



Nottingham Building Society

Pillar 3 Disclosures

31 December 2017

Contents

1. Overview	4
1.1. Background	4
1.2. Basis and Frequency of Disclosures	4
1.3. Location and Verification.....	4
1.4. Scope of Application	5
1.5. Directors	6
2. Risk management objectives & policies	7
2.1. Introduction.....	7
2.2. Risk Management Framework	7
2.3. Organisation and Structure of Risk Management	8
2.4. Risk Strategy	11
2.5. Risk appetite.....	11
2.6. Stress testing and planning.....	12
3. Capital resources	13
3.1. Reconciliation of Regulatory Capital	14
4. Capital adequacy	15
4.1. Capital Management	15
4.2. Capital Requirements Summary	16
4.3. Leverage Ratio	16
4.4. Total Capital Requirement	17
5. Credit risk	18
5.1. Loans and advances to customers	18
5.2. Wholesale Lending.....	21
5.3. Impairment Provisions.....	23
5.3.1. Impairment of Loans and advances to customers	23
5.3.2. Impairment of Treasury Assets	24
5.4. Credit risk mitigation.....	25
5.4.1. Loans and advances to customers	25
5.4.2. Treasury Assets & Counterparty Credit Risk	25
6. Market risk.....	27
7. Operational risk.....	28
7.1. Minimum Capital Requirements for Operational Risk	28
8. Liquidity risk	29
9. Other risks.....	31
9.1. Business Conduct Risk	31
9.2. Business Risk.....	31
9.3. Strategic Risk	31

- 9.4. Regulatory and Compliance Risk 32
- 9.5. Concentration Risk..... 32
- 9.6. Pension Scheme Obligation Risk 33
- 10. Securitisation..... 34
 - 10.1. Overview..... 34
 - 10.2. Originated securitisation 34
 - 10.3. Treatment of originated securitisations 35
 - 10.4. Purchased securitisation positions..... 35
- 11. Asset encumbrance 36
 - 11.1. Assets 36
 - 11.2. Collateral received..... 36
 - 11.3. Encumbered assets/collateral received and associated liabilities..... 36
- 12. Remuneration Committee and policy..... 37
 - 12.1. Material Risk Takers..... 37
 - 12.2. Remuneration Policy 38
- 13. Contacts 39

1. Overview

1. Overview

1.1. Background

The Basel Committee on Banking Supervision (BCBS) introduced the Basel II framework (Basel II) which was implemented in the EU at the beginning of 2007.

In January 2014, the Basel Committee replaced the Basel II framework with the Capital Requirements Regulation (CRR) and Capital Requirements Directive (CRD), commonly known as the Capital Requirements Directive IV (CRD IV), which introduced a revised definition of capital resources as well as capital and disclosure requirements. The rules are enforced in the UK by the Prudential Regulatory Authority (PRA).

The disclosure in this document meets the Society's obligation under Pillar 3 which applies to banks and building societies and complements the minimum capital requirements in Pillar 1 and the supervisory review process in Pillar 2. The Pillar 3 disclosures require firms to publish key information about their underlying risks, capital and risk management and are aimed at promoting market discipline.

1.2. Basis and Frequency of Disclosures

This document details The Nottingham's Pillar 3 disclosures as at 31 December 2017, with comparative figures for 31 December 2016 where relevant, and has been prepared to meet the disclosure requirements of CRD IV as presented in Part Eight of Regulation (EU) No 575/2013. The Society has adopted the standardised approach for all exposures and risk areas and uses the capital risk weighting percentages set by the CRR.

The Pillar 3 report is based upon the Society's Annual Report and Accounts for the year ended 31 December 2017, unless otherwise stated. Pillar 3 disclosures are issued on an annual basis in conjunction with the publication of the Annual Report and Accounts in accordance with regulatory guidelines.

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 by the Executive Committee 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 2017 Annual Report and Accounts.

The Society has a formal policy in place which outlines how it complies with Pillar 3 disclosure requirements.

1. Overview

1.4. Scope of Application

The disclosure requirements in this document apply to Nottingham Building Society (“the Society”). 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, which are 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

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.

The following company is a special purpose vehicle (SPV) established in connection with the Society’s securitisation programme. Although The Nottingham has no direct or indirect ownership interest in this company, it is accounted for as a subsidiary of Nottingham Building Society. This is because the SPV is principally engaged in providing a source of funding to the Society, which in substance means the Society is exposed to rights of variable returns from its involvement in the SPV and has the ability to affect those returns through its power over the entities.

Name of SPV	Nature of business
Arrow Mortgage Finance No. 1 Limited	Secured funding vehicle

There is no significant risk transfer associated with the securitisation, so for as the purposes of regulatory capital and Pillar 3, the SPV is consolidated within the Society disclosures.

1. Overview

1.5. Directors

A summary of the relevant experience of each of the Executive and Non-executive Directors is given on pages 18 and 19 of the 2017 Annual Report and Accounts.

Confirmation of directorships held is disclosed in the Annual Business Statement, which is available on page 96 of the 2017 Annual Report and Accounts.

The policy regarding recruitment and diversity for selection of Directors is outlined on page 29 of the 2017 Annual Report and Accounts.

A copy of the 2017 Annual Report and Accounts is available at www.thenottingham.com.

2. Risk management objectives & policies

2. Risk management objectives & policies

2.1. Introduction

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

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 Group and Society face in the course of delivering its strategic objectives.

This includes both current risks and those associated with the implementation of future strategy. The Board annually reviews and approves a risk appetite statement. In pursuing its strategy, the Board ensures there are appropriate capabilities and resources available, along with sufficient capital strength to succeed. This includes focusing on risk and reward to ensure it is at an acceptable level.

