2012

Annual Report and Accounts

The Nottingham

Bringing your finances closer to home

Contents

Executive summary

The foundations of the Society's strength are based on an excellent capital position and an acute focus on a lending policy that ensures we lend our members' money appropriately. The 2012 results demonstrate that the Society has consistently and significantly improved its financial performance since 2009.

Below are some of the key achievements and financial highlights of 2012:

- Group underlying profit up by 22% to £10.5 million;
- Group pre-tax profit at £8.5m up from £7.2m in 2011;
- Asset growth of 10.2%;
- Stable net interest margin at 1.17%;
- Strong capital ratios with Tier 1 ratio at 16.9% and gross capital at 7.0%;
- Underlying cost income ratio down from 66.6% to 64.7%;
- Gross mortgage lending up by 28% to £559m;
- The mortgage book is 100% matched by retail savings;
- Arrears remain consistently lower than industry average, with only 0.64% of loans greater than three months in arrears (approximately a third of the industry average);
- Strong retail franchise – total retail balances up by 14%; and
- Non retail funding ratio down to 10.1% from 12.6% in 2011 and 16.7% in 2010.

Chairman's statement

"Our conservative business model has enabled the Society to weather the worst of the economic storm in recent years. Indeed it has been one of the key enablers behind our recent resurgence."

David Thompson

Market and economic background

I spoke at our 2012 AGM about the continued fragility of the UK economy and the on-going challenges in the Eurozone. Regrettably these same challenges are still evident as the UK and almost every other Western economy struggles to generate positive momentum.

The UK economy remains fragile and three out of the last four quarters saw negative GDP growth. It was only in the third quarter of the year that positive GDP growth of 0.9% was recorded boosted by the Olympics and the Diamond Jubilee. So growth over the full year was flat, but there are signs we shall hopefully see some modest growth in 2013.

Internationally we continue to see high levels of uncertainty about the prospects for both the Eurozone and further afield, with evidence of growth slowdown in China, India, and Brazil as well as some other emerging economies. The long term outlook for the euro and the Eurozone remains in the balance. In December we saw the announcement that Greece was to receive the latest tranche of bailout funds needed to keep the country going. Italy, Spain, Ireland and Portugal continue to face serious challenges to their economic recovery and latterly we have seen France drawn into the spotlight.

The end of the year was no less dramatic in the United States, with the threat of political and fiscal deadlock only averted on 1st January 2013 when legislation was finally passed to impose higher taxes on the wealthiest Americans and to postpone spending cuts but only until April. Failure to have reached agreement would have most likely sent the US economy back into recession as it lurched close to the so-called 'fiscal cliff'.

Here at home, the banking industry continues to be plagued by controversy, with the Libor scandal being the latest major challenge to the industry's credibility. In June Barclays Bank was fined by both UK and US regulators for significant fraud and collusion connected to Libor rate submission rigging. Since then, multi-million pound fines have also been imposed on UBS and RBS. At a time when the industry is seeking to rebuild its damaged reputation, the succession of investigations and revelations does nothing to restore public confidence.

Over the course of recent months we have seen the implementation of the Retail Distribution Review and we now know what changes we must put in place as a result of the Mortgage Market Review. In both instances we are very confident that the Society is well placed to meet these new requirements. We have seen several major organisations withdraw or limit their financial advice propositions, whilst we continue to provide our members with access to 'whole of market' expert advice. From a mortgage perspective we have always been a prudent lender and we are confident the changes will not disrupt the progress we have made in growing our lending in recent years.

In July 2012, the Bank of England and HM Treasury announced the launch of the Funding for Lending Scheme (FLS) which is designed to boost lending to the real economy. Banks and building societies that increase lending to UK households and businesses are able to borrow more under the scheme, and do so at lower cost than those that scale back lending. This has led to a fall in the cost of mortgages as lenders are able to pass on the benefit of the cheaper funding. However, it has been to the detriment of savings rates as the requirement for lenders to raise funding from the retail market has fallen. Our challenge, as ever, will be to continue to balance the interests of both our savers and mortgage customers through this period.

Our response

As we have said before, our conservative business model has enabled the Society to weather the worst of the economic storm in recent years. Indeed it has been one of the key enablers behind our recent resurgence.

Our key focus will be to continue to deliver strong financial performance, to give protection to members and to maintain our capital.

As David Marlow will outline in his report, I am pleased to say that the Society has consistently and significantly improved its financial performance since 2009. This needs to continue so that we can serve more members in future and put ourselves in the position where we can absorb market shocks.

The trials and tribulations of the banks referred to above give us the opportunity to persuade customers about the benefits of being part of a mutually owned organisation. Raising our profile across our heartland will be a key part of our strategy over the coming years.

Strategy

In December, we were pleased to announce the proposed merger with Shepshed Building Society (the Shepshed). Subject to a 'yes' vote at their AGM in April, the merger will complete in July 2013. The Shepshed has three branches in Leicestershire and Nottinghamshire and as well as providing long term security to the staff and members of the Shepshed, a successful merger will support the further expansion for The Nottingham into new high streets and towns. We very much look forward to welcoming the staff and members of Shepshed Building Society to The Nottingham family.

"The trials and tribulations of the banks give us the opportunity to persuade customers about the benefits of being part of a mutually owned organisation"

The proposed merger is only one part of our strategy to extend our geographical reach and make us available to more customers. In January we announced our acquisition of Harrison Murray, a leading independent estate agency operating in 17 locations across Northamptonshire, Leicestershire, Hertfordshire, Cambridgeshire and Bedfordshire. The acquisition represents an exciting new chapter for the Society as it is the first acquisition we have completed. The lack of overlap between the businesses, coupled with their complementary core competencies, will provide significant opportunities to extend the provision of our building society services into a number of these new locations as well as improve our overall performance as an estate agent.

Board changes

I am pleased to announce the appointment of a further non-executive director to the Board.

Mary Phibbs, who joined the Board on 1 February 2013, has over 30 years' experience in audit, advisory, finance and insurance both here and in Australia. Mary has held key executive roles at Standard Chartered Bank, ANZ Banking Group, KPMG, National Australia Bank and Bankers Trust. Mary has a strong commitment to mutuality and currently holds non-executive directorship posts at The Charity Bank Limited, Friends Life Group plc, Stewart Title Limited and Novae Group plc. We welcome Mary to the Board and look forward to working with her in the years to come.

Governance and Regulation

In April 2013 the Prudential Regulation Authority (PRA), as part of the Bank of England, will become the UK's prudential regulator for banks, building societies, credit unions, insurers and major investment firms. This is part of a wider reform of the UK regulatory framework, which also sees the creation of a Financial Policy Committee within the Bank, and a new conduct regulator, the Financial Conduct Authority (FCA).

Both the PRA and the FCA have vowed to be far more active than their predecessor in overseeing the running of the country's larger financial institutions. With this increase in regulatory activity comes increased compliance and with that cost.

Whilst we have always held ourselves to strong standards of conduct, we have further enhanced our governance for example through the creation of a specific Conduct Risk Committee chaired by our Chief Operating Officer.

Supporting local communities

During 2012 the Society continued to support local communities through a wide range of activities aimed at supporting causes and groups that improve financial literacy, assist with employability and support the battle against homelessness. Our community investment programme, 'Doing Good Together' completed a second and highly successful year.

Through our partnerships with Nottinghamshire Community Foundation, Nottingham Post, regional radio station Gem 106, and our chosen partner charity, Framework, we have undertaken a variety of fundraising and support activities. In 2012, I am delighted to report we increased our fundraising by 55% with more than £78,000 being distributed.

We have gained immense satisfaction from working closely with so many groups and are so grateful for the enthusiastic commitment of our staff who have made this possible.

Looking ahead

The Nottingham is in good shape, with one of the highest capital ratios in the sector and with strong asset quality. We will continue to deliver value and a high level of service to our members and to remain a strong, successful and independent Society, safeguarding our members' interests. Our future remains firmly in our own hands, and the welcome additions of the Harrison Murray team and Shepshed Building Society will serve only to further strengthen our position in the marketplace.

Thank you

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

Finally, I would also like to thank our business partners, intermediaries and suppliers, who have equally shared our commitment to deliver value and security to our members and to express my personal thanks to our members for trusting us with their financial ambitions. This is a trust that we do not take lightly.

David Thompson

David Thompson
Chairman

20 February 2013

Chief Executive's Review

"Building long lasting relationships with our customers remains our overriding objective, with many of our new initiatives focused on improving the products, service and efficiency with which we operate the Society."

2012 will be remembered as a memorable year. The achievements of our Olympians in a home based Olympics and the historic events of the Queen's Diamond Jubilee will live long in the memory.

Amongst these medal winning performances it is very pleasing to report that your Society had many achievements of its own and has returned a strong performance, building on our recent progress, despite continued challenges and uncertainty in the economy at large.

Our performance

After a number of years' hard work to ensure the Society was well placed to meet the increasingly complex needs of our members and exceed the standards of the new regulatory environment, in 2012 the Society saw a good return on its hard work and investment.

Our efforts to ensure that we balance the conflicting needs of our savings and mortgage customers were recognised by strong growth on both sides of our balance sheet, with retail savings deposits increasing by 14% and our balance sheet overall growing by 10%, driven by a 28% increase in gross mortgage lending to £559m. This strong growth is compelling evidence that we are supporting households and making finance available for home purchase across the lending spectrum but especially to first time buyers. In fact in 2012, 50% of our lending was for LTVs greater than 80%.

This strong performance in our core activity underpinned a good all-round financial performance highlighted by the following:

- We have consistently stressed the importance of achieving a sustainable interest margin. Throughout 2012, by very careful management of our product mix and pricing the interest margin has been stable at 1.17%;
- We have also been careful to closely manage our costs whilst continuing to invest in the Society and it is pleasing to report a reduction in both our management expense ratio to 0.81% and the cost income ratio – an important measure of our efficiency to 64.7% – this compares favourably with 90.1% only 3 years ago;
- Both of the Society's subsidiaries continue to contribute well and despite their dependence upon a tentative housing market, delivered a steady performance maintaining their income levels and delivering 25% of the mortgages written by Society staff. This ability to widen our distribution and provide advice to a broader spectrum of customers will be increasingly important in the years ahead;
- We have also seen the increasing popularity of our broader product range, including our unique offering of planning and protection products which supported an increase in our non-interest income of 14%;
- In total this strong overall performance delivered an improved level of profitability, with underlying profit before tax up 22% to £10.5m;
- Profit before tax, which takes account of deductions for ongoing FSCS costs (£2m in 2012) and fair value movements on the derivatives we hold to manage the interest rate risk of our fixed rate savings and mortgage products, increased by 18% to £8.5m.

Quality and strength

The foundations of the Society's strength are based on an excellent capital position and an acute focus on a lending policy that ensures we lend our members' money appropriately; 2012 has seen this long term trend continue.

- We continue to remain one of the most strongly capitalised Societies in the UK with a Tier 1 Capital Ratio of 16.9%, well in excess of the regulatory requirements;
- Our arrears performance in 2012 has been exceptional with only 0.64% of our total account base 3 months or more in arrears, a reduction of 0.09% over 2011. In fact this means that at the end of 2012 we only have 135 accounts 3 months or more in arrears out of a total of over 21,000. This is down from 153 in 2011. This places us at just above a third of the CML industry average;
- Despite the uncertain market conditions we have seen our repossession levels remain very low at 23 cases (21 in 2011);
- We always seek to support our customers who do encounter financial difficulties. Each customer's individual circumstances are reviewed and once a forbearance option has been implemented it is subject to regular monitoring and review. At the end of 2012 there were 242 customers receiving some form of forbearance from the Society, compared to 295 at the end of 2011. This represents 1.1% of the total number of mortgage customer accounts and includes 35 cases reported in our arrears figures;
- As we have continued to strongly support borrowers with smaller deposits we have seen the overall loan to value ratio of our residential lending book increase from 51% to 55%. This was also impacted by a small reduction in house values generally. This position is regularly monitored by management and continues to remain well within our risk appetite;
- We have maintained our presence in the buy-to-let market, which reflects our view of the changing nature of property tenure and demographics in the UK, but have upheld our high standards of prudence. In fact at the end of 2012, only 12 accounts were three months or more in arrears out of a buy-to-let lending book of 4,326, a performance which continues to be better than our very strong residential lending;
- Secured business lending represents 3.4% of the total lending book; only 4 accounts were 3 months or more in arrears out of a total book of 525. The average loan size has continued to fall and stands at £137k;
- We acknowledge that the outlook remains uncertain and have decided to prudently make a provision charge against potential mortgage losses of £1.4m.

Funding and Liquidity

Our strong performance attracting retail funds, especially in our branch network where balances have increased by 15% in 2012, has not only underpinned our asset growth but enabled us to reduce our exposure to unsecured wholesale funding, which in recent years has been relatively scarce and expensive; this has supported margin whilst also improving the quality of our liquidity.

Our retail funding continues to fully fund our mortgage assets.

We remain vigilant when managing our treasury counterparties and hold high levels of quality assets as part of our liquidity, far in excess of the levels required of us by the regulator; underlining our prudent approach in the continued challenging environment.

Your Society

It is important in these times to continue to invest in the Society to improve our products and service offering to our members, as well as to further improve the efficiency with which we operate the Society in the members' interest.

In 2012 we moved to a new head office building bringing three disparate central operations together in one modern efficient head office building, which has reduced the overall running costs of our head office function; whilst also improving the way we conduct our business, with quicker, more effective communication and decision making.

We have invested in our branches too with the complete refurbishment or relocation of three of our largest branches; Arnold, Sheffield and our flagship office on Upper Parliament Street in Nottingham. The response to our new look and feel from members and new customers has been instant with business levels markedly up. In fact, in the first 10 months, activity levels at Sheffield are up 20%.

We have also continued to improve the infrastructure of the Society with the goal of making us easier to deal with. We have installed a new state of the art telephony network across the Society replacing a system which was over 20 years old. This new system enables us to seamlessly move call traffic around the Society. Previously, we were unable to transfer calls into or out of our central service team or head office.

We have also completely updated our savings system; meaning that for the first time all of our customers are on one single system platform for mortgage and savings; with further added links to our partners' systems to give us a complete single picture of our members' dealings with us. This will be essential to our future developments focused on building meaningful and valuable relationships with our customers.

We also continue to invest in the development of our team members ensuring that they have the right skills and knowledge to meet our customers' needs. In fact the work we have carried out in this area during 2012 has received accredited status from the Institute of Leadership and Management, as well as The National Skills Academy.

"Our plans for the year ahead are focused on extending the reach of the Society beyond its current locations and continuing to develop and improve the products and services that we offer to members."

Customer relationships

"Building long lasting relationships with our customers" remains our overriding objective, with many of our new initiatives focused on improving the products, service and efficiency with which we operate the Society.

Our customer satisfaction survey is central to assessing how well we are delivering against this, focused as it is on customers' responses to actual transactions and activity with the Society. In 2012 we have maintained our industry leading levels of satisfaction, with 96.7% of our customers rating us as excellent or good.

Our customer net promoter score which enables us to accurately compare our performance against businesses from all sectors was 79%, which places us firmly in the top 10% of all firms and even ahead of Apple, who are world renowned for their advocacy. We have set the bar at a high standard and aim to keep it there.

This satisfaction level is now manifesting itself in our customer retention rates on both sides of the balance sheet – which during 2012 increased markedly to new highs. This is a clear demonstration that we are establishing relationships that last longer than one product cycle.

We do believe that as the Retail Distribution Review regulation takes effect and people increasingly become aware of the need to plan for their own independent financial future - as the state becomes unable to maintain current levels of welfare benefits and pension payments - that providing broad financial planning advice will be an important role for a building society. We have worked hard in recent years to offer our members this style of service supported by a number of expert partners. During 2012 we have seen strong demand for this, especially from members who use our branches and expect this to increase further in the coming years, as larger banks continue to withdraw this service to the majority of their customers.

Further endorsement of our service credentials were provided through the readers of "What Mortgage?" who voted us as the Best Regional Building Society for the second year running and our strong performance in the Financial Adviser Service Awards where we were the top scoring recipient of a 4* award.

Plans for the year ahead

The Society is well positioned to move forward, despite continued uncertainty in the economy, supported by its strong capital position and robust financial performance.

Our plans for the year ahead are focused on extending the reach of the Society beyond its current locations and continuing to develop and improve the products and services that we offer to members.

- We were pleased to announce the proposed merger with the Shepshed Building Society and look forward to welcoming their members to The Nottingham following their members vote in April. We are currently planning the work required to effect a smooth transition;
- We were also pleased to announce the acquisition of East Midlands estate agency Harrison Murray early in 2013. This acquisition not only strengthens our estate agency offering through the expertise and strong track record that Harrison Murray brings but also provides us with a number of potential high street locations to add building society services to, giving members, especially in Leicestershire, more choice on where to conduct their business with the Society and also a good opportunity to acquire new members to the Society;
- In terms of improving our products and service, consistent customer feedback has been that we should seek to communicate relevant information to customers more frequently. Throughout 2013 we aim to introduce new forms of communication with members which should help us improve our insight to their needs and allow us to better understand what they want from your Society;
- We will also be looking at how we can develop our increasingly popular and unique planning and protection offering –ensuring that more members are aware of its availability and how favourably it compares to almost all High Street advice offerings in the new post Retail Distribution Review environment;
- We also aim to continue to strengthen and develop our infrastructure with system enhancements planned for our estate agency branches, our risk decisioning systems and further refurbishments of our branches; and
- We shall adjust to the new regulatory regime where our regulatory supervision will be split into two distinct elements, with the PRA focusing on prudential matters such as capital adequacy, liquidity requirements, business model sustainability and financial stability. Whereas the FCA will focus solely on conduct matters and ensuring that we are treating our customers fairly and achieving the right outcomes for them.

Thank you

It has been a very full and successful year for the Society with a number of achievements in which we can be justly proud.

As always these achievements have only been possible due to the commitment, hard work and enthusiasm of all the team members at The Nottingham who continue to strive hard to serve members in a way in which they would wish to be dealt with themselves.

It has been a privilege to lead such a dedicated team who are focused on supporting our members to achieve their financial goals and ambitions.

I would finally wish to thank our loyal members who place their trust and confidence in us to help them achieve those financial ambitions.

David Marlow
Chief Executive

20 February 2013

Key performance indicators

The results have been prepared under International Financial Reporting Standards (IFRS).

	Group		Society	
	2012	2011	2012	2011
	£m	£m	£m	£m
Underlying profit before tax	10.5	8.6	10.8	8.7
FSCS costs	(2.0)	(1.4)	(2.0)	(1.4)
Derivative fair value movements	-	-	-	-
Reported profit before tax	8.5	7.2	8.8	7.3

The Group monitors many aspects of financial (and other) performance on a regular basis, this report focuses on those that are key to our business success.

The Chief Executive's review includes a summary of factors affecting our performance in 2012 and should be read in conjunction with this report.

The Board monitors both reported and underlying profit before tax. Reported profit before tax is a commonly used comparative measure of profit. However, it includes a number of items which the board does not believe represent ongoing business performance and therefore underlying profit is also used to measure performance. Underlying profit before tax equates to reported results, adjusted to exclude derivative fair value movements and exceptional costs relating to the Financial Services Compensation Scheme (FSCS). The comparative periods are disclosed on a similar basis.

