The Nottingham

Nottingham Building Society

Basel II - Pillar 3 Disclosures 2013

Contents

1. Overview

1.1 Background

The Basel Committee on Banking Supervision introduced the Basel II framework (Basel II) for calculating how much capital all banks and building societies must hold to protect their members, depositors and shareholders. The EU Capital Requirements Directive (CRD) is the means by which Basel II was implemented in the EU at the beginning of 2007. In the UK it was implemented by our regulator the Financial Services Authority (FSA), now the Prudential Regulation Authority (PRA).

The Basel II framework consists of regulatory requirements that fall within 3 pillars:

Pillar 1 – Sets out the regulatory minimum capital requirements for credit, operational and market risk.

Pillar 2 – Supervisory review process which assesses whether additional capital should be held for those risks not captured under Pillar 1.

Pillar 3 – Sets out the disclosure requirements for firms to publish key information about their underlying risks, capital and risk management. These are aimed at promoting market discipline and complement Pillar 1 and Pillar 2.

The Nottingham adopted Pillar 1 from 1 January 2008. It also became subject to the Pillar 2 and Pillar 3 regimes from that date.

1.2 Basis and Frequency of Disclosures

This document forms a key part of The Nottingham's compliance with the PRA's Pillar 3 policy on disclosure. This policy requires The Nottingham to disclose a range of key information, such as material risk exposures, risk management processes and capital, the aim being to promote management discipline via enhanced external reporting.

All figures within this document are correct as at 31 December 2013 unless otherwise stated. Future Pillar 3 disclosures will be issued annually and are published as soon as practicable following the publication of the Annual Report and Accounts.

1.3 Location and Verification

These disclosures and the Annual Report and Accounts are published on the Nottingham's website (www.thenottingham.com).

These disclosures have been reviewed and approved by the Board. The disclosures are not subject to external audit; however, some of the information within the disclosures also appears in the Society's audited 2013 Annual Report and Accounts.

1.4 Scope of Application

The disclosure requirements in this document apply to Nottingham Building Society (“the Society”) only. For prudential purposes the Society is shown on an unconsolidated basis.

PRA number: 200785

The principal office of the Society is Nottingham House, 3 Fulforth Street Nottingham NG1 3DL.

The trading subsidiaries of the Society (consolidated for financial statement purposes only) are:

Name of Subsidiary	Ownership	Nature of business
Harrison Murray Ltd	100%	Estate Agency
HM Lettings Ltd	100%	Lettings
Nottingham Mortgage Services Ltd	100%	Mortgage Broker
Nottingham Property Services Ltd	100%	Estate Agency
The Mortgage Advice Centre (East Midlands) Limited	100%	Mortgage Broker

There are no current or foreseen material, practical or legal impediments to the prompt transfer of capital resources or repayment of liabilities among Nottingham Building Society and its subsidiaries.

2. Risk Management Objectives and Policies

2.1 Introduction

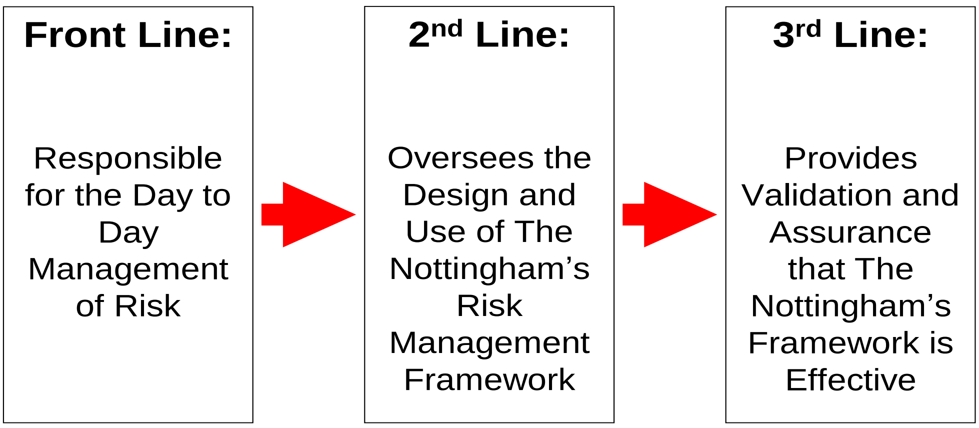
The Nottingham recognises risk as a natural consequence of its business activities and environment. Through prudent management it aims to manage risk in a manner that supports achievement of its strategic objectives and business plans whilst protecting members' interests and its financial resources. It also ensures ongoing compliance with the prevailing regulatory framework and best practice relating to risk management and corporate governance.

2.2 Risk Management Framework

The board is responsible for ensuring that an effective framework is in place to promote and embed an effective risk-aware culture that identifies, appropriately mitigates and manages the risks which The Nottingham faces in the course of delivering its strategic objectives.

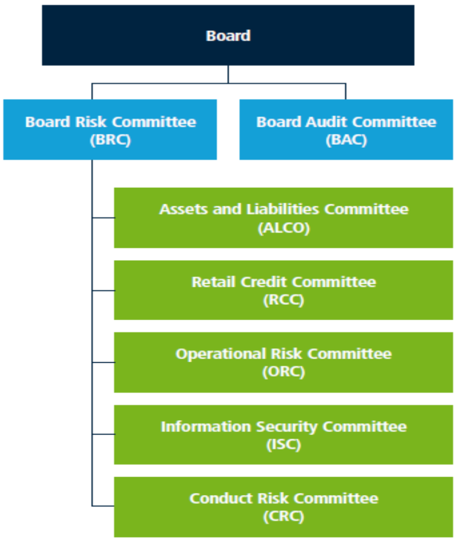
The Nottingham operates a 'three lines of defence' approach to the allocation of responsibilities for risk identification and management. This is illustrated in the following diagram:

