2017 ANNUAL REPORT AND ACCOUNTS

The Nottingham

Contents

KEY HIGHLIGHTS

The Society has continued to focus on the development of its strategy to offer members a unique brand of advice, service, value and choice. The Society's approach is gathering pace, as it has delivered this unique proposition to more customers in more locations across its heartland and in doing so achieved another year of strong performance and record balance sheet growth.

Below are some of the key achievements and financial highlights of 2017:

We strive to be the leading home related financial services mutual in our heartland

- Group pre-tax profit of £14.5m
- Total assets of £3.9 billion
- Record gross mortgage lending of over £1 billion resulting in mortgage book growth of 11.6%
- Strong retail franchise – total branch balances of £2.1 billion – more than doubled in the last five years
- The Society welcomed over 25,500 new customers and opened seven new branch locations
- Member Rewards scheme launched rewarding over £250,000 to members
- Net promoter score of 79%
- Arrears levels remain very low at less than a quarter of industry average
- Strong capital ratios with Tier 1 ratio at 15.4% and leverage ratio of 4.9%

CHAIRMAN'S STATEMENT

John Edwards

Market and economic background

In my statement last year, I highlighted a number of domestic and global events that were set to bring uncertainty to the economic environment in which your Society operates. As we progressed through 2017 that uncertainty remained a constant.

Brexit dominated our news in 2017, with the second week of December demonstrating how uncertain the Exit process has been, and will continue to be, for some considerable time yet. The week began with the embarrassment of the Prime Minister having to leave Brussels, not only without an expected agreement but with the complex issue of the Irish border and Government Coalition partners to satisfy. What looked, at first glance, to be a situation that could take weeks, or even months to sort out, was resolved four days later, following a middle of the night dash to Brussels. Accommodations had been made and all parties were now ready to move to the next, far more complex, stage with much higher stakes. This small example provides evidence of the uncertainty that will hang over the UK economy during the next two years or so – something markets dislike and provides the environment for volatility.

Against that backdrop the UK economy fared reasonably well but did begin to lag behind the growth achieved in a number of other key global economies.

Inflation, driven predominantly by sterling's weakness relative to the dollar and euro, rose throughout the year, peaking at 3.1% in November. The path for inflation remains uncertain in 2018, although the UK economy should benefit from weaker currency values falling out of the comparative figures. The continued low level of wage increases also helped inflation, but at the cost of a squeeze on real household incomes.

In response to the inflationary pressure, the Bank of England decided in November to reverse its 2016 0.25% reduction in bank base rate and increased it to 0.50%. As I stated last year, we did not believe it was necessary to reduce bank base rate in 2016 and welcomed the reversal of that decision, albeit rates remain at record low levels. Ultimately it makes sense to return rates closer to the long term average and certainly to a more appropriate level for an economy growing at 1% - 2% per annum and inflation at 2.5% - 3%.

The housing market reflected the rather muted economic environment, with housing transactions remaining around 1.1 million in the year, broadly in line with 2016. As expected, this was reflected in house prices, with the Nationwide House Price Index reporting a year-on-year increase of 2.6%, resulting in the average value of a house in the UK rising to £211,156. However, what was worthy of note was that within that increase we saw some diversity in regional values – whilst central London prices fell by almost 3% (driven mainly by significant increases in stamp duty payable for houses worth £1m plus), there was growth of more than 4.0% reported in some regions across the country such as the East Midlands, South West and West Midlands. We do expect to see further regional differences throughout 2018.

With rates now expected to steadily rise, one area of lending which was very active in 2017 was remortgaging as consumers sought to secure current low rates. In fact 37% of all UK mortgage lending in 2017 was for remortgages and we expect this to continue in 2018. During the year, the Government continued to highlight the need to increase annual house building starts to 300,000 plus – something which the Society continues to support.

As we enter 2018, we expect uncertainty in the market to continue and, although the UK economy remains reasonably resilient and continues to grow, albeit at a lower rate than other major economies, productivity remains a concern because it is low relative to other major economies and could hold back future growth prospects.

Against this backdrop, the Society remains confident in its strategy, recognising that it is as important now as it ever has been for our members to plan for and protect their financial futures, something which our unique strategy is strongly focussed on providing.

Regulation

The fast pace of regulatory change of recent years has continued in 2017 and is expected to remain so for the foreseeable future. The Society has had to prepare for a number of regulatory changes that touch every element of our operations – whether that be through the Payment Services Directive II, new accounting rules for losses and provisions (IFRS 9) or a raft of changes in capital rules.

We have also seen significant changes in the buy-to-let market (which represents approximately 25% of all of our mortgage lending) with new fiscal rules to be applied for landlords over the next 2-3 years and in prudential requirements for lending to landlords with more than four properties.

However, one of the widest ranging changes to the regulation of our business is set to be implemented in May 2018. The General Data Protection Regulation (GDPR) which comes into force on 25 May 2018 will harmonise data privacy laws across Europe and the way in which all organisations can use the data that they hold on customers. This will bring many changes to us all in how we go about our business and daily lives.

In our increasingly digital world, not only is it important how we store and use data but also how we protect it from the increasing threat of cyber theft. The Society and its Board take this very seriously and have continued to invest significantly in developing and increasing the resilience of our data storage and network. In 2017 this included an expert, independently run session with Board members to enhance our knowledge and understanding of this ever-changing threat – this session included simulated attacks and defence techniques for a range of scenarios. We believe this reflects the importance we now place on this key risk.

Strategy and progress

In my statement last year I highlighted the importance the Board places on ensuring that we remain relevant to a wide section of our communities now and in the future, helping them to plan and protect their family's financial future and in doing so demonstrate the value and benefits of being a member of the Nottingham Building Society.

David highlights the progress and achievements of the past 12 months in his Chief Executive review on page 6 – which reflects the success of our unique and developing strategy.

Your Board continues to encourage the management team to demonstrate the delivery of member value to our loyal customers, whilst also ensuring that we can continue to grow and reward future members by remaining relevant and accessible in our communities.

That is why we were pleased to both continue to increase our branch presence in 2017, which now spans 11 counties, as well as to commit to significant investment in developing our digital capability which will be designed to complement our physical branch presence – something already being successfully demonstrated by some of the world's very best consumer businesses.

We will continue to encourage the management team to build on the progress achieved in recent years and particularly in 2017.

Board

After an active period of changes during 2016 and early 2017, the Board has had a relative period of stability.

Following Ashraf Piranie's resignation in February we were delighted to appoint Daniel Mundy as Finance Director. Daniel joined us from the Co-operative Bank where he was Director of Finance. Prior to that role, he had an impressive track record at Santander, the Financial Services Authority and fellow mutuals Nationwide and Yorkshire Building Society. He has already made a telling contribution in support of the development of our strategy and I welcome him to The Nottingham and the Board for what I trust will be a long and successful career with the Society.

We were disappointed to receive the resignation of Guy Thomas as non-executive Director of the Society during the year. Guy was in his first term as a director with the Society but chose to leave us to pursue other career opportunities. We wish him well for the future.

The Board continues to regularly review its membership to ensure that collectively it has the most appropriate balance of skills and experience to ensure it continues to operate effectively in a changing environment. Following Guy's resignation, the Board is currently in active recruitment of an additional non-executive director.

Supporting the communities

Our Doing Good Together initiative continued to go from strength to strength in 2017.

Staff have continued to generously give their time volunteering to support a whole range of worthy causes from financial education workshops to gardening projects – in fact we saw a 30% increase in staff volunteering during the year – demonstrating how important our team members view supporting their local communities.

Our Grants for Good programme saw 14 charities receiving valuable financial support to fund work in the areas of financial education, tackling homelessness and improving employability – our key themes for community support.

We have also continued to work with our key partners throughout the year. With Young Enterprise, we supported 24 schools across the East Midlands to run their Company Programmes, providing invaluable experience in commerce and entrepreneurship to young people. We extended our programme with SportsAid, supporting 50 budding local athletes in their quest to achieve Olympic stardom – in fact four athletes from our programme represented Great Britain at the World Athletics Championship in London in August.

We also passed a milestone with our charity partner Framework – with £50,000 raised to tackle homelessness across the East Midlands since our partnership began. With some of the money raised we have provided 5,000 hours of tuition for the charity's Skills Plus programme to help build skills such as budgeting and tenancy management to help avoid homelessness in the future.

In recognition of our efforts to support our communities, the Society was delighted to be invited to an event at 10 Downing Street, organised to recognise contributions to civil society in the Midlands. This gave us an excellent opportunity to show case our work to government officials and ministers.

Summary

Whilst the uncertainty of the past year will continue for some time yet, it is as important as ever for families and individuals across our heartland to take the appropriate steps to plan for, and protect, their financial futures. Our research and customer feedback tells us that they want the support of a trusted organisation rooted in their communities.

The Society has demonstrated in recent years that it has the strategy and the financial strength to be that organisation. We therefore remain focused on developing and investing in our capability to ensure we can continue to support a growing membership who feel valued and rewarded for being a member of the Nottingham Building Society.

I would, as always, like to warmly thank all of our team members, partners and suppliers who have supported the Society in the delivery of its strategy in 2017 and offer our very best wishes for this continued support in 2018 and beyond.

We will continue to encourage the management team and all their colleagues to build on the progress achieved in recent years, particularly in 2017, when they delivered more member and customer focused initiatives than I can remember over the six years that I have been a member of the Society's board. They achieved this whilst also implementing a significant volume of regulatory changes. On behalf of the Board, I want to take this opportunity to thank David Marlow and all his colleagues at The Nottingham for what they have achieved in 2017.

Finally, I would like to thank all our members for your support in 2017.

John Edwards
Chairman

21 February 2018

CHIEF EXECUTIVE'S REVIEW

David Marlow

Despite continuing uncertainty facing the UK economy highlighted in the Chairman's statement, I am pleased to report a year of strong progress in the development of our 'all under one roof' strategy which is focused on supporting and rewarding our members for doing the right thing to plan for and protect their financial futures.