Commentary in this report refers to underlying results, except where stated.

Underlying profit after tax

As a mutual the Society has no outside shareholders to whom we have to pay dividends and as such we do not have to maximise profit. However, the Society needs to make sufficient profit to maintain its capital strength and to protect its members' interests.

Underlying profit performance has improved from prior year with our underlying profit after tax ratio as a percentage of mean assets up from 0.26% in 2011 to 0.32%.

The improvement in profitability is driven by increases to net interest income of £2.0m, an increase of 7.0%, and non-interest income of £0.5m, an increase of 13.5%. In addition there is an improvement in the loan impairment charge of £0.4m reflecting a reduction in the level of arrears.

The improvement in net interest income has largely been driven by increased mortgage volumes which have contributed to the increased asset base of the Group (see the Assets section opposite). However, these benefits have to some extent been offset by increases to the cost base, by 4.2%, as the Group continues to invest in the business for the future benefit of its members.

Society interest margin

The Society interest margin measures the gap between interest received and interest paid, and is a simple way of determining the value given to customers via competitively priced mortgage and savings products.

The Society's net interest margin (measured as net interest income divided by mean assets) remained flat at 1.17%.

The Society's interest margin has again performed strongly throughout the year. This has been achieved through the delivery of strong margins on new mortgage lending and active management of the balance sheet. However, the increased cost associated with a reduction in our non-retail funding balances and falls in the London Interbank Offered Rate (LIBOR) have offset some of these benefits.

Underlying Group cost income ratio

The cost income ratio measures the proportion of income that is consumed by operating costs. Broadly, the lower the ratio the more effective the business is in generating income.

The Group's underlying cost income ratio has again improved, falling from 66.6% in 2011 to 64.7% in 2012. The improvement in the cost income ratio can be attributed to the absolute increase in net interest income which has been driven by asset growth of 10.2%.

Growth in non-interest income has also been a contributing factor to the improvement with Group net fees and commissions receivable growing from £3.7 million to £4.2 million.

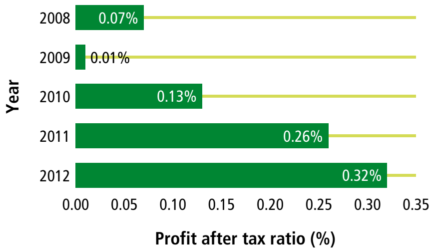
Society management expenses ratio

The ratio of management expenses to mean total assets is monitored closely and provides a guide to the efficiency of the Society.

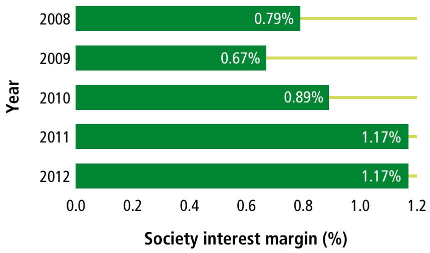
The Society management expenses ratio has fallen slightly from 0.84% to 0.81%. The decrease in the ratio reflects the growth in balance sheet size during the year. However these benefits have been partially offset by continued levels of investment within the business.

The investment includes costs associated with consolidating our head office from multiple sites to one, IT investment which included completion of the core system replacement and developing secured funding capabilities which will initially support entry to the Funding for Lending Scheme.

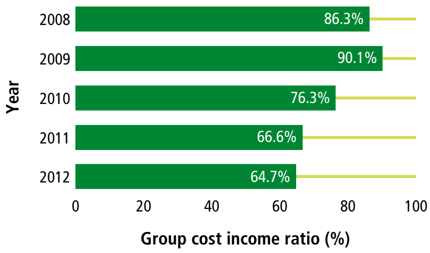
UNDERLYING PROFIT AFTER TAX RATIO



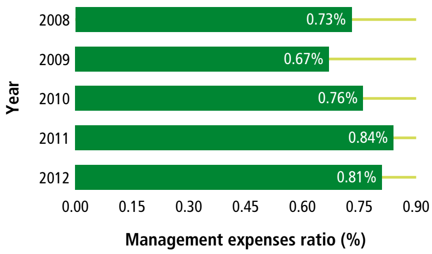
SOCIETY INTEREST MARGIN



UNDERLYING GROUP COST INCOME RATIO



SOCIETY MANAGEMENT EXPENSES RATIO



Society arrears performance

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

The Society's arrears ratio was 0.64% at the end of 2012, just above a third of the industry average.

The fall in the arrears ratio reflects the Society's conservative business model that ensures customers can afford to meet their regular repayments from the outset. It is this approach, together with the Society's high quality loan portfolios, that has ensured arrears levels have remained consistently low throughout the economic downturn.

Assets

The Group produced a strong level of asset growth during 2012 despite the continued economic uncertainty. The Group increased its balance sheet to £2.73 billion an increase of 10.2% (2011: 3.1%). The growth was driven by an increase in mortgage balances to £2,129.9 million with new advances up by 28% to £559 million (£436 million in 2011) and retention levels at 56% demonstrating the Society's ability to attract and retain customers through its range of competitive mortgage products. The mortgage book was prudently managed throughout the year and all new lending met the Society's desired rates of return.

Retail savings balances

During 2012 the Society continued its approach to increase the level of retail savings balances and decreasing reliance on wholesale funding. Retail savings balances increased by 14% during 2012 (2011: 8.1%), with its wholesale funding ratio falling from 12.6% in 2011, to 10.1% by the end of 2012.

Total retail balances now stand at £2.268 billion and branch balances at £1.093 billion, continuing to represent 48% of all retail savings, and indicates the continued strength of our branch franchise.

Our mortgage book is 100% matched by retail savings balances.

Tier 1 capital ratio

The Society's Tier 1 capital is the strongest form of capital and comprises general reserves and 100% of our permanent interest bearing shares (pibs). Under Basel III (as described on page 25 of the Risk Management report) the proportion of pibs counting towards Tier 1 Capital will be reduced over a 10 year period.

The Society's general reserves (which represents accumulated profit from past years) represents 85% of total capital which underlines the strong capital strength of the Society. The Tier 1 ratio compares this capital to its assets weighted according to their risk. The Society's Tier 1 ratio declined from 17.7% in 2011 to 16.9% at the end of 2012 as the Society grew its asset base by 10.2%.

Our capital is comfortably in excess of the minimum regulatory requirements.

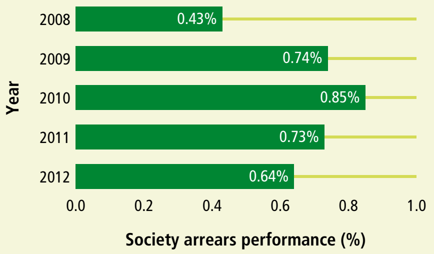
Liquid assets ratio

The liquid assets ratio measures the proportion of liquid assets held in the form of cash, short term deposits and investments compared to the Group's shares and borrowings. As liquid assets are by their nature readily realisable, this assists the Group in its cash management and enables the Group to meet requests by investors for withdrawals from their accounts, to make new mortgage loans to borrowers and to fund its general business activities.

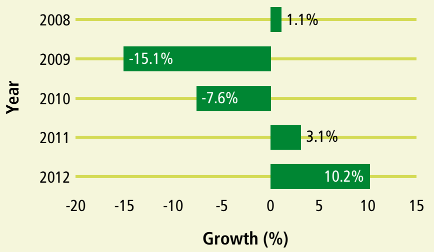
Over two thirds of the Group's liquid assets are now held in highly liquid UK sovereign debt securities and the Bank of England reserve account. The Group continues to hold levels of liquidity that are significantly above regulatory requirement.

At the end of the year the ratio of liquid assets to shares, deposits and other liabilities was 22.1%, compared to 22.7% at the end of 2011.

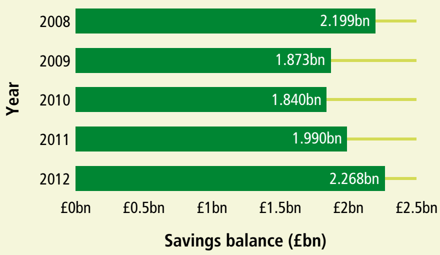
SOCIETY ARREARS PERFORMANCE



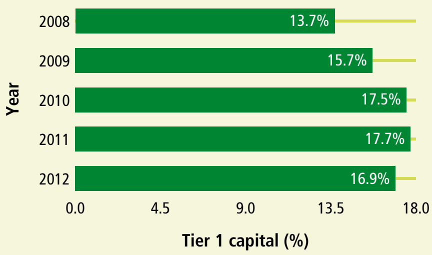
ASSETS



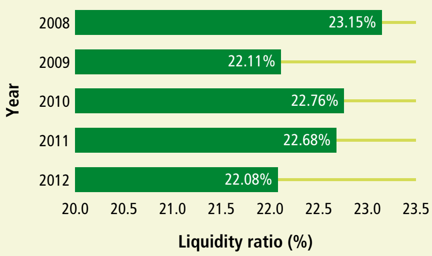
RETAIL SAVING BALANCES



TIER 1 CAPITAL RATIO



LIQUID ASSETS RATIO



Your board of directors

David Thompson

FCA

Chairman

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

Bob Marchant

BSc (Social Sciences), FCA

Vice-Chairman

Bob joined the board in 2003 and was appointed Vice-Chairman in 2008. His previous roles include senior client partner and Head of Sales at the Midlands practice of KPMG. He has over 30 years' experience in accountancy and in business advisory roles.

David Marlow*

ACIB

Chief Executive

David joined the board in 2006 and became Chief Executive in 2011. Prior to his appointment as Chief Executive, David held the post of Retail Director. David has over 25 years' experience in a variety of roles, mainly in the financial services industry. Before joining The Nottingham, David held a number of senior posts in retail banking at Alliance & Leicester Plc. He is a director of Nottingham Property Services Ltd, Nottingham Mortgage Services Ltd, The Mortgage Advice Centre (East Midlands) Limited, TMAC (East Midlands) Ltd and HM Lettings Ltd.

John Edwards

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

Richard Fiddis

BSc (Hons), PhD

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

Jane Kibbey

BSc, MCIPD

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

Mary Phibbs

BSc (Hons), FCA

Mary joined the board in 2013. She is a Chartered Accountant with over 30 years' experience in financial services and risk management in the UK and overseas. She has held senior roles in a number of leading institutions such as Standard Chartered Bank and the ANZ Bank where she was Chief Retail Credit Officer. She served as a director of Northern Rock plc through its public ownership and current directorships include the Charity Bank Limited where she chairs the Nominations and Remuneration committee.

Mahomed Ashraf Piranie*

FCCA, MBA

Deputy Chief Executive & Finance Director

Ashraf joined the board in 2007 and is responsible for finance, treasury and credit risk. Previously, he held the positions of Finance Director and Joint Managing Director at the Islamic Bank of Britain and Director of Finance at Alliance & Leicester Plc. He is a director of Nottingham Property Services Ltd, Nottingham Mortgage Services Ltd, The Mortgage Advice Centre (East Midlands) Limited, TMAC (East Midlands) Ltd and HM Lettings Ltd.

Simon Taylor*

ACIB, MBA

Chief Operating Officer

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

Keith Whitesides

MBE, LLB, MPhil

Keith joined the board in 2004. He retired from his position as Director of Investor Relations at The Boots Company Plc in 2001, after working for the company for 27 years. He was awarded an MBE in 1996 for services to the community in the East Midlands. Keith, a barrister, also served as Justice of the Peace in Nottinghamshire and was national Commissioner for Racial Equality.

Board Committees

Audit

Bob Marchant – Chairman
Richard Fiddis
Jane Kibbey
Keith Whitesides

Nominations

David Thompson – Chairman
Bob Marchant
David Marlow

Remuneration

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

Risk

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

* Executive Director

Directors' report

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

Business objectives and activities

At The Nottingham we aim to build strong, lasting relationships with our customers and to be recognised for the excellent service we provide.

We are proud to be a forward thinking, successful mutual which builds upon its strong regional foundations, with a track record of serving our members for over 160 years.

These objectives place us in a strong position to anticipate our customers' needs and deliver great value through a carefully chosen range of products and services in five target markets: mortgages, home sales, savings and investments, insurance and personal financial planning. We do this through Nottingham Building Society, Nottingham Property Services and Nottingham Mortgage Services. Investments and personal financial planning are offered through an independent third party, Towergate Financial (East).

Business review

The Group's business activities and future plans are reviewed in the Chairman's statement and Chief Executive's review. Additionally, we comment upon the financial (and other) key performance indicators used by the board during 2012 to assist its control, direction and drive for business results. These can be found on pages 11 to 13.

Principal risks and uncertainties

Overview

Building societies, together with all other financial institutions, operate in a highly competitive market.

The ongoing Eurozone sovereign debt crisis and threat of sovereign defaults continue to have a major impact on the UK economy. Although the Group has no direct exposure to sovereign debt (other than within the UK) the risks of financial market turmoil in the event of a default remain a concern.

"We are proud to be a forward thinking, successful mutual which builds upon its strong regional foundations, with a track record of serving our members for over 160 years."

Despite the continued downturn in the economic environment, the level of retail impairments has remained benign with the number of arrears cases falling from prior year. Although arrears are expected to remain stable while interest rates remain at an historical low, the Society will need to remain vigilant if interest rates begin to rise or if there is any further decline to economic conditions.

The announcement of the Funding for Lending Scheme (FLS) in July has led to a fall in mortgage rates. However, savings rates have also fallen to the detriment of the saver. The Society will need to continue to balance the interests of both its mortgage and savings customers through this period.

There are a number of forthcoming regulatory initiatives that require the Society's focus. Two of the most notable include the replacement of the FSA in 2013 by two new bodies – the Prudential Regulatory Authority (PRA) and Financial Conduct Authority (FCA). They will aim to be more forward looking, identifying future possible issues and intervening when considered necessary. Furthermore, the Mortgage Market Review (MMR) which was published in October 2012, and with an implementation date of April 2014, will require changes to the way the Society conducts its retail lending.

The board of directors, aided by a number of committees (see page 22 for details), ensures risk management and strategic direction are considered thoroughly and appropriate actions implemented.

Details of the risks and how they are managed can be found in the Risk management section on pages 22 to 25.

Financial risk management objective and policies

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

Results

Group underlying profit before derivative fair value movements and Financial Services Compensation Scheme (FSCS) costs was £10.5m (2011: £8.6m).

Group reported profit before tax was £8.5m (2011: £7.2m). The profit after tax for the year transferred to general reserves was £6.8m (2011: £5.3m). Of the total profit for the year, the Society's subsidiaries, Nottingham Property Services and Nottingham Mortgage Services delivered losses before tax of £0.3m and a profit before tax of £0.1m respectively.

Loans and advances

During 2012, total lending was £559 million (2011: £436 million) and the average advance made was £141,697 (2011: £131,536), with the average debt at the end of the year being £99,325 (2011: £91,353).

At 31 December 2012 there were 18 cases (2011: 21 cases) of properties being 12 or more months in arrears or in possession. The total amount of balances outstanding in those cases was £1.5 million (0.07% of the total mortgage book), with arrears of £125,467.

Mortgage losses of £0.7m were realised during the year from existing provisions. Provisions for potential mortgage losses total £3.9 million, (0.17% of mortgage balances).

The Group offers a number of different forbearance options to customers including interest only concessions, reduced payment concessions, payment plans, capitalisations and mortgage term extensions. At 31 December 2012 the Group had 242 loans (2011: 295) subject to some form of forbearance. Note 32 to the accounts on page 68 provides further details.

"We were delighted to have achieved "Approved Centre" status with the ILM (Institute of Leadership and Management)."

Capital

Group gross capital at 31 December 2012 was £176.9 million, being 7.02% of total shares and borrowings. Free capital, at the same date, amounted to £158.9 million and 6.31% of total shares and borrowings.

The definitions of gross capital, free capital and total shares and borrowings are given in the annual business statement on page 80.

The directors remain committed to maintaining a strong capital position.

Property, plant and equipment

Freehold premises owned by the Group are shown in the accounts at cost less depreciation. An estimate of the value of those properties, prepared in late 2012 by the Group's professional services team, indicates that market value is £2.5 million higher than book value.

Supplier payment policy

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

At 31 December 2012, the total amount owed to suppliers was equivalent to 3 days' credit.

Charitable and political donations

During the year the Group made charitable donations of £60,533 (2011: £48,862).

No contributions were made for political purposes.

Our people

A key focus for 2012 was to continue building on our skills and capability whilst responding to an ever changing external operating environment. During the year we:

- continued to offer Bite-Size Development sessions for all our staff members, supported by self-study packs which assist with the individuals development;
- provided skills and technical knowledge during the transition of our new core systems;
- continued to embed the coaching culture across senior and middle managers;
- designed and provided a development programme for aspiring managers (Releasing Your Potential); and
- continued to provide a programme of skills development to support our customer facing team members to further enhance the service we provide for our customers.

We were delighted to have achieved "Approved Centre" status with the ILM (Institute of Leadership and Management), recognising the quality of The Nottingham's Leadership and Management Development Programme – "Management Milestones".

The programme is designed to help Managers transition from operational management to leaders of tomorrow. Through ILM, team members can achieve an externally recognised qualification validating their enhanced skills.

In recognition of both the quality and investment in the development of our people, we have been independently assessed and have achieved the National Skills Academy for Financial Services Accreditation of in-house training.

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

Open and clear communication amongst all our team members is vital to the success of The Nottingham. To this end we run regular training and communication sessions for our teams to keep everyone informed.

"94% of our staff are 'proud to say they work at The Nottingham'."

To help gather team member views and opinions, we hold regular meetings with our Staff Council and our Team Survey is distributed annually to all team members. We were delighted with the results of our 2012 team survey which showed positive shifts in the majority of key measures and that 94% of our staff are 'proud to say they work at The Nottingham'. Throughout 2012 we have been taking actions to further improve the areas that our staff told us we could be better at.

Finally, our Doing Good Together initiative has flourished during 2012 and through the efforts of our teams over £70,000 has been donated and raised for chosen causes. We look forward to building on this throughout 2013.

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

The directors are responsible for preparing the annual report, annual business statement, directors' report and the annual accounts in accordance with applicable law and regulations.

The Building Societies Act ("the Act") requires the directors to prepare Group and Society annual accounts for each financial year. Under that law they are required to prepare the Group annual accounts in accordance with IFRSs as adopted by the EU and applicable law and have elected to prepare the Society annual accounts on the same basis.

The Group and Society annual accounts are required by law and IFRSs as adopted by the EU to present fairly the financial position and the performance of the Group and the Society; the Building Societies Act 1986 provides in relation to such annual accounts that references in the relevant part of that Act to annual accounts giving a true and fair view are references to their achieving a fair presentation.

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

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the annual accounts on the going concern basis unless it is inappropriate to presume that the Group and Society will continue in business.

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

Directors' responsibilities for accounting records and internal control

The directors are responsible for ensuring that the Group:

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

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

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

Directors' statement pursuant to the disclosures and transparency rules

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

- the annual accounts, prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group and Society; and
- the management report contained in the Chairman's statement and Chief Executive's review includes a fair review of the development and performance of the business and the position of the Group and Society, together with a description of the principal risks and uncertainties that they face.

Going concern

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

The directors have considered the risks and uncertainties discussed on page 16 and pages 22 to 25, and the extent to which they might affect the preparation of the annual report and accounts on a going concern basis.