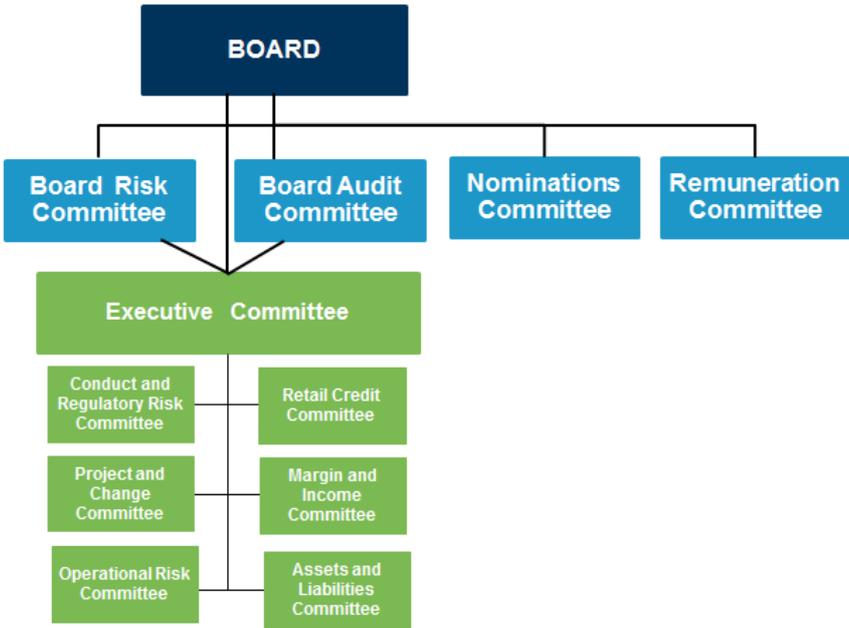
The Nottingham operates a 'three lines of defence' approach to the allocation of responsibilities for risk identification and management. This is illustrated in the following diagram:

3 Lines of Defence	Focus	Summary of core responsibilities
1st line of defence: Front Line Function	Control	Day to day management and control of risk
2nd line of defence: Risk Management	Oversight	Oversight and challenge of first line of defence
3rd Line of defence: Internal Audit	Assurance	Independent assurance of the first two lines of defence.

2. Risk management objectives & policies

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 seven 'management level' risk committees reports to the Board Risk Committee, through the Executive Committee. It is the responsibility of the Board Risk Committee to take a Society wide view of The Nottingham's overall exposure to risk.



The risk management framework, outlined on page 7, is based on the three lines of defence model 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.

2. Risk management objectives & policies

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

Board Risk Committee (BRC)	
<i>Committee members</i>	All Board members
<i>Summary terms of reference</i>	<p>The BRC is responsible for providing focused management and governance of risk by ensuring:</p> <ul style="list-style-type: none"> • Devoting sufficient time to the consideration of risks and issues and ensuring that adequate resources are allocated to the management of risk at The Nottingham. • Providing adequate levels of oversight to ensure risk management processes and systems are in place and fully operational and monitor the operating effectiveness of risk management processes. • Establishing and maintaining risk appetite statements and policies for each of The Nottingham's categories of risk. <p>It also oversees, at a high level, the operation of the Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP).</p> <p>In addition the BRC monitors The Nottingham's overall capital and liquidity adequacy and exposure to risk.</p>
<i>Frequency</i>	Quarterly
Board Audit Committee (BAC)	
<i>Committee members</i>	4 Non-Executive Directors
<i>Summary terms of reference</i>	<p>The BAC considers all audit matters relating to The Nottingham, including systems of internal control, financial reporting, accounting policies and judgemental accounting issues.</p> <p>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.</p> <p>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.</p>
<i>Frequency</i>	Quarterly with additional meetings to deal with the interim financial statements and Annual Report and Accounts.
Executive Committee (ExCo)	
<i>Committee members</i>	3 Executive Directors and senior managers
<i>Summary terms of reference</i>	<p>The Executive Committee is responsible to act on behalf of the Board in the organising, managing and protection of the Society's assets.</p> <p>In relation to risk, the Committee is responsible for ensuring the management and delivery of the following areas on behalf of Board:</p> <ul style="list-style-type: none"> • The setting and steering of the risk management framework, including recommendation for approval to the Board of all Board Risk appetites, policies and delegated authorities related to the principal risks of the Society. • Oversight of operations and effective execution of the Risk and Operational risk management framework.
<i>Frequency</i>	At least monthly

2. Risk management objectives & policies

Assets and Liabilities Committee (ALCO)	
<i>Committee members</i>	2 Executive Directors and relevant senior managers.
<i>Summary terms of reference</i>	<p>The Assets and Liabilities Committee (ALCO) is responsible for overseeing The Nottingham's liquidity risk, market and interest rate risk and its wholesale credit risk. In addition, ALCO reviews treasury activity for compliance with approved treasury policies and procedures.</p> <p>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.</p>
<i>Frequency</i>	Monthly
Retail Credit Committee (RCC)	
<i>Committee members</i>	2 Executive Directors and relevant senior managers.
<i>Summary terms of reference</i>	<p>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.</p> <p>The Committee performs this role through the implementation of agreed credit risk policies, strategies and processes in order to ensure that the impairment charges and capital utilisation are aligned with the Society's strategy, financial plan and ICAAP.</p> <p>The Committee ensures that the management of retail credit risk is consistent with the Retail Credit Risk Appetite Statement approved by the Board Risk Committee (BRC). The Committee also ensures the adequacy of the impairment and provision levels for the mortgage lending portfolio. The Committee owns the Society's Rating System together with the Standardised and Provisioning Models and must ensure that they remain fit for purpose.</p>
<i>Frequency</i>	Minimum 6 meetings per annum
Operational Risk Committee (ORC)	
<i>Committee members</i>	Head of Operations and relevant senior managers.
<i>Summary terms of reference</i>	The ORC oversees the management of the risk of loss resulting from human factors, inadequate or failed internal processes and systems or from external events (including the risks associated with fraud and financial crime).
<i>Frequency</i>	Quarterly
Conduct & Regulatory Risk Committee (CRRC)	
<i>Committee members</i>	Head of Operations and relevant senior managers.
<i>Summary terms of reference</i>	The CRRC is responsible for overseeing how The Nottingham conducts its business, ensuring that all customer-impacting activities are conducted in a clear, transparent and fair manner, delivering fair outcomes for customers. The CRRC is also responsible for overseeing compliance with all applicable laws and regulations.
<i>Frequency</i>	Minimum 4 meetings per annum

2. Risk management objectives & policies

2.4. Risk Strategy

The Nottingham's risk strategy reflects its committee structure. As such the Board approves the Board Risk Appetite Statement which contains both quantitative and qualitative risk measures. These statements are supported by a suite of risk metrics, limits and triggers designed to ensure The Nottingham stays within risk appetite.