The three lines of defence



2.3 Organisation and Structure of Risk Management

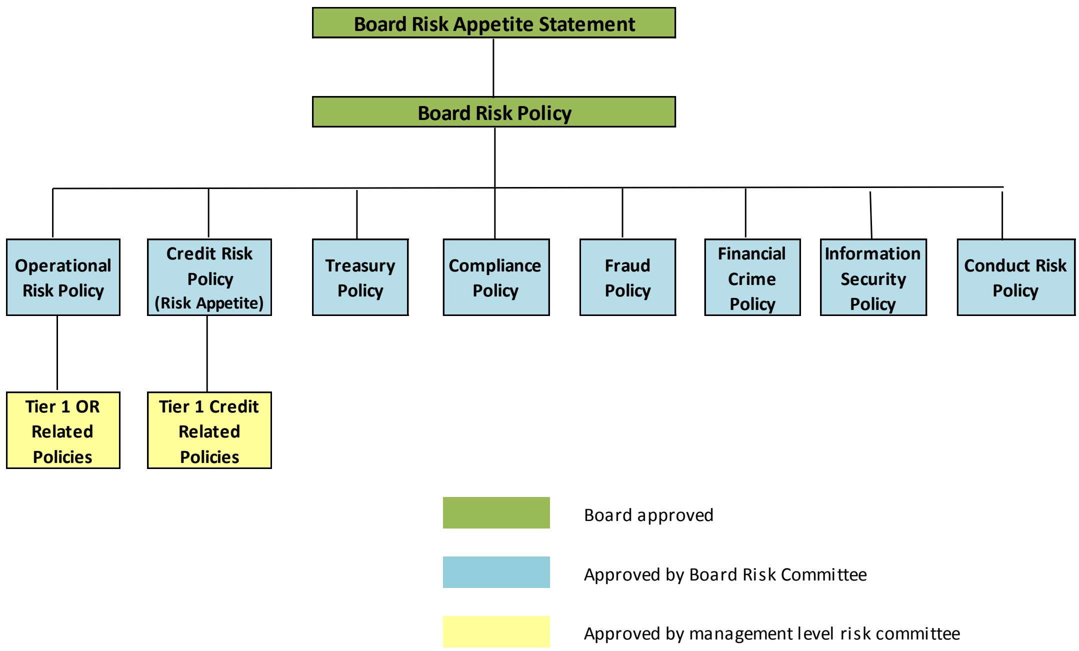
The Nottingham's risk committee structure has been designed to support a wide ranging approach to the identification and management of risk. In so doing each of the five 'management level' risk committees report to the Board Risk Committee, whose responsibility it is to take a Society wide view of The Nottingham's overall exposure to risk.



The table below illustrates how The Nottingham's committees fit into the three lines of defence framework:

Key Risks	First Line	Second Line	Third Line
Credit Risk			
Retail Credit Risk (Residential and Buy to Let Mortgages)	Retail Lending	Retail Credit Committee	
Secured business lending Credit Risk (Commercial Mortgages)	Secured business lending	Retail Credit Committee	
Treasury Credit Risk	Treasury Risk	ALCO	Board Risk Committee and Board Audit Committee
Liquidity & Funding Risk	Treasury Risk	ALCO	
Market Risk	Treasury Risk	ALCO	
Operational Risk (including Financial Crime and Project Risk)	All business areas	Operational Risk Committee	
Information Security Risk and Data Protection	All business areas	ISC	
Conduct Risk	All business areas	Conduct Risk Committee	

The Nottingham's risk policy framework reflects its committee structure. As such the Board approves the 'Board Risk Appetite Statement' and 'Board Risk Policy'. The Nottingham's primary risk specific appetite statements are approved, in turn, by the Board Risk Committee (thus ensuring that these risk statements are properly aligned to the Board Risk Policy). Secondary risk policies, along with all procedures, are approved by either the relevant management level risk committee or one of their sub-committees – depending on the nature and content of the policy or procedure in question.



Detailed below are the board and management level risk committees along with a summary of their respective remits:

Board Risk Committee (BRC)	
Committee members	All Board members
Terms of reference	The BRC is responsible for overseeing the management of risk by ensuring: a. Key risks are identified and steps taken to mitigate them. b. Due consideration is given to all significant matters relating to governance, control, regulatory and compliance issues. c. Risks and controls are monitored adequately. It also oversees, at a high level, the operation of the Internal Capital Adequacy Assessment Process (ICAAP) and Individual Liquidity Adequacy Assessment (ILAA). In addition the BRC monitors The Nottingham's overall capital and liquidity adequacy and exposure to risk.
Frequency	Quarterly

Board Audit Committee (BAC)	
Committee members	4 Non-executive Directors
Terms of reference	The BAC considers all audit matters relating to The Nottingham, including systems of internal control, financial reporting, accounting policies and judgemental accounting issues. The BAC oversees the work of Internal Audit. This includes considering the findings from audit reports and reviewing the progress of management in implementing identified actions. The BAC considers the scope and planning of external audit activities and recommends to the Board any decisions on the engagement of external auditors for non-audit services.
Frequency	Quarterly with an additional meeting to deal with the Annual Report and Accounts.