The Group's business activities and future plans are reviewed in the Chairman's statement and Chief Executive's review on pages 4 to 10. In addition note 32 to the annual report and accounts includes the Group's policies and processes for managing financial instrument risk such as liquidity risk, interest rate risk and credit risk.

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

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

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

Directors

Information on the directors is given in the annual business statement on page 81 and 82. Bob Marchant and Simon Taylor retire by rotation at the annual general meeting and, being eligible, seek re-election under Rule 26(1). Bob Marchant was first elected in 2004 and has been assessed by the board as continuing to be independent in character and judgement. The board considers that his independence is in no way affected or compromised by his length of service.

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

Mary Phibbs who was appointed to the board in February 2013, also retires and being eligible, seeks election under Rule 25(4).

Further information on the directors who have served during the year can be found in the directors' report on remuneration (page 32).

Other business interests are shown in the annual business statement. None of the directors have any beneficial interest in, or any rights to subscribe for shares in, or debentures of, any connected undertaking of the Society, at 31 December 2012.

Auditor

The auditor, KPMG Audit Plc, has expressed its willingness to continue in office and in accordance with section 77 of the Building Societies Act 1986, a resolution for the reappointment of KPMG Audit Plc as auditor is to be proposed at the annual general meeting.

On behalf of the board of directors,

David Thompson

David Thompson
Chairman

20 February 2013

Corporate and social responsibility

Following on from the launch in 2011 of the Group's community investment programme 'Doing Good Together' the Group continued to develop its community work in 2012 around three key elements, namely; fundraising, community grants and volunteering, with activity during 2012 continuing to be primarily focused on the themes of homelessness, financial education and employability.

With the assistance from Nottinghamshire Community Foundation and East Midlands radio station Gem 106, the Group gave community grants of £23,173 to six charitable groups in its heartland. In addition the Group awarded 30 grants of £72 each to those groups who were not successful in their grant application enabling them to subscribe to localgiving.com, the UK's leading fundraising website supporting small, local charities and community groups.

In collaboration with The Nottingham Post, £35,000 (of which The Nottingham contributed £25,000) was given to over 130 worthy causes in the Nottinghamshire area. In addition, in November 2012, The Nottingham assisted Gem 106 with its 'Give It Up Appeal' acting as a point for donation to raise money for the Children's Ward at Nottingham's Queen's Medical Centre. As well as acting as a donation point, The Nottingham awarded a grant of £4,000 to help better facilitate education for patients during their stay on the ward.

Throughout the year, the Group has assisted its fundraising partner charity, Framework in a variety of initiatives culminating in the 'Bike It Challenge' in September when staff members cycled around the heartland. The Group's donations to Framework in 2012 totalled £7,812.

In January 2011, staff at The Nottingham selected Framework as the Group's fundraising partner, this partnership continued in 2012. Framework is head quartered in Nottingham and works throughout the East Midlands and South Yorkshire, helping more than 9,000 people a year. Framework provides a range of services that change and save lives by preventing homelessness, stopping rough sleeping and helping people live independently.

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

In 2012, staff and customers raised over £17,000 for Framework which will contribute towards a variety of projects as well as organising many food, clothing and toiletry collections. We aim to continue working with Framework in 2013 raising money through initiatives in branches and Head Office.

The Nottingham DOING GOOD TOGETHER

framework opening doors to homeless and vulnerable people

What have we done in 2012?

	FUNDRAISING	VOLUNTEERING	GRANT GIVING
February	Staff at our Brigg branch raised over £100 in a sponsored ice skate		
March	We turned unwanted mobile phones that were collected in branches and head office into cash	Mobile phone collections	
April	Netherfield and Mansfield branch staff collected over £100 with a dress down day as well as a cake and book sale. While staff at head office raised a further £135 with a cake competition and raffle		'Cash for your Community' launched in association with the Nottingham Post attracting over 130 applications. The cash awards were open to local community groups and charities
May	Peter Burton from the Will Writing company completes the Manchester Marathon raising £1,269 and a book sale at Head Office raises £40		Over 250,000 tokens were collected by community groups trying to get a share of The Nottingham and The Post's Cash for your Community grant of £35,000
June	Staff and business partners pledged nearly £1,000 to get Head of IT Jack Cutts out of jail when he took part in Framework's Jail and Bail event	Staff from the Marketing team help The Ear Foundation with their Facebook page	
July	Staff at Head Office took part in a Jubilee themed quiz, dress down day and the office Olympics to raise nearly £300		
August	Fundraising starts for our sponsored BIKE IT event	Staff from The Nottingham join Framework's Big Sleep Out committee to help plan the 2012 event	
September	Staff pedalled around our heartland and in a five day sponsored bike ride to raise almost £8,000		In association with Nottinghamshire Community Foundation and Gem 106, we opened our DGT Grants for 2012
October	Our Customer Service team raised funds with a Halloween themed cake sale		By the end of the month we had awarded DGT grants valued at over £25,000 to worthy causes across the heartland
November	Branch staff took part in Framework's Big Sleep Out as well as selling charity Christmas cards to customers	North Hykeham branch launch a warm clothing collection in branch to donate to their local Framework in Lincoln	We acted as a donation point for Gem 106's Give It Up Appeal. The appeal raised over £85,000 for the Children's Cancer Ward at Nottingham's QMC
December	Customers helped us raise money by taking part in Christmas themed raffles. Teams from our branches took part in an Apprentice style challenge and gathered donations for Framework worth over £4,000	Wollaton and Bramcote Lane branches collect food and warm clothing for Framework's London Road rough sleeper's service	We teamed up with Nottinghamshire Community Foundation to launch a Dragons Den and invited budding local entrepreneurs to apply for £2,000 grants and advice from leading business people from the East Midlands

Risk management

For the year ended 31 December 2012.

The Society recognises risk as a natural consequence of its business environment, as with any organisation. Through prudent management it aims to manage risk in a manner that supports the achievement of its strategic objectives, whilst protecting members' interests and its financial resources.

The board is responsible for ensuring that an effective framework is in place to identify and manage the risks which the Society faces in the course of delivering its strategic objectives, both current risks and those associated with the implementation of future strategy. The board annually approves a risk appetite statement. In pursuing its strategy the board ensures there are appropriate capabilities and resources available, along with sufficient capital strength to succeed. This includes focusing on risk and reward to ensure it is at an acceptable level.

The Board Risk Committee

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

The risk management framework is based on the three lines of defence model (described on page 28) and focuses on:

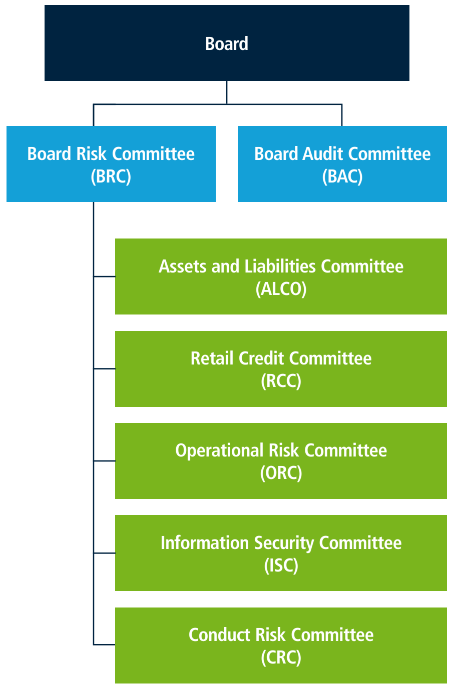
- clear accountability and ownership;
- defined roles and responsibilities;
- the identification of business objectives;
- identification of the risks arising from these objectives;
- an assessment of the identified risks and controls using the board approved risk framework;
- assessing the effectiveness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

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

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

Retail Credit Committee comprises three executive directors and a number of senior managers. It has responsibility for oversight of the Group's retails assets which includes Residential, Buy to Let and Secured Business Loans.

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



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

Conduct Risk Committee comprises one executive director and a number of senior managers. It has responsibility for overseeing the manner in which the Group conducts business ensuring it is conducted in a clear, transparent and fair manner and is compliant with conduct rules set by the FSA, both in letter and in spirit.

The board risk committee regularly reviews risk management activities to remain focused on managing not only existing risks but also identifying emerging risk areas such as the current distortion of interest rates and the impact this has for net interest margin management.

To help monitor risk, the Society has in place various risk registers, this includes an Executive risk register as well as individual departmental and project risk registers. The risk registers assist the Society to track the probability and impact of the risks identified.

The principal risks considered during the year related to credit, liquidity, the market, business, strategic, operational, conduct of business and regulatory/compliance risk.

Credit risk

Credit risk is the risk that a financial loss arises from the failure of a customer or counterparty to meet their contractual obligations.

As a building society this is most likely to arise through the inability of borrowers to repay their mortgage commitments (retail credit risk) or through the failure of a treasury counterparty or country (wholesale credit risk).

The Society manages the level of credit risk it undertakes by applying various control disciplines, the objectives of which are to maintain asset quality in line with stated risk appetite.

Retail credit risk

The current level of retail credit risk within the Society is fairly benign, characterised by the low interest rate environment which is expected to extend beyond the end of 2013.

The Society has been actively engaged in the higher Loan-to-Value (LTV) and Buy-to-Let (BTL) markets throughout the year. Although the BTL market is perceived to be higher risk than the prime residential market, average new lending margins and arrears performance remain strong.

Exposure to retail credit risk is carefully monitored by the retail credit risk committee. Day to day retail credit risk is managed through the application of prudent lending policies which are aligned to the stated risk appetite, which is reviewed and approved annually by the board.

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

Exposure to retail credit risk is limited to the provision of loans secured on property within the UK. All mortgage loan applications are reviewed by an individual underwriter supported by the use of application scorecards. Credit reference bureau data is obtained on all applications in line with industry best practice. The Society also shares account performance data with the selected bureau.

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

The Society is a responsible lender and its approach to lending is based on making sure that customers can afford to meet their mortgage repayments from the outset. Should customers find themselves in financial difficulty, it responds with appropriate forbearance activities. The purpose of forbearance is to support customers who have temporary financial difficulties and assist them to get back on their feet. Only as a matter of last resort would the Society take the property into possession. In addition the Society continues to work within best practice guidelines to ensure customers with interest only loans have appropriate repayment vehicles in place.

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

A Secured Business Lending (SBL) policy is used to manage levels of business lending risk. To ensure appropriate management of lending risk the Society maintains watch lists of those loans it has concerns with and ensures any credit risks are adequately covered. Primarily, SBL loans are made available to Small and Medium sized Enterprises (SMEs) for either owner occupied or investment property purposes.

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

Wholesale credit risk

In addition to retail credit risks, the Society is also exposed through its treasury function. This arises from counterparties who may be unable to repay loans and other financial instruments that the treasury team holds as part of its liquidity portfolio.

The day to day management of wholesale credit risk is carried out by treasury which reports to the ALCO members on a weekly and monthly basis.

2012 has continued to be characterised by the Eurozone debt crisis and the possibility of sovereign defaults. This risk has been managed through treasury policy which only permits sterling denominated lending to UK and other central governments, UK local authorities, banks and building societies. However, during the year the Society has not permitted any lending directly to sovereign states, other than the UK. Lending is also permitted to selected European based Multilateral Development Banks in instances where it qualifies as High Quality Liquidity Buffer (HQLB) eligible assets.

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

Exposure to the Eurozone debt crisis has been further reduced during the year, through its holding of HQLB securities. The proportion of total liquidity held in UK Sovereign debt securities and the Bank of England reserve account has again increased and is significantly above the level required to be held by the FSA.

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

Liquidity risk

Liquidity risk is the risk that the Society will not have sufficient financial resources available to meet its obligations as they fall due, under either normal business conditions or a stressed environment. It is managed through holding cash and other readily realisable liquid assets. The base level and composition of the Society's liquidity is subject to FSA guidance and regular stress testing. This forms part of the Society's Individual Liquidity Adequacy Assessment (ILAA) as required by the FSA's liquidity regime. A separate board approved policy statement, which is aligned to the ILAA, ensures day-to-day activities of the treasury team are conducted within a prudent framework.

The ALCO assists the board and executive in the prudent management of the treasury function. It is responsible for developing and defining the treasury risk appetite of the Society and for ensuring that the activities of the treasury function support the corporate plan, whilst remaining compliant with all applicable regulatory requirements. Responsibility for the day-to-day management of the risk lies with the Society's treasury team.

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

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

Market risk

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

Although the economy is still dominated by the low interest rate environment LIBOR and Gilt yields have continued to fall. As the Society has a greater proportion of LIBOR earning assets than liabilities, this has reduced interest margins.

The announcement of the Funding for Lending Scheme (FLS) has seen changes to market rates for both retail lending and savings products. Any further change to rates may impact interest margin further.

The Society manages market risk through a board approved policy statement which defines the maximum acceptable level of risk and what steps may be taken to reduce it.

The treasury team is responsible for day-to-day management and for producing the Society's interest rate view and economic forecast.

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

The ALCO is responsible for reviewing treasury activity, performance and compliance with the approved policy statements.

A detailed analysis of the Society's interest rate sensitivity exposure can be found in note 32 to the annual accounts.

Business risk

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

During December 2012, the Society announced the proposed merger of The Nottingham and Shepshed building societies and in January the acquisition of Harrison Murray estate agents. This will lead to a degree of integration and transformation work which will be managed in line with the Society's project management framework.

Strategic risk

Strategic risk is the risk that the Group pursues an inappropriate strategy or that risks associated with its implementation are not fully recognised. When discussing strategy the board takes care to ensure that risks such as system changes, long term funding approach and acquisitions are evaluated and that management has plans to mitigate them. The board risk committee oversees the detailed evaluation of these risks.

Operational risk

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

Given the nature of our business the Society places significant focus on managing information security, data protection and fraud risks whilst also ensuring appropriate staff awareness. Although the level of cyber-crime is on the increase and financial criminals continue to innovate, the Society aims to stay ahead through robust technical and organisational controls which have been developed and implemented to ensure the ongoing safety and security of members' funds.

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

Prior to the acquisition of Harrison Murray considerable work was undertaken to ensure the Group considered all operational risks and how these risks could be mitigated. Following the acquisition all procedures and controls will be aligned with the Group's ORCA framework.

Regulatory/Compliance risk

These risks are the risk of loss from failure to comply with statutory and regulatory requirements. The Society, being a retailer of mortgage, savings and insurance products, is regulated by the Financial Services Authority (FSA). The FSA requires the Society to comply with various external laws, regulations and codes, including areas such as training and authorisation of staff, documentation, systems and processes. Failure to comply with relevant regulations could lead to sanctions, fines or other actions from the FSA.

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

Recent and upcoming changes to regulation include:

- Basel III;
- Mortgage Market Review (MMR);
- Retail Distribution Review (RDR);
- Creation of the Financial Conduct Authority (FCA) and Prudential Regulatory Authority (PRA);
- Recovery & Resolution Plans; and
- Payment Services Directive.

Capital management

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

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

The FSA use the ICAAP during their Supervisory Review and Evaluation Process (SREP) through which it determines the Society's Internal Capital Guidance (ICG).

The board monitors the level of capital held by the Society in relation to its ICG on a quarterly basis. The Society's capital levels remain well in excess of the FSA requirements.

An analysis of the components of the Group's capital position under Basel II can be found in note 33 to the accounts.

It was expected that from 1 January 2013, capital management would fall under a new regime, Basel III. However, during December 2012 it was announced that the implementation date had been delayed, although no new timetable had been given. The objective of the new regulation is to improve further the banking sector's ability to absorb shocks arising from financial and/or economic stress. This will be achieved through increasing both the quality and quantity of regulatory capital firms will be required to hold.

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

Given the Basel III text has yet to be incorporated into the European and UK regulatory framework it still remains subject to change. However, the main impact on the Society is expected to be that permanent interest bearing shares (PIBS) will no longer count as regulatory capital and will be phased out from the calculation of Tier 1 capital over a 10 year period, originally beginning in 2013.

The proposed changes have all been factored into the Society's capital management plan and when coupled with the Society's strong capital foundation are not expected to significantly impact the Society.

On behalf of the board of directors,

David Thompson

David Thompson
Chairman

20 February 2013

Report of the directors on corporate governance

Nottingham Building Society supports the principles of good corporate governance.

This report explains how the Society has regard for the principles of the UK Corporate Governance Code as well as following guidance for building societies issued by the Building Societies Association (BSA).

During the year the board again reviewed the Society's corporate governance practices against the current UK Corporate Governance Code that is applicable for all listed companies. Whilst the Society does not have to comply with the Corporate Code, as it is not a listed company, where appropriate the board has voluntarily taken steps to adopt its principles and recommendations. The board considers the Society complies with all the Code provisions, where relevant, unless the contrary is stated.

Leadership

The Board

At 31 December 2012, the board comprised of six non-executive directors (including the Chairman) all of whom are considered to be independent, and three executive directors, providing a complementary balance of skills and expertise.

The board held 10 meetings and two strategy review meetings during 2012.

In addition the non-executive directors meet regularly and consider all aspects of board responsibilities, governance and performance.

The board's principal role is to focus on the formulation of strategy, approving and reviewing policy. Additionally, it ensures the appropriate financial and business systems and controls are in place to safeguard members' interests, maintain effective corporate governance and measure business performance. All directors are able to obtain independent professional advice, at the Society's expense, should that be necessary in the fulfilment of their duties.

Division of Responsibilities

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

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

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

The Chairman

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

Non-executive Directors

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

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

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

Effectiveness

Composition of the Board

The names of the directors together with brief biographical details are set out on pages 14 and 15.

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 15.

The table to the right shows the attendance of each director at the relevant board and board committee meetings. The number to the left is the number of meetings actually attended; the number to the right is the number of meetings the director was eligible to attend during 2012.

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

Director	Board	Risk	Nominations	Remuneration	Audit
J Edwards (Appointed 10 January 2012)	9/10	3/3	-	2/2	-
R. Fiddis	10/10	4/4	-	3/3	5/5
J. Kibbey	10/10	4/4	-	3/3	5/5
R. Marchant	10/10	4/4	2/2	-	5/5
D. Marlow	10/10	4/4	2/2	-	-
M. Piranie	10/10	4/4	-	-	-
S. Taylor	10/10	3/3	-	-	-
D. Thompson	10/10	4/4	2/2	2/2	-
K. Whitesides	10/10	3/3	-	3/3	5/5

Appointments to the Board

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

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

Appointments to the board are made on merit and against objective criteria. Candidates for both executive and non-executive directorships are selected by the nominations committee, with the assistance of external consultants.

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

Commitment

Prior to appointment non-executive directors are expected to disclose their other significant commitments. Before appointment non-executive directors undertake that they will have sufficient time to meet what is expected of them.

Development

Upon appointment and throughout their tenure all directors receive timely and appropriate training to enable them properly to fulfil their roles. The information and training requirements of all directors are reviewed annually.

Information and Support

All directors have access to the advice and services of the company Secretary and independent professional advisors should this be required.

Evaluation

Executive directors are evaluated using the performance management framework for all employees and, for remuneration purposes, by the remuneration committee. The executive directors are appraised by the Chief Executive. The Chief Executive is appraised by the Chairman. The performance of non-executive directors is reviewed annually by the Chairman.