Secondary, more granular, risk policies are approved by the relevant management level risk committee. These risk policies set out the key risks, how they are managed and incorporate further limits and triggers which are monitored by the individual management level risk committees.

In addition the third line of defence review the operation of controls during their assessments to provide assurance to the Board Risk Committee that controls are operating as expected or where weaknesses are identified to assist the strengthening of the risk management framework.

During 2017, the information received and considered by the risk committees provided reasonable assurance that during the year there were no material breaches of control or regulatory standards and that The Nottingham maintained an adequate system of internal control. Where weaknesses in controls are identified by the three lines of defence the Board monitor the steps taken to remedy the issues and to ensure that the Society responds to changing external threats and economic circumstances and to the changing regulatory environment.

2.5. Risk appetite

The Nottingham defines its overall appetite for risk in two ways:

1. Quantitatively, by outlining, in numerical and or financial terms, objective limits for risk taking (as described below); and
2. Qualitatively, by outlining in non-numerical terms the basic principles that are adopted by The Nottingham when managing its exposure to risk.

The Nottingham's strategic objectives and business plan, as approved by the Board, are aligned with its risk appetite. In so doing the risk appetite is consistent with the outcomes of these processes and has been designed to support both the maintenance of The Nottingham's financial position and the achievement of its strategic objectives.

2. Risk management objectives & policies

The Nottingham's overall risk appetite is used to determine the appetites for the seven risk categories that are defined in the risk management framework:

- Strategy & Capital Sustainability;
- Project & Change;
- Liquidity;
- Market & Interest Rate;
- Retail Credit;
- Operational; and
- Conduct & Regulatory.

2.6. Stress testing and planning

The Nottingham uses stress testing and scenario planning to help inform management of the impact from high impact stress events. Stress testing forms an integral part of the corporate planning process to ensure The Nottingham remains within risk appetite and has sufficient capital and liquid resources to carry out its strategic objectives.

3. Capital resources

3. Capital resources

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 regulations 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.

The following table show The Nottingham's capital resources as at 31 December 2017 based on both the transitional and final CRD IV rules basis.

		2017 CRD IV Transitional £m	2017 CRD IV Final £m	2016 CRD IV Transitional £m	2016 CRD IV Final £m
Common Equity Tier 1 (CET1) Capital					
2	General Reserves	215.5	215.5	201.2	201.2
3	Available-for-sale reserve (AFS)	-	-	0.3	0.3
6	CET 1 Capital before regulatory adjustments	215.5	215.5	201.5	201.5
CET 1 capital: regulatory adjustments					
8	Intangible assets	(3.0)	(3.0)	(2.9)	(2.9)
20b	Qualifying holdings	(6.3)	(6.3)	(7.9)	(7.9)
21	Deferred tax assets	-	-	(2.3)	(2.3)
28	Total regulatory adjustments to CET 1	(9.3)	(9.3)	(13.1)	(13.1)
29	Common Equity Tier 1 capital	206.2	206.2	188.4	188.4
Additional Tier 1 Capital					
32	Capital instruments classified as liabilities - Permanent interest bearing shares (PIBS)	11.9	-	14.3	-
36,44	Additional Tier 1 Capital	11.9	-	14.3	-
45	Total Tier 1 Capital	218.1	206.2	202.7	188.4
Tier 2 Capital					
46	Capital instruments classified as liabilities - Permanent interest bearing shares (PIBS)	11.9	23.8	-	-
50	Credit risk adjustment - Collective provision	2.9	2.9	2.9	2.9
51,58	Total Tier 2 Capital	14.8	26.7	2.9	2.9
59	Total Capital	232.9	232.9	205.6	191.3
60	Total risk weighted assets (RWA)	1,412.8	1,412.8	1,279.3	1,279.3
Capital ratios and buffers					
61	Common equity tier 1 ratio (as a % of RWA)	14.6%	14.6%	14.7%	14.7%
62	Tier 1 ratio (as a % of RWA)	15.4%	14.6%	15.8%	14.7%
63	Total capital (as a % of RWA)	16.5%	16.5%	16.1%	15.0%

3. Capital resources

Common Equity Tier 1 capital

The available-for-sale reserve is included in regulatory capital under CRD IV.

Under the rules of CRD IV, intangible assets and the Society's investments in subsidiary undertakings are deducted from CET 1 capital. At 31 December 2017, deferred tax assets that rely on future profitability and that arise from temporary differences are risk weighted and no longer deducted from capital.

There are no transitional provisions which apply to the CET 1 items in the current or prior year.

IFRS 9 'Financial Instruments' is effective from 1 January 2018. The impact on the financial statements is outlined on page 51 of the Annual Report and Accounts. It is estimated that the impact on the CET 1 ratio, from the adoption of this new accounting standard, following the provisions of the PRA transitional rules, will be an increase of between 10 and 30 basis points on an end point basis.

Additional Tier 1 capital

Under the CRD IV rules, PIBS no longer contribute towards Tier 1 capital due to their lack of loss absorbency features. They are subject to the transitional rules of CRD IV which allow the instrument to be grandfathered until December 2021.

Tier 2 capital

The Tier 2 capital includes collective impairment provisions.

During 2017, a review was completed of the regulatory treatment of the Society's PIBS instruments. As a result of this review, the PIBS are now classified as Tier 2 instruments as they transition out of Additional Tier 1 capital. The prior year position has not been restated.