Management Assets and Liabilities Committee (ALCO)	
Committee members	Chief Executive, Deputy Chief Executive & Finance Director, Head of Treasury Risk, Treasurer, Head of Finance and Head of Risk.
Terms of reference	The ALCO assists the Board and Executive in the prudent management of The Nottingham's Treasury function. It is responsible for developing and defining the treasury risk appetite of The Nottingham and for ensuring that the activities of the Treasury function support the corporate plan whilst remaining compliant with all applicable regulatory requirements. It fulfils this role by ensuring that appropriate policies, strategies and processes exist for the management of The Nottingham's Treasury function. It receives regular reports on the activities and performance of The Nottingham's treasury function.
Frequency	Monthly

Management Retail Credit Committee (RCC)	
Committee members	Deputy Chief Executive & Finance Director, Chief Operating Officer, Head of Risk, Head of Central Sales & Service and Senior Credit Risk Manager.
Terms of reference	The RCC assists the Board and Executive in the identification and prudent management of the credit risks that are associated with The Nottingham's mortgage lending portfolios.
Frequency	Minimum 5 meetings per annum

Operational Risk Committee (ORC)	
Committee members	Deputy Chief Executive & Finance Director, Chief Operating Officer, Head of Risk, Head of HR, Head of IT, Head of Branch Network*, Head of Central Sales & Service*, Head of Marketing, Head of Business Development, Head of Treasury Risk and Group Secretary. * Attendance is rotated
Terms of reference	The ORC oversees the identification and management of system, project and operational risk (including the risks associated with fraud and financial crime) and related compliance issues across The Nottingham.
Frequency	Quarterly

Information Security Committee (ISC)	
Committee members	Chief Executive, Information Security Manager, Head of IT, Head of Risk, Computer Services Manager, Technical Architect, Group Secretary and Senior IT Security Analyst.
Terms of reference	The ISC supports the board in ensuring the security of the Society's information is managed effectively. It performs this role through the approval of appropriate frameworks and policy and oversight of policy implementation.
Frequency	Minimum 6 meetings per annum

Conduct Risk Committee (CRC)	
Committee members	Chief Operating Officer, Head of Marketing, Head of Branch Network, Head of Central Sales & Service, Head of HR, Head of Risk, Senior Manager Conduct Risk and Group Secretary.
Terms of reference	The CRC has responsibility for overseeing the manner in which The Nottingham conducts business ensuring it is conducted in a clear, transparent and fair manner and is compliant with conduct rules set by the Regulator.
Frequency	Minimum 4 meetings per annum

3. Capital Resources

At 31 December 2013 and throughout the year, the Society has complied with the applicable capital requirements as set out by the PRA.

The Nottingham's capital resources are broken down as follows:

	31 December 2013 (£m)	31 December 2012 (£m)
Tier 1 Capital		
General Reserves	163.7	150.3
PIBS	23.9	23.9
Intangible assets	(6.1)	(7.3)
Total Tier 1 Capital	**181.5**	**166.9**
Collective provision	1.6	1.0
Total Tier 2 Capital	**1.6**	**1.0**
Total Tier 1 and Tier 2 Capital	**183.1**	**167.9**
Deductions from Tiers 1 and 2 capital	(9.1)	(1.6)
Total Capital	**174.0**	**166.3**

Tier 1 capital comprises reserves and subscribed capital (PIBS). Intangible assets do not qualify as capital for regulatory purposes and are deducted from capital. Tier 2 capital includes collective provisions. Deductions from Tiers 1 and 2 capital relate to investments in subsidiary companies.

The subscribed capital was issued for an indeterminate period and is only repayable in the event of winding up the Society.

4. Capital Adequacy

4.1 Capital Management

The Nottingham's policy is to maintain a strong capital base to maintain member, creditor and market confidence and to sustain the future development of the business. The Board manages The Nottingham's capital and risk exposures to maintain capital in line with regulatory requirements. This is subject to regular stress tests to ensure The Nottingham maintains sufficient capital for future possible events.

As a mutual, The Nottingham has no outside shareholders to whom it needs to pay dividends. As such The Nottingham does not have to maximise profitability so long as it maintains an adequate capital position.

The Nottingham's capital requirements are also monitored by the Prudential Regulatory Authority (PRA).

The Board monitors The Nottingham's capital position with the aid of its Internal Capital Adequacy Assessment Process (ICAAP). This requires The Nottingham to assess its capital adequacy over a 3 year period and determine the level of capital it requires to support both current and future potential risks.

The Nottingham adopted the Standardised Approach to calculate its credit risk weightings from 1 January 2008. Internally The Nottingham operates a similar standard to the Internal Ratings Based (IRB) approach for its retail mortgages, the benefit of which is an enhanced risk management capability.

Under the Standardised Approach the level of capital required against a given level of exposure to credit risk is calculated as:

Credit risk capital requirement = Exposure value x Risk weighting* x 8%.

* The risk weighting applied will vary depending on whether the asset is retail or wholesale. For retail assets, variables such as loan to value and security will impact the risk weighting. Wholesale assets are dependent on counterparty, duration and credit rating.

The primary source for obtaining information on counterparties' creditworthiness is External Credit Assessment Institutions (ECAIs). Unrated counterparties may be approved by the Assets and Liabilities Committee (ALCO).

Credit ratings are reviewed regularly and a list of relevant changes provided to the monthly ALCO meeting. Consideration will be given to selling holdings where ratings fall below the minimum criteria for a counterparty.

4.2 Capital Requirements Summary

The Society's minimum capital requirement under Pillar 1 is the sum of the credit risk capital requirement and the operational risk capital requirement.

The following table shows the Society's overall minimum capital requirement as at 31 December 2013:

	31 December 2013 (£m)	31 December 2012 (£m)
Credit Risk		
- Loans and advances to customers	75.1	65.4
- Wholesale lending	2.9	5.2
- Other	1.3	2.7
Operational Risk	5.4	4.5
Minimum capital requirement	**84.7**	**77.8**
Capital resources (section 3)	174.0	166.3
Excess of own funds over minimum Pillar 1 capital requirement	**89.3**	**88.5**

5. Measurement of Risk

5.1 Overview

The Nottingham aims to manage all the risks that arise from its operations. The main categories of risk in our business are credit, liquidity, market, conduct of business, operational, business, strategic, regulatory, concentration and pension scheme obligation risk.

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

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).

a) Lending and Business Decisions

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

Through the use of scorecards, The Nottingham is able to estimate the likely level of default, mortgage arrears, impairment charges and capital allocation.