The Board and each of the committees formally evaluates its own performance annually. This process is co-ordinated by the Vice-Chairman and the outcomes of each is presented to the Nominations committee who assess the results or each review for trends and themes. This review also includes an overall assessment of the review undertaken by the key management committees, which report to the various board committees, of their performance. The overall outcome of the review is then reported to the board.

Re-election

All directors are submitted for election at an annual general meeting (the 'AGM') in accordance with the Society's rules.

Non-executive directors can serve up to a maximum of three three-year terms. Any extension must be approved annually, and be explained giving due consideration to the continuing independence and objectivity of the non-executive director. Bob Marchant was first elected in 2004 and has been assessed by the Board as continuing to be independent in character and judgement. The Board considers that his independence is in no way affected or compromised by his length of service. David Thompson has, having reached the age of 70, been approved as eligible for re-election by resolution of the Board. The Board has taken into account his vast experience and continued contribution as Chairman in coming to that decision. Being eligible, they offer themselves for re-election this year.

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

Accountability

Financial and Business Reporting

The directors' report on pages 16 to 19 details the responsibilities of the directors in preparing the Group's accounts.

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

The Chief Executive's review on pages 7 to 10 gives an extensive review of the Group's performance and financial position.

Risk management and internal control

The board risk committee oversees the entire risk management framework of the Group. The committee fulfils its obligations through two approaches. Firstly it is responsible for monitoring operational risks to ensure they are in line with the Group's prudent policies and in line with its agreed group risk appetite statement. In doing so the committee considers any emerging risks and ensures significant changes in exposures to existing risks are promptly identified and addressed by management. This includes overseeing the identification and management of project risks across the Group.

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

To assist in monitoring the risk management framework, the assets and liabilities, retail credit, conduct risk, operational risk (formerly management risk) and information security committees report into the board risk committee. The committee meets at least quarterly.

More information on risk management is given in the report commencing on page 22.

In accordance with the UK Corporate Governance Code the Society's board is committed to maintaining a sound system of internal controls to safeguard both its own assets and those of its members.

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

The operation of these three lines of defence is embodied in the terms of reference of the Society's six risk committees (assets and liabilities, retail credit, conduct risk, operational risk, information security along with the board risk committee) as well as a range of policies and procedures that relate to the identification, assessment, monitoring and control of all the main areas of risk that the Group faces.

The information received and considered by the risk committees provided reasonable assurance that during 2012 there were no material breaches of control or regulatory standards and that the Society maintained an adequate system of internal control.

Audit committee and auditors

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

- **Financial reporting**
  The committee reviews the Group's accounting policies at least annually and on a quarterly basis receives updates on any key judgemental areas. In addition the committee reviews the integrity of the financial statements and any formal announcements, including review of any significant financial reporting judgements contained within them.
- **Systems of internal financial controls**
  The committee receives reports and monitors the systems of internal control. This includes review of internal financial controls. The review of the Society's risk management systems is performed by the board risk committee.
- **External auditors**
  The committee reviews and recommends to the board annually the re-appointment/appointment of external auditors. The committee also examines the external auditors' independence and approves their terms of engagement and remuneration. This includes any decisions on the engagement of the external auditors for non-audit services.
- **Internal Audit**
  The committee monitors and reviews the performance of the internal audit function. This is achieved through approval of the annual audit plan and monitoring of progress against this plan. In addition, the committee reviews the results of audits undertaken, conclusions on the effectiveness of the control environment and progress made by management in addressing any concerns raised.
- **Compliance monitoring plan**
  In addition, the committee approves the compliance monitoring plan and monitors progress against it.

The committee consists of non-executive directors only and met on five occasions during 2012. The board is satisfied that at least one member of the committee has recent and relevant financial experience.

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

Remuneration

Policy and Procedures

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

The remuneration committee's work and the Society's compliance with code principles relating to remuneration, is covered in the report of the directors on remuneration on pages 30 to 33.

Membership

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

The remuneration committee reviews employment terms for the Group's team members, reporting recommended changes to the board.

More information on remuneration is given in the report commencing on page 30.

Relations with members

Dialogue with members

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

The Society is keen to find out its members' views so that it can continually improve. It provides them with a number of ways and opportunities to give their feedback. It surveys a selection of its members on a regular basis and uses its 'Customer Panel' to provide input into the services and products it offers. The Society also encourages its members to attend its annual general meeting where they are able to ask questions and voice their opinions.

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

Constructive use of the AGM

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

All postal and proxy votes are counted using independent scrutineers.

All members of the board are present at the AGM each year (unless, exceptionally, their absence is unavoidable) and the Chairman of the audit, nominations, risk and remuneration committees are therefore available to answer questions.

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,

David Thompson.

David Thompson
Chairman

20 February 2013

Report of the directors on remuneration

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

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

Introduction

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

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

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

Remuneration matters are considered for the board by a remuneration committee whose membership is shown on page 15.

The Nottingham adheres to the requirements of the FSA's Remuneration Code and can confirm that, for the year 2012, the executive directors fall within the proportionality rule i.e. variable remuneration is less than 33% of total remuneration and total remuneration is no more than £0.5m per annum. The non-executive directors do not receive variable remuneration. Information on the Society's other Remuneration Code Staff is set out in the Pillar 3 disclosures published on our website www.thenottingham.com.

Executive directors

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

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.

Basic salary is assessed by reference to roles carrying similar responsibilities in comparable organisations and by reference to data relating to jobs of a similar size using the job evaluation process of the Hay Group, a leading provider of remuneration data. A comparator group is used that consists of executive director positions within building societies of a similar size and complexity.

The Society introduced a HMRC approved pension salary sacrifice scheme for all staff during 2011. The executive directors are eligible to participate in the scheme, however their gross salaries and pension contributions (before salary sacrifice is applied) are shown in the tables on pages 32 and 33.

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

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

   If the Group bonus scheme is not triggered, no payment is made to the executive directors. In 2012 the Group bonus scheme was triggered.

b) The three year Medium Term Incentive (MTI) scheme maturing at the end of 2011, and paid in 2012 focused primarily on the Group's cost income ratio, and was dependent on the Group's relative performance to a comparator group of societies for the period 2009-2011.

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

The schemes currently in operation mature at the end of 2012, 2013 and 2014 respectively and all require achievement of a minimum level of:

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

Payment for the scheme maturing in 2012 is determined by the movement in the cost income ratio in comparison with peer societies.

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

Any payment under the 2010 – 2012 scheme cannot be confirmed until later in 2013 when all comparator societies' annual accounts are available. The maximum bonus achievable under each scheme is 40% of annual salary.

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

Executive directors receive other taxable benefits including a car allowance.

Non-executive directors

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

The fees are reviewed by the Chairman together with the executive directors before recommendations are referred to the board. Remuneration of the Chairman is considered by the remuneration committee together with the Society's Chief Executive without the Chairman being present, with a recommendation being referred to the board.

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

Remuneration of directors

Audited	Society	2012	2011
		£000	£000
(A) TOTAL DIRECTORS' REMUNERATION		1,091	970
(B) NON-EXECUTIVE DIRECTORS' REMUNERATION			
J.S. Edwards (appointed 10.01.12)		30	-
R. W. Fiddis		33	32
J. C. Kibbey		33	32
R. P. Marchant (Vice-Chairman)		46	45
D. A. R. Thompson (Chairman)		60	59
K. R. Whitesides		38	37
Total emoluments for services as directors		**240**	**205**

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

[1] Basic salary pre-salary sacrifice

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

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

Audited	Society						
	Salary[1]	Annual[2] bonus	Medium term[2] incentive scheme	Benefits	Sub-total	Society's [3] contribution to pension scheme	Total
2011	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
I J Rowling (retired 03.03.11)	33	6	-	2	41	4	45
D J Marlow	186	37	40	9	272	19	291
M A Piranie	173	35	40	9	257	18	275
S J Taylor (appointed 01.02.11)	121	17	-	8	146	8	154
	513	**95**	**80**	**28**	**716**	**49**	**765**

I J Rowling received contractual payments (salary £41,000, annual bonus £7,000, medium term incentive £50,000, pension contributions of £5,000 and benefits of £2,000) for the period from ceasing to be a director on 3 March 2011 to his retirement date on 15 May 2011.

On behalf of the board of directors,

Keith Whitesides
Chairman of the Remuneration Committee

20 February 2013

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

We have audited the group and society annual accounts of Nottingham Building Society for the year ended 31 December 2012 set out on pages 35 to 79. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU.

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

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 18, the directors are responsible for the preparation of annual accounts which give a true and fair view. Our responsibility is to audit, and express an opinion on, the annual accounts in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the annual accounts

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

Opinion on annual accounts

In our opinion the annual accounts:

- give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of affairs of the group and of the society as at 31 December 2012 and of the income and expenditure of the group and of the society for the year then ended; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and regulations made under it and, as regards the group annual accounts, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Building Societies Act 1986

In our opinion:

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

Matters on which we are required to report by exception

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

- proper accounting records have not been kept by the Society; or
- the annual accounts are not in agreement with the accounting records; or
- we have not received all the information and explanations and access to documents we require for our audit.

Simon Clark (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc,
Statutory Auditor

Chartered Accountants,
One Snowhill,
Queensway,
Birmingham
B4 6GH

20 February 2013

Statements of comprehensive income

For the year ended 31 December 2012

	Notes	Group 2012 £m	Group 2011 £m	Society 2012 £m	Society 2011 £m
Interest receivable and similar income	3	97.1	81.7	97.1	81.7
Interest payable and similar charges	4	(66.5)	(53.1)	(66.5)	(53.1)
NET INTEREST INCOME		**30.6**	**28.6**	**30.6**	**28.6**
Fee and commissions receivable		4.6	4.0	3.4	2.8
Fees and commissions payable		(0.4)	(0.3)	(0.4)	(0.3)
Net gains/(losses) from derivative financial instruments	5	-	-	-	-
TOTAL NET INCOME		**34.8**	**32.3**	**33.6**	**31.1**
Administrative expenses	6	(19.7)	(18.9)	(18.3)	(17.7)
Depreciation and amortisation	18, 19	(2.9)	(2.9)	(2.9)	(2.8)
Finance income	27	0.1	0.3	0.1	0.3
OPERATING PROFIT BEFORE IMPAIRMENT LOSSES AND PROVISIONS		**12.3**	**10.8**	**12.5**	**10.9**
Impairment losses on loans and advances	15	(1.4)	(1.8)	(1.4)	(1.8)
Provisions for liabilities – FSCS levy	26	(2.0)	(1.4)	(2.0)	(1.4)
Provisions for liabilities - Other	26	(0.4)	(0.2)	(0.3)	(0.2)
Loss on disposal of property, plant and equipment	18	-	(0.2)	-	(0.2)
PROFIT BEFORE TAX		**8.5**	**7.2**	**8.8**	**7.3**
Tax expense	9	(1.7)	(1.9)	(1.8)	(1.9)
PROFIT FOR THE FINANCIAL YEAR	**29**	**6.8**	**5.3**	**7.0**	**5.4**
Other comprehensive income:					
Available-for-sale reserve					
Valuation (losses)/gains taken to reserves	12	(1.8)	1.2	(1.8)	1.2
Amount transferred to income statement	12	0.2	-	0.2	-
Actuarial (loss) on retirement benefit obligations	27	(1.0)	(3.1)	(1.0)	(3.1)
Tax on other comprehensive expense	9	0.6	0.4	0.6	0.4
Other comprehensive (expense) for the period net of income tax		(2.0)	(1.5)	(2.0)	(1.5)
TOTAL COMPREHENSIVE INCOME FOR THE PERIOD		**4.8**	**3.8**	**5.0**	**3.9**

Profit for the financial year arises from continuing operations.
Both the profit for the financial year and total comprehensive income for the period are attributable to the members of the Society.
A reconciliation from profit before tax for the financial year to underlying profit used by management can be found on page 11.
The notes on pages 39 to 79 form part of these accounts.

Statements of financial position

As at 31 December 2012

		Group 2012	Group 2011	Society 2012	Society 2011
	Notes	£m	£m	£m	£m
ASSETS					
Liquid assets					
Cash in hand	10	1.1	1.2	1.1	1.2
Loans and advances to credit institutions	11	374.2	209.9	374.2	209.9
Debt securities	12	181.0	305.0	181.0	305.0
Derivative financial instruments	13	23.3	13.3	23.3	13.3
Loans and advances to customers	14	2,129.9	1,927.8	2,129.9	1,927.8
Investments in subsidiary undertakings	16	-	-	-	-
Other assets	17	1.8	2.1	3.2	3.5
Property, plant and equipment	18	11.9	11.1	10.9	10.1
Intangible assets	19	7.3	6.5	7.3	6.5
Deferred tax assets	20	1.4	1.3	1.4	1.3
TOTAL ASSETS		**2,731.9**	**2,478.2**	**2,732.3**	**2,478.6**
LIABILITIES					
Shares	21	2,268.0	1,989.8	2,268.0	1,989.8
Amounts owed to credit institutions	22	55.7	63.9	55.7	63.9
Amounts owed to other customers	23	176.1	190.3	176.1	190.3
Debt securities in issue	24	19.7	31.7	19.7	31.7
Derivative financial instruments	13	21.8	17.4	21.8	17.4
Other liabilities and accruals	25	3.4	4.7	3.2	4.6
Current tax liabilities		0.3	0.5	0.3	0.5
Deferred tax liabilities	20	1.1	1.1	1.1	1.1
Provisions for liabilities	26	3.8	2.3	3.7	2.3
Retirement benefit obligations	27	5.1	4.8	5.1	4.8
Subscribed capital	28	27.4	27.0	27.4	27.0
TOTAL LIABILITIES		**2,582.4**	**2,333.5**	**2,582.1**	**2,333.4**
RESERVES					
General reserves	29	149.6	143.6	150.3	144.1
Available-for-sale reserves	30	(0.1)	1.1	(0.1)	1.1
Total reserves attributable to members of the Society		**149.5**	**144.7**	**150.2**	**145.2**
TOTAL RESERVES AND LIABILITIES		**2,731.9**	**2,478.2**	**2,732.3**	**2,478.6**

The notes on pages 39 to 79 form part of these accounts.
These accounts were approved by the board of directors on 20 February 2013 and signed on its behalf:

David Thompson

David Thompson
Chairman

David Marlow
Chief Executive

Ashraf Piranie

Ashraf Piranie
Deputy Chief Executive
and Finance Director

Statements of changes in members' interests

As at 31 December 2012

	Notes	General reserves £m	Available-for-sale reserves £m	Total £m
GROUP				
Balance as at 1 January 2012		143.6	1.1	144.7
Profit for the year		6.8	-	6.8
Other comprehensive income for the period (net of tax)				
Net (losses) from changes in fair value		-	(1.2)	(1.2)
Actuarial loss on retirement benefit obligations		(0.8)	-	(0.8)
Total other comprehensive (expense)		(0.8)	(1.2)	(2.0)
Total comprehensive income/(expense) for the period		6.0	(1.2)	4.8
BALANCE AS AT 31 DECEMBER 2012	**29,30**	**149.6**	**(0.1)**	**149.5**
Balance as at 1 January 2011		140.7	0.2	140.9
Profit for financial the year		5.3	-	5.3
Other comprehensive income for the period (net of tax)				
Net gain from changes in fair value		-	0.9	0.9
Actuarial loss on retirement benefit obligations		(2.4)	-	(2.4)
Total other comprehensive (expense)/income		(2.4)	0.9	(1.5)
Total comprehensive income for the period		2.9	0.9	3.8
BALANCE AS AT 31 DECEMBER 2011	**29,30**	**143.6**	**1.1**	**144.7**

	Notes	General reserves £m	Available-for-sale reserves £m	Total £m
SOCIETY				
Balance as at 1 January 2012		144.1	1.1	145.2
Profit for the year		7.0	-	7.0
Other comprehensive income for the period (net of tax)				
Net (losses) from changes in fair value		-	(1.2)	(1.2)
Actuarial loss on retirement benefit obligations		(0.8)	-	(0.8)
Total other comprehensive (expense)		(0.8)	(1.2)	(2.0)
Total comprehensive income/(expense) for the period		6.2	(1.2)	5.0
BALANCE AS AT 31 DECEMBER 2012	**29,30**	**150.3**	**(0.1)**	**150.2**
Balance as at 1 January 2011		141.1	0.2	141.3
Profit for financial the year		5.4	-	5.4
Other comprehensive income for the period (net of tax)				
Net gains from changes in fair value		-	0.9	0.9
Actuarial loss on retirement benefit obligations		(2.4)	-	(2.4)
Total other comprehensive (expense)/income		(2.4)	0.9	(1.5)
Total comprehensive income for the period		3.0	0.9	3.9
BALANCE AS AT 31 DECEMBER 2011	**29,30**	**144.1**	**1.1**	**145.2**

The notes on pages 39 to 79 form part of these accounts.

Cash flow statements

For the year ended 31 December 2012

	Notes	Group 2012 £m	Group 2011 £m	Society 2012 £m	Society 2011 £m
CASH FLOWS FROM OPERATING ACTIVITIES					
Profit before tax		8.5	7.2	8.8	7.3
Depreciation and amortisation		2.9	2.9	2.9	2.8
Loss on disposal of property, plant and equipment		-	0.2	-	0.2
Interest on subscribed capital		2.0	2.0	2.0	2.0
Net losses/(gains) on disposal and amortisation of debt securities		0.8	(1.8)	0.8	(1.8)
Increase in impairment of loans and advances		1.4	2.0	1.4	2.0
TOTAL		**15.6**	**12.5**	**15.9**	**12.5**
CHANGES IN OPERATING ASSETS AND LIABILITIES					
(Increase)/decrease in prepayments, accrued income and other assets		(13.8)	7.1	(14.1)	7.2
Increase in accruals, deferred income and other liabilities		11.6	1.5	11.6	1.4
(Increase) in loans and advances to customers		(198.8)	(65.4)	(198.8)	(65.4)
Increase in shares		270.7	151.2	270.7	151.2
(Decrease) in amounts owed to other credit institutions and other customers		(23.2)	(97.5)	(23.2)	(97.5)
Decrease/(increase) in loans and advances to credit institutions		16.3	(3.2)	16.3	(3.2)
(Decrease)/increase in debt securities in issue		(11.8)	14.4	(11.8)	14.4
(Decrease) in retirement benefit obligation		(0.7)	(1.6)	(0.7)	(1.6)
Taxation paid		(1.6)	(1.1)	(1.6)	(1.1)
NET CASH GENERATED BY OPERATING ACTIVITIES		**64.3**	**17.9**	**64.3**	**17.9**
CASH FLOWS FROM INVESTING ACTIVITIES					
Purchase of debt securities		(212.8)	(733.0)	(212.8)	(733.0)
Disposal of debt securities		315.3	733.2	315.3	733.2
Purchase of property, plant and equipment		(2.1)	(5.9)	(2.1)	(5.9)
Purchase of intangible assets		(2.4)	(1.4)	(2.4)	(1.4)
NET CASH GENERATED BY/(USED IN) INVESTING ACTIVITIES		**98.0**	**(7.1)**	**98.0**	**(7.1)**
CASH FLOWS FROM FINANCING ACTIVITIES					
Interest paid on subscribed capital		(1.9)	(1.9)	(1.9)	(1.9)
NET INCREASE IN CASH AND CASH EQUIVALENTS		**160.4**	**8.9**	**160.4**	**8.9**
Cash and cash equivalents at 1 January		190.4	181.5	190.4	181.5
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	**31**	**350.8**	**190.4**	**350.8**	**190.4**

The notes on pages 39 to 79 form part of these accounts.