3.1. Reconciliation of Regulatory Capital

A reconciliation of balance sheet capital to regulatory capital is presented below:

	2017 CRD IV Transitional £m	2017 CRD IV Final £m
Total equity attributable to members per the Statement of Financial Position	215.5	215.5
Adjustments for items not eligible for inclusion in CET 1 capital:		
- Intangible fixed assets	(3.0)	(3.0)
- Qualifying holdings	(6.3)	(6.3)
Total adjustments to CET 1 Capital	(9.3)	(9.3)
Adjustments to Additional Tier 1 capital:		
- Amortisation of PIBS under transitional rules	11.9	-
Adjustments to Tier 2 capital:		
- Permanent interest bearing shares (PIBS)	11.9	23.8
- Add back: Collective impairment	2.9	2.9
Regulatory Capital	232.9	232.9

4. Capital adequacy

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 possible future 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:

$$\text{Credit risk capital requirement} = \text{Exposure value} \times \text{Risk weighting}^* \times 8\%.$$

*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. In addition to credit ratings, The Nottingham reviews the capital adequacy, assesses the financial performance, non-performing loans and any other risks associated with financial institutions.

4. Capital adequacy

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 2017:

Capital requirements	31 December 2017 £m	31 December 2016 £m
Credit Risk		
- Loans and advances to customers	97.7	87.4
- Wholesale lending	1.2	0.7
- Other Items	3.7	3.7
Operational Risk	7.4	7.5
Minimum capital requirement	110.0	99.3
Capital resources (section 3)	232.9	205.6
Excess of own funds over minimum Pillar 1 capital requirement	122.9	106.3

4.3. Leverage Ratio

The CRD IV framework requires firms to calculate a simple, transparent, non-risk based leverage ratio that is a supplementary measure to the risk-based capital requirements.

The leverage ratio measures the relationship between the capital resources of the Society and its total assets as well as certain off balance sheet exposures. The ratio is defined as the Capital Measure divided by the Exposure Measure, with this ratio expressed as a percentage on an end point basis.

The capital measure for the leverage ratio is Tier 1 capital from the risk-based capital framework as defined in paragraphs 49 to 96 of the Basel III framework (see table in Section 4), taking account of the transitional arrangements.

The Exposure measure is the total on and off balance sheet exposures (subject to credit conversion factors) as defined in the Delegated Act amending CRR Article 429, which includes deductibles applied to Tier 1.

4. Capital adequacy

Leverage ratio	Transitional rules		2017 £m	Final rules 2016 £m
	2017 £m	2016 £m		
Total Tier 1 capital	218.1	202.7	206.2	188.4
Exposure:				
- Total regulatory balance sheet exposure	3,902.6	3,592.6	3,902.6	3,592.6
- Netted Derivative adjustment	7.8	7.3	7.8	7.3
- Mortgage Pipeline	95.3	90.4	95.3	90.4
- Other committed facilities	200.1	388.6	200.1	388.6
- Tier 1 deductions	(9.3)	(13.1)	(9.3)	(13.1)
Leverage ratio exposure	4,196.5	4,065.8	4,196.5	4,065.8
Leverage ratio	5.2%	5.0%	4.9%	4.6%
Leverage ratio excluding central bank deposits	5.7%	5.5%	5.4%	5.1%

At the 31 December, at 5.2%, the leverage ratio of The Nottingham was well above the 3% regulatory minimum based on the transitional rules. Upon full implementation of the CRD IV rules this will reduce to 4.9%, but still well above the 3% regulatory minimum.

The Nottingham will continue to operate at a level considerably in excess of the regulatory minimum.

4.4. Total Capital Requirement

The Society is required to hold a certain amount of capital against the assets it holds, which is referred to as its Total Capital Requirement (TCR). At 31 December 2017, the Society's Total Capital Requirement was set at 9.87% of risk weighted assets or £139.5m.

5. Credit risk

5. 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).

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.

If the scorecard decision is to accept, the mortgage application will be processed. Where applications are declined, applicants are given as much information as possible regarding the reason for the decision.

Pricing

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

Concentration Risk

The design of retail products takes into account the overall mix of products to ensure that The Nottingham's exposure to market risk remains within permitted parameters.

5.1. Loans and advances to customers

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 ultimately 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 through the Executive Committee. Responsibility for day to day management is delegated to the Head of Finance.

5. Credit risk

5.1 Loans and advances to customers (continued)

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/ re-mortgaging 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 Finance.

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

Standardised exposure classes	31 December 2017		31 December 2016	
	Exposure Value £m	Capital Requirement £m	Exposure Value £m	Capital Requirement £m
Retail	49.3	3.0	28.1	1.7
Secured by Mortgages on Residential Property	3,233.5	90.5	2,905.4	81.3
Secured by Mortgages on Commercial Real Estate	66.7	4.0	68.6	4.1
Past Due Items	2.6	0.2	3.1	0.2
Other Loans	-	-	1.1	0.1
Total Loans and advances to customers	3,352.1	97.7	3,006.3	87.4

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

31 December 2017	<3 months	>3 months < 1 year	>1 year < 5 years	>5 years	Total
	£m	£m	£m	£m	
Retail	-	-	0.2	49.1	49.3
Secured by Mortgages on Residential Property	1.6	6.2	83.1	3,142.6	3,233.5
Secured by Mortgages on Commercial Real Estate	0.1	1.2	4.6	60.8	66.7
Past Due Items	-	0.2	0.1	2.3	2.6
Other Loans	-	-	-	-	-
Total Loans and advances to customers	1.7	7.6	88.0	3,254.8	3,352.1

31 December 2016	<3 months	>3 months < 1 year	>1 year < 5 years	>5 years	Total
	£m	£m	£m	£m	
Retail	-	-	-	28.1	28.1
Secured by Mortgages on Residential Property	2.6	8.4	78.2	2,816.2	2,905.4
Secured by Mortgages on Commercial Real Estate	0.2	0.7	3.9	63.8	68.6
Past Due Items	-	-	0.5	2.6	3.1
Other Loans	-	-	0.2	0.9	1.1
Total Loans and advances to customers	2.8	9.1	82.8	2,911.6	3,006.3