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 The Nottingham's exposure to market risk remains within permitted parameters.

5.2.1 Credit Risk: Loans and advances to customers

a) Retail Credit Risk

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 and are assessed with reference to The Nottingham's retail credit risk appetite statement which is approved by the Board Risk Committee. Exposure to retail credit risk is carefully monitored by the Retail Credit Committee which reports to the Board Risk Committee. Responsibility for day to day management is delegated to the Head of Risk.

b) Secured Business Lending Credit Risk

The Nottingham's secured business lending policy is used to manage the level of credit risk. Primarily, secured business lending loans are made available to Small and Medium sized Enterprises (SME market) 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/remortgaging of a property and not for working capital or machinery, etc.)

Secured business lending credit risk is monitored by the Retail Credit Committee with day to day management delegated to the Head of Risk.

The table below details the minimum credit risk capital requirement by standardised exposure class at 31 December 2013 broken down by exposure value.

	31 Dec 2013 (£m)		31 Dec 2012 (£m)	
Standardised exposure class	Exposure Value	Capital Requirement	Exposure Value	Capital Requirement
Retail	37.3	2.2	61.9	3.7
Secured by Mortgages on Residential Property	2,350.6	65.8	1,968.7	55.1
Secured by Mortgages on Commercial Real Estate	78.1	6.2	71.1	5.7
Past Due Items	8.6	0.7	10.5	0.9
Other Items	1.9	0.2	-	-
Total Loans and advances to customers	**2,476.5**	**75.1**	**2,112.2**	**65.4**

The following table shows the residual maturities of all Loans and Advances exposures as at 31 December 2013.

31 Dec 2013	< 3 months (£m)	> 3 months but < 1 year (£m)	> 1 year but < 5 years (£m)	> 5 years (£m)	**Total (£m)**
Retail	-	-	1.0	36.3	**37.3**
Secured by Mortgages on Residential Property	2.7	7.2	89.5	2,251.2	**2,350.6**
Secured by Mortgages on Commercial Real Estate	0.4	0.3	3.1	74.3	**78.1**
Past Due Items	0.2	-	0.5	7.9	**8.6**
Other Items	0.2	-	0.1	1.6	**1.9**
Total Loans and advances to customers	**3.5**	**7.5**	**94.2**	**2,371.3**	**2,476.5**

31 Dec 2012	< 3 months (£m)	> 3 months but < 1 year (£m)	> 1 year but < 5 years (£m)	> 5 years (£m)	**Total (£m)**
Retail	-	-	1.1	60.8	**61.9**
Secured by Mortgages on Residential Property	2.3	8.1	83.1	1,875.2	**1,968.7**
Secured by Mortgages on Commercial Real Estate	0.2	-	2.0	68.9	**71.1**
Past Due Items	0.2	0.1	1.0	9.2	**10.5**
Total Loans and advances to customers	**2.7**	**8.2**	**87.2**	**2,014.1**	**2,112.2**

Credit risk exposures can be further sub-divided. The table below shows the geographical analysis of these exposures at 31 December 2013

31 Dec 2013 Region (All UK)	Retail (£m)	Secured by Mortgages on Residential Property (£m)	Secured by Mortgages on Commercial Real Estate (£m)	Past Due Items (£m)	Other Items (£m)	**Total (£m)**
Eastern	5.0	246.7	4.7	0.5	-	**256.9**
East Midlands	16.7	518.0	22.6	3.5	1.3	**562.1**
London	0.6	269.5	5.2	0.2	-	**275.5**
North East	1.1	73.8	0.6	0.1	-	**75.6**
North West	2.0	188.0	13.5	1.4	-	**204.9**
South East	1.5	356.6	6.5	0.2	0.1	**364.9**
South West	1.3	187.7	4.9	0.4	0.1	**194.4**
Wales	0.8	55.6	4.0	0.1	-	**60.5**
West Midlands	2.7	194.1	6.6	0.7	0.1	**204.2**
Yorkshire and Humberside	5.3	253.9	7.8	1.5	0.1	**268.6**
Other	0.3	6.7	1.7	-	0.2	**8.9**
Total	**37.3**	**2,350.6**	**78.1**	**8.6**	**1.9**	**2,476.5**

31 Dec 2012 Region (All UK)	Retail (£m)	Secured by Mortgages on Residential Property (£m)	Secured by Mortgages on Commercial Real Estate (£m)	Past Due Items (£m)	**Total** **(£m)**
Eastern	4.3	203.3	5.4	0.6	**213.6**
East Midlands	23.8	452.6	17.2	3.6	**497.2**
London	2.0	217.3	5.3	0.8	**225.4**
North East	2.0	57.6	0.6	0.1	**60.3**
North West	7.9	156.7	13.4	1.6	**179.6**
South East	4.1	283.5	5.8	0.7	**294.1**
South West	3.4	156.9	4.4	0.1	**164.8**
Wales	2.1	45.8	3.8	0.6	**52.3**
West Midlands	4.9	161.3	5.3	0.7	**172.2**
Yorkshire and Humberside	7.2	229.4	8.4	1.7	**246.7**
Other	0.2	4.3	1.5	-	**6.0**
Total	**61.9**	**1,968.7**	**71.1**	**10.5**	**2,112.2**

5.2.2 Credit Risk: Wholesale Lending

A Board approved policy statement 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. This is reported by the Assets and Liabilities Committee to the Board Risk Committee.

The Nottingham's treasury policy only permits sterling denominated lending to UK and other central governments, UK local authorities, banks and building societies. During the year lending has been permitted to selected European based Multilateral Development Banks in instances where it qualifies as High Quality Liquidity Buffer (HQLB) eligible assets, The Society has not permitted any lending directly to sovereign states, other than the UK. In addition, every bank must have a minimum 'A' rating from an external credit assessment institution.