Your Society

At the beginning of 2017 we set a number of objectives which sought to continue to grow the membership of the Society, look at ways in which we could reward membership through the delivery of our unique advice and service proposition, continue to invest in the infrastructure and capability of the Society, maintain our world class level of service and continue to support our communities under our Doing Good Together initiative.

I am pleased to report that we have made excellent progress against all of these key objectives during the year.

One area that has clearly set us apart is the role of the branch network in delivering our strategy. We are committed to branches as they are the ideal place to most effectively deliver our all under one roof advice and service proposition. The continuing popularity of our branches is supported by the fact that our branch savings balances continued to grow, increasing by a further 8% in 2017.

I am pleased therefore that at the end of the year, we added a further seven new locations to our branch network in 2017 in Bourne, Dereham, Fakenham, Huntingdon, Spalding, Stamford and Thetford; this takes our branch network to 67 branches spanning 11 counties. We are now trading on the high street in Norfolk for the first time in the Society's history. The majority of these locations have been on our target list for a number of years and we were happy to adopt an approach successfully used at a number of our new locations in recent years by replacing a strong incumbent in these towns. In this instance it was the Norwich & Peterborough Building Society (N&P) who announced the closure of their branch network early in 2017. I am grateful to the directors at the Yorkshire Building Society (of which N&P is a part) who agreed to work closely with us to ensure a smooth transition to the new Nottingham branches. We were also delighted to be able to offer employment opportunities to 21 ex-members of the N&P teams, who are now serving Nottingham customers. We have been universally welcomed to all our new locations and I hope that the residents of these towns will enjoy and support our unique proposition for many years to come.

Whilst branches are vital to our strategy, increasing and improving our digital offering to existing and prospective new members will also be important in the years ahead. As technology improves, we believe that we can develop our unique proposition to work seamlessly between the world of face-to-face and digital service. 2017 saw us commit to a multi-million pound investment to develop our digital capability to complement our growing physical presence. Working with world class customer relationship management experts at Salesforce, we are planning to create a unique and seamless savings, mortgage and advice proposition which will combine the best of face-to-face and digital service. Customers and members will see the first step in this journey in 2018 as we replace our current web portals for intermediary mortgage business and online savings with significantly improved functionality.

Serving and rewarding membership

In a crowded marketplace, not only is it vital to have a differentiated proposition but as a mutual to clearly demonstrate the benefits and value of membership.

We were delighted therefore to launch our member rewards scheme in 2017. As we laid out last year we want to be able to highlight the benefits of membership through our unique advice and service proposition. 'Member Rewards' achieves this by offering a range of discounts on our services to members who have saved more than £500 with us and have been a member for longer than 12 months (mortgage customers saving more than £500 qualify immediately).

These exclusive offers are designed to reward our loyal members for doing the right thing to plan for and protect their financial futures and includes £500 off estate agency fees, £25 cashback on home insurance, £120 cashback on funeral plans, free whole-of-market mortgage advice (£249 otherwise) and access to exclusive savings offers during the year. These represent genuine savings on a number of important services designed to reward members for planning ahead and for their loyalty to the Society.

Whilst the scheme was only launched in May, we have returned over £250,000 of rewards to members in the first few months of operating the scheme, an encouraging start. Members are clearly attracted to the concept as the numbers of eligible members has increased by approximately 10%. We expect 'Member Rewards' to be a consistent and enduring feature of membership of the Society in the future, constantly reflecting its benefit and value.

Another key initiative undertaken in 2017 is how we organise ourselves to deliver our unique proposition in branch to enable more customers access to our entire range of services in a consistent manner. Whilst this will take some time to complete, we have made significant progress in the last year which has included reorganising every job in our branch network, affecting 300+ team members, with roles that are now appropriately aligned to delivering our broad range of services consistently. We have reviewed opening hours, which means some branches will now open earlier and close later in line with customer demand, and in 2018 we will begin adding estate agency and building society services to some branches that currently do not offer these services.

Another commitment we made at the beginning of this year was to maintain our world class level of service. Despite the extensive and rapid rate of change across the Society's operations, we are pleased to have achieved this with a Net Promoter Score of 79% for the year, which places us amongst the best organisations in the world.

We have also continued to run member events, which we have aimed to make more interactive and to engage more directly with members around how they would like us to develop our advice and service proposition. One example of this was a request to enable members to 'donate' their member rewards to close family members – a great idea which we have put in place and enables long-standing loyal members to give their children and close relatives access to valuable services, such as free whole-of-market mortgage advice.

Our performance

As a consequence of a wide range of activity, some of which I have highlighted, we have produced a strong set of financial results in 2017 – the strategic report on page 8 covers our performance in detail. However, the highlights are:

In mortgage lending terms it has been a record year. We have processed mortgage applications of £1.4 billion, an increase of 29% over the previous record achieved in 2016, and this has enabled us to achieve gross lending of £1.021bn, a 28% increase on performance in 2016, the first time in the history of the Society we have achieved annual gross lending of £1 billion. Customers choosing to remain with the Society at the end of their mortgage deal is still at high levels with almost two out of every three choosing to do so, representing £601m, an 8% increase on 2016. Overall this enabled us to increase our mortgage assets by 11.6% – a strong performance.

Whilst it is important to grow the Society and its balance sheet, this must be achieved whilst balancing the conflicting needs of both our mortgage and savings members. We have therefore ensured that the mortgage yield we accrue is sufficient to pay our savings members a competitive return, cover the costs of running the organisation, make sufficient profit to enable us to cover our regulatory capital requirements and continue to invest in the Society for the future. This has been challenging at times when assessed against the high number of sub 1% mortgage rates that were available on the market throughout the year and our average savings rate of 1.0% over the period. We chose to avoid this aggressive level of mortgage pricing and managed to achieve record lending whilst not compromising on our credit quality. We believe the fact that we achieved this, whilst increasing our branch savings balances and delivering an average interest margin of 1.29%, only 3bps lower than in 2016, strongly demonstrates our mutual credentials of striking the right balance for members.

A crucial element in our financial performance is to execute our spending plans carefully, ensuring that costs are at an appropriate level whilst having the capability to deliver our proposition and invest effectively for the future. It is also important that with a higher than average cost model we see continued cost efficiencies being achieved. Again, in 2017 we have made good progress with our management expense ratio dropping by 2 basis points to 1.10% for the year. Good evidence that we are targeting our expenditure effectively.

Overall this enabled us to report a profit before tax of £14.5m up 2% on 2016, equating to a profit after tax ratio of 0.31% per £100 of assets – in line with our plan.

Quality and strength

The Society has continued to maintain its very high level of financial strength, whether viewed from a capital, liquidity or credit risk perspective.

Our capital levels remains significantly ahead of our regulatory requirements and our leverage ratio at 4.9% demonstrates the strength of our balance sheet for what is a relatively low risk model. Our liquidity position also remains strong and well controlled, backed up by rising branch retail savings balances and an increasing number of options available to our Treasury team, including Bank of England market facilities and secured bilateral wholesale lending.

We continue to maintain the highest standards of credit assessment and quality – despite increasing the mortgage book to almost 26,000 accounts we only have 40 accounts three months or more in arrears and have taken a total of eight properties into possession during the entire year. This remains a de-minimis level for a book of this size, which we believe is appropriate for where we currently are in the credit cycle. Whilst we expect credit conditions to return to more normal levels as rates rise, we remain extremely well positioned to deal with future events, something which is reflected in the maintenance of our strong overall external credit rating from Moody's.

Outlook

After a year of strong progress and despite the continuing uncertainty in the economic and political environment, we can be confident that we can move forward on our firm foundations. In 2018 we will be focusing on four key pillars of growing and rewarding membership; people, culture and community; operational excellence and strong financial adequacy. This will involve continuing the work of recent years; developing our nascent member reward programme, bedding in our enlarged and reorganised branch network, rolling out our plans to fuse digital and physical to create a strong platform for our unique proposition and building on our progress in mortgage lending.

As always, we will strive to deliver first class service across all of our customer facing operations, maintain our strength in financial adequacy and continue to support our communities through our Doing Good Together initiative.

I would like to thank all our team members and colleagues on the Board for their unwavering enthusiasm and commitment to develop our strategy and deliver our unique advice and service propositions.

Finally, I would like to thank our members who continue to loyally support the Society and who in growing numbers can look forward to an increasingly valued and rewarding relationship with us.

David Marlow
Chief Executive

21 February 2018

STRATEGIC REPORT

Daniel Mundy

Business model and Group strategy

The Nottingham is the UK's ninth largest building society with £3.9 billion of assets and a regional presence extending to 67 branches over 11 counties, which includes seven new branch openings in 2017, making us the fifth largest building society branch network in the UK.

The essence of a successful building society is to provide a safe and secure home for members' savings and to use these funds to provide mortgages to members to purchase their homes. This places us in the pivotal position of balancing the conflicting needs of both borrowing and saving members; striving to find the optimal point between offering good value to savers and competitive rates to borrowers.

The Nottingham's Board believes it is also our duty to ensure that our members are well positioned to manage their own financial affairs and plan for their futures. A core focus of The Nottingham's strategy is to continue to develop its franchise as the leading 'home related financial services mutual' in our heartland. Our success in doing this over recent years has been assisted through utilising existing estate agency locations and by opening new branches on our target list, particularly where other financial institutions have closed. The Nottingham is able to operate with a relatively larger branch network due to the synergy benefits of offering both estate agency and building society services from the same location.

As we embark on the next phase of our strategy to deliver increased value to members, we have launched our 'Member Reward' programme. This allows members to further benefit from our range of advice services such as whole-of-market mortgage advice, financial planning advice and estate planning services. In delivering customer value through these propositions, members will be able to enjoy more compelling reasons for being a member of The Nottingham, which in turn should help us to attract more new members.