5. Credit risk

5.1 Loans and advances to customers (continued)

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

31 December 2017						
Region (United Kingdom)	Retail £m	Secured by Mortgages on Residential Property £m	Secured by Mortgages on Commercial Real Estate £m	Past Due Items £m	Other Loans £m	Total £m
Eastern	3.1	301.7	3.5	-	-	308.3
East Midlands	9.6	629.1	18.8	1.0	-	658.5
London	2.0	241.3	5.6	0.2	-	249.1
North East	2.8	169.8	0.9	0.2	-	173.7
North West	6.3	344.9	11.7	0.2	-	363.1
South East	6.2	450.8	5.7	0.3	-	463.0
South West	3.8	260.0	4.3	0.2	-	268.3
Wales	1.5	89.4	3.0	0.1	-	94.0
West Midlands	6.7	323.5	5.6	0.2	-	336.0
Yorkshire & Humberside	6.7	414.9	5.8	0.2	-	427.6
Other	0.6	8.1	1.8	-	-	10.5
Total	49.3	3,233.5	66.7	2.6	-	3,352.1

31 December 2016						
Region (United Kingdom)	Retail £m	Secured by Mortgages on Residential Property £m	Secured by Mortgages on Commercial Real Estate £m	Past Due Items £m	Other Loans £m	Total £m
Eastern	1.3	290.5	3.6	0.3	-	295.7
East Midlands	5.7	593.1	20.2	1.5	0.9	621.4
London	0.4	233.8	5.0	0.3	-	239.5
North East	3.3	136.5	0.9	-	-	140.7
North West	4.4	291.4	12.1	0.2	-	308.1
South East	1.5	410.0	5.7	0.1	-	417.3
South West	1.4	227.6	4.7	-	0.1	233.8
Wales	1.0	73.1	3.1	0.1	-	77.3
West Midlands	3.2	280.4	5.3	0.2	-	289.1
Yorkshire & Humberside	5.2	359.5	6.1	0.3	0.1	371.2
Other	0.7	9.5	1.9	0.1	-	12.2
Total	28.1	2,905.4	68.6	3.1	1.1	3,006.3

5. Credit risk

5.2. 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 Executive Committee and Board Risk Committee.

The Nottingham's treasury policy only permits sterling denominated lending to UK and other central governments, UK local authorities, UK and overseas banks and building societies. In addition, lending is permitted to selected European based Multilateral Development Banks in instances where it qualifies as High Quality Liquid Assets (HQLA) eligible assets. The Nottingham 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 and meet The Nottingham's thresholds on capital and non-performing loan measures.

During the year, investments in Residential Mortgage Backed Securities (RMBS) have been permitted in instances where it meets minimum investment criteria which only allows AAA rated senior tranches which are sterling denominated.

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

Standardised exposure class	31 December 2017		31 December 2016	
	Exposure Value £m	Capital Requirement £m	Exposure Value £m	Capital Requirement £m
Central Government or Central Banks	382.0	-	440.7	-
Multilateral Development Banks	28.6	-	15.2	-
Institutions	26.9	0.6	40.1	0.7
Securitisation positions	33.5	0.5	-	-
Derivative Financial Instruments	15.1	0.1	10.7	-
Total Wholesale lending	486.1	1.2	506.7	0.7

The following table shows the residual maturities of all wholesale credit exposures as at 31 December.

31 December 2017	<3 months	>3 months < 1 year	>1 year < 5 years	>5 years	Total
	£m	£m	£m	£m	
Central Government or Central Banks	351.1	10.1	20.8	-	382.0
Multilateral Development Banks	5.1	-	23.5	-	28.6
Institutions	18.3	8.6	-	-	26.9
Securitisation positions	-	-	30.5	3.0	33.5
Derivative Financial Instruments	-	0.2	14.1	0.8	15.1
Total Wholesale lending	374.5	18.9	88.9	3.8	486.1

5. Credit risk

5.2 Wholesale lending (continued)

31 December 2016	<3 months £m	>3 months < 1 year £m	>1 year < 5 years £m	>5 years £m	Total £m
Central Government or Central Banks	399.2	10.1	31.4	-	440.7
Multilateral Development Banks	-	10.1	5.1	-	15.2
Institutions	13.3	9.3	17.5	-	40.1
Corporates	1.1	-	9.6	-	10.7
Total Wholesale lending	413.6	29.5	63.6	-	506.7

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

31 December 2017 Credit Rating	UK £m	Supranational Institutions £m	North America £m	Asia £m	Total £m
Credit Quality Step 1	415.5	28.6	12.7	3.6	460.4
Credit Quality Step 2	23.2	-	-	-	23.2
Credit Quality Step 3	2.5	-	-	-	2.5
Unrated	-	-	-	-	-
Total	441.2	28.6	12.7	3.6	486.1

31 December 2016 Credit Rating	UK £m	Supranational Institutions £m	North America £m	Asia £m	Total £m
Credit Quality Step 1	389.2	15.2	12.7	8.9	426.0
Credit Quality Step 2	15.8	-	-	-	15.8
Credit Quality Step 3	11.4	-	-	-	11.4
Unrated	53.5	-	-	-	53.5
Total	469.9	15.2	12.7	8.9	506.7

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. Credit risk

5.3. Impairment Provisions

5.3.1. 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 are shown in the table below.