The table below details the exposure value and minimum credit risk capital requirement by standardised exposure class at 31 December 2013.

	31 Dec 2013 (£m)		31 Dec 2012 (£m)	
Standardised exposure class	Exposure Value	Capital Requirement	Exposure Value	Capital Requirement
Central Government or Central Banks	339.4	-	339.6	-
Multilateral Development Banks	20.7	-	32.1	-
Institutions	156.2	2.9	209.1	5.2
Total Wholesale lending	**516.3**	**2.9**	**580.8**	**5.2**

The following table shows the residual maturities of all Wholesale Credit exposures as at 31 December 2013.

31 Dec 2013	< 3 months (£m)	> 3 months but < 1 year (£m)	> 1 year but < 5 years (£m)	> 5 years (£m)	**Total (£m)**
Central Government or Central Banks	318.6	-	20.8	-	**339.4**
Multilateral Development Banks	-	-	20.7	-	**20.7**
Institutions	52.2	51.6	50.0	2.4	**156.2**
Total Wholesale lending	**370.8**	**51.6**	**91.5**	**2.4**	**516.3**

31 Dec 2012	< 3 months (£m)	> 3 months but < 1 year (£m)	> 1 year but < 5 years (£m)	> 5 years (£m)	**Total (£m)**
Central Government or Central Banks	317.1	0.5	22.0	-	**339.6**
Multilateral Development Banks	-	-	32.1	-	**32.1**
Institutions	70.9	74.5	60.1	3.6	**209.1**
Total Wholesale lending	**388.0**	**75.0**	**114.2**	**3.6**	**580.8**

The geographical split and credit rating of The Nottingham's treasury exposures at 31 December 2013 are detailed in the table below.

31 Dec 2013 Credit Rating Moody's	Fitch	UK (£m)	Eurozone (£m)	North America (£m)	Asia (£m)	**Total (£m)**
Aaa	AAA	-	20.7	-	-	**20.7**
Aa1	AA+	339.4	-	5.0	-	**344.4**
Aa2	AA	-	-	-	-	**-**
Aa3	AA-	25.3	-	-	31.3	**56.6**
A1	A+	-	-		-	**-**
A2	A	62.4	-	-	-	**62.4**
A3	A-		-	-	17.2	**17.2**
Baa1	BBB+		-	-	-	**-**
Unrated		15.0	-	-	-	**15**
Total		**442.1**	**20.7**	**5.0**	**48.5**	**516.3**

31 Dec 2012		UK	Eurozone	North America	Asia	**Total**
Credit Rating		(£m)	(£m)	(£m)	(£m)	**(£m)**
Moody's	Fitch					
Aaa	AAA	339.6	31.9	-	-	**371.5**
Aa1	AA+	-	-	-	-	**-**
Aa2	AA	-	-	-	-	**-**
Aa3	AA-	23.2	-	-	44.8	**68.0**
A1	A+	0.1	2.9	5.2	-	**8.2**
A2	A	84.8	-	-	-	**84.8**
A3	A-	6.0	-	-	5.1	**11.1**
Baa1	BBB+	17.5	-	-	-	**17.5**
Unrated		19.7	-	-	-	**19.7**
Total		**490.9**	**34.8**	**5.2**	**49.9**	**580.8**

The credit ratings of the external credit assessment institutions correspond to the following credit quality steps:

Credit Quality Step	Moody's	Fitch
1	Aaa to Aa3	AAA to AA-
2	A1 to A3	A+ to A-
3	Baa1 to Baa3	BBB+ to BBB-
4	Ba1 to Ba3	BB+ to BB-
5	B1 to B3	B+ to B-
6	Caa1 and below	CCC+ and below

5.3 Impairment Provisions

a) Impairment of Loans and advances to customers

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

Objective evidence 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 annual 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 that may be needed against the value of the property at the balance sheet date thought necessary to achieve a sale and amounts recoverable under mortgage indemnity policies and anticipated realisation costs.

In addition, The Nottingham assesses quarterly whether there is objective evidence to suggest that 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 assets is split into groups of assets with similar credit risk characteristics. The Nottingham measures the amount of impairment loss by applying expected loss factors based on The Nottingham's experience of default, loss emergence periods, the effect of movements in house prices and any adjustment for the expected forced sales value.

The resultant impairment charge is deducted from the appropriate asset values in the balance sheet.

Details of past due loans and provisions for impaired exposure at 31 December 2013 are shown in the table below.

31 Dec 2013	Loans fully secured on residential property (£m)	Loans fully secured on land (£m)	Total (£m)
Not impaired			
Neither past due or impaired	2,370.2	73.4	2,443.6
Past due up to 3 months but not impaired	16.3	1.1	17.4
Past due over 3 months but not impaired	2.4	0.4	2.8
Possessions	0.2	-	0.2
Impaired			
Not past due	1.0	1.4	2.4
Up to 3 months	2.4	1.8	4.2
3 to 6 months	2.1	0.8	2.9
6 to 12 months	0.9	-	0.9
Over 12 months	0.3	-	0.3
Possessions	1.2	0.6	1.8
Total Exposure	**2,397.0**	**79.5**	**2,476.5**
Provision	1.4	2.5	**3.9**
Charge for the year	0.3	0.6	**0.9**

31 Dec 2012	Loans fully secured on residential property (£m)	Loans fully secured on land (£m)	Total (£m)
Not impaired			
Neither past due or impaired	2,008.5	66.0	2,074.5
Past due up to 3 months but not impaired	17.3	1.3	18.6
Past due over 3 months but not impaired	3.6	-	3.6
Possessions	0.3	-	0.3
Impaired			
Not past due	1.2	0.5	1.7
Up to 3 months	3.6	3.1	6.7
3 to 6 months	3.4	0.2	3.6
6 to 12 months	1.6	0.4	2.0
Over 12 months	0.3	-	0.3
Possessions	0.8	0.1	0.9
Total Exposure	**2,040.6**	**71.6**	**2,112.2**
Provision	1.6	2.3	**3.9**
Charge for the year	0.5	0.9	**1.4**

The values shown in the table relate to the full value of the loan, not just the amount past due. All past due and impaired loans are UK based.