Notes to the accounts

1. ACCOUNTING POLICIES

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

Basis of preparation

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

The accounts have been prepared on the going concern basis as outlined in the Directors' report on page 19.

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.

Future accounting developments

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

- IFRS 9 'Financial Instruments' – effective from 1 January 2015 but not yet endorsed by the EU. The standard will eventually replace all of IAS 39. Phase one of this process specifically requires financial assets to be classified at amortised cost or at fair value. Consequently, the available-for-sale category currently used will become void. Further development phases for IFRS 9 are scheduled to cover key areas such as impairment and hedge accounting. Early adoption is permitted once endorsed by the EU. The impact of IFRS 9 is likely to be material to the Group once it becomes effective;
- Amendment to IFRS 7, Offsetting Disclosures – effective from 1 January 2013. The amendment requires additional disclosures to enable users to evaluate the effect of netting arrangements, including rights of set off, of financial assets and liabilities. This is unlikely to have a material impact to the Group;
- Amendment to IFRS 10 'Consolidated Financial Statements' – effective from 1 January 2014 but not yet endorsed by the EU. The standard replaces IAS 27 'Consolidated and Separate Financial Statements' and SIC 12 'Consolidation-Special Purposes Entities' by introducing a single model to be applied in the control analysis for all investees. This is unlikely to have a material impact to the Group;
- Amendment to IFRS 12 'Disclosure of Involvement with Other Entities' – effective from 1 January 2014 but not yet endorsed by the EU. The standard requires enhanced disclosures regarding consolidated and unconsolidated entities in which the entity has an involvement. The standard is currently being reviewed by the Group, with some minor changes to disclosures expected;
- IFRS 13 'Fair Value Measurement' – effective from 1 January 2013. The standard defines fair value and acts as its single authority, dealing with both measurement and disclosure. It does not require fair value measurements in addition to those already required, or permitted by other IFRSs, and is not intended to establish valuation standards or affect valuation practices outside of financial reporting. The standard is unlikely to have a material impact to the Group;
- Amendment to IAS 19 'Employee Benefits – effective from 1 January 2013 but not yet endorsed by the EU. This amendment covers the standard's recognition, measurement and presentation criteria with regard to a pension scheme's expense contained within IAS 19's 'defined benefit' scope. The amendment eliminates the 'expected return on assets' from the measurement of a pension's expense and directs entities to instead charge a cost of finance against its net unfunded liability position. When determining a discount rate, that which calculates a pension obligation's present value, reference should be made to market yields. These yields should be matched to high quality corporate bonds, in terms of both the obligation's currency and maturity, ahead of any previously assumed government bond yield reference point. If the new standard had been applied in the year ended 31 December 2012, 'Finance income' would be approximately £0.3m lower with an equivalent increase to other comprehensive income. There would have been no impact on the Group's net assets or reserves;
- Amendment to IAS 1 'Presentation of Financial Statements': Presentation of items of Other Comprehensive Income – effective for accounting periods beginning on or after 1 July 2012. This amendment requires entities to group items presented in the statements of other comprehensive income on the basis of whether they are potentially reclassifiable to profit or loss in subsequent periods. The amendment will only have a presentational impact on the Group's statements of comprehensive income.

Subsidiaries

Subsidiary companies are defined as those in which the Society has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. 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 accounts of the Society and its subsidiaries, Nottingham Property Services and Nottingham Mortgage Services, eliminating intercompany balances and transactions. All entities have accounting periods ending on 31 December.

Notes to the accounts

1. ACCOUNTING POLICIES (CONTINUED)

Interest income and expense

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

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

Fees and commissions

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

Commission receivable from the sale of third party products is recognised upon fulfilment of contractual obligations, that is when policies go on risk or on completion of a mortgage.

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

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

Cash and cash equivalents

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

Derivative financial instruments and hedge accounting

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

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

Fair value hedges

When a derivative is designated as the hedging instrument in a hedge of the change in fair value of a recognised asset or liability or a firm commitment that could affect profit and loss, changes in the fair value of the derivative are recognised immediately in profit and loss together with changes in the fair value of the hedged item that are attributable to the hedged risk (in the same line item in the statement of comprehensive income as the hedged item).

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

Financial assets

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

a) Loans and receivables

The Group's loans and advances to customers are classified as loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

The Group measures its loans and receivables at amortised cost less impairment provisions.

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

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

b) Available-for-sale assets

Available-for-sale assets are non-derivative assets that are intended to be held for an indefinite period of time. They may be sold in response to needs for changes in liquidity or changes in interest rates. The Group's debt securities are classified as available-for-sale assets. The Group measures debt securities at fair value, with subsequent changes in fair value being recognised through other comprehensive income except for impairment losses which are recognised in profit or loss. Further information regarding how fair values are determined can be found in note 32 to the accounts.

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

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

a) Assets carried at amortised cost

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

Notes to the accounts

1. ACCOUNTING POLICIES (CONTINUED)

Objective evidence of impairment may include:

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

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

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

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

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

b) Available-for-sale assets

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

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

Forbearance strategies and renegotiated loans

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

The main options offered by the Society include:

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

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

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

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

Financial liabilities

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

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

Subscribed capital

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

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

Intangible assets

Purchased software and costs directly associated with the internal development of computer software are capitalised as intangible assets where the software is an identifiable asset controlled by the Group which will generate future economic benefits and where

Notes to the accounts

1. ACCOUNTING POLICIES (CONTINUED)

costs can be reliably measured. Costs incurred to establish technological feasibility or to maintain existing levels of performance are recognised as an expense as incurred.

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

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

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

Property, plant and equipment

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

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

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

Employee benefits

a) Pensions

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

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

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

b) Long term incentive schemes

The costs of bonuses payable after the end of the year in which they are earned are recognised in the year in which the employees render the related service. The long term incentive bonuses disclosed in the Directors remuneration report are included when paid.

Leases

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

Taxation

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

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

Deferred tax is provided using the statement of financial position liability method, providing for temporary differences between the carrying amount of assets and liabilities for accounting purposes and the amounts used for taxation purposes. Deferred tax assets and liabilities are recognised gross on the statement of financial position and deferred tax assets are only recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised.

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

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

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

Provisions

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

The Society has an obligation to contribute to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet compensation claims from, in particular, retail depositors of failed banks. A provision is recognised to the extent it can be reliably estimated and when the Society

Notes to the accounts

1. ACCOUNTING POLICIES (CONTINUED)

has an obligation in accordance with IFRIC 6. The amount provided is based on information received from the FSCS, forecast future interest rates and the Society's historic share of industry protected deposits.

Financial guarantees

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

Accounting estimates and judgements

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

a) Impairment losses on loans and advances to customers

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

The accuracy of the provision would therefore be affected by unexpected changes to these assumptions.

To the extent that default rates differ from that estimated by 10%, the impairment provisions on loans and advances would change by an estimated £0.4 million.

b) Expected mortgage life

In determining the expected life of mortgage assets, the Group uses historical and forecast redemption data as well as management judgement.

At regular intervals throughout the year, the expected life of mortgage assets is reassessed for reasonableness. Any variation in the expected life of mortgage assets will change the carrying value in the statement of financial position and the timing of the recognition of interest income.

A 10% increase in the life profile of mortgage assets would result in an increase in the value of loans on the statement of financial position by approximately £0.4 million.

c) Employee benefits

The Group operates a defined benefit pension scheme. Significant judgements (on such areas as future interest and inflation rates and mortality rates) have to be exercised in estimating the value of the assets and liabilities of the scheme, and hence of its net deficit. The assumptions are outlined in a note to the accounts. Of these assumptions, the main determinant of the liability is the discount rate. A variation of 0.1% in the discount rate will change liabilities by approximately £0.7 million.

d) Financial Services Compensation Scheme (FSCS)

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

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

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

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

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

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

A change to the Society's share of protected deposits by 1% would change the provision by £0.2 million. A 1% increase to 12mth LIBOR would increase the provision by £0.5 million.

e) Fair value of derivatives and financial assets

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

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

A change in the yield curve of 1% would change the total net fair value of derivative financial instruments by £16.2 million.

The classification of these fair value techniques is in line with the fair value hierarchy detailed in IFRS 7: 'Financial Instrument Disclosures' which splits the source of input when deriving fair values into three levels, as follows:

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

Notes to the accounts

2 SEGMENTAL REPORTING

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

The Group reports through three operating segments:

- Building Society – Provides mortgages, savings, third party insurance and investments. Includes all income and costs associated with Nottingham Building Society.
- Estate Agency – Provides estate agency services. Includes all income and costs associated with Nottingham Property Services Ltd.
- Mortgage Broking – Provides whole of market mortgage broking services. Includes all income and costs associated with Nottingham Mortgage Services Ltd.

	Building Society	Estate Agency	Mortgage Broking	Consolidation adjustments	Total
2012	**£m**	**£m**	**£m**	**£m**	**£m**
Net interest income	30.6	-	-	-	30.6
Net fees and commission receivable	3.0	1.2	0.2	(0.2)	4.2
TOTAL INCOME	**33.6**	**1.2**	**0.2**	**(0.2)**	**34.8**
Administrative expenses	(18.3)	(1.4)*	(0.2)	0.2	(19.7)
Depreciation and amortisation	(2.9)	-	-	-	(2.9)
Finance income	0.1	-	-	-	0.1
Impairment losses on loans and advances	(1.4)	-	-	-	(1.4)
Provisions for other liabilities	(0.3)	(0.1)	-	-	(0.4)
UNDERLYING PROFIT/(LOSS)	**10.8**	**(0.3)**	**-**	**-**	**10.5**
Net gains/(losses) from derivative financial instruments	-	-	-	-	-
Provisions for liabilities – FSCS levy	(2.0)	-	-	-	(2.0)
PROFIT/(LOSS) BEFORE TAX	**8.8**	**(0.3)**	**-**	**-**	**8.5**
Tax expense	(1.8)	0.1	-	-	(1.7)
PROFIT/(LOSS) AFTER TAX	**7.0**	**(0.2)**	**-**	**-**	**6.8**
Total assets	2,732.3	1.1	0.1	(1.6)	2,731.9
Total liabilities	2,582.1	1.8	0.1	(1.6)	2,582.4
Capital expenditure	4.5	-	-	-	4.5

Notes to the accounts

2 SEGMENTAL REPORTING (CONTINUED)

	Building Society	Estate Agency	Mortgage Broking	Consolidation adjustments	Total
2011	**£m**	**£m**	**£m**	**£m**	**£m**
Net interest income	28.6	-	-	-	28.6
Net fees and commission receivable	2.5	1.2	0.2	(0.2)	3.7
TOTAL INCOME	**31.1**	**1.2**	**0.2**	**(0.2)**	**32.3**
Administrative expenses	(17.7)	(1.3)	(0.1)	0.2	(18.9)
Depreciation and amortisation	(2.8)	(0.1)	-	-	(2.9)
Finance Income	0.3	-	-	-	0.3
Impairment losses on loans and advances	(1.8)	-	-	-	(1.8)
Provisions for other liabilities	(0.2)	-	-	-	(0.2)
Loss on disposal of property, plant and equipment	(0.2)	-	-	-	(0.2)
UNDERLYING PROFIT/(LOSS)	**8.7**	**(0.2)**	**0.1**	**-**	**8.6**
Net gains/(losses) from derivative financial instruments	-	-	-	-	-
Provisions for liabilities – FSCS levy	(1.4)	-	-	-	(1.4)
PROFIT/(LOSS) BEFORE TAX	**7.3**	**(0.2)**	**0.1**	**-**	**7.2**
Tax expense	(1.9)	-	-	-	(1.9)
PROFIT/(LOSS) AFTER TAX	**5.4**	**(0.2)**	**0.1**	**-**	**5.3**
Total assets	2,478.6	1.1	-	(1.5)	2,478.2
Total liabilities	2,333.4	1.5	0.1	(1.5)	2,333.5
Capital expenditure	7.3	-	-	-	7.3

* Includes legal and professional costs associated with the acquisition of Harrison Murray.

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

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

There are no further reportable segments or activities which are not presented above or in the primary statements on pages 35 to 38.

Notes to the accounts

Group and Society	2012	2011
3 INTEREST RECEIVABLE AND SIMILAR INCOME	**£m**	**£m**
On loans fully secured on residential property	99.1	91.1
On other loans	2.2	2.0
On debt securities	3.2	3.8
On liquid assets	2.2	1.2
Profit on sale of liquid assets	0.2	-
Net interest (expense) on derivatives	(9.8)	(16.4)
	97.1	**81.7**

Interest on debt securities includes £1.6 million (2011: £2.0 million) arising from fixed income investment securities.

Included within interest income is £1.0 million (2011: £1.1 million) in respect of interest income accrued on impaired loans two or more months in arrears.

Group and Society	2012	2011
4 INTEREST PAYABLE AND SIMILAR CHARGES	**£m**	**£m**
On shares held by individuals	61.0	50.1
On deposits and other borrowings	5.5	5.1
On subscribed capital	2.0	2.0
Net interest (income) on derivatives	(2.0)	(4.1)
	66.5	**53.1**

Group and Society	2012	2011
5 NET GAINS/(LOSSES) FROM DERIVATIVE FINANCIAL INSTRUMENTS	**£m**	**£m**
Derivatives in designated fair value hedge relationships	2.5	2.7
Adjustments to hedged items in fair value hedge accounting relationships	(2.7)	(2.5)
Derivatives not in designated fair value hedge relationships	0.2	(0.2)
	-	**-**

The net gains/(losses) from derivative financial instruments of £nil (2011: £nil) represents the net fair value movement on derivative instruments that are matching risk exposure on an economic basis. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting is not achievable on certain items. The movement is primarily due to timing differences in income recognition between derivative instruments and the hedged assets or liabilities. This gain or loss will trend to zero over time and this is taken into account by the board when considering the Group's underlying performance.

Notes to the accounts

	Group 2012	Group 2011	Society 2012	Society 2011
6 ADMINISTRATIVE EXPENSES	**£m**	**£m**	**£m**	**£m**
Staff costs				
Wages and salaries	10.5	10.4	9.7	9.7
Social security costs	0.8	0.9	0.8	0.8
Other pension costs	0.6	0.6	0.5	0.5
	11.9	11.9	11.0	11.0
Capitalised staff costs	(0.5)	(0.4)	(0.5)	(0.4)
	11.4	11.5	10.5	10.6
Operating lease rentals	0.5	0.6	0.4	0.5
Other administrative costs	7.8	6.8	7.4	6.6
	19.7	**18.9**	**18.3**	**17.7**

The 2012 wages and salaries costs include £nil (2011: £0.2 million) in respect of redundancy costs.

	Group 2012	Group 2011	Society 2012	Society 2011
OTHER ADMINISTRATIVE COSTS INCLUDE:	**£000**	**£000**	**£000**	**£000**
Remuneration of auditors and associates (excluding VAT)				
Audit of these financial statements	80	77	80	77
Audit of subsidiary undertakings	12	10	-	-
Audit of associated pension schemes	5	5	5	5
Other assurance services	-	-	-	-
Other services related to taxation	70	12	70	12

	Group 2012	Group 2011	Society 2012	Society 2011
7 EMPLOYEES	**Number**	**Number**	**Number**	**Number**
The average number of persons employed during the year was:				
Full time	284	270	253	244
Part time	124	131	111	118
	408	**401**	**364**	**362**
Building Society				
Central Administration	183	167	183	167
Branches	181	195	181	195
Subsidiaries	44	39	-	-
	408	**401**	**364**	**362**

8 REMUNERATION OF DIRECTORS

Directors' emoluments are shown as part of the report of the directors on remuneration on pages 32 and 33.

Total Directors' emoluments totalled £1.1 million (2011: £1.0 million).

Notes to the accounts

	Group 2012	Group 2011	Society 2012	Society 2011
9 TAX EXPENSE	**£m**	**£m**	**£m**	**£m**
Current tax	2.5	2.3	2.6	2.3
Adjustments for prior years	(0.7)	(0.2)	(0.7)	0.1
	1.8	2.1	1.9	2.4
Deferred tax (note 20)	(0.4)	(0.3)	(0.4)	(0.3)
Adjustments for prior years	0.3	0.1	0.3	(0.2)
TOTAL TAX EXPENSE	**1.7**	**1.9**	**1.8**	**1.9**
The total tax charge for the period differs from that calculated using the UK standard rate of corporation tax. The differences are explained below.				
Profit before taxation	8.5	7.2	8.8	7.3
Expected tax at 24.5% (2011: 26.5%)	2.1	1.9	2.2	1.9
Expenses not deductible for corporation tax purposes	0.1	0.2	0.1	0.2
Effect of tax change in tax rate on deferred tax	(0.1)	(0.1)	(0.1)	(0.1)
Adjustment for prior years	(0.4)	(0.1)	(0.4)	(0.1)
TAX EXPENSE FOR THE YEAR	**1.7**	**1.9**	**1.8**	**1.9**
Tax recognised directly in other comprehensive income				
Tax on available-for-sale assets	(0.4)	0.3	(0.4)	0.3
Deferred tax on pension scheme	-	(0.3)	-	(0.3)
Corporation tax on pension scheme	(0.2)	(0.4)	(0.2)	(0.4)
TAX (CREDIT) FOR THE YEAR	**(0.6)**	**(0.4)**	**(0.6)**	**(0.4)**

The 2012 Autumn statement on 5 December 2012 announced that the UK corporation tax rate will reduce to 21% by 2014. A reduction in the rate from 26% to 25% (effective 1 April 2012) was substantively enacted on 5 July 2011 and further reductions to 24% (effective 1 April 2012) and 23% (effective from 1 April 2013) were substantively enacted on 26 March 2012 and 3 July 2012 respectively. This results in a weighted average rate of 24.5% for 2012 (2011: 26.5%). This will reduce the Group's future current tax charge accordingly.

	Group and Society	2012	2011
10 CASH IN HAND	**Note**	**£m**	**£m**
Cash in hand		1.1	1.2
Included in cash and cash equivalents	31	1.1	1.2

Notes to the accounts

	Group and Society	2012	2011
11 LOANS AND ADVANCES TO CREDIT INSTITUTIONS	**Note**	**£m**	**£m**
Repayable on call and short notice		335.7	137.2
Placements with credit institutions		14.0	32.0
Included within cash and cash equivalents	31	349.7	169.2
Other loans and advances to credit institutions		24.5	40.7
		374.2	**209.9**

At 31 December 2012 £7.7m (2011: £nil) of cash has been pledged by the Group and Society against derivative contracts.

	Group and Society	2012	2011
12 DEBT SECURITIES			
Securities available-for-sale			
Gilts		27.0	60.2
Treasury bills		0.5	-
Certificate of deposit		32.8	126.8
Fixed rate notes		40.8	32.9
Floating rate notes		79.9	85.1
		181.0	**305.0**

Of this total £101.1 million (2011: £219.9 million) is attributable to fixed income debt securities.
All debt securities are unlisted.
Included within the certificates of deposit balance is £nil (2011: £20.0 million) in respect of cash and cash equivalents.