31 December 2017	Loans fully secured on residential property £m	Loans fully secured on land £m	Total £m
Not impaired	3,301.0	63.9	3,364.9
Impaired			
Not past due	0.1	2.0	2.1
Past due up to 3 months	0.6	0.7	1.3
Past due over 3 months	0.2	-	0.2
Possessions	-	-	-
Total Exposure	3,301.9	66.6	3,368.5
Provision	1.7	1.5	3.2
Charge for the year	0.2	(1.5)	(1.3)

5. Credit risk

5.3 Impairment provisions (continued)

5.3.1 Impairment of Loans and advances to customers (continued)

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:

	2017 Loans fully secured on residential property £m	2017 Loans fully secured on land £m	2017 Total £m	2016 Loans fully secured on residential property £m	2016 Loans fully secured on land £m	2016 Total £m
Individual provision						
At 1 January	0.4	1.2	1.6	0.4	1.9	2.3
Provision for loan impairment	(0.2)	-	(0.2)	-	(0.7)	(0.7)
Provision utilised	-	-	-	-	-	-
At 31 December	0.2	1.2	1.4	0.4	1.2	1.6
Collective provision						
At 1 January	1.1	1.8	2.9	0.7	1.5	2.2
Provision for loan impairment	0.4	(1.5)	(1.1)	0.4	0.3	0.7
At 31 December	1.5	0.3	1.8	1.1	1.8	2.9

5.3.2. 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 income statement. Any loss previously recognised through other comprehensive income is reversed out and charged to the income statement as part of the impairment cost.

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

5. Credit risk

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.

5.4.1. 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 and affordability assessment, 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 (AVM).

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.

5.4.2. Treasury Assets & Counterparty Credit Risk

In addition to retail credit risks, The Nottingham 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.

5. Credit risk

5.4 Credit risk mitigation (continued)

5.4.2 Treasury Assets & Counterparty Credit Risk (continued)

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. Derivatives are not used in trading activity or for speculative purposes.

The derivative instruments used by The Nottingham in managing its statement of financial position risk exposures are interest rate swaps. These are used to protect The Nottingham 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 Nottingham 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

Under the new European Securities & Market Authority (ESMA) regulations it will become mandatory for all eligible derivative instrument transactions to be centrally cleared. Although not yet required The Nottingham has decided to centrally clear all eligible derivatives. As such the vast majority of The Nottingham's derivatives are fully collateralised with a central clearing member, and therefore mitigating counterparty credit risk.

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 2017	8.8	6.3	15.1
31 December 2016	4.9	7.1	12.0

6. Market risk

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. This is measured against risk appetite for market risk which is currently set at a maximum of 4.0% of capital. In addition management review interest rate basis risk, the risk that different market interest rates move by different amounts, to assess the possible impact on profit.

The Nottingham’s sensitivity to this measurement (in terms of economic value) was:

	2% shift in interest rates £m	4.0% of capital £m
31 December 2017	(6.7)	9.3

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 Executive Committee.

7. Operational risk

7. Operational risk

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

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

Furthermore as part of the risk management framework all business areas are required to maintain functional risk registers. These documents include an assessment of the key risks faced by each functional area and an evaluation of the controls in place to ensure that risks are managed within risk appetite. The functional risk registers are used by management to document the effective management of both risks and controls within their business areas.

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 Executive Committee and then to the Board Risk Committee that in turn reports to the Board.

The Information Risk Committee, a sub-committee of the Operational Risk Committee is responsible for ensuring that The Nottingham’s information is securely managed.

7.1. 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 is:

	2017 Operational risk capital requirement £m	2016 Operational risk capital requirement £m
Basic Indicator approach	7.4	7.5

8. Liquidity risk

8. 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 prudent amount of its total assets are carried in the form of cash and other readily realisable liquid 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.

The monitoring of the liquidity policy is performed regularly as set out in the Board approved Risk Appetite and Policy statements. Compliance with these policies is reported to the Assets and Liability Committee monthly, and also to the Executive Committee and Board Risk Committee.

The Nottingham maintains a diverse funding base and ensures compliance with applicable regulatory requirements. Defined control limits determine the overall level of liquidity to be maintained. The base level and composition of The Nottingham's liquidity is subject to PRA guidance. The Nottingham's Internal Liquidity Adequacy Assessment Process (ILAAP) is reviewed annually and approved by the Board. The ILAAP forms a central part of The Nottingham's risk management and includes stress testing which analyses a range of severe scenarios to confirm that The Nottingham holds an adequate amount of available liquidity.

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

As outlined in section 5.4.2, the Society uses derivative financial instruments in accordance with the Building Societies Act 1986 for the purpose of limiting the extent to which The Nottingham 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 Nottingham in managing its statement of financial position risk exposures are interest rate swaps.

Since October 2015, The Nottingham has been required to be compliant with the Liquidity Coverage Ratio (LCR), which measures the amount of high quality liquid assets relative to estimated net stressed cash outflows within a 30 day period.

8. Liquidity risk

The table below shows the major components of the LCR on an average basis at each quarter end, based on the previous twelve months of data.

		Total weighted value			
		Quarter ending 31 March 2017 £m	Quarter ending 30 June 2017 £m	Quarter ending 30 September 2017 £m	Quarter ending 31 December 2017 £m
21	Liquidity buffer	570.6	586.5	579.3	577.0
22	Total net cash outflows	307.7	336.3	365.3	370.6
23	Liquidity coverage ratio (%)	190%	180%	159%	156%

12 data points are used in the calculation of the averages for each period of reporting.

The LCR at 31 December 2017 was 154% (31 December 2016: 177%).

9. Other risks

9. Other risks

9.1. 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 & Regulatory Risk Committee, which comprises the Head of Operations and other senior managers, supports the Board Risk Committee through the Executive 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.

9.2. 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 Finance Director and Chief Operating Officer.

9.3. 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 Executive Committee and Board Risk Committee oversee the detailed evaluation of these risks.

9. Other risks

9.4. 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 General Counsel.

9.5. 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.

Retail Credit Risk

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.

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.

Minimum acceptable credit ratings are approved by the Board Risk Committee with the Assets and Liabilities Committee reviewing details of changes to counterparty ratings on a monthly basis.

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.

9. Other risks

9.6. 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; and
- 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.

10. Securitisation

10. Securitisation

10.1. Overview

The Society has securitised a number of mortgage loans by pooling them together and transferring the beneficial interest of the loans to a Special Purpose Vehicle (SPV), Arrow Mortgage Finance No.1 Limited (Arrow 1).