Looking forward, whilst we expect digital services to continue to be increasingly popular, we believe our target market will be attracted by a strong combination of high street presence, digital accessibility and convenience. We will continue with our strategy to grow and develop our offering to achieve these aims in the years ahead.

Group structure and brands

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

Business performance

The Chief Executive's review includes a summary of factors affecting our performance in 2017 and should be read in conjunction with this report.

This section focuses on the financial performance indicators which the Board reviews on a regular basis and are key to our business success. The Board is pleased with the overall performance of the Group in the context of its strategic objectives.

Strategic objective	Key Performance Indicator	2017 performance		Achieved
Capital	Maintain an excess over regulatory requirements	CET1 ratio:	14.6%	✔
		Tier 1 ratio:	15.4%	✔
	Retain the leverage ratio above 4%	Leverage ratio:	4.9%	✔
Profit	Ensure profit after tax ratio and interest margin supports the capital objective for any given growth plan and investment in the business	PAT ratio:	0.31%	✔
		Interest margin:	1.29%	✔
Sustainability	Deliver strong efficiency ratio taking into account the scale of the Society	Cost income ratio:	74.8%	✔
		Manex ratio:	1.10%	✔
	Maintain strong asset quality with arrears/ impairment performance in the industry upper quartile	Arrears ratio:	0.15%	✔
Customer	To look after our member interests offering good value products and services	Net promoter score:	79%	✔
		More than 25,500 new customers		✔
	To be seen as a leading source of expert advice	Customer satisfaction:	82%	✔

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Underlying profit before tax	**15.6**	**15.3**	**16.8**	**15.9**
FSCS costs	(0.2)	(0.2)	(0.2)	(0.2)
Losses from derivative financial instruments	(0.2)	(0.9)	(0.3)	(0.7)
Strategic investment costs	(0.7)	-	(0.6)	-
Reported profit before tax	**14.5**	**14.2**	**15.7**	**15.0**

The Board monitors both reported and underlying profit before tax. Reported profit before tax is a commonly used comparative measure of profit. However, it includes a number of items which the Board does not believe fully reflect underlying business performance and therefore underlying profit is also used to measure performance. Underlying profit before tax equates to reported results, adjusted to exclude charges in respect of the Financial Services Compensation Scheme (FSCS), fair value gains or losses from derivatives and hedge accounting as well as one-off strategic investment costs, which are not on-going in nature. The comparative periods are disclosed on a similar basis.

2017 Financial review and key performance indicators

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

Underlying profit and profit after tax ratio

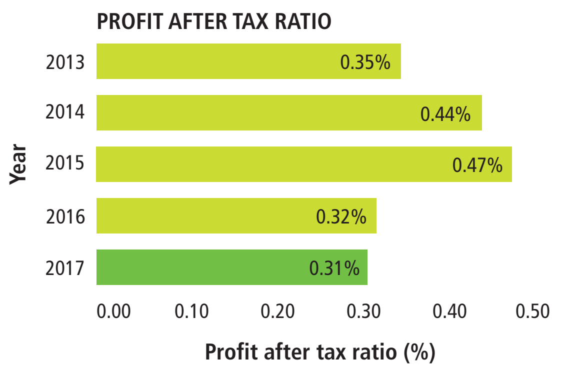
The Group's underlying profit before tax increased by 2% from £15.3m to £15.6m in 2017. This reflects increased net interest income driven by a larger asset base and a release of £1.3m of mortgage impairment provisions, partially offset by an additional provision recognised for PPI costs and an increase in operating costs. The rise in operating costs is driven by an increase in spend in our technology, people and our growing branch network as we invest in our digital capability and structure our network to support our 'all under one roof' operating model.

Strategic investment costs of £0.7m, which are excluded from underlying profit, reflect one-off costs incurred in relation to the the network transformation and the relocation of our IT data centre.

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

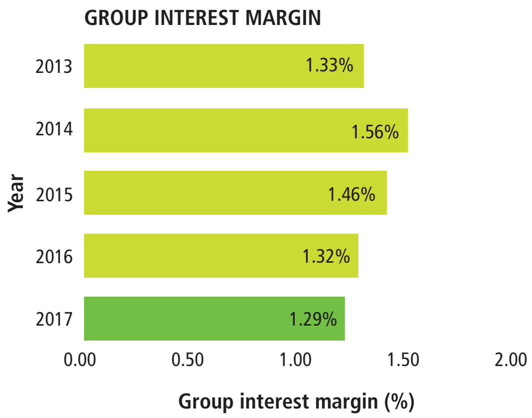
A year of strong performance from the Group's whole-of-market mortgage advice business has contributed £0.5m of profit to the Group. This however has been offset by difficult trading conditions in the estate agency division, which has reported a loss for the year of £1.2m. However this loss includes additional costs incurred for network re-organisation and the relaunch of our lettings proposition. The Board continues to recognise the valued strategic contribution which estate agency makes towards our 'all under one roof' proposition.

As a result of the above, the Group's profit after tax ratio has marginally reduced from 0.32% in 2016 to 0.31% in 2017, which is within the Board's appetite and plan.



Net interest income

Net interest income increased by £2.7m in the year to £48.3m as we delivered a net interest margin of 1.29%, a small reduction of 3 bps against 2016.



Asset yields continue to remain suppressed, driven by the low interest rate environment and access to low cost central bank funding through the Term Funding Scheme (TFS) and Funding for Lending Scheme (FLS) facilities.

However, we continue to try and protect our savings members from the low interest rate environment as much as possible. To highlight this, our average savings rate in 2017 was 1.0%, double the current bank base rate, and our average rate payable at the end of the year stood at 0.9%. Our members have responded positively to this move which is best reflected in our branch savings balances, which increased by 8% in 2017 and now stand at £2.1bn, double the level of five years ago.

Fee income

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

	2017 £m	2016 £m
Building society	3.2	3.3
Estate agency	4.3	5.2
Mortgage broking	1.6	1.3
Total	**9.1**	**9.8**

The total Group fee income has fallen by 7% in 2017 to £9.1m as a fall in estage agency fees has been partially offset by an increase in mortgage broking fees.

The overall fee income for the Society is broadly flat against the prior year. Levels of fee income continue to be impacted by intense competition in the mortgage market which has seen mortgage arrangement fees fall or disappear altogether on new mortgage lending. Third party estate planning income, through provision of wills, financial planning and protection products, has continued to perform well and is in line with our expectations.

Income from the estate agency business reduced by 17% to £4.3m, driven by the downturn in the housing market which has been particularly impacted by uncertainty following the EU referendum and changes in stamp duty which have effected the buy-to-let market in our heartland.

The success of the Group's whole-of-market mortgage advice proposition continues with income up by 23% to £1.6m in the year.

Derivatives

The Nottingham uses derivative instruments to manage exposure to changes in interest rates which arise from fixed rate mortgage lending and fixed rate retail savings products. This leads to volatility in results; such volatility would only be realised if we chose to sell the derivatives before they reach maturity. The Nottingham has no need or intention to sell these derivatives and so expects the £0.2m negative fair value adjustment to reverse out over the derivatives' remaining lives. As this volatility arises primarily due to timing differences, the Board excludes its impact from underlying performance.

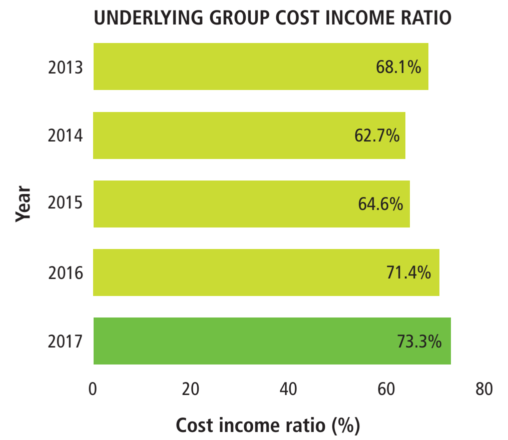
Management expenses

The Group's management expenses have increased by 7% to £41.3m in 2017.

The Society has invested significantly during 2017, particularly in the areas of branch network structure and technology. The reorganisation in the branch network will allow the Group to better deliver its customer and member focused 'all under one roof' offering in the future and ensure an agile branch network is in place. The investment in digitalisation will deliver improved accessibility to our services for members and the IT infrastructure spend will ensure that the Society continues to evolve and improve its IT capability and resilience.

The larger asset base of the Group is, however, supporting this increased spend and overall has resulted in a slight fall in the Group management expense ratio to 1.10% for the year (2016: 1.12%).

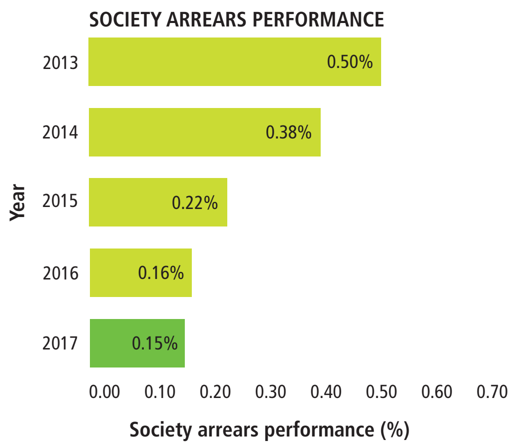
The Group's underlying cost income ratio is defined as total administrative expenses (excluding one-off strategic investment costs) as a percentage of total income (excluding the impact of fair value gains or losses from derivatives and hedge accounting).



The Group's underlying cost income ratio increased to 73.3% from 71.4% as the increased spend slightly outweighed the increase in income. Notwithstanding the increase in the year the ratio remains within the Board's target range.

Impairment and provisions

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



The Society's arrears ratio has continued to reduce, with the ratio at the end of 2017 at 0.15%. This incredibly low level of arrears should be regarded as almost de-minimis for a mortgage book of this size given that only 40 cases out of almost 26,000 mortgage accounts are three months or more in arrears and in fact at the year end, the Society had only one properties in possession.