The table below details the movement of impairment provisions during the year:

2013	Loans fully secured on residential property (£m)	Loans fully secured on land (£m)	Total (£m)
Individual provision			
At 1 January 2013	1.1	1.6	**2.7**
Provision for loan impairment	0.2	0.3	**0.5**
Provision utilised	(0.5)	(0.4)	**(0.9)**
At 31 December 2013	**0.8**	**1.5**	**2.3**
Collective provision			
At 1 January 2013	0.5	0.7	**1.2**
Provision for loan impairment	0.1	0.3	**0.4**
At 31 December 2013	**0.6**	**1.0**	**1.6**

2012	Loans fully secured on residential property (£m)	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**

b) Impairment of Treasury Assets

The Nottingham assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. Available for sale assets are impaired and impairment losses are 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.

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.

During the year The Nottingham incurred no impairment charges on its treasury available for sale assets.

5.4 Credit risk mitigation

The Nottingham employs a range of techniques and strategies to reduce the credit risks of its retail and wholesale lending.

a) Loans and advances to customers

All mortgage loan applications are assessed with reference to the Nottingham's retail credit risk appetite statement and lending policy, which includes assessing applicants for potential fraud risk, and which is approved by the board.

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 Nottingham. 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.

In the event of a default, the ultimate source of collateral remains the borrower's property. The Nottingham takes a first charge on all residential lending. The collateral is supported by an appropriate form of valuation using either an independent firm of valuers or an Automated Valuation Model (ALM).

The Nottingham insures its residential mortgage book against losses using Mortgage Indemnity Guarantee (MIG) Insurance. MIG Insurance is taken on all purchases where the loan to value (LTV) exceeds 80%. However, for prudence, no credit risk mitigation benefits have been taken from this purchase when assessing its Pillar 1 capital requirements.

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

b) Treasury Assets

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.

A regular assessment of investment quality is undertaken by the Treasury Risk team which is reported monthly to the Assets and Liabilities Committee (ALCO).

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 Society in using derivatives is in accordance with the Building Societies Act 1986 and is to limit the extent to which the Society 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 Society in managing its statement of financial position risk exposures are interest rate swaps. These are used to protect the Society 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 Society 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	Society pays fixed, receives variable
Fixed rate savings bond	Decrease in interest rates	Society receives fixed, pays variable
Fixed rate funding	Decrease in interest rates	Society receives fixed, pays variable

Credit Support Annexes (CSA) exist for collateralising derivative transactions with counterparties with which the Nottingham has derivative exposures in order to mitigate credit risk on the derivatives portfolio. The CSAs require collateral to be posted against changes in the net mark to market value of derivative exposures with a particular counterparty.

The table below shows the derivative contracts held using the Mark to Market (MTM) method:

	Replacement Cost £m	Credit Exposure £m	Total Exposure £m
31 December 2013	18.9	6.3	25.2
31 December 2012	22.3	4.5	26.8

5.5 Liquidity Risk

Liquidity risk is the risk that The Nottingham 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 Nottingham'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:

- Meet day-to-day business needs;
- Meet any unexpected cash needs;
- Maintain public confidence; and
- Ensure maturity mismatches are provided for.

Monitoring of liquidity and funding policies, in line with The Nottingham's prudent framework, is performed daily as set out by a Board approved policy statement. Compliance with these policies is reported, to the Assets and Liability Committee monthly and to the Board Risk Committee.

5.6 Market Risk

Market risk is the risk of changes to The Nottingham's financial condition caused by market variables in particular interest rates and property prices. Differing interest rate characteristics between assets and liabilities, and in particular fixed rate products, expose The Nottingham to the risk of either a reduction in interest income or an increase in interest expense relative to variable rate interest flows.

The instruments that are used for market risk management purposes include derivative financial instruments (derivatives). The objective of The Nottingham in using derivatives is in accordance with the Building Societies Act 1986 and is to limit the extent to which The Nottingham will be affected by changes in interest rates.

The treasury risk team is responsible for the day to day management of market risks. The balance sheet is subjected to a stress test of a 2% rise in interest rates on a weekly basis and the results are reported monthly to the Assets and Liabilities Committee. In addition management review interest rate basis risk, the risk that different market interest rates move by different amounts, to assess the possible impact on profit. Both sets of results are measured against risk appetite for market risk which is currently set at a maximum of 5% of capital.
The Nottingham's sensitivity to this measurement (in terms of economic value) was:

	2% shift in interest rates (£m)	5% of capital (£m)
31 December 2013	(0.5)	8.7

A Board approved policy statement defines the maximum acceptable level of market risk as well as the steps that may be taken to reduce it. The Assets and Liabilities Committee is responsible for reviewing treasury activity, performance and compliance with approved policy statements. It reports to the Board Risk Committee.

5.7 Business Conduct Risk

Business conduct risk is the risk that The Nottingham does not conduct its business activities in a clear, transparent and fair manner. The Nottingham must ensure it complies with the FCA's Principles of Business (PRIN).

Each business area is responsible for ensuring compliance with all regulatory and legal obligations with regard to conduct of business that affect its area of operations.

The Conduct Risk Committee, which comprises an executive director and senior managers, supports the Board Risk Committee by overseeing the manner in which The Nottingham conducts business with its members and customers.

It achieves this by ensuring effective governance and control frameworks are in place, maintained and monitored. In addition the committee will identify and drive actions to address priorities for improvement that will enable The Nottingham to deliver and sustain self-imposed targets in customer satisfaction and ensuring good customer outcomes.