The Society has a bilateral securitisation facility to raise wholesale funding and provide funding diversification. Securitisation funding forms a balanced portion of the Society's wholesale funding which helps generate liquidity from illiquid asset types, i.e. residential mortgage loans.

10.2. Originated securitisation

Originated securitisation transactions involve the sale of a portfolio of mortgage assets to another entity, the SPV. An SPV is a purposely created company where the ultimate holding company is unrelated to the originator of the loans, and is usually held by a trust, meaning Nottingham Building Society does not legally own the SPV.

The Society has securitised certain residential mortgage loans by the transfer of the beneficial interest in such loans to a SPV. The legal title to the mortgages remains with the Society and would only transfer to the SPV in limited circumstances, including the insolvency of the Society.

The table below sets out the roles that Society takes in relation to a securitisation transaction. The Society retains the first loss element.

Securitisation Company	Society's role in the securitisation process	
	Originator, Seller, Administrator, Cash Manager	Subordinated Loan Provider
Arrow 1	✓	✓

To raise funds for the purchase (being initially equal to the face value of the assets), a senior bilateral loan was provided to the SPV by the investor. Interest and principal received from the underlying assets is used to fund the payment of senior loan interest and principal. Any residual income after paying the interest and principal and any fees and other operating costs is distributed to the originating entity.

As there has been no transfer of significant credit risk, the Society does not calculate specific risk weighted exposure amounts for any positions it holds in the securitisation, or assets awaiting securitisation and these continue to be calculated in line with the capital requirements consistent with other mortgage assets.

10. Securitisation

10.2 Originated securitisation (continued)

The position on originated securitisations at 31 December is detailed below.

31 December 2017					
Securitisation company	Issue date	Gross assets securitised £m	Senior Loan £m	Subordinated Loan £m	Underlying assets past due and impaired £m
Arrow 1	July 2016	158.7	146.5	20.1	-

31 December 2016					
Securitisation company	Issue date	Gross assets securitised £m	Senior Loan £m	Subordinated Loan £m	Underlying assets past due and impaired £m
Arrow 1	July 2016	102.4	92.7	13.9	-

In November 2017, the bilateral facility was extended, with an additional £98m of mortgage assets provided as security to support an additional £93m of senior loan funding.

10.3. Treatment of originated securitisations

Residential mortgages have been pledged by the Society in order to raise wholesale funding. The pledged mortgages remain on the balance sheet of the Society, as it has retained substantially all the risks and rewards of ownership. These assets are held at amortised cost. Arrow 1 is fully consolidated into the Group accounts in accordance with IFRS 10. The transfer of mortgage loans to the securitisation company is not treated as a sale by the Society (as originator), and therefore no gains are recognised.

At 31 December 2017, there are no assets awaiting securitisation (2016: none).

10.4. Purchased securitisation positions

The Society has also invested in mortgage backed securities during 2017 as part of its overall investment strategy to maintain a diverse and liquid portfolio.

Purchases and retention of residential mortgage backed securities are undertaken within a clearly defined credit risk policy. All residential mortgage backed securities are monitored on a daily basis and if the credit rating deteriorates below AAA level, the position is reviewed. The Society holds no re-securitisations.

The valuation process of our investments in securitisation exposures primarily focuses on quotations from third parties and observed trade levels. The process has been consistent through 2017.

The Society's exposure to purchased securitisation positions amounted to £33.5m at 31 December 2017 (2016: £nil).

At 31 December 2017, no purchased securitisation positions were past due or impaired.

11. Asset encumbrance

11. Asset encumbrance

In October 2013 the EBA published final draft implementing technical standards (ITS) on asset encumbrance reporting under Article 100 of Capital Requirements Regulation (CRR) which was adopted and published by the European Commission in December 2014. Article 100 of the CRR requires the institutions to report to the competent authorities the level of their repurchase agreements, securities lending and all forms of asset encumbrance.

From a legal perspective, asset encumbrance is a claim against a property by another party. From a financial perspective, such claims have traditionally taken the form of security interests, such as pledges, given on assets by a borrower to a lender. In other words, giving collateral encumbers assets.

The majority of Nottingham's encumbrance is driven by secured financing activities, which include transactions in repo and collateral swaps as well as securitisation. The remaining encumbrance is driven by hedging derivatives. The Society maintains a level of asset encumbrance in line with the scale and scope of its operations.

11.1. Assets

The tables below show components of our encumbered and unencumbered assets for the year ended 31 December 2017.

31 December 2017	Carrying amount of encumbered assets £m	Fair value of encumbered assets £m	Carrying amount of unencumbered assets £m	Fair value of unencumbered assets £m
Assets of the reporting institution	1,305.7	-	2,596.9	-
Debt securities	-	-	109.2	109.2
Other assets	1,305.7	-	2,487.7	-

Other assets include loans and advances (including mortgages) and other balance sheet items not listed above.

11.2. Collateral received

The EBA Guidelines allow competent authorities to waive the requirement to disclose template B subject to a firm meeting certain criteria. The Society meets the criteria and therefore template B, Collateral received, is not disclosed.

11.3. Encumbered assets/collateral received and associated liabilities

31 December 2017	Matching liabilities, contingent liabilities or securities lent £m	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m
Carrying amount of selected financial liabilities	820.0	1,049.7

12. Remuneration Committee and policy

12. Remuneration Committee and policy

The primary objective of the Committee is to make recommendations to the Board on the general remuneration policy of The Nottingham and specifically on the remuneration of Executive Directors. The Committee also has oversight of the remuneration of both the Society's senior management team and Remuneration Code staff.

From 1 January 2011, The Nottingham 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 a minimum of three non-executive directors (one of which acts as Chairman of the Committee) and the Chief Executive, the Head of HR and the Company Secretary attend.

Further details regarding the remuneration policy and the role of Remuneration Committee are set out in the Directors Remuneration Report in the 2017 Annual Report and Accounts which are published on The Nottingham's website www.thenottingham.com.

12.1. Material Risk Takers

Material risk takers 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'. This includes executive and non-executive directors.