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

The Society's total overall impairment provisions at 31 December is £3.2m (2016: £4.5m), which equates to 0.09% of the total book. The impact of reducing arrears, resolution of legacy cases and positive house price inflation over the last few years has led to a £1.3m release of impairment provisions in the year.

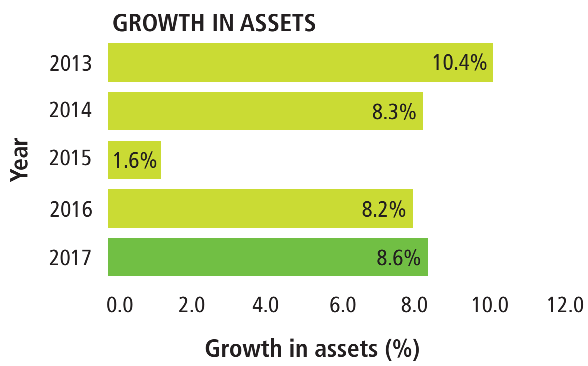
As outlined in the future accounting policy section on page 51, the Society is transitioning to accounting for impairment under IFRS 9 from January 2018.

In common with all other UK regulated deposit takers, the Society is required to pay levies under the Financial Services Compensation Scheme (FSCS) and has made provisions for the costs. For 2017 the FSCS levy has remained low at £0.2m (£0.2m in 2016) and covers the interest element of the scheme only.

Following the Financial Conduct Authority's (FCA) announcement during the year regarding a time barring of claims, effective from August 2019 as well as the Plevin case ruling, an additional £0.6m has been recognised in respect of PPI provision. At 31 December 2017 £0.8m (2016: £0.4m) is held in respect of customer redress provisions.

Assets

The Group balance sheet increased by 8.6% in the year to £3.9 billion.



The growth was driven by an 11.6% increase in our mortgage book, offset by a 6.1% fall in liquidity balances at year end.

Liquid assets

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

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

The Group's liquidity is made up as follows:

	2017	2016
	£m	£m
Bank of England	351.1	389.2
Multilateral Development Banks	28.6	15.2
UK Gilts & T'Bills	30.9	51.5
Certificates of deposit	-	9.1
Floating rate notes	16.2	16.2
Fixed rate notes	-	5.4
Mortgage backed securities	33.5	-
Other	34.6	40.4
Total	**494.9**	**527.0**

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

The Society supplements on-balance sheet liquidity with access to the Bank of England's Sterling Monetary Framework facilities supported by prepositioned collateral. When taking into account both on- and off-balance sheet liquidity, total liquid resources was 25.8% (2016: 20.7%), with prepositioned assets in addition.

The two key measures of liquidity introduced under CRD IV are the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). The final requirements for the NSFR are still to be finalised but the Society is currently in excess of the minimum levels required for both measures, with the LCR at the end of year being 154% (2016: 177%).

Mortgages

Gross lending totalled £1,021m, a record for the Society, of which £779m related to prime residential lending and £237m to buy-to-let. This mix is in line with prior years with mortgage lending remaining concentrated in prime high quality mortgage assets. Residential mortgages, excluding buy-to-let, account for 75% of the total lending book.

The Secured Business Lending (SBL) book reduced to £66.6m.

	2017	2016
	£m	£m
Residential	3,301.9	2,950.4
SBL	66.6	69.0
Total	**3,368.5**	**3,019.4**

Total mortgage balances increased by 11.6% during the year to £3,368.5m, driven by 28% increase in gross lending, reflecting our continued success on customer retention where we retained 59% of customers who reached the end of their fixed or discounted product term in the year.

Residential mortgage lending is focused primarily in the 60% to 80% LTV category but performance continues to be underpinned by the low interest rate environment and levels of House Price Inflation (HPI). The Society's average LTV increased marginally from 55% to 56% during the year.

	2017	2016
	%	%
<60%	38.7	41.2
60% - 80%	41.6	46.0
80% - 90%	16.6	10.4
>90%	3.1	2.4

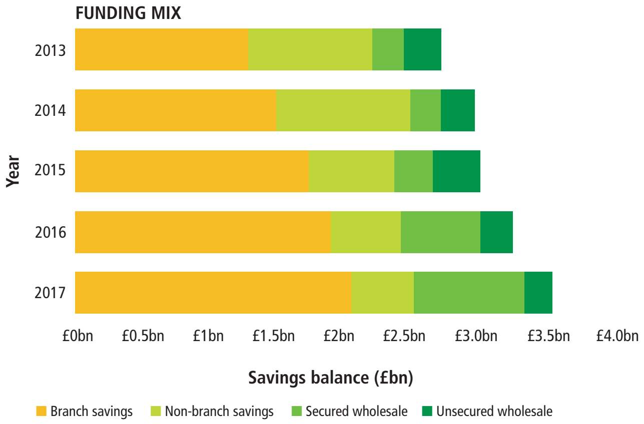
Geographic distribution continues to remain focused in two broad areas, our heartland of the East Midlands/Yorkshire and London/South East.

	2017	2016
	%	%
East Midlands/Yorkshire	32.4	33.1
London & South East	21.2	21.8
North	16.0	14.9
Eastern	9.2	9.8
West Midlands	10.0	9.6
South West	8.0	7.8
Other	3.2	3.0

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

Retail and wholesale funding

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



Retail savings continue to be the cornerstone of our funding requirement with the remainder obtained from the secured and unsecured wholesale funding markets. The Bank of England's Term Funding Scheme (TFS) has continued to provide access to secured funding and has supported asset growth during the year, with £485m (2016: £130m) drawn down under TFS at 31 December. This is in addition to the £297m remaining under the Funding for Lending (FLS) scheme (2016: £530m). The Society also has £146.5m (2016: £93.0m) outstanding at 31 December borrowed through a secured bilateral funding agreement. Overall this has resulted in a higher proportion of secured wholesale funding than in previous years, with the wholesale funding ratio increasing from 26.2% to 28.6%.

Retail savings have increased by £139m to £2.59bn in 2017. We have continued to see inflows into our branch based retail accounts with branch balances having increased by £158m to £2.1bn by the end of the year, representing an increase of 8%. Branch balances represent over 80% of total retail balances and this provides further support of the Group's combined operating model. It also continues to demonstrate the strength of our growing retail franchise and provides strong evidence that customers have responded positively to our moves to maintain good rates for savers alongside our 'Member Reward' proposition.

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

Customer satisfaction

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

Our customer satisfaction survey is central to assessing how well we are delivering customer service and is based on customers' responses to actual transactions and activity with The Nottingham. In 2017 we have maintained our industry leading levels of satisfaction, with 82% of our customers rating us as excellent, an increase from 81% in 2016.

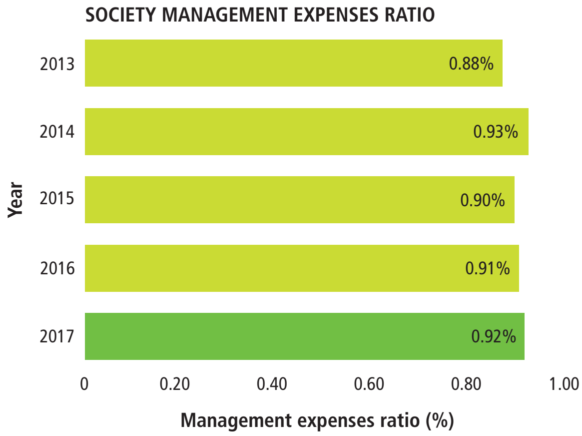
The net promoter score measures the percentage of customers strongly prepared to recommend The Nottingham to others, less those who are not prepared to recommend The Nottingham, which results in a net percentage of our customers who would recommend our products and services.

The Nottingham's net promoter score also saw an improvement, increasing to 79% compared to 78% in 2016.

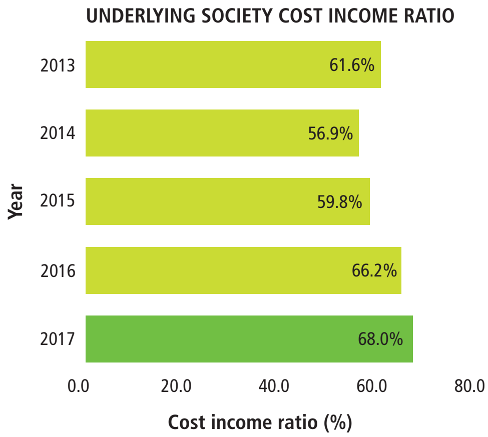
Our customer base continues to grow, with over 25,500 new customers welcomed to the Society during 2017. With strong customer satisfaction scores, a growing branch network and the 'Member Rewards' programme in place, we anticipate that this growth will continue.

Society performance

Overall, the Society has delivered a profit before tax of £15.7m for 2017 (2016: £15.0m). A growing asset base and a net interest margin of 1.29% has supported higher net income overall, alongside the benefit of the payment of a £0.3m dividend from its mortgage broking subsidiary entity in the year. This higher income has been offset by additional investment expenditure as previously outlined, resulting in a slight increase to the Society management expense ratio to 0.92% (2016: 0.91%).



The Society's underlying cost income ratio (excluding FSCS costs, fair value movement on derivatives and one-off strategic investment costs) has increased to 68.0%, in the main reflecting the slight fall in net interest margin and increase in costs as outlined above.



Capital

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

Common Equity Tier 1 (CET1) capital is the strongest form of capital and comprises the Society's general reserves. Whilst CET1 resources have increased by £17.8m, driven by the retained profit of the Society, this has been offset by an increase in risk weighted assets, reflecting the growth in mortgage assets. Overall this resulted in a CET1 ratio of 14.6%.