	Group and Society	2012	2011
Movements on debt securities during the year may be analysed as follows:			
At 1 January		305.0	369.7
Additions		212.8	753.0
Disposals and maturities		(335.2)	(818.9)
Net gains from changes in fair value recognised in other comprehensive income		(1.6)	1.2
AT 31 DECEMBER		**181.0**	**305.0**

Notes to the accounts

13 DERIVATIVE FINANCIAL INSTRUMENTS AT 31 DECEMBER 2012 (Group and Society)	Contract/notional amount £m	Fair values – Assets £m	Fair values – Liabilities £m
a) Unmatched derivatives – Interest rate swaps	24.7	-	(0.6)
b) Derivatives designated as fair value hedges – Interest rate swaps	1,350.1	23.3	(21.2)
TOTAL RECOGNISED DERIVATIVE ASSETS/(LIABILITIES)	**1,374.8**	**23.3**	**(21.8)**
AT 31 DECEMBER 2011			
a) Unmatched derivatives – Interest rate swaps	34.8	0.4	(0.6)
b) Derivatives designated as fair value hedges – Interest rate swaps	1,392.7	12.9	(16.8)
TOTAL RECOGNISED DERIVATIVE ASSETS/(LIABILITIES)	**1,427.5**	**13.3**	**(17.4)**

Group and Society		2012	2011
14 LOANS AND ADVANCES TO CUSTOMERS	**Note**		
Loans fully secured on residential property		2,043.3	1,846.2
Other loans – loans fully secured on land		71.6	70.6
		2,114.9	1,916.8
Provision for impairment losses on loans and advances	15	(3.9)	(3.2)
		2,111.0	1,913.6
Fair value adjustment for hedged risk		18.9	14.2
		2,129.9	**1,927.8**

Notes to the accounts

15 PROVISION FOR IMPAIRMENT LOSSES ON LOANS AND ADVANCES Movement in provision for impairment losses on loans and advances may be analysed as follows:	Group and Society Loans fully secured on residential property £m	Other loans fully secured on land £m	Total £m
Individual provision			
At 1 January 2012	1.2	1.1	2.3
Provision for loan impairment	0.4	0.7	1.1
Provision utilised	(0.5)	(0.2)	(0.7)
AT 31 DECEMBER 2012	**1.1**	**1.6**	**2.7**
Collective provision			
At 1 January 2012	0.4	0.5	0.9
Provision for loan impairment	0.1	0.2	0.3
AT 31 DECEMBER 2012	**0.5**	**0.7**	**1.2**
Individual provision			
At 1 January 2011	1.8	1.5	3.3
Provision for loan impairment	1.0	0.7	1.7
Provision utilised	(1.6)	(1.1)	(2.7)
AT 31 DECEMBER 2011	**1.2**	**1.1**	**2.3**
Collective provision			
At 1 January 2011	0.3	0.3	0.6
Provision for loan impairment	0.1	0.2	0.3
AT 31 DECEMBER 2011	**0.4**	**0.5**	**0.9**
The charge to the statement of comprehensive income comprises:			
Provision for loan impairment	0.5	0.9	1.4
Recoveries of debts previously written off	-	-	-
CHARGE TO THE STATEMENT OF COMPREHENSIVE INCOME IN 2012	**0.5**	**0.9**	**1.4**
CHARGE TO THE STATEMENT OF COMPREHENSIVE INCOME IN 2011	**0.9**	**0.9**	**1.8**

16 INVESTMENTS IN SUBSIDIARY UNDERTAKINGS

Investments in subsidiary undertakings represent the cost of ordinary shares owned in Nottingham Property Services Limited, Nottingham Mortgage Services Limited and the cost of ordinary shares owned in a number of dormant subsidiaries. All subsidiary companies are incorporated in England and are 100% owned.

Nottingham Property Services' principal activity is the provision of estate agency services.

Nottingham Mortgage Services' principal activity is the provision of mortgage broking services.

Ordinary shares held in subsidiary undertakings were £112 (2011: £112).

17 OTHER ASSETS	Group 2012 £m	Group 2011 £m	Society 2012 £m	Society 2011 £m
Prepayments	1.8	1.9	1.6	1.8
Other Debtors	-	0.2	1.6	1.7
	1.8	**2.1**	**3.2**	**3.5**

Other debtors in the Society include amounts owed by subsidiary undertakings of £1.6 million (2011: £1.5 million).

Notes to the accounts

18 PROPERTY, PLANT AND EQUIPMENT	Group			Society		
	Land and buildings	Equipment, fixtures, fittings and vehicles	Total	Land and buildings	Equipment, fixtures, fittings and vehicles	Total
2012	£m	£m	£m	£m	£m	£m
Cost						
At 1 January 2012	13.8	12.8	26.6	11.9	12.5	24.4
Additions	0.5	1.6	2.1	0.5	1.6	2.1
AT 31 DECEMBER 2012	**14.3**	**14.4**	**28.7**	**12.4**	**14.1**	**26.5**
Depreciation						
At 1 January 2012	6.7	8.8	15.5	5.8	8.5	14.3
Charge for the year	0.4	0.9	1.3	0.4	0.9	1.3
AT 31 DECEMBER 2012	**7.1**	**9.7**	**16.8**	**6.2**	**9.4**	**15.6**
Net Book Value						
AT 31 DECEMBER 2012	**7.2**	**4.7**	**11.9**	**6.2**	**4.7**	**10.9**
2011						
Cost						
At 1 January 2011	11.6	9.5	21.1	9.7	9.2	18.9
Additions	2.5	3.4	5.9	2.5	3.4	5.9
Disposals	(0.3)	(0.1)	(0.4)	(0.3)	(0.1)	(0.4)
AT 31 DECEMBER 2011	**13.8**	**12.8**	**26.6**	**11.9**	**12.5**	**24.4**
Depreciation						
At 1 January 2011	6.4	8.1	14.5	5.6	7.8	13.4
Charge for the year	0.4	0.8	1.2	0.3	0.8	1.1
On disposals	(0.1)	(0.1)	(0.2)	(0.1)	(0.1)	(0.2)
AT 31 DECEMBER 2011	**6.7**	**8.8**	**15.5**	**5.8**	**8.5**	**14.3**
Net Book Value						
AT 31 DECEMBER 2011	**7.1**	**4.0**	**11.1**	**6.1**	**4.0**	**10.1**

	Group 2012	Group 2011	Society 2012	Society 2011
	£m	£m	£m	£m
The net book value of land and buildings comprises:				
Freehold	6.5	6.4	5.5	5.5
Short Leasehold	0.7	0.7	0.7	0.6
	7.2	**7.1**	**6.2**	**6.1**
The net book value of land and buildings occupied for own use:				
Building Society	5.8	5.7	5.8	5.7
Subsidiaries	1.0	1.0	-	-
Non - Group	0.4	0.4	0.4	0.4
	7.2	**7.1**	**6.2**	**6.1**

Notes to the accounts

19 INTANGIBLE ASSETS – SOFTWARE	Group			Society		
	Purchased Software £m	Developed Software £m	Total £m	Purchased Software £m	Developed Software £m	Total £m
2012						
Cost						
At 1 January 2012	6.5	9.3	15.8	6.4	9.3	15.7
Additions	0.3	2.1	2.4	0.3	2.1	2.4
AT 31 DECEMBER 2012	**6.8**	**11.4**	**18.2**	**6.7**	**11.4**	**18.1**
Amortisation						
At 1 January 2012	5.3	4.0	9.3	5.2	4.0	9.2
Charge for the year	0.4	1.2	1.6	0.4	1.2	1.6
AT 31 DECEMBER 2012	**5.7**	**5.2**	**10.9**	**5.6**	**5.2**	**10.8**
Net Book Value						
AT 31 DECEMBER 2012	**1.1**	**6.2**	**7.3**	**1.1**	**6.2**	**7.3**
2011						
Cost						
At 1 January 2011	6.4	8.0	14.4	6.3	8.0	14.3
Additions	0.1	1.3	1.4	0.1	1.3	1.4
AT 31 DECEMBER 2011	**6.5**	**9.3**	**15.8**	**6.4**	**9.3**	**15.7**
Amortisation						
At 1 January 2011	4.8	2.8	7.6	4.7	2.8	7.5
Charge for the year	0.5	1.2	1.7	0.5	1.2	1.7
AT 31 DECEMBER 2011	**5.3**	**4.0**	**9.3**	**5.2**	**4.0**	**9.2**
Net Book Value						
AT 31 DECEMBER 2011	**1.2**	**5.3**	**6.5**	**1.2**	**5.3**	**6.5**

Notes to the accounts

	Group 2012	Group 2011	Society 2012	Society 2011
20 DEFERRED TAX	**£m**	**£m**	**£m**	**£m**
Movement on deferred tax				
At 1 January	0.2	(0.3)	0.2	(0.6)
Statement of comprehensive income credit/(expense)	0.1	0.2	0.1	0.5
Recognised directly in other comprehensive income	-	0.3	-	0.3
AT 31 DECEMBER	**0.3**	**0.2**	**0.3**	**0.2**
The deferred tax charge in the statement of comprehensive income comprises the following temporary differences:				
Property, plant and equipment	0.1	-	0.1	-
IFRS transitional adjustment	0.2	0.2	0.2	0.2
Pensions and other post tax retirement benefits	0.1	-	0.1	-
Adjustment for prior years	(0.3)	(0.1)	(0.3)	0.2
Effect of change in tax rate	(0.1)	0.1	(0.1)	0.1
Other provisions	0.1	-	0.1	-
	0.1	**0.2**	**0.1**	**0.5**
Deferred income tax assets and liabilities are attributable to the following items:				
Deferred tax assets				
Pensions and other post retirement benefits	1.2	1.2	1.2	1.2
Other provisions	0.2	0.1	0.2	0.1
Tax losses carried forward	-	-	-	-
	1.4	**1.3**	**1.4**	**1.3**
Deferred tax liabilities				
IFRS transitional adjustments	0.6	0.9	0.6	0.9
Property, plant and equipment	0.5	0.2	0.5	0.2
	1.1	**1.1**	**1.1**	**1.1**

During the year the Government substantively enacted a reduction in the UK corporation tax rate to 23% with effect 1 April 2013. This will reduce the Group's future current tax charge accordingly. Deferred tax has been calculated at the corporation tax rates applicable to the financial years in which it is expected that the assets will be realised or other liabilities settled, being 23%.

On the 5 December 2012 the Government announced its intention to further reduce the UK corporation tax rate to 21% by 1 April 2014. It had been announced during the 2012 Budget that the main rate of corporation tax would reduce to 22% from 1 April 2014. It has not yet been possible to quantify the full anticipated effect of the announced further 1% rate reduction, although this will further reduce the Group's current tax charge and reduce the Group's deferred tax accordingly.

Group and Society	2012	2011
21 SHARES	**£m**	**£m**
Held by individuals	2,266.2	1,989.6
Fair value adjustment for hedged risk	1.8	0.2
	2,268.0	**1,989.8**

Group and Society	2012	2011
22 AMOUNTS OWED TO CREDIT INSTITUTIONS	**£m**	**£m**
Amounts owed to credit institutions	55.7	63.9
	55.7	**63.9**

Notes to the accounts

Group and Society	2012	2011
23 AMOUNTS OWED TO OTHER CUSTOMERS	£m	£m
Retail customers: Demand accounts	5.5	2.6
Local Authorities: Term deposits	68.0	87.8
Pension Funds/Insurers: Term deposits	13.4	17.3
Other		
Demand accounts	12.0	14.4
Term deposits	77.1	68.1
	176.0	190.2
Fair value adjustment for hedged risk	0.1	0.1
	176.1	**190.3**

Group and Society	2012	2011
24 DEBT SECURITIES IN ISSUE	£m	£m
Certificates of deposit	19.7	31.7
	19.7	**31.7**

	Group 2012	Group 2011	Society 2012	Society 2011
25 OTHER LIABILITIES AND ACCRUALS	£m	£m	£m	£m
Income tax	0.1	0.6	0.1	0.6
Accruals and deferred income	1.8	2.0	1.7	1.9
Other creditors	1.5	2.1	1.4	2.1
	3.4	**4.7**	**3.2**	**4.6**

	Group 2012	Group 2011	Society 2012	Society 2011
26 PROVISION FOR LIABILITIES	£m	£m	£m	£m
FSCS levy				
At 1 January	2.1	1.3	2.1	1.3
Charge for the year	2.0	1.4	2.0	1.4
Provision utilised	(0.7)	(0.6)	(0.7)	(0.6)
AT 31 DECEMBER	**3.4**	**2.1**	**3.4**	**2.1**
Customer redress and other related provisions				
At 1 January	0.2	0.1	0.2	0.1
Charge for the year	0.4	0.2	0.3	0.2
Provision utilised	(0.2)	(0.1)	(0.2)	(0.1)
AT 31 DECEMBER	**0.4**	**0.2**	**0.3**	**0.2**
TOTAL	**3.8**	**2.3**	**3.7**	**2.3**

Notes to the accounts

26 PROVISION FOR LIABILITIES – FSCS LEVY (CONTINUED)

In common with all regulated UK deposit takers, the Society pays levies to the FSCS to enable the FSCS to meet claims against it. The FSCS levy consists of two parts: a management expenses levy and a compensation levy. The management expenses levy covers the costs of running the scheme and the compensation levy covers the amount of compensation the scheme pays, net of any recoveries it makes using the rights that have been assigned to it. During 2008 and 2009 claims were triggered against the FSCS in relation to Bradford & Bingley plc, Kaupthing Singer and Friedlander, Heritable Bank plc, Landsbanki Islands hf, London Scottish Bank plc and Dunfermline Building Society.

The FSCS meets these current claims by way of loans received from HM Treasury. The terms of these loans were interest only for the first three years, and the FSCS seeks to recover the interest cost, together with ongoing management expenses, by way of annual management levies on members over this period.

The Society's FSCS provision reflects market participation up to the reporting date. £2.6m of the provision relates to the estimated management expense levy for the scheme years 2012/13 and 2013/14. This amount was calculated on the basis of the Society's current share of protected deposits taking into account the FSA's estimate of total management expense levies for each scheme year.

The management expenses levy for scheme year 2011/12, which formed part of the provision at 31 December 2011, was calculated using the agreed funding rate of 12 month LIBOR + 30bps. Following the expiry of the initial three year fixed interest term, extensive negotiations between HMT and FSCS resulted in an agreed funding rate of 12 month LIBOR + 100bps which is the rate that will be charged for the HMT loans for the period from 1 April 2012, on which the management expenses levy for scheme year 2012/13 and 2013/14 has been based.

In addition to the management levies, from scheme year 2013/14, triggered by participation in the market at 31 December 2012, the FSCS is to levy over three years the current estimated shortfall on capital loans outstanding of £802m. A further statement on 6 February 2013 confirmed that the 2013/14 compensation levy would be £363m due to increased uncertainty over the timing of recoveries due to FSCS. In common with the management expenses levy, the capital loan repayment was calculated on the basis of the Society's current share of UK protected deposits. The Society has therefore recognised a provision of £0.8m related to the compensation levy.

Customer redress and other related provisions

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

27 RETIREMENT BENEFIT OBLIGATIONS

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

The pension cost is assessed following the advice of a qualified independent actuary using the projected unit method. The latest funding review of the scheme was at 1 April 2011 and takes into account the closure of the scheme for future service accrual. This review showed that the market value of the scheme assets at 1 April 2011 was £35.4 million and that the actuarial value of those assets represented 90% of the benefits that had accrued to members after allowing for expected future increase in salaries.

An updated actuarial valuation at 31 December 2012 was carried out on a market value basis by a qualified independent actuary, as follows:

Group and Society	2012	2011
	%	%
Principal actuarial assumptions used were as follows:		
Discount rate	4.40	4.80
Expected return on plan assets	5.40	5.70
Rate of increase in salaries	3.25	4.25
Rate of increase in pensions	3.30	3.30
Inflation	3.00	3.25
The table below shows the assumptions used for expected life at 31 December (normal retirement age of 62).	**Years**	**Years**
Expected life at retirement for a new pensioner (yrs) - Male	27.0	26.6
Expected life at retirement for a new pensioner (yrs) - Female	28.7	28.4
Expected life at retirement in 20 years' time (yrs) – Male	29.9	29.5
Expected life at retirement in 20 years' time (yrs) - Female	30.8	30.6

Notes to the accounts

Group and Society	2012	2011
27 RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)	**£m**	**£m**
Fair value of scheme assets:		
As at 1 January	38.0	36.3
Expected return on pension scheme assets	2.1	2.4
Contributions by employer	0.6	1.3
Benefits paid	(2.3)	(1.3)
Actuarial gain/(loss)	1.3	(0.7)
AS AT 31 DECEMBER	**39.7**	**38.0**
Present value of defined benefit obligations:		
As at 1 January	(42.8)	(39.6)
Interest on pension scheme liabilities	(2.0)	(2.1)
Benefits paid	2.3	1.3
Experience gain/(loss) on liabilities	0.1	(0.3)
Actuarial (loss)	(2.4)	(2.1)
AS AT 31 DECEMBER	**(44.8)**	**(42.8)**
The amounts recognised in the statement of financial position are determined as follows:		
Present value of funded obligations	(44.8)	(42.8)
Fair value of plan assets	39.7	38.0
LIABILITY IN THE STATEMENT OF FINANCIAL POSITION	**(5.1)**	**(4.8)**
The actual return on plan assets was a gain of £3.4 million (2011: £1.7 million gain). The amounts recognised in the statement of comprehensive income are as follows:		
Amounts recognised in finance income		
Interest cost	(2.0)	(2.1)
Expected return on plan assets	2.1	2.4
TOTAL	**0.1**	**0.3**
Movement in the liability recognised in the statement of financial position:		
Opening defined benefit obligation	(4.8)	(3.3)
Total as above	0.1	0.3
Employer contributions	0.6	1.3
Actuarial (loss)	(1.0)	(3.1)
CLOSING DEFINED BENEFIT OBLIGATION	**(5.1)**	**(4.8)**
During 2012 the Group made additional contributions of £0.6 million (2011: £0.6 million) as part of its funding plan. The Group and Society expect to contribute £0.6 million to the fund during 2013.		
The amounts recognised in the statement of other comprehensive income are as follows:		
Actual return less expected return on plan assets	1.3	(0.7)
Experience gain/(loss) arising on scheme liabilities	0.1	(0.3)
Changes in assumptions underlying the present value of the scheme liabilities	(2.4)	(2.1)
ACTUARIAL (LOSS)	**(1.0)**	**(3.1)**

The cumulative amount recognised outside profit and loss at 31 December 2012 is an actuarial loss of £10.1m (2011: £9.1m).