5.8 Business Risk

Business risk is the risk of unexpected changes in the external environment that have the potential to affect The Nottingham's business model either through the level of demand for The Nottingham's products and services and or its ability to meet it.

The Nottingham looks to mitigate its exposure to business risk by having a diverse range of products and services so that its income source is not reliant on one product or one area of its business.

The Board monitors The Nottingham's exposure to business risk. In so doing it receives a range of Management Information on a monthly basis from both the Deputy Chief Executive & Finance Director and Chief Operating Officer.

5.9 Strategic Risk

Strategic risk is the risk that the Nottingham 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.

5.10 Regulatory and Compliance Risk

These risks are the risk of loss from failure to comply with statutory and regulatory requirements. The Nottingham, being a retailer of mortgage, savings and insurance products, is regulated by the Prudential Regulatory Authority (PRA) and Financial Conduct Authority (FCA) and as such must comply with relevant policies.

The Nottingham must also comply with the relevant sections of the Building Society Act 1986 and other legal requirements.

Each business area is responsible for ensuring compliance with all regulatory and legal requirements that affect its area of operations. Oversight of the business is undertaken by the Compliance function supported by the Society's Secretary.

5.11 Concentration Risk

As a regional building society The Nottingham is exposed to concentration risk. This includes the potential for geographical and product concentrations in terms of both its mortgage book and wholesale funding activities.

a) Retail Credit Risk

The Nottingham receives its mortgage business via two main sources: its branch network and intermediaries. Over 75% of its business is introduced by intermediaries, which are spread throughout England and Wales.

The Nottingham has geographic concentration risk as it is regionally based in the East Midlands and domiciled in the UK, acquiring all of its current business from England and Wales.

Geographic concentration risk is monitored by observing the spread of The Nottingham's exposure by region and the impact of house price changes during various economic scenarios. The risk is monitored on an ongoing basis.

b) Wholesale Credit Risk

The Nottingham carries out wholesale lending predominantly in the London money markets. This creates a potential source of concentration risk if, for example, there is a general tightening of credit conditions.

Stress testing has been carried out to consider a systematic downgrading of all current non-UK government counterparties by one credit notch. This scenario is designed to mimic a general deterioration in the credit conditions in the UK money markets and recognises that there is concentration risk inherent within the wholesale lending function.

Funding concentration risk is mitigated by limiting the amount of exposure to each specific risk. Treasury monitors large exposures on a daily basis and reports any exceptions to policy to the ALCO on both a weekly and monthly basis. Limits are monitored on an ongoing basis and are formally reviewed twice a year as a minimum as part of the overall review of treasury policy.

5.12 Pension Scheme Obligation Risk

Pension liability risk is the risk that there may be a shortfall with respect to meeting the benefits that are due within a defined benefit pension scheme.

The Nottingham operates a contributory defined benefit pension scheme. The scheme closed to new members in 1997 and closed to future service accrual from 31 January 2009. The membership consists of pensioners, those with deferred benefits and current members.

The Nottingham is exposed to the risk that it will need to make further unexpected future contributions to the scheme. The risk may arise from a number of factors including:

- A fall in the discount rate increasing the present value of scheme liabilities.
- An increase in life expectancy increasing the present value of scheme liabilities.
- A fall in equity prices reducing the fair value of scheme assets.

The Nottingham uses independent actuarial advice to advise on the risks that may lead to an increase in the deficit. This is reviewed by the Board.

6 Measurement of Operational Risk Capital

6.1 Operational Risk

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

All of The Nottingham's teams and functions are required to identify, assess, monitor and control their operational risks via an agreed framework and methodology. As part of the risk management framework all business areas are required to complete an Objectives, Risks and Control Assessment (ORCA) and review it on an annual basis. In addition line management are held directly responsible for the assessment and management of the operational risks and associated controls that fall within their area of responsibility.

The Operational Risk Committee, which comprises two executive directors and senior managers, oversees the management of operational risk. In so doing it monitors a range of management information and other reports on The Nottingham's operational risk exposures. It also reviews the results of the operational risk scenario analysis that is performed for the purposes of The Nottingham's Internal Capital Adequacy Assessment Process.

The Operational Risk Committee reports regularly to the Board Risk Committee that in turn reports to the Board.

6.2 Minimum Capital Requirements for Operational Risk

The Nottingham calculates its operational risk capital requirement using the Basic Indicator Approach. This is determined in relation to the Society's net income averaged over the previous 3 years.

The Nottingham's minimum (Pillar 1) capital requirement for operational risk at 31 December 2013 is:

	2013 Operational risk capital requirement (£m)	2012 Operational risk capital requirement (£m)
Basic Indicator approach	**5.4**	**4.5**

7 Impact of CRD IV

From the 1 January 2014, the Basel III, regulations more commonly known as CRD IV, has become part of European law. One of the objectives of the new regulation is to improve the banking sector's ability to absorb shocks arising from financial and/or economic stress. This is to be achieved through increasing both the quality and quantity of regulatory capital firms will be required to hold.

7.1 Quality of capital

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

The table below shows the impact to capital under the new rules, both under the transitional rules (as they stand in 2014) and the final CRD IV rules (as they will stand in 2022).

	Current rules 31 December 2013 £m	Transitional rules 31 December 2013 £m	Final rules 31 December 2013 £m
Common Equity Tier 1			
General Reserves	163.7	163.7	163.7
Available for sale reserve	-	-	(0.2)
Intangible assets	(6.1)	-	(5.4)
Total Common Equity Tier 1	**157.6**	**163.7**	**158.1**
Additional Tier 1			
PIBS	23.9	19.1	-
Intangible assets	-	(5.4)	-
Total Additional Tier 1	**23.9**	**13.7**	**-**
Total Tier 1 Capital	**181.5**	**177.4**	**158.1**
Tier 2 Capital			
Collective provision	1.6	1.6	1.6
Total Tier 2 Capital	**1.6**	**1.6**	**1.6**
Deductions from capital	(9.1)	-	-
Total Capital	**174.0**	**179.0**	**159.7**

The table above shows that the Society will maintain a strong capital position.