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

CAPITAL RESOURCES	2017 Final CRD IV £m	2016 Final CRD IV £m	2017 Transitional CRD IV £m	2016 Transitional CRD IV £m
COMMON EQUITY TIER 1 CAPITAL				
General reserves	215.5	201.2	215.5	201.2
Available for sale reserve	-	0.3	-	0.3
Regulatory adjustments and deductions	(9.3)	(13.1)	(9.3)	(13.1)
TOTAL COMMON EQUITY TIER 1 CAPITAL	**206.2**	**188.4**	**206.2**	**188.4**
ADDITIONAL TIER 1 CAPITAL				
Permanent Interest Bearing Shares	-	-	11.9	14.3
TOTAL ADDITIONAL TIER 1 CAPITAL	**-**	**-**	**11.9**	**14.3**
TIER 2 CAPITAL				
Permanent Interest Bearing Shares	23.8	-	11.9	-
Collective provision	2.9	2.9	2.9	2.9
TOTAL TIER 2 CAPITAL	**26.7**	**2.9**	**14.8**	**2.9**
TOTAL REGULATORY CAPITAL	**232.9**	**191.3**	**232.9**	**205.6**
RISK WEIGHTED ASSETS	**1,412.8**	**1,279.3**	**1,412.8**	**1,279.3**

CAPITAL RATIOS	2017 Final CRD IV %	2016 Final CRD IV %	2017 Transitional CRD IV %	2016 Transitional CRD IV %
Common Equity Tier 1 ("CET1") ratio	14.6	14.7	14.6	14.7
Total Tier 1 ratio	14.6	14.7	15.4	15.8
Total capital ratio	16.5	16.1	16.5	16.1
Leverage ratio – transitional rules	4.9	4.6	5.2	5.0

Regulatory adjustments in 2017 includes deductions for intangible assets and investments in qualifying holdings. In 2016, deferred tax assets were also deducted.

At 15.4%, the Society's Tier 1 ratio – which compromises both CET1 and Additional Tier 1 capital – has also fallen in the year driven by the increased risk weighted assets and the transitional provisions applied to the Society's PIBS.

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 on an end point basis, as they transition out of Additional Tier 1 capital. The prior year position has not been restated.

The leverage ratio, which is calculated as Tier 1 capital divided by total balance sheet exposure, has increased slightly in the year to 4.9% under the final rules basis. This is driven by the retained profit of the Society in the year offset by an increase in asset exposures from the growing mortgage book.

STRATEGIC REPORT

The leverage ratio excluding central banks deposits would be 5.2% under the final rules basis.

The Regulator requires that the Society holds a certain amount of capital against the assets it holds. This is referred to as the Total Capital Requirement. At 31 December 2017, the Society's Total Capital Requirement was set at 9.87% of risk weighted assets or £139.5m.

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

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

Principal risks and uncertainties

In common with other financial institutions, the nature of our business results in a number of inherent risks which are continuously monitored and managed by the Board. These inherent risks and how the Board manage them are considered in the risk management report on page 23 to 27.

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

Whilst we are a low-risk organisation, we inevitably face challenges that pose risk to the delivery of our strategic objectives. We continue to operate in an uncertain global environment which creates risks and challenges for the mutual building society model, particularly ultra-low bank base rates. These risks and uncertainties, and how we mitigate them, are summarised below.

Core mortgage lending yield

Margin earned on core mortgage lending products has and will continue to be reduced due to increasing market lending capacity and appetite in an already highly competitive marketplace. The Society has clear risk-adjusted return thresholds which it aims to meet, and will adjust its growth plans to ensure it continues to deliver a long-term sustainable return on its lending whilst delivering good value, relative to the market conditions, to savers.

Government lending stimulus

The introduction of the Term Funding Scheme (TFS) in 2016 as a replacement for the Funding for Lending Scheme (FLS), which was introduced alongside the Help to Buy Scheme in 2013, has continued to provide strong stimulus to the mortgage market through the availability of high levels of inexpensive funding. This has resulted in a reduction in new business market rates for both mortgages and savings. The Society has robust plans in place to replace this funding as it is removed however there are forward-looking risks in terms of how the market will adjust as to the removal of this stimulus.

Retail lending impairments

The level of retail lending impairments has continued to remain benign with the Society experiencing a very low number of arrears cases. Although arrears are expected to continue to be stable while interest rates remain low, the Society will need to remain vigilant over the medium term.The pace of future increases in interest rates and the regulator's concern regarding the level of customer indebtedness may potentially put borrowers under additional financial pressure. The majority of the Society's customers are currently on fixed rate mortgages and would therefore not be immediately impacted by changes in interest rates. Management regularly conducts stress testing on the mortgage book to gauge possible impacts of higher interest rate costs on our borrowers and are confident that our customers are well placed to manage rising costs.

Housing market

The Group's business model has very close links to the housing market and therefore a downturn in the UK economy accompanied by challenging housing market conditions would have an adverse impact on the Group's performance.

The UK regulatory authorities continue to remain concerned over the significant growth in the buy-to-let market and the potential future risks this may bring, culminating in a number of changes to the profitability of owning buy-to-let properties. The Society is closely monitoring the impact of these changes and adjusting its appetite for this type of lending accordingly.

The Board remains vigilant to monitoring trends in the housing market as uncertainty fuelled by the ongoing EU negotiations, 2017 general election result and global markets volatility prevail.

The Board actively monitors performance of the estate agency and lending activity and is therefore well positioned to respond effectively to any impact, volatility or downturn in the market.

Cyber risk

Cyber attacks continue to be experienced across a number of large and high profile organisations in the UK, with significant impacts. The regulatory authorities continue to remind financial services organisations of the constant need to remain vigilant in this area. Guarding against potential cyber attacks remains a key focus for Society management. The Society strives to keep pace with market trends in the prevention and detection of any potential attacks, in order to safeguard the business and protect its members' data and savings. This vigilance will need to be ongoing and a permanent feature of our risk management. The Society has allocated budget each financial year to make continued investment in this area to ensure that controls and defences keep pace with the risk.

Third party delivery of key services

The Nottingham works closely with key suppliers who provide services to members on our behalf. The Society closely manages such relationships which are supported by rigorous contractural requirements and strict service delivery standards. All suppliers are monitored to ensure that their services meet the Society's high standards at all times, and to ensure that they meet defined financial adequacy requirements. Metrics on service delivery are regularly reviewed at management committees. The Nottingham is committed to ensuring that its trusted suppliers continue to provide the highest level of service to our members.

Daniel Mundy
Finance Director

21 February 2018

Doing good together

Throughout the year we have continued our work in the community to provide much-needed help to a variety of local projects and charitable causes.

Our community programme focuses on the themes of homelessness, financial education and employability.

This year, through our Grants for Good scheme, we have donated £37,000 to 14 local charities, which has made a positive impact on the lives of over 3,500 people in our communities.

Our partnership with local homelessness charity Framework remains strong and this year we have supported the Do It for Framework (DIFF) Day and the 'Jail and Bail' initiative as well as the flagship event, the Big Sleep Out, to raise more than £3,000 for the charity. This takes our total raised, since the start of our partnership, to more than £50,000.

Our amazing staff have, once again, exceeded over 1,350 hours of volunteering to community projects. This year we have also supported some day-long volunteer challenges at Stonebridge City Farm in Nottingham and Age Concern, along with other local charities.

A major highlight of the year took place in March when we were invited to 10 Downing Street as part of the Midlands Civil Society celebrations, to recognise our work in the local community with the not-for-profit sector.

Ten local schools have benefitted from members of our staff acting as Business Advisers as part of Young Enterprise's Company Programme. We have also supported a further 24 schools across Nottinghamshire, Derbyshire, Leicestershire and Lincolnshire to help them run the programme.

We have provided financial education lessons to more than 300 pupils in our trading area through our Money Academy sessions.

Sports sponsorship

Our sports partnerships have also been a prominent feature of 2017. We have sponsored 50 local athletes through the charity SportsAid, and also during the year we raised over £3,000 through fundraising. Several athletes and alumni are now regulars at elite competitions. The World Championships in London saw para-sprinter Zac Shaw and Julie Rogers, as well as sprinter Alicia Barrett and hurdler Jess Turner, making their senior GB debut. Gymnast Elliot Browne won bronze in the World Tumbling Championships and gold in the men's team event.

Following the success of our partnership with the Lawn Tennis Association, we marked our third year as Official Partner of the Aegon Open Nottingham in 2017. The international tournament is played on outdoor grass courts at The Nottingham Tennis Centre and is seen by players as a major warm up to Wimbledon.

It was a record breaking year for the tournament, which ran over one week rather than the usual two. It proved to be a great success, with a total attendance of over 15,000 people.

We are now in our second year as Official Building Society of Leicester Tigers rugby club and we are extremely proud of our branded Robin Hood Stand.

Through our partnership with the club the TAG rugby scheme has been delivered to over 2,500 pupils in over 50 schools throughout Leicestershire.

This is just one more example of the work that has been undertaken through our community and partnership programme in 2017 – another fantastic year.

Our people strategy

Our people are important to us and play a pivotal role in our success. We have a strategy which focusses on recruiting the right people to support the delivery of the Society's strategic goals and ambitions and to develop, inspire and motivate them throughout their career with us as well as rewarding and recognising great performance.

In 2017 our key strategic objectives were to align our internal structures, roles and people with our business operating model of all 'under one roof' and to invest in new processes and systems that underpin our HR Operating Model.

Organisational alignment

Our focus has been on the integration of our retail network and the transition to the new business model to enable delivery of our customer and member value proposition. The new operating model will establish an efficient and agile branch network led by one management team to deliver our vision for the future.

This was the single largest people project the Society has undertaken and has resulted in one network team with clear roles and responsibilities and redeveloped career paths to support our people to develop their careers within the Society. All of our colleagues are now rewarded with the same benefits and terms and conditions of employment. We have reduced complexity across the network and delivered a consistent framework for resourcing, with the right people, in the right place, at the right time. Creating a unified culture led by one management team and reducing inconsistent working practices was key to the success of this project.