Notes to the accounts

Group and Society	2012	2012	2011	2011
27 RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)	**Expected rate of return**	**£m**	**Expected rate of return**	**£m**
The major categories of plan assets and their expected rate of return are as follows:				
Equities	7.0%	16.4	7.0%	15.4
Bonds	4.3%	20.6	4.7%	19.5
Cash	2.0%	0.6	2.0%	0.1
Secured pensioners	4.4%	1.5	4.8%	1.3
Property	6.5%	0.6	6.5%	1.7
TOTAL		**39.7**		**38.0**

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

Group and Society	2012	2011	2010	2009	2008
	£m	**£m**	**£m**	**£m**	**£m**
Present value of defined benefit obligation	(44.8)	(42.8)	(39.6)	(38.2)	(30.1)
Fair value of plan assets	39.7	38.0	36.3	32.2	28.2
Plan (deficit)	(5.1)	(4.8)	(3.3)	(6.0)	(1.9)
Experience adjustments on plan liabilities	(0.1)	0.3	(0.9)	(0.1)	(0.7)
Percentage of scheme liabilities	0.2%	0.7%	2.3%	0.3%	2.3%

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

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

The pension charge for the period represents contributions payable by the Group and Society to the schemes and amounted for the Group to £0.5 million (2011: £0.4 million) and for the Society £0.5 million (2011: £0.4 million). There were no outstanding or prepaid contributions at either the beginning or end of the year.

Group and Society	2012	2011
28 SUBSCRIBED CAPITAL	**£m**	**£m**
7.875% sterling permanent interest bearing shares	23.9	23.9
Fair value adjustment for hedged risk	3.5	3.1
	27.4	**27.0**

The subscribed capital was issued for an indeterminate period and is only repayable in the event of the winding up of the Society. PIBS holders do not have any right to a residual interest in the Society and as such they have been classified as a debt instrument rather than equity.

	Group 2012	Group 2011	Society 2012	Society 2011
29 GENERAL RESERVES	**£m**	**£m**	**£m**	**£m**
At 1 January	143.6	140.7	144.1	141.1
Profit for the financial year	6.8	5.3	7.0	5.4
Net (loss) recognised directly in other comprehensive income	(0.8)	(2.4)	(0.8)	(2.4)
AT 31 DECEMBER	**149.6**	**143.6**	**150.3**	**144.1**

Notes to the accounts

Group and Society	2012	2011
30 AVAILABLE-FOR-SALE RESERVES	**£m**	**£m**
At 1 January	1.1	0.2
Net (loss)/gain from changes in fair value	(1.2)	0.9
AT 31 DECEMBER	**(0.1)**	**1.1**

Group and Society		2012	2011
31 CASH AND CASH EQUIVALENTS	**Notes**	**£m**	**£m**
Cash in hand	10	1.1	1.2
Loans and advances to credit institutions	11	349.7	169.2
Debt securities	12	-	20.0
AT 31 DECEMBER		**350.8**	**190.4**

32 FINANCIAL INSTRUMENTS

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

The Group has a formal structure for managing risk, including established risk limits, reporting lines, mandates, credit risk appetite and other control procedures. The board risk committee (BRC) is tasked with monitoring the Group's overall exposure to risk. Five sub committees, the assets and liabilities committee (ALCO), retail credit committee (RCC), operational risk committee (ORC), information security (ISC) and the conduct risk committee (CRC) monitor the individual areas of risk and report to the board risk committee quarterly.

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

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

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

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

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

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

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

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

The fair values of these hedges at 31 December 2012 are shown in note 13.

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

Summary terms and conditions and accounting policies of financial instruments

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

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

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

	Group					
Carrying values by category 31 December 2012	**Held at amortised cost**		**Held at fair value**			
	Loans and receivables	Financial assets and liabilities at amortised cost	Available-for-sale	Derivatives designated as fair value hedges	Unmatched derivatives	Total
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Financial assets						
Cash in hand	-	1.1	-	-	-	1.1
Loans and advances to credit institutions	374.2	-	-	-	-	374.2
Debt securities	-	-	181.0	-	-	181.0
Derivative financial instruments	-	-	-	23.3	-	23.3
Loans and advances to customers	2,129.9	-	-	-	-	2,129.9
Other assets	-	22.4	-	-	-	22.4
	2,504.1	**23.5**	**181.0**	**23.3**	**-**	**2,731.9**
Financial liabilities						
Shares	-	2,268.0	-	-	-	2,268.0
Amounts owed to credit institutions	-	55.7	-	-	-	55.7
Amounts owed to other customers	-	176.1	-	-	-	176.1
Debt securities in issue	-	19.7	-	-	-	19.7
Derivative financial instruments	-	-	-	21.2	0.6	21.8
Other liabilities	-	13.7	-	-	-	13.7
Subscribed capital	-	27.4	-	-	-	27.4
	-	**2,560.6**	**-**	**21.2**	**0.6**	**2,582.4**
Carrying values by category 31 December 2011						
Financial assets						
Cash in hand	-	1.2	-	-	-	1.2
Loans and advances to credit institutions	209.9	-	-	-	-	209.9
Debt securities	-	-	305.0	-	-	305.0
Derivative financial instruments	-	-	-	12.9	0.4	13.3
Loans and advances to customers	1,927.8	-	-	-	-	1,927.8
Other assets	-	21.0	-	-	-	21.0
	2,137.7	**22.2**	**305.0**	**12.9**	**0.4**	**2,478.2**
Financial liabilities						
Shares	-	1,989.8	-	-	-	1,989.8
Amounts owed to credit institutions	-	63.9	-	-	-	63.9
Amounts owed to other customers	-	190.3	-	-	-	190.3
Debt securities in issue	-	31.7	-	-	-	31.7
Derivative financial instruments	-	-	-	16.8	0.6	17.4
Other liabilities	-	13.4	-	-	-	13.4
Subscribed capital	-	27.0	-	-	-	27.0
	-	**2,316.1**	**-**	**16.8**	**0.6**	**2,333.5**

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

Fair values of financial assets and liabilities carried at amortised cost

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

	Group and Society	2012	2012	2011	2011
		Book value £m	Fair value £m	Book value £m	Fair value £m
Financial assets					
Cash in hand	a	1.1	1.1	1.2	1.2
Loans and advances to credit institutions	b	374.2	374.3	209.9	210.0
Loans and advances to customers	c	2,129.9	2,211.3	1,927.8	1,989.2
Financial liabilities					
Shares	d	2,268.0	2,300.5	1,989.8	2,027.6
Amounts owed to credit institutions	d	55.7	55.8	63.9	63.9
Amounts owed to other customers	d	176.1	178.4	190.3	191.0
Debt securities in issue	e	19.7	19.8	31.7	31.8
Subscribed capital	f	23.9	26.3	23.9	19.1

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

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

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

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

c) **Loans and advances to customers**
Loans and advances are recorded net of provisions for impairment together with the fair value adjustment for hedged items as required by IAS39. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received taking account of expected prepayment rates.

Estimated cash flows are discounted at prevailing money market rates for items of similar remaining maturity.

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

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

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

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

Fair values of financial assets and liabilities carried at fair value

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

Group	Notes	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
31 December 2012					
Financial assets					
Available-for-sale					
Debt securities	12	148.3	32.7	-	181.0
Derivative financial instruments					
Interest rate swaps	13	-	23.3	-	23.3
		148.3	**56.0**	**-**	**204.3**
Financial liabilities					
Derivative financial instruments					
Interest rate swaps	13	-	(21.8)	-	(21.8)
		-	**(21.8)**	**-**	**(21.8)**
31 December 2011					
Financial assets					
Available-for-sale					
Debt securities	12	-	305.0	-	305.0
Derivative financial instruments					
Interest rate swaps	13	-	13.3	-	13.3
		-	**318.3**	**-**	**318.3**
Financial liabilities					
Derivative financial instruments					
Interest rate swaps	13	-	(17.4)	-	(17.4)
		-	**(17.4)**	**-**	**(17.4)**

Valuation techniques

The fair value hierarchy detailed in IFRS 7: 'Financial Instrument Disclosures' 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 – During the year all UK government instruments and other bonds for which traded prices are readily available have been transferred from a Level 2 to Level 1 valuation basis. The valuation technique has been changed to ensure the fair value remains an accurate reflection of the true value of the instrument. Those debt securities for which there is no readily available traded price continue to be based on the 'present value' method. This requires expected future principal and interest cash flows to be discounted using prevailing LIBOR yield curves. The LIBOR yield curves are generally observable market data which is derived from quoted interest rates in similar time bandings which match the timings of the cash flows and maturities of the instruments.
- Interest rate swaps - the valuation of interest rate swaps is also based on the 'present value' method. Expected interest cash flows are discounted using the prevailing LIBOR yield curves. The LIBOR yield curves are generally observable market data which is derived from quoted interest rates in similar time bandings which match the timings of the interest cash flows and maturities of the instruments.

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk

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

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

Group and Society	2012	2011
Credit risk exposure	**£m**	**£m**
Cash in hand	1.1	1.2
Loans and advances to credit institutions	374.2	209.9
Debt securities	180.9	303.5
Derivative financial instruments	23.3	13.3
Loans and advances to customers	2,111.0	1,913.6
Total statement of financial position exposure	2,690.5	2,441.5
Off balance sheet exposure – mortgage commitments	64.4	64.2
TOTAL	**2,754.9**	**2,505.7**

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

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

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

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

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

Group	2012	2012	2011	2011
Industry sector	**£m**	**%**	**£m**	**%**
Banks	152.3	27.4	233.2	45.2
Building Societies	31.2	5.6	44.2	8.6
Multilateral Development Banks	31.9	5.7	50.2	9.7
Central Government	340.9	61.3	188.5	36.5
TOTAL	**556.3**		**516.1**	

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

Group	2012	AAA	AA	A	Other	2011
Geographic region	**£m**	%	%	%	%	**£m**
United Kingdom	466.4	73.1	5.0	14.0	7.9	345.8
Multilateral Development banks	31.9	100.0	-	-	-	50.2
France	2.9	-	-	100.0	-	3.0
Germany	-	-	-	-	-	5.0
Netherlands	-	-	-	-	-	15.8
Canada	-	-	-	-	-	25.0
United States of America	5.2	-	-	100.0	-	-
Australia	44.8	-	100.0	-	-	59.8
Japan	5.1	-	-	100.0	-	11.5
TOTAL	**556.3**					**516.1**

'Other' relates to investments in unrated Building Societies.

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

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

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

Group	2012	AAA	AA	A	2011
Geographic region	**£m**	%	%	%	**£m**
United Kingdom	1,372.8	-	-	100.0	1,385.5
Eurozone	-	-	-	-	38.0
Other Western Europe	2.0	-	-	100.0	4.0
TOTAL	**1,374.8**				**1,427.5**

b) Loans and advances to customers

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

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

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

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

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

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

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

The maximum credit risk exposure is disclosed in table on page 64.

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

Loans and advances to customers are predominately made up of retail loans fully secured against UK residential property (£2,043.3 million), split between residential and buy-to-let loans with the remaining £71.6 million being secured on commercial property.

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

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

Group and Society	2012	2011
Geographical analysis	**£m**	**£m**
Eastern	10.1	9.4
East Midlands	23.5	25.2
London	10.7	10.4
North East	2.9	2.8
North West	8.5	8.5
South East	13.9	12.8
South West	7.8	7.4
Wales	2.5	2.7
West Midlands	8.1	8.0
Yorkshire & Humberside	11.7	12.4
Other	0.3	0.4

Retail loans

Loans fully secured on residential property are split between residential and buy to let. The average loan to value (LTV) is the mean LTV for the portfolio. Each individual LTV is calculated by comparing the value of the mortgage loan to the value of collateral held adjusted by a house price index.

The average LTV of residential mortgages is 55% (2011: 51%) with the increase due to a combination of a small reduction in house values and as a consequence of us continuing to support home buyers with smaller deposits. All loans above 80% LTV are insured with a Lloyds of London insurance firm.

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

Group and Society	2012	2011
LTV analysis	**%**	**%**
Residential		
0% - 30%	8	10
30% - 60%	17	20
60% - 80%	33	34
80% - 90%	31	28
90% - 100%	9	7
> 100%	2	1
Average loan to value of residential mortgage loans	55	51
Average loan to value of new business	78	80
Buy-to-let		
0% - 30%	-	1
30% - 60%	8	8
60% - 80%	72	64
80% - 90%	12	17
90% - 100%	7	10
> 100%	1	-
Average loan to value of buy-to-let loans	74	74
Average loan to value of new business	72	72

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

The quality of the Group's retail mortgage book is reflected in the number and value of accounts in arrears. By volume 0.60% (2011: 0.72%) of loans are three months or more in arrears and by value it is 0.48% (2011: 0.63%). There has been a reduction during 2012 due to prudent underwriting combined with effective arrears management activities. The outcome is that the Group's arrears performance remains less than half the industry average at 31 December 2012.

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

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

Group and Society	2012	2012	2011	2011
Arrears analysis	**£m**	**%**	**£m**	**%**
Not impaired:				
Neither past due or impaired	2,011.2	98.43	1,807.4	97.91
Past due up to 3 months but not impaired	17.3	0.85	22.6	1.22
Past due over 3 months but not impaired	3.6	0.17	3.5	0.19
Possessions	0.3	0.02	0.2	0.01
Impaired:				
Not past due	1.2	0.06	0.6	0.03
Past due up to 3 months	3.6	0.17	4.1	0.22
Past due 3 to 6 months	3.4	0.17	3.4	0.18
Past due 6 to 12 months	1.6	0.08	2.8	0.15
Past due over 12 months	0.3	0.01	0.4	0.02
Possessions	0.8	0.04	1.2	0.07
	2,043.3		**1,846.2**	
	Indexed	Unindexed	Indexed	Unindexed
Value of Collateral held:	**£m**	**£m**	**£m**	**£m**
Neither past due or impaired	3,523.6	3,440.7	3,438.4	3,257.7
Past due but not impaired	44.1	40.1	53.1	48.1
Impaired	12.4	13.6	14.8	16.2
	3,580.1	**3,494.4**	**3,506.3**	**3,322.0**

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

With collateral capped to the amount of outstanding debt, the value of collateral held against loans 'Past due but not impaired' at 31 December is £21.2m (2011: £26.2m) against outstanding debt of £21.2m (2011: £26.3m). In addition, the value of collateral held against 'Impaired' assets at 31 December is £10.5m (2011: £12.4m) against outstanding debt of £10.9m (2011: £12.5m).

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

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

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

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

Forbearance

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

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

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

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

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

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

Regular monitoring of the level and different types of forbearance activity are reviewed by the retail credit committee (RCC) on a bimonthly basis. In addition the conduct risk committee monitors the level of arrears and forbearance cases. In addition all forbearance arrangements are reviewed and discussed with the customer on a regular basis to assess the ongoing potential risk to the Society and suitability of the arrangement for the customer.

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

Group and Society	2012	2011
Type of Forbearance	**Number**	**Number**
Interest only concessions	37	135
Reduced payment concessions	18	-
Payment plans	102	75
Capitalisations	41	27
Mortgage term extensions	55	23
Less: cases with more than one form of forbearance	(55)	(25)
TOTAL	**198**	**235**

These are covered by an individual impairment provision of £0.4m (2011: £0.3m).

In total £3.6m (2011: £7.9m) of loans that would be past due are subject to forbearance.

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

Secured Business Loans

Secured Business Loans (SBL) are primarily made available to Small and Medium sized enterprises for either owner occupied or investment property purposes. Loans are also only granted against the 'bricks and mortar' of the property and not against working capital or machinery etc. The make up of the SBL book at 31 December is as follows:

Group and Society	2012	2012	2011	2011
	£m	%	£m	%
Owner occupied	41.0	57.3	42.5	60.2
Investment property	30.6	42.7	28.1	39.8
	71.6		70.6	

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

Group and Society	2012	2011
SBL LTV analysis	%	%
0% - 30%	3	3
30% - 60%	23	23
60% - 80%	47	45
80% - 90%	27	29
90% - 100%	-	-
> 100%	-	-
Average loan to value of SBL	63	64
Average loan to value of new business	53	50

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

Group and Society	2012	2012	2011	2011
Arrears analysis	£m	%	£m	%
Not impaired:				
Neither past due or impaired	66.0	92.17	65.3	92.49
Past due up to 3 months but not impaired	1.3	1.81	2.3	3.26
Past due over 3 months but not impaired	-	-	0.4	0.57
Impaired:				
Not past due	0.5	0.72	1.4	1.98
Past due up to 3 months	3.1	4.32	0.4	0.57
Past due 3 to 6 months	0.2	0.28	0.5	0.71
Past due 6 to 12 months	0.4	0.56	0.3	0.42
Past due over 12 months	-	-	-	-
Possessions	0.1	0.14	-	-
	71.6		70.6	
Fair value of collateral held:				
Neither past due or impaired	115.4		110.0	
Past due but not impaired	2.0		3.7	
Impaired	4.3		2.2	
	121.7		115.9	

Collateral reflects the latest valuation. If a property has had a desktop valuation since the latest full valuation, the collateral reflects the desktop valuation (42% of the SBL book have had a desktop valuation). With collateral capped to the amount of outstanding debt, the value of collateral held against loans 'Past due but not impaired' at 31 December is £1.3m (2011: £2.7m) against outstanding debt of £1.3m (2011: £2.7m). In addition, the value of collateral held against 'Impaired' assets at 31 December is £3.8m (2011: £2.1m) against outstanding debt of £4.3m (2011: 2.6m).

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

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

In terms of SBL risk, the single largest borrower represents less than 2.0% (2011: 2.1%) of the SBL mortgage book. SBL assets totalling £4.3 million (2011: £2.8m) have individual provisions against them.

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

Forbearance

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

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

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

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

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

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

Group and Society	2012	2011
Type of Forbearance	**Number**	**Number**
Interest only concessions	3	3
Re-negotiation of contractual payment	4	-
Payment plans	2	-
Capitalisations	1	1
Mortgage term extensions	-	1
TOTAL	**10**	**5**

These loans are covered by the £0.6m (2011: £0.5m) collective provision.

£2.2m (2011:£1.0m) of loans that would be past due or impaired are subject to forbearance.

Liquidity risk

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

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

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

The Group maintains a high proportion of its total liquidity portfolio, in excess of its regulatory requirements, in high quality liquid assets primarily in a reserve account at the Bank of England and in UK Gilts. At the end of the year the ratio of liquid assets to shares, deposits and other liabilities was 22.1% compared to 22.7% at the end of 2011.

