have experienced a significant increase in credit risk since initial recognition. Lifetime ECL is recognised as an impairment provision. Interest revenue is the EIR on the gross carrying amount. |
| **Stage 3** | A component of the IFRS 9 expected credit loss calculation. Stage 3 assets are identified as in default and considered credit impaired. Lifetime ECL is also recognised as an impairment provision. Interest revenue is the EIR on the net carrying amount. |
| **Standardised approach** | The basic method used to calculate capital requirements for credit risk. In this approach the risk weighting used in the capital calculation are determined by specified percentages. |
| **Term Funding Scheme (TFS)** | A scheme launched by the Bank of England and HM Treasury, which provides funding to participating banks and building societies with the aim of stimulating lending within the economy. |

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| **Tier 1 capital** | A component of regulatory capital, it comprises CET1 and AT1. |
| **Tier 1 ratio** | Tier 1 capital as a percentage of risk weighted assets. |
| **Tier 2 capital** | Comprises the collective impairment allowance (for exposures treated on a Standardised basis), less certain regulatory deductions. |
| **Total Capital Requirement (TCR)** | The total amount of capital the regulator requires the Society to hold, which is made up of Pillar 1 and Pillar 2A capital. |
| **Underlying profit** | A measure which aims to present management's view of the Group's underlying performance for the reader of the Annual Report & Accounts with like for like comparisons of performance across years without the distortion of one-off volatility and items which are not reflective of the Group's ongoing business activities. |
| **Wholesale funding** | Amounts owed to credit institutions, amounts owed to other customers and debt securities in issue. |

The Nottingham

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