Colleagues across the business now operate in one model in the network carrying out dual roles rather than separate Estate Agency and Building Society roles.

Training and Development

Two thirds of our network colleagues have undertaken training around our new ways of working as well as skills refresher programmes.

We have continued to invest in our management population with the development of a number of management spotlight development sessions which focus on key management and leadership topics. These sessions are aimed at equipping leaders and managers with key people management skills including - licence to hire which is designed to ensure that we are giving the best possible experience to prospective employees, as well as identifying talented individuals to join our growing teams, HR skills development so we deliver fair and thorough processes to protect our employees and members, and finally annual appraisal training to ensure teams are motivated and supported to deliver their objectives and fulfil their potential.

We continue to invest in professional development, with many people across the organisation completing external qualifications during 2017, including our apprentices who are working towards a Level 2 Apprenticeship in customer service or property sales. As we continue to strengthen our talent pools we have delivered our second cohort of apprentices within our branch network, customer service teams and IT. A new partnership with 3aaa Limited, a local training provider who specialise in financial and professional services development, will see us continue to support young people into the world of work.

We have two senior leaders undertaking the Masters Programme at Loughborough University and we have continued to support the development of this programme in conjunction with the Building Societies Association.

Values and Leadership

We launched a new format for engaging with our leaders in 2017 with a new leadership conference where we are able to share our plans in much more depth and engage in debate and discussion. New organisation wide values were developed and launched across all teams during the year. We've started to embed these in our business through activities such as linking team events, recognition awards and individual and team objectives to the values. We have plans to do even more in 2018 to align our values with our strategic objectives through the redesign of our performance management system.

Talent Acquisition

Acquiring the best talent has again been key to delivering The Nottingham's vision. Focus has been on sourcing talent for the opening of new branches and assessment of our current talent in appointing our new network management team. By working collaboratively with the Yorkshire Building Society we were able to secure 21 experienced N&P colleagues to join our team and continue to serve the community in our new branches.

During the year we have also continued to source talented individuals to support the start-up and design of a challenging and complex change and regulatory agenda.

Equality and Diversity

We continue to support the Women in Finance Charter, a Government initiative introduced in 2016 to promote gender balance at all levels across the financial services sector. We set a gender diversity floor of 30% female representation across our senior leadership population and monitor and report on this. In 2017, we were pleased to report that we maintained our strong position on diversity at 45% female representation in the senior leadership population.

Environment

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

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

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

The Nottingham is also committed to procuring its goods and services in an ethically and environmentally sensitive way, yet with proper regard to its commercial obligations. Purchasing is undertaken in a manner that encourages competition and offers fair and objective evaluation of offers from all potential suppliers and we deal responsibly with suppliers by endeavoring to pay them on time and not expecting any discounts that will have a detrimental impact on their business.

YOUR BOARD OF DIRECTORS

Non-executive Directors

John Edwards

Chairman

John joined the Board in February 2012 and was appointed Chairman in May 2014. In his executive career, he held a number of roles at a CEO level in the insurance and investment sector, retiring in 2009. He was the senior independent non-executive director of the LV Group until September 2015 and is currently a non-executive director of Saga Services Ltd and GreyCastle Life Reinsurance (SAC) Ltd.

Jane Kibbey

BSc, MCIPD

Vice-Chairman & Senior Independent Director

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

Andrew Neden

MA, FCA

Andrew joined the Board in 2014. He is a Chartered Accountant with over 30 years' experience in financial services in the UK and overseas. After a number of years running KPMG's UK financial sector transaction services team, he was the global Chief Operating Officer for KPMG's financial services business. He is chair of Aetna Insurance Company Ltd. Other directorships include the Wesleyan Assurance Society and ABC International Bank Plc; he chairs the Audit committee for both organisations.

Kavita Patel

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

Kerry Spooner

LLB (Hons)

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

Executive Directors

David Marlow

ACIB

Chief Executive

David joined the Board in 2006 and became Chief Executive in 2011. Prior to his appointment as Chief Executive, David held the post of Retail Director. David has over 30 years' experience in a variety of roles in the financial services industry. Before joining The Nottingham, David held a number of senior posts in retail banking at Alliance & Leicester Plc, including Director of Current Accounts & Savings and Managing Director Alliance & Leicester Direct. He is currently a member of the Building Societies Association Council representing the Midlands and West Regional Association, which he chairs, and also represents building societies on the FCA's Small Business Practitioners Panel. He is a director of Nottingham Property Services Ltd, Nottingham Mortgage Services Ltd, Harrison Murray Ltd and HM Lettings Ltd.

Daniel Mundy

BA (Hons)

Finance Director

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

Simon Taylor

ACIB, MBA

Chief Operating Officer

Simon joined the Board in 2011 and is responsible for Customer Service, Operations, Distribution, the Branch Network, Estate Agency, Marketing and IT. He is also the Chairman of Nottingham Mortgage Services Ltd, Nottingham Property Services Ltd, Harrison Murray Ltd and HM Lettings Ltd. Simon joined the Society from Lloyds Banking Group where he was Regional Director for the North of England. Prior to this he had a number of senior roles within Lloyds Banking Group.

Board Committees

Audit

Andrew Neden – Chairman
Jane Kibbey
Kavita Patel
Kerry Spooner

Nominations

John Edwards – Chairman
David Marlow
Jane Kibbey

Remuneration

Kerry Spooner – Chairman
John Edwards
Andrew Neden

Risk

John Edwards – Chairman
Jane Kibbey
David Marlow
Daniel Mundy
Andrew Neden
Kavita Patel
Kerry Spooner
Simon Taylor

DIRECTORS' REPORT

The Directors' report should be read in conjunction with the Chairman's statement, Chief Executive's review and Strategic report on pages 4 to 15.

Business objectives and activities

The Nottingham is a strong and successful mutual building society which builds upon its strong regional foundations, with a track record of serving members for over 165 years. At The Nottingham we aim to build long-lasting relationships with our customers and to be recognised for the excellent service we provide.

Information on the Group's business objectives and activities are provided in the Strategic report on pages 8 to 15.

Business review, future developments and key performance indicators

The Group's business activities and future plans are reviewed in the Strategic report section of the Annual Report and Accounts on pages 8 to 15. Additionally within the Strategic report, we comment upon the financial (and other) key performance indicators used by the Board during the year to assist its control, direction and drive for business results.

Principal risks and uncertainties

The principal risks and uncertainties faced by the Group are outlined on page 15 and our approach to managing these risks can be found in the Risk management report on pages 23 to 27.

Financial risk management objectives and policies

As a result of its normal business activities, the Group is exposed to a variety of risks, including credit, market and liquidity. The Group's objective is to minimise the impact of these risks as well as financial risk upon its performance. The risk management report on pages 23 to 27 considers this in detail. A further explanation of the financial risks and the controls in place to manage them (including the use of derivatives) is given in note 30 to the annual accounts.

Results

Group reported profit before tax for the year was £14.5 million (2016: £14.2 million). The Group profit after tax for the year transferred to general reserves was £11.5 million (2016: £11.0 million.) As at 31 December 2017, total Group reserves and equity were £212.7 million (2016: £199.8 million).

Capital

Group gross capital at 31 December 2017 was £238.3 million, (2016: £226.0 million) being 6.55% (2016: 6.79%) of total shares and borrowings. Free capital, at the same date, amounted to £218.3 million (2016: £208.5 million) and 6.00% (2016: 6.26%) of total shares and borrowings.

The annual business statement on page 95 gives the explanation of these ratios. The directors remain committed to maintaining a strong capital position.

Loans and advances

During 2017, total lending was £1,021 million (2016: £798 million) and the average advance made was £167,205 (2016: £149,352), with the average debt at the end of the year being £129,849 (2016: £122,990). At 31 December 2017 there were two cases (2016: one case) of properties being 12 or more months in arrears or in possession. The total amount of balances outstanding in those cases was £56,691, with arrears of £7,800.

No mortgage losses were realised during the year from existing provisions. Provisions for potential mortgage losses total £3.2 million, (0.09% of mortgage balances).

The Group offers a number of different forbearance options to customers including reduced payment concessions, payment plans, capitalisations and mortgage term extensions. At 31 December 2017 the Group had 106 loans (2016: 127) subject to some form of forbearance. Note 30 to the accounts on page 85 provides further details.

Property, plant and equipment

Freehold premises owned by the Group are shown in the accounts at cost less depreciation. An estimate of the value of those properties, prepared in late 2017 by the Group's professional services team, indicates that market value is £1.9 million (2016: £1.4 million) higher than book value.

Supplier payment policy

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

At 31 December 2017, the total amount owed to suppliers was equivalent to 3 days' credit (2016: 1 day).

Charitable and political donations

During the year the Group made charitable donations of £106,000 (2016: £103,000). No contributions were made for political purposes.

Country-by-country reporting

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 came into effect on 1 January 2014 and place certain reporting obligations on financial institutions within scope of the Capital Requirements Directive (CRD IV).

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

Environmental policy

The environmental policy is set out in the corporate responsibility report on page 17.

Our people

Recruiting and retaining the best talent is key to delivering The Nottingham's vision and is reflected in the Society's people strategy, as outlined in the corporate responsibility report on page 16.

We are committed to maintaining and supporting a culture of equality, diversity and inclusion in all aspects of employment, and the provision of the services we offer. Our commitment is reflected in our Dignity at Work and Diversity and inclusion policies. Team members are briefed as part of their induction, an online training session is available for all people managers and all training reflects these principles and relevant legislation.

Team member views and opinions are important to us at The Nottingham and we hold regular meetings with our Staff Council, hold regular Training and Competence sessions with our Leadership Team twice a year and have also sought feedback this year through staff surveys. Responses were discussed at our new leadership conference detailed in our people strategy on page 16 and will help shape how we share information about business performance, goals and strategic plans with our team members.

As detailed on page 16, our Doing Good Together initiative continues to be extremely important to us and we are proud that our team members wholeheartly embrace this initiative giving their time and support to so many charities and community projects.

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

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

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

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

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

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

Directors' responsibilities for accounting records and internal control

The directors are responsible for ensuring that the Group:

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

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

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

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

Directors' statement pursuant to the disclosures and transparency rules

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

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

Directors' statement pursuant to the UK Corporate Governance Code

As required by the UK Corporate Governance Code, the directors confirm their opinion that the annual report and accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for members to assess the performance, strategy and business model of the Society. Details of the governance procedures which have been implemented to support this can be found in the Board Audit Committee report on page 32.

Going concern and viability

Going concern

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

The directors have considered the risks and uncertainties discussed on page 15 and 23 to 27, and the extent to which they might affect the preparation of the Annual Report and Accounts on a going concern basis.

The Group's business activities and future plans are reviewed in the Chairman's statement and Chief Executive's review on pages 4 to 7. In addition, note 30 to the annual report and accounts includes the Group's policies and processes for managing financial instrument risk such as liquidity risk, interest rate risk and credit risk.

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

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

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

Viability statement

In accordance with the 2014 revision of the Corporate Governance Code, the Board has also assessed the prospects of the Society over a period longer than the 12 months required by the going concern provision. The Board has conducted this review for a period of four years, which has been selected to align it to the Group's corporate planning period, however the Board has less certainty over the last year of the planning period.

The four year corporate plan considers the Group's profitability, cash flows, liquidity and capital requirements as well as other key financial ratios over the period. These ratios are subject to sensitivity analysis and stress testing, which involves varying a number of the main assumptions underlying the forecast both individually and in unison. Where appropriate, this stress testing is carried out to evaluate the potential impact of the Group's principal risks, as outlined on page 15 of the Strategic report and the risk management report on page 23, actually occurring. Based on the reviews completed, the Board considers that the Society is viable over the medium term.

Directors

The names of the directors of the Society who served during the year and up to the date of signing the accounts, their roles and membership of Board committees are detailed in the governance section on pages 18 to 19. Other business interests are shown in the annual business statement. None of the directors have any beneficial interest in, or any rights to subscribe for shares in, or debentures of, any connected undertaking of the Society, at 31 December 2017.

In accordance with the agreement made by the Board and in line with the rules for re-election outlined on page 29, John Edwards, David Marlow, Jane Kibbey and Andrew Neden will all stand for re-election at the 2018 AGM. Daniel Mundy joined the Board in April 2017 and will seek election at the 2018 AGM. Keith Whitesides retired at the end of the AGM in March 2017. Ashraf Piranie and Guy Thomas also served as directors during the year, resigning in February 2017 and June 2017, respectively.

Auditor

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

On behalf of the Board of directors,

John Edwards
Chairman

21 February 2018

RISK MANAGEMENT REPORT

For the year ended 31 December 2017

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

The Board is responsible for ensuring that an effective framework is in place to promote and embed 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.

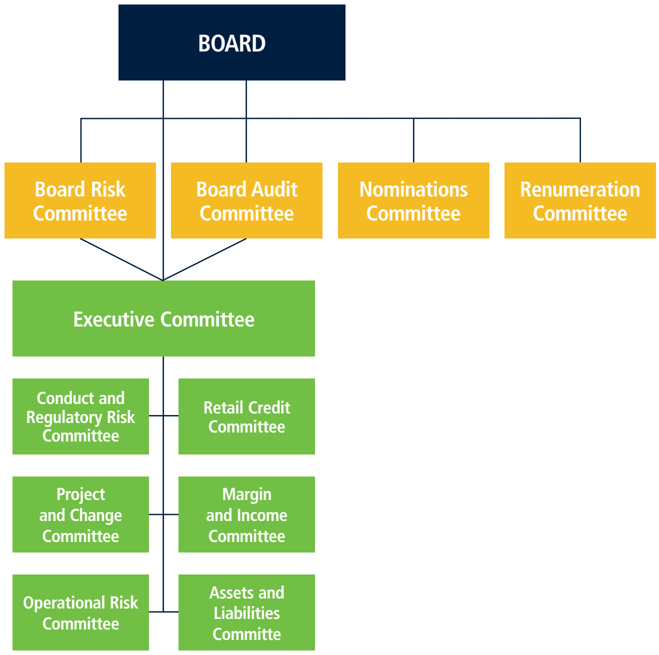
In pursuing its strategy the Board ensures there are appropriate capabilities and resources available, along with sufficient capital strength to succeed. This includes focusing on risk and reward to ensure it is at an acceptable level.

During the prior year, the Board sponsored a Group-wide initiative culminating in the design, delivery and implementation of an enhanced governance and risk management framework. This has ensured that The Nottingham has robust and scalable governance and risk management processes to enable delivery of its long term strategy.

The scope of the initiative included the implementation of a revised risk management framework containing the following key elements:

- A revised governance framework, incorporating improvements to the Risk Management Committee structure, Committee membership and responsibilities;
- Redefined key risk categories with individually assigned risk category ownership;
- Standardised and aligned risk management policy and appetite documentation; and
- Standardised reporting of risk profile against appetite through Management and Board Risk Committees.

The revised framework became fully operational during 2016 and has been in operation throughout 2017. The Board is committed to ensuring that the risk management framework continues to be reviewed and evolves in the future as the business develops and reacts to the changing requirements. As a result of this, the Executive Committee came into force during 2017 and the governance structure will continue to be enhanced throughout 2018.



The Board Risk Framework

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

The risk management framework is based on the three lines of defence (described on page 30) and focuses on:

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

GOVERNANCE

Board Risk Committee

As detailed on page 19, the Board Risk Committee comprises all full Board members, both executive and non-executive. It is responsible for:

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

The Board Risk Committee meets quarterly to review risk management activities and consolidated management information regarding existing and emerging areas of risk.

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

Executive Committee (formerly Strategy, Capital, Planning and Performance)

The Executive Committee has been in place for the second half of the 2017 financial year and replaces the Strategy, Capital, Planning and Performance Committee. The Nottingham defines Strategy and Capital Sustainability risk as the risk that The Nottingham does not have sufficient capital or allocates it ineffectively in pursuit of its long term strategy to deliver sustainable value to members. This includes The Nottingham's ability to manage its capital and strategy effectively in a range of business and economic environments.

The Committee is chaired by the Chief Executive and comprises all three Executive Directors and certain senior managers from across the business.

Strategic risk

When discussing future strategy, the Committee and subsequently 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 in place to effect any required mitigation. The Executive Committee oversees the detailed evaluation of these risks.

The Committee also oversees management of the risks that unexpected changes in the affect the Group's business model either through the level of demand for the Group's products and services and/or its ability to meet that demand. This includes proposed or agreed changes to regulation which may impact upon The Nottingham's ability to compete, how it conducts business and its liquidity and capital requirements.

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

Capital sustainability risk

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

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

The Prudential Regulation Authority (PRA) uses the ICAAP during its Supervisory Review and Evaluation Process (SREP) through which it determines the amount of capital which it requires The Nottingham to hold against its Individual Capital Guidance (ICG).

The Board monitors the level of capital held by the Society in relation to its ICG on a regular basis. The Society's current and future capital levels remain well in excess of the PRA requirements. An analysis of the components of The Nottingham's current capital position can be found in the Strategic report on page 14.

Assets and Liabilities Committee

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.

The Committee comprises at least one Executive Director and relevant senior managers.

Market and interest rate risk

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

The economy is still dominated by low interest rates and an uncertain economic environment. Current market expectations indicate that this will remain the case for some months to come. The Nottingham actively monitors its position against its basis risk appetite to ensure any future change to interest rates does not adversely affect The Nottingham's interest margin.

Previous Bank of England intervention to stimulate the economy such as the Funding for Lending Scheme (FLS) and the Term Funding Scheme (TFS) has seen reductions to market rates for both retail lending and savings products. Competition in an already highly competitive lending market continues to drive tighter interest margins across the industry. We continue to monitor anticipated market rate changes and assess the impact on The Nottingham's position.

The Nottingham's limits for the management of market and interest rate risk are documented in the market and interest rate risk appetite statement which is developed, defined and recommended by ALCO and considered and approved by the Board.

Basis risk, which arises from changes in the relationship between different interest rates which have similar but not identical characteristics, is included within this risk category as a subset of interest rate risk.

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

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

ALCO is responsible for reviewing Treasury activity, performance and compliance with the approved policy and risk appetite statements. A detailed analysis of The Nottingham's interest rate sensitivity exposure can be found in note 30 to the annual accounts.

Liquidity risk

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

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

The liquidity policy sets the framework for the day-to-day activities of the Treasury team to ensure that all liquidity management activities are conducted within approved risk appetites. The 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 and regular stress testing and is documented as part of our Individual Liquidity Adequacy Assessment Process (ILAAP) document, as required by the PRA.

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

The Society also maintains a funding profile in line with a longer term funding measure, the Net Stable Funding Ratio (NSFR), for which the final rules are yet to be published.

Based on our current and forecast liquidity positions, the liquidity portfolio held by The Nottingham comfortably exceeds the minimum requirements of both the LCR and NSFR.

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.

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

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

A detailed analysis of the Society's liquidity profile can be found in note 30 to the annual accounts.

Wholesale credit risk

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

The Nottingham's risk of counterparty default is relatively low due to the high proportion of total liquidity held in UK Sovereign debt securities and the Bank of England reserve account. Total liquidity remains significantly above the level required by the PRA. The composition of the treasury loans can be found on page 81.

The Nottingham's liquidity policy sets out the counterparties which the Treasury team may transact with, currently limited to lending in sterling to the UK government, UK banks and building societies plus highly rated overseas banks. Strict criteria are applied to all counterparties who must meet external rating thresholds as well as satisfying The Nottingham's internal assessment measures. As permitted by policy, we have continued to hold liquidity with carefully selected European based Multilateral Development Banks in instances where it qualifies as High Quality Liquid Assets (HQLA). Our Board has not permitted any lending directly to sovereign states, other than the UK.

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

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

Retail Credit Committee

The Retail Credit Committee (RCC) is responsible for oversight of The Nottingham's retail assets which includes residential and buy-to-let mortgages and Secured Business Loans.

It comprises at least one Executive Director and a number of relevant senior managers.

Retail credit risk

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

A Retail Credit Risk Appetite Statement and Policy are proposed by the Retail Credit Committee and considered and approved by the Board. 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 approved risk appetite. The Board receives monthly information on key risk appetite limits.

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

We regularly stress-test the mortgage portfolio to detect any signs of potential payment stress or sensitivity for our borrowers to the impact of future rate rises. The mortgage portfolio shows resilience to the impact of rate rises, but we maintain a watching brief to ensure the adequate monitoring and analysis is in place to detect any signs of deterioration.

The Nottingham remains committed to promoting home ownership and its risk appetite allows lending to first time buyers, with a minimum deposit of 5%, but restricts the overall level to ensure the risk is managed sufficiently. Similarly, we continue to follow our long term policy of offering interest-only products. However, we operate strict policies and monitoring procedures to ensure an appropriate repayment vehicle is in place.

All mortgage loan applications are reviewed by an individual underwriter supported by the use of application scorecards. Credit reference bureau data is obtained on all applications as part of our responsible lending requirements. The Nottingham also shares account performance data with the selected bureau.

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

The Nottingham continues to be a responsible lender and its approach to lending is based on making sure that customers can afford to meet their mortgage repayments from the outset, through the use of a prudent affordability calculator, as well as our manual underwriting processes. Should customers find themselves in financial difficulty, we respond with appropriate forbearance activities to ensure fair customer outcomes. The purpose of forbearance is to support customers who have temporary financial difficulties and assist them to get back on their feet. Only as a matter of last resort does The Nottingham take the property into possession. In addition we continue to work within best practice guidelines to ensure customers with interest-only loans have appropriate repayment vehicles in place.

Residential, BTL and Secured Business Lending (SBL) loans are granted only against the 'bricks and mortar' value (i.e. loans are provided only for the purchase or re-mortgaging of a property and not for working capital or machinery etc.).

An SBL policy is used to manage levels of business lending risk with loans manually underwritten. To ensure appropriate management of lending risk The Nottingham maintains watch lists to monitor those loans which are a possible cause for concern in order that risk mitigating action can be taken as appropriate. Primarily, SBL loans are made available to Small and Medium-sized Enterprises (SMEs) for either owner-occupied or investment property purposes.

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

Conduct and Regulatory Risk Committee

The Nottingham, being a retailer of mortgage, savings and insurance products, is regulated by both the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA).

The Conduct and Regulatory Risk Committee (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.

The Committee is chaired by the Head of Operations supported by a number of relevant senior managers.

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

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

Operational Risk Committee

The Operational Risk Committee (ORC) is responsible for actively overseeing the management of operational risk across The Nottingham.

The Committee is chaired by the Head of Operations supported by relavent senior managers.

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 functional and project risk registers. These risk registers help management assess the probability and impact of the risks identified, and the effectiveness of mitigating controls.

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

Project and Change Committee

The Project and Change Committee supports the Board in ensuring the optimum use of resources when delivering The Nottingham's programme of projects. It performs this role through the approval and prioritisation of all requests to initiate or materially change a project and ensures their status is monitored.

The Committee is chaired by the Chief Operating Officer or Head of IT & Change, supported by relevant senior managers.

As the scale and pace of change intensifies, it is essential that The Nottingham manages and prioritises resources effectively to serve both current and future members while maximising member benefit.

On behalf of the Board of directors,

John Edwards
Chairman of the Board Risk Committee

21 February 2018

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

The Board has reviewed the Society's corporate governance practices against the revised UK Corporate Governance Code (April 2016), (the 'Code'), which is intended to apply to listed companies, to the extent that they are relevant to a building society. In the interest of transparency, the regulator encourages each building society to explain in its Annual Report and Accounts whether, and to what extent, it adheres to the Code.

This report sets out how the Board has operated in 2017 and complied with the provisions of the Code. The Board is committed to complying with best practice in corporate governance but where it believes that there is a justifiable reason to depart from the Code then it will do so. The key consideration is that such a departure is believed to be in the best interests of members and that the governance of the Society is not compromised.

The Board does not comply with the Code provision that all directors should be subject to annual election. The Board is concerned that in extreme circumstances that requirement could have implications for the financial stability of the Society which would not be in the best interests of members.

All directors are submitted for election at an annual general meeting in accordance with the Society's rules. The rules require re-election at three-yearly intervals. The exception to this rule and to ensure good governance is that the Board has decided the Chairman and the Chief Executive will each stand for re-election annually. Subject to that, the Board considers that the current voting arrangements are satisfactory and provide for a continuity of experience and knowledge. However, the issue will continue to be kept under review.

Leadership

The Board

At 31 December 2017, the Board consists of five non-executive directors (including the Chairman), all of whom are considered to be independent in character and judgement, and three executive directors, providing a complementary balance of skills and expertise.

The Board held 10 meetings and two strategy review meetings during 2017.

In addition the non-executive directors meet regularly, without the executive directors present, and consider all aspects of Board responsibilities, governance and performance.

In line with Code principles, the Board operates effectively and is collectively responsible for the long-term success of the Group and ensuring that the necessary resources are in place for the Group to meet this objective. It has a schedule of reserved matters and its principal function is to focus on the formulation of strategy, approving and reviewing policy. Additionally, it ensures the appropriate financial and business systems and controls are in place to safeguard members' interests, maintain effective corporate governance and measure business performance. All directors are able to obtain independent professional advice, at the Society's expense, should that be necessary in the fulfilment of their duties, and have access to the services and advice of the General Counsel and Company Secretary.

Division of responsibilities

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

The Chief Executive has direct charge of the Group on a day-to-day basis and is accountable to the Board for the financial and operational performance of the Group as well as for the formation of its strategy. Some responsibilities are delegated to the Group's managers and officers and these are listed and reviewed by the Board.

The Chairman

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

Non-executive directors

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

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

One of the independent non-executive directors is appointed as the senior independent director, to provide a sounding board for the Chairman and to serve as an intermediary for the other directors as necessary. The senior independent director is identified on page 18.

Effectiveness

Composition of the Board

The names of the directors together with brief biographical details are set out on pages 18 and 19.

The Board uses four committees (Risk, Nominations, Remuneration, and Audit) to help it discharge its duties.

The four committees meet regularly and current membership of these committees is shown on page 19.

The table below shows the attendance of each director at the relevant Board and Board committee meetings. The number to the left is the number of meetings actually attended; the number to the right is the number of meetings the director was eligible to attend during 2017.

Director	Board	Risk	Nominations	Remuneration	Audit
J. Edwards	10/10	4/4	5/6	6/6	-
J. Kibbey	10/10	4/4	5/5	5/5	6/6
D. Marlow	10/10	4/4	6/6	-	-
D. Mundy	8/8	3/3	-	-	-
A. Neden	10/10	4/4	-	1/1	6/6
K. Patel	10/10	4/4	-	-	-
M. Piranie	1/1	1/1	-	-	-
K Spooner	9/10	4/4	-	6/6	3/4
S. Taylor	10/10	4/4	-	-	-
G. Thomas	5/5	2/2	-	5/5	3/3
K. Whitesides	1/1	1/1	2/2	-	-

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

In addition to the four committees identified above, the Board has also established an Executive Committee during 2017 to support the Board in managing the day-to-day operations of the Group. The Executive Committee is responsible for acting on behalf of the Board in organising, managing and protecting the Society's assets to deliver value to members, whilst ensuring the Society operates within the law, regulation and clear, agreed Board risk appetites. It is responsible therefore for ensuring the management and delivery of four key areas on behalf of the Board: Strategy; Risk Management; Business Planning; and Operational Oversight. The Risk Management Report on page 23 covers this Committee in further detail.

Appointments to the Board

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

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

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

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

Commitment

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

Development

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

Information and support

The Chairman ensures that all directors receive accurate, timely and clear information. All directors have access to the advice and services of the Group Company Secretary and independent professional advisers should this be required.

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

Evaluation

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

The performance of non-executive directors is reviewed annually by the Chairman. The senior independent director conducts interviews with each director in order to appraise the performance of the Chairman, the results of which are discussed with the Chairman by the non-executives.

The Board and each of the committees formally evaluate their own performance and effectiveness each year. These evaluations take into consideration the balance of skills, experience, independence and knowledge, and consider the diversity of the group and its ability to work together. The process is co-ordinated by the senior independent director and the outcome of each evaluation is presented to the Nominations Committee who assesses the results for trends and themes. This process also includes an overall assessment of the performance reviews undertaken by the key management committees, which report to the various board committees. The overall outcome of the review is then reported to the Board. The Code requires the Board to conduct an external evaluation every three years. The last review was performed in 2016. The Board will keep under review and consider, for 2019, the Code requirement for FTSE 350 companies to conduct an external evaluation every three years.

Re-election

All directors are submitted for election at an annual general meeting (the 'AGM') in accordance with the Society's rules, and in this regard the Society has departed from the recommendations of the Code.

The Code indicates that all directors should stand for re-election annually whereas the Society's rules require re-election at three-yearly intervals. The Board considers that the current voting arrangements are satisfactory and provide for stability of the Society as well as a continuity of experience and knowledge. However the requirement will continue to be kept under review.

Non-executive directors can serve up to a maximum of three three-year terms. Any extension must be approved annually, subject to rigorous review, and be explained giving due consideration to