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

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

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

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

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

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

	Group					
Residual maturity as at 31 December 2011	On demand	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	More than five years	Total
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Financial assets						
Liquid assets						
Cash in hand	1.2	-	-	-	-	1.2
Loans and advances to credit institutions	137.2	54.6	18.1	-	-	209.9
Debt securities	-	76.2	107.1	121.7	-	305.0
Total liquid assets	138.4	130.8	125.2	121.7	-	516.1
Derivative financial instruments	-	1.1	4.9	4.2	3.1	13.3
Loans and advances to customers	4.3	13.0	44.8	274.0	1,591.7	1,927.8
Other assets	-	1.1	1.9	0.4	17.6	21.0
	142.7	**146.0**	**176.8**	**400.3**	**1,612.4**	**2,478.2**
Financial liabilities and reserves						
Shares	640.4	433.3	216.5	699.6	-	1,989.8
Amounts owed to credit institutions	3.2	43.6	17.1	-	-	63.9
Amounts owed to other customers	22.1	94.6	64.5	9.1	-	190.3
Debt securities in issue	-	4.0	27.7	-	-	31.7
Derivative financial instruments	0.4	0.3	3.0	13.7	-	17.4
Other liabilities	1.3	2.5	2.1	2.7	4.8	13.4
Subscribed capital	-	-	0.1	-	26.9	27.0
Reserves	-	-	-	-	144.7	144.7
	667.4	**578.3**	**331.0**	**725.1**	**176.4**	**2,478.2**
NET LIQUIDITY GAP	**(524.7)**	**(432.3)**	**(154.2)**	**(324.8)**	**1,436.0**	**-**

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

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

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

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

	Group					
31 December 2012	Repayable on demand	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	More than five years	Total
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Shares	772.8	432.2	640.2	467.2	-	2,312.4
Amounts owed to credit institutions	1.2	48.0	5.6	1.0	-	55.8
Amounts owed to other customers	18.4	84.6	47.7	30.8	-	181.5
Debt securities in issue	-	5.1	14.8	-	-	19.9
Derivative financial instruments	-	0.2	1.5	35.8	-	37.5
Subscribed capital	-	0.5	1.5	7.9	23.9	33.8
TOTAL LIABILITIES	**792.4**	**570.6**	**711.3**	**542.7**	**23.9**	**2,640.9**
31 December 2011						
Shares	665.6	448.8	220.4	745.0	-	2,079.8
Amounts owed to credit institutions	3.2	43.7	17.2	-	-	64.1
Amounts owed to other customers	22.0	94.8	65.4	9.5	-	191.7
Debt securities in issue	-	4.1	27.9	-	-	32.0
Derivative financial instruments	-	0.8	5.4	36.3	1.3	43.8
Subscribed capital	-	0.5	1.5	7.9	23.9	33.8
TOTAL LIABILITIES	**690.8**	**592.7**	**337.8**	**798.7**	**25.2**	**2,445.2**

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

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

Market risk

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

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

The management of interest rate risk is based on a full statement of financial position gap analysis. The statement of financial position is subjected to a stress test of a 2% rise in interest rates on a weekly basis and the results are reported to the monthly ALCO meeting. In addition management review interest rate basis risk. Both sets of results are measured against the risk appetite for market risk which is currently set at a maximum of 5% of capital. These are in turn reviewed monthly by the ALCO and reported to the board risk committee.

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

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

Notes to the accounts

32 FINANCIAL INSTRUMENTS (CONTINUED)

	Group					
Interest rate risk as at 31 December 2011	Not more than three months	More than three months but not more than one year	More than one year but not more than five years	More than five years	Non interest bearing	Total
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Financial assets						
Cash in hand	-	-	-	-	1.2	1.2
Loans and advances to credit institutions	191.6	17.0	-	-	1.3	209.9
Debt securities	152.4	76.8	74.4	-	1.4	305.0
Derivative financial instruments	-	-	-	-	13.3	13.3
Loans and advances to customers	716.3	387.8	801.4	7.7	14.6	1,927.8
Other assets	-	-	-	-	21.0	21.0
	1,060.3	**481.6**	**875.8**	**7.7**	**52.8**	**2,478.2**
Financial liabilities and reserves						
Shares	854.7	423.4	690.3	-	21.4	1,989.8
Amounts owed to credit institutions	62.3	-	-	-	1.6	63.9
Amounts owed to other customers	113.6	67.5	9.1	-	0.1	190.3
Debt securities in issue	8.1	9.0	14.6	-	-	31.7
Derivative financial instruments	-	-	-	-	17.4	17.4
Other liabilities	-	-	-	-	13.4	13.4
Subscribed capital	-	-	-	23.9	3.1	27.0
Reserves	-	-	-	-	144.7	144.7
	1,038.7	**499.9**	**714.0**	**23.9**	**201.7**	**2,478.2**
Impact of derivative instruments	358.2	(144.4)	(91.1)	(123.2)	0.5	-
Interest rate sensitivity gap	**379.8**	**(162.7)**	**70.7**	**(139.4)**	**(148.4)**	**-**
Sensitivity to profit and reserves						
Parallel shift of +1%	(0.4)	1.5	(2.3)	2.0	-	0.8
Parallel shift of +2%	(0.8)	3.1	(4.7)	4.0	-	1.6

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

The Group is not exposed to foreign currency risk.

Notes to the accounts

33 CAPITAL STRUCTURE

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

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

a) **Lending and Business Decisions -** The Group uses application scorecards to help it assess whether mortgage applications fit within its appetite for credit risk. Once loan funds have been advanced behavioural scorecards are used to review the ongoing risk profile of both the portfolio's and individual customers. In addition, for residential and buy-to-let mortgages property values are updated on a quarterly basis.

b) **Pricing -** Pricing models are utilised for all mortgage product launches. The models include expected loss estimates and capital utilisation enabling the calculation of a risk adjusted return on capital.

c) **Concentration risk -** The design of retail products takes into account the overall mix of products to ensure that exposure to market risk remains within permitted parameters.

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

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

The Group's capital requirements are set and monitored by the Financial Services Authority (FSA). During 2012 the Group has continued to comply with the EU Capital Requirements Directive (Basel II). Once finalised, the Group will be required to comply with Basel III. Further details of the Basel III requirements and their impact on the Group are provided in the Risk Management report on page 25.

Regulatory capital is analysed into two tiers:

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

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

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

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

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

	Note	Group 2012	Group 2011	Society 2012	Society 2011
Tier 1 capital		£m	£m	£m	£m
General reserves	29	149.6	143.6	150.3	144.1
Subscribed capital	28	23.9	23.9	23.9	23.9
Less: Intangibles	19	(7.3)	(6.5)	(7.3)	(6.5)
TOTAL TIER 1 CAPITAL		**166.2**	**161.0**	**166.9**	**161.5**
Tier 2 Capital					
Collective provision		1.0	0.9	1.0	0.9
TOTAL TIER 2 CAPITAL		**1.0**	**0.9**	**1.0**	**0.9**
TOTAL TIER 1 AND TIER 2 CAPITAL		**167.2**	**161.9**	**167.9**	**162.4**
Less: Investments in subsidiary undertakings		-	-	(1.6)	(1.5)
TOTAL REGULATORY CAPITAL		**167.2**	**161.9**	**166.3**	**160.9**

Under Basel II Pillar 3 the Society is required to publish further information regarding its capital position and exposures.

The Society's Pillar 3 disclosures are available on our website www.thenottingham.com

Notes to the accounts

34 GUARANTEES AND FINANCIAL COMMITMENTS

a) The Society guarantees its subsidiaries' bank overdrafts; at the year end this was £nil (2011: £nil).

	Group 2012	Group 2011	Society 2012	Society 2011
b) Capital commitments	**£m**	**£m**	**£m**	**£m**
Capital expenditure contracted for but not provided for in the accounts	-	0.5	-	0.5
c) Leasing commitments				
The total of future minimum lease payments under non-can operating leases are payable as follows:				
Land and buildings:				
Commitments expiring:				
Less than one year	-	0.1	-	0.1
Between one year and five years	0.3	0.6	0.3	0.6
In more than five years	1.6	0.8	1.6	0.8
Other:				
Commitments expiring:				
Less than one year	-	-	-	-
Between one year and five years	0.2	0.2	0.1	0.1
	2.1	**1.7**	**2.0**	**1.6**

35 RELATED PARTY TRANSACTIONS

a) Transaction with Group companies

Nottingham Building Society holds a 100% share in Nottingham Property Services (NPS) and Nottingham Mortgage Services (NMS).

During the normal course of business the following transactions were undertaken during the year:

Society	2012	2011
	£m	**£m**
Management charges paid by NPS	0.3	0.3
Fees and commissions paid to NPS	(0.1)	(0.1)
	0.2	**0.2**

Details of the intercompany debtor are disclosed in note 17.

b) Key management personnel compensation

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

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

Group and Society	2012	2011
	£m	**£m**
Short term employee benefits	1.1	1.0
	1.1	**1.0**

Notes to the accounts

35 RELATED PARTY TRANSACTIONS (CONTINUED)

c) Transactions with key management personnel, and their close family members with Nottingham Building Society.

The following transactions were undertaken through the normal course of business:

Group and Society	Number of key management personnel and their close family members	Amounts in respect of key management personnel and their close family members	Number of key management personnel and their close family members	Amounts in respect of key management personnel and their close family members
	2012	**2012**	**2011**	**2011**
Loans and advances		**£m**		**£m**
Net movements in the year		-		-
Balances outstanding 31 December	-	-	-	-
Deposits, share accounts and investments				
Net movement in the year		(0.3)		0.2
Balances outstanding 31 December	13	0.4	11	0.7

Key management personnel and members of close family paid interest totalling £nil (2011: £nil), and received interest totalling £19,000 (2011: £17,000) during the year.

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

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

d) Directors' loans and transactions

At 31 December 2012 there were no outstanding mortgage loans (2011: £nil) made in the ordinary course of business to directors and their connected persons. A register is maintained at the head office of the Society which shows details of all loans, transactions and arrangements with directors and their connected persons. A statement of the appropriate details contained in the register, for the financial year ended 31December 2012, will be available for inspection at the head office for a period of 15 days up to and including the annual general meeting.

36 POST BALANCE SHEET EVENTS

On 31 January 2013, the Group announced the acquisition of two companies Harrison Murray Ltd and Harrison Murray Commercial Ltd (HMC) for cash consideration of £6 million. On the 18 February 2013 the trade and assets of a third company AMS were purchased. In addition the trade and assets relating to Lettings within HMC were hived across to an existing group subsidiary. HMC was then sold to a third party.

Name of subsidiary undertaking	Principal business activity	Date of acquisition	Percentage of ownership interest	Cost £m	Goodwill arising £m
Harrison Murray Ltd	Estate Agents	31 January 2013	100%	5.5	4.7
Harrison Murray Commercial Ltd	Lettings & Surveying	31 January 2013	100%	0.5	0.5
TOTAL				**6.0**	**5.2**

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

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

Notes to the accounts

36 POST BALANCE SHEET EVENTS (CONTINUED)

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

The disclosures have been determined on a provisional basis because the fair values assigned to the acquirees' identifiable assets and liabilities have not been finalised at the time of signing the accounts.

The provisional net assets of subsidiaries acquired are as follows:

	Book values of assets acquired	Fair value adjustments	Total
	£m	£m	£m
Cash consideration			6.0
Property, plant and equipment	1.1	(0.3)	0.8
Debtors	0.4	-	0.4
Cash	0.6	-	0.6
Liabilities	(1.0)	-	(1.0)
NET ASSETS	**1.1**	**(0.3)**	**0.8**
GOODWILL			**5.2**

Other than the Property, plant and equipment there are no other significant net assets that will give rise to fair value adjustments.

The costs related to the acquisition are included within Group administrative expense within the statement of comprehensive income.

Annual business statement

For the year ended 31 December 2012

1. Statutory percentages	2012	Statutory limit
	%	%
Lending limit		
Proportion of business assets not in the form of loans fully secured on residential property	5.31	25
Funding limit		
Proportion of shares and borrowings not in the form of shares held by individuals	10.05	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	2012	2011
	%	%
As a percentage of shares and borrowings		
Gross capital	7.02	7.54
Free capital	6.31	6.81
Liquid assets	22.08	22.68
As a percentage of mean total assets		
Profit after taxation	0.26	0.22
Management expenses (Group)	0.87	0.89
Management expenses (Society)	0.81	0.84

'Shares and borrowings' are the aggregate of 'shares', 'amounts owed to credit institutions', 'amounts owed to other customers' and 'debt securities in issue' in the Group statement of financial position.

'Gross capital' is the aggregate of subscribed capital and aggregated reserves as shown in the Group statement of financial position.

'Free capital' is gross capital plus collective impairment for losses on loans and advances (note 15) less property, plant and equipment and intangible assets in the Group statement of financial position.

'Mean total assets' are calculated by halving the aggregate of total assets at the beginning and end of the financial year for the Group/Society.

'Liquid assets' are the first three items on the asset side of the Group statement of financial position.

'Management expenses' are the aggregate of administrative expenses and depreciation and amortisation taken from the Group/Society statements of comprehensive income.

Annual business statement

For the year ended 31 December 2012

3. Information about the directors at 31 December 2012:

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

Correspondence to directors jointly or individually should be addressed 'Private and Confidential' and c/o KPMG Audit Plc, One Snowhill, Snow Hill, Queensway, Birmingham B4 6GH.

Annual business statement

For the year ended 31 December 2012

3. Information about the directors at 31 December 2012 (continued):

Directors' service contracts:

David Marlow entered into his contract as Chief Executive on 21 February 2011, however, he has been a Director of the Society since 16 January 2006. Ashraf Piranie entered into his current contract as Deputy Chief Executive and Finance Director on 21 February 2011 however, he has been a Director of the Society since 16 April 2007. Simon Taylor entered into his contract as Operations Director on 1 February 2011. All contracts are terminable at any time by the Society on 12 months' notice and by the individual on six months' notice. All the contracts are reviewed annually in June.

Officers:

D. R. Watts, LLB Group Secretary	**L. E. Giddings, DMS, MCMI** Head of Branch Network	**A. J. Lumby, BA (Hons), FCA** Head of Finance
A. M. Bayes, BCom (Hons) Head of Marketing	**M. J. W. Griffin** Treasurer	**S. J. Owen, MBA** Head of Business Development
J. A. Cutts, MSc Head of Information Technology	**T. M. Hayton-Banks MBA** Head of Customer Services	**S. Rudkin, BSc (Hons), ACMA, MCT** Head of Treasury Risk
A. S. E. Doll, CFIIA, QiCA, Head of Internal Audit	**C. L. Jones, FCIPD, Ch.Occ.Psych.** Head of Human Resources	

D.R. Watts holds directorships for:

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

Auditor:

KPMG Audit Plc, One Snowhill, Snow Hill Queensway, Birmingham, B4 6GH

Bankers:

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

Solicitors:

Nelsons Solicitors, 8 Stanford Street, Nottingham

Glossary

Set out below are the definitions of the terms used within the Annual Report and Accounts to assist the reader and to facilitate comparison with other financial institutions:

Arrears	A customer is in arrears when they are behind in meeting their contractual obligations with the result that an outstanding loan payment is overdue. The value of the arrears is the value of any payments that have been missed.
Basel II	Basel II is the second of the Basel Accords, issued by the Basel Committee on Banking Supervision, which defines the methods by which firms should calculate their regulatory capital requirements to retain sufficient capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive, and was implemented in the UK via the FSA Handbook.
Basel III	The Basel Committee on Banking Supervision issued the Basel III rules text in December 2010, which presents the details of strengthened global regulatory standards on bank capital adequacy and liquidity. It is expected that Basel III will be implemented progressively across the EU (and elsewhere) between 2013 and 2019.
Buy to let loans	Buy to let loans are those loans which are offered to customers buying residential property specifically to let out.
Contractual maturity	The date at which a loan or financial instrument expires, at which point all outstanding principal and interest has been paid.
Core Tier 1 capital	The FSA specifically defines what can be included as Core Tier 1 Capital. In respect of the Society this equates to its General Reserves.
Credit risk	This is the risk that a customer or counterparty fails to meet their contractual obligations.
Debt securities	Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings excluding those issued by central banks.
Debt securities in issue	Transferable certificates of indebtedness of the Society to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit.
Derivative financial instruments	A derivative financial instrument is a contract between two parties whose value is based on an underlying price or index rate it is linked to, such as interest rates, exchange rates of stock market indices. The Society uses derivative financial instruments to hedge its exposure to interest rates.
Effective interest rate method (EIR)	The method used to measure the carrying value of a financial asset or liability and to allocate associated interest income or expense over the relevant period. The calculation includes all fees and penalties paid and received between parties which are integral to the contract.
Fair value	Fair value is the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
Financial Services Compensation Scheme	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every firm authorised by the FSA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.
Forbearance strategies	Strategies to support borrowers in financial difficulty, such as agreeing a temporary reduction in the monthly payment, extending mortgage terms and a conversion to an interest-only basis. The aim of forbearance strategies is to avoid repossession.
Free Capital	The aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment and intangible assets.
Funding Limit	Measures the proportion of shares and borrowings (excluding the fair value adjustment for hedged risk) not in the form of shares held by individuals. The calculation of the funding limit is explained in the Annual Business Statement.
General reserves	The accumulation of the Society's historic and current year profits which is the main component of Tier 1 Capital.
Gross capital	The aggregate of general reserves, available for sale reserves and subscribed capital.
Impaired loans	Loans where there is objective evidence that an impairment event has occurred, meaning that the Society does not expect to collect all the contractual cash flows or expect to collect them later than they are contractually due.
Individually/collectively assessed impairment	Individual assessments are made of all mortgage loans where objective evidence indicates losses are likely or the property is in possession. A collective impairment provision is made against the remaining group of loans and advances where objective evidence indicates that it is likely that losses may be realised.
Interest rate risk	The risk of loss due to a change in market interest rates. Interest rate risk can have an impact on Society's mortgages and savings products.

Glossary (continued)

Internal Capital Adequacy Assessment Process (ICAAP)	The Society's own assessment, as part of Basel II requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements for risks it faces under a business as usual scenario including stress events.
Lending limit	Measures the proportion of business assets not in the form of loans fully secured on residential property.
Liquid Assets	Total of cash in hand, loans and advances to credit institutions, and debt securities.
Liquidity risk	Liquidity risk is the risk that the Society is unable to meet its financial obligations as they fall due, or can only secure them at excessive cost. This risk arises from timing mismatches of cash inflows and outflows.
Loan to value (LTV)	LTV expresses the amount of a mortgage as a percentage of the value of the property.
Loans past due	Loans are past due when a loan payment that has not been made as of its due date.
Management expenses	The aggregate of administrative expenses, depreciation and amortisation. The management expense ratio is management expenses expressed as a percentage of mean total assets.
Market risk	The risk that movements in market risk factors, including foreign exchange rates, interest rates, credit spreads and customer-driven factors will create potential losses or decrease the value of the Society balance sheet.
Mean total assets	Represents the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
Member	A person who has a share investment or a mortgage loan with the Society.
Net interest income	The difference between interest receivable on assets and similar income and interest paid on liabilities and similar charges.
Operational risk	The risk of loss arising from inadequate or failed internal processes, people and systems, or from external events.
Permanent interest bearing shares (PIBS)	Unsecured, deferred shares of the Society that are a form of Tier 1 capital. PIBS rank behind the claims of all depositors, payables and investing members of the Society. PIBS are also known as subscribed capital.
Renegotiated loans	Loans are classed as renegotiated where an agreement between a borrower and a lender has been made to modify the loan terms either as part of an on-going relationship or if the borrower is in financial difficulties. The renegotiated loan may no longer be treated as past due or impaired.
Risk appetite	The articulation of the level of risk that the Society is willing to accept (or not accept) in order to safeguard the interests of the Society's members whilst also achieving business objectives.
Risk weighted assets (RWA)	The value of assets, after adjustment, under the relevant Basel II capital rules to reflect the degree of risk they represent.
Residential loans	Loans that are loaned to individuals rather than institutions. Residential mortgage lending is secured against residential property.
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.
Tier 1 capital	A measure of financial strength as defined by the FSA. Comprises general reserves from retained profits and permanent interest bearing shares (PIBS), less intangible assets and other regulatory adjustments.
Tier 2 capital	Comprises the collective impairment allowance (for exposures treated on a Basel II Standardised basis), less certain regulatory deductions.
Tier 1 ratio	Tier 1 capital as a percentage of risk weighted assets.
Underlying profit	Profit before tax adjusted to exclude derivative fair value movements and the FSCS levy.
Wholesale funding	The total of amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.

Notes

Notes

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

LIT1873/0313