7.2 Quantity of capital

To ensure firms hold sufficient capital to withstand future shocks, CRD IV requires firms to hold capital buffers. A capital conservation buffer equivalent 2.5% of RWA's which will come into force from 2016 and increase gradually to the full 2.5% by 2019. In addition a countercyclical buffer, also 2.5% of RWA, may be required during periods of excessive credit growth in the market.

7.3 Counterparty credit risk

CRD IV also requires an additional capital charge for counterparty credit risk through a credit valuation adjustment. It arises from The Nottingham's us of derivatives to manage its interest rate risk.

7.4 Leverage

A further requirement under CRD IV is the introduction of a leverage ratio which measures the levels of Tier 1 capital against both on and off balance sheet exposures. CRD IV requires a minimum ratio of 3%. At the 31 December 2013 the Nottingham's ratio was at 5.5%.

8 Remuneration Committee and Policy

The primary objective of the Committee is to make recommendations to the Board on the general remuneration policy of the Society and specifically on the remuneration of Executive Directors. The Committee also has oversight of the remuneration of the senior management team.

From the 1st January 2011 the Society came within the scope of the Regulator's Remuneration Code (then the FSA). As a result those individuals who comprise Remuneration Code staff also fall within the remit of the Remuneration Committee.

The Committee comprises four non-executive directors (one of which acts as Chairman of the Committee) and the Chief Executive, the Head of HR and the Group Secretary attend.

Further details regarding the remuneration policy are set out in the Directors Remuneration Report in the 2013 Annual Report and Accounts.

Code Staff:

Code staff are defined by the Regulator as 'staff whose activities have a material impact on the firms risk profile, this includes staff that perform significant influence functions, senior managers and risk takers'.

The table below sets out the aggregate quantitative remuneration for code staff in relation to their services for The Nottingham for the year ended 31st December 2013.

	Total remuneration (£)	Deferred variable remuneration (£)
Senior Management	1,856,566	Nil
Other code staff	172,769	Nil
Non-Executive Directors	214,917	Nil

Remuneration structure:

1. Basic salary = grade and performance driven. Grade determined via the HAY evaluation process. All roles (except executive level) graded and placed at the appropriate point on the appropriate salary scales.
2. Variable pay = all code staff participate in one (Executive Directors participate in two) discretionary bonus schemes. This is calculated by reference to business performance measured together with individual performance against personal objectives, both of these are derived from the Society's strategic goals which include effective risk management. As a mutual the Society does not issue shares on the Stock Exchange. For this reason the annual performance pay cannot be based upon Share Option Schemes or Share Incentive plans. The

Society is a level three firm (as assets are less than £15bn) and is therefore not subject to the rules on retained shares and other instruments and deferral of variable pay.

3. Pensions = the Society contributes up to a maximum of 16% of salary (dependent upon age of joining and period of time in the scheme) for members of the Group Personal Pension Plan. The pension benefits relating to the Executive Directors are outlined in the 2013 Annual Report and Accounts.
4. Benefits = include the provision of a car or car allowance and permanent health insurance/death in service benefit for code staff who are also pension scheme members.

9. Glossary

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.
BIPRU	The prudential sourcebook for banks, building societies and investment firms which sets out the FSA's capital requirements.
Central Government or Central Banks	Treasury assets with central governments or central banks.
Credit Quality Steps	A credit quality assessment scale as set out in BIPRU 3.4 (Risk weights under the Standardised Approach to credit risk).
Credit risk	This is the risk that a customer or counterparty fails to meet their contractual obligations.
External Credit Assessment Institution (ECAI)	An ECAI (e.g. Moody's, Standard and Poor's, Fitch) is an institution that assigns credit ratings to issuers of certain types of debt obligations as well as the debt instruments themselves.
Financial Services Authority (FSA)	The financial services industry regulator in the UK, until April 2013.
Financial Conduct Authority (FCA)	The statutory body responsible for conduct of business regulation and supervision of UK authorised firms for 1 April 2013.
Internal Capital Adequacy Assessment Process (ICAAP)	The Society's own assessment, as part of Basel II requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements for risks it faces under a business as usual scenario including stress events.
Individual liquidity adequacy assessment (ILLA)	The Society's own assessment of the liquidity resources it requires in order to remain within the risk tolerances it has set. This will include an evaluation of potential stresses based on multiple market environments.
Institutions	Treasury assets with financial institutions.
Loan to value (LTV)	LTV expresses the amount of a mortgage as a percentage of the value of the property.
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.
Minimum capital requirement	The minimum amount of regulatory capital that a financial institution must hold to meet the Basel II Pillar 1 requirements

	for credit, market and operational risk.
Multilateral Development Banks	Treasury assets with Multilateral Development banks.
Operational risk	The risk of loss arising from inadequate or failed internal processes, people and systems, or from external events.
Other items	Other assets not included in other definitions.
Past due items	Loans which are 90 days or more in arrears.
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.
Provisions	Amounts set aside to cover incurred losses associated with credit risks.
Prudential Regulation Authority (PRA)	The statutory body responsible for the prudential supervision of banks, building societies, insurers and small number of significant investment firms in the UK from the 1 April 2013. The PRA is a subsidiary of the Bank of England.
Retail	Residential mortgages where LTV is greater than 80%.
Risk appetite	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 achieving business objectives.
Secured by Mortgages on Residential Property	Residential mortgages where LTV is less than or equal to 80%.
Secured by Mortgages on Commercial Real Estate	Secured business lending.
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.