The table below sets out the aggregate quantitative remuneration for code staff in relation to their services for The Nottingham for the year ended 31 December 2017.

31 December 2017		Senior Management	Other Code Staff	Non-Executive Directors	Total
Number of staff	No	15	1	7	23
Fixed pay	£000	2,075	62	269	2,406
Variable pay	£000	341	4	-	345
Total	£000	2,416	66	269	2,751
Proportion of variable to total pay	%	14%	6%	-	13%
Deferred variable pay	£000	143	-	-	143
Severance payments	£000	-	-	-	-

No severance payments and no signing on payments were made to individual material risk takers during the year.

No one individual has received remuneration of EUR1 million or more in 2017.

12. Remuneration Committee and policy

12.2. Remuneration Policy

The main components of remuneration are outlined on pages 36 and 37 of the 2017 Annual Report and Accounts but are summarised below. As a building society, with no share instruments, there are no non-cash forms of remuneration.

Fixed pay	
Basic salary	Band, market benchmarking and performance driven. Band is determined via the HAY evaluation process and salaries for roles are determined by using functional external market benchmark data.
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 2017 Annual Report and Accounts.
Benefits	Include the provision of a car allowance, private medical insurance and death in service benefits.
Variable pay	
Variable pay	All code staff participate in one (some Executive Directors participate in two) discretionary bonus schemes. The bonus schemes are based upon a modular scorecard approach 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.

13. Contacts

13. Contacts

Should you have any queries regarding this document, please contact:

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Nottingham House,
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Nottingham,
NG1 3DL

14. Glossary

Arrears	A customer is in arrears when they are behind in meeting their contractual obligations with the result that an outstanding loan payment is overdue. The value of the arrears is the value of any payments that have been missed.
Additional Tier 1 capital (AT1)	Capital that meets certain rules under CRD IV and which comprises the Society's PIBS but only under the transitional provisions.
Basel 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 PRA/FCA Handbook.
Basel III	Basel III became effective in the UK on 1 January 2014 through CRD IV and sets out the details of strengthened global regulatory standards on bank capital adequacy and liquidity.
Capital Requirements Directive (CRD IV)	CRD IV is the European legislation which came into force from 1 January 2014 to implement Basel III. It is made up of the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD), outlining the capital requirements framework and introduced liquidity requirements, which regulators use when supervising firms.
Common Equity Tier 1 capital (CET1)	CET1 capital consists of internally generated capital generated from retained profits, other reserves less intangible assets and other regulatory deductions. CET1 capital is fully loss absorbing.
Common Equity Tier 1 ratio	Common Equity Tier 1 capital as a percentage of risk weighted assets.
Counterparty credit risk	Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.
Credit Quality Steps	A credit quality assessment scale as set out in CRR Articles 111 - 141 (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.
Debt securities	Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings excluding those issued by central banks.
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 or stock market indices. The Society uses derivative financial instruments to hedge its exposure to interest rates.
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.
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.

14. Glossary

Financial Conduct Authority (FCA)	The statutory body responsible for conduct of business regulation and supervision of UK authorised firms.
Impairment	The term impairment is usually associated with a long-lived asset that has a fair market value less than the historical cost (or book value) of the asset.
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. Impaired loans are defined as those which are more than three months in arrears or in possession. However other indicators of impairment may result in provisioning for losses.
Internal Capital Adequacy Assessment Process (ICAAP)	The Society's own assessment of the levels of capital that it needs to hold in respect of its regulatory capital requirements for risks it faces under a business as usual scenario including stress events.
Internal liquidity adequacy assessment Process (ILAAP)	The Society's own assessment of the liquidity resources it requires in order to remain within the risk tolerances it has set. This will include an evaluation of potential stresses based on multiple market environments.
Institutions	Treasury assets with financial institutions such as banks and building societies.
Leverage Ratio	The ratio of Tier 1 capital divided by the total exposures which includes on and off balance sheet items.
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 III Pillar 1 requirements for credit, market and operational risk.
Multilateral Development Banks	Treasury assets with Multilateral Development banks. These are also known as supranational institutions.
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 Additional 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.
Pillar 1	The parts of CRD IV which set out the minimum capital requirements for credit, market and operational risk.
Pillar 2	Those aspects of CRD IV which set out the process by which the Society should review its overall capital adequacy and the processes under which the regulators/ supervisors evaluate how well financial institutions are assessing their risks and take appropriate actions in response to the institutions' assessments.

14. Glossary

Pillar 3	The part of CRD IV governing the production of this document. It sets out information disclosures relating to risks, the amount of capital required to cover these risks, and the approach to risk management.
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. The PRA is a subsidiary of the Bank of England.
Retail	Residential mortgages where LTV is greater than 80%.
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 achieving business objectives.
Risk weighted assets (RWA)	The value of assets, after adjustment, under the relevant Basel III capital rules to reflect the degree of risk they represent.
Secured 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 which is only made available to Small and Medium sized Enterprises.
Securitisation	The process by which a group of assets (usually mortgage loans) is aggregated into a pool which is used to back the issuance of new securities. A company transfers assets to a special purpose vehicle which secures funding backed by those assets. The Society has established a securitisation structure (using residential mortgages as assets) as part of its funding activities.
Special Purpose Vehicle (SPV)	A legal entity (usually a limited company) created to fulfil narrow, specific or temporary objectives. In the context of the Society, the SPV is used in relation to securitisation activities.
Standardised Approach	The basic method used to calculate capital requirements for credit risk. In this approach the risk weighting used in the capital calculation are determined by specified percentages.
Tier 1 capital	A component of regulatory capital, it comprises CET1 and AT1.
Tier 2 capital	Comprises the collective impairment allowance (for exposures treated on a Standardised basis), less certain regulatory deductions.
Tier 1 ratio	Tier 1 capital as a percentage of risk weighted assets.
Total Capital Requirement	The total amount of capital the regulator requires the Society to hold, which is made up of Pillar 1 and Pillar 2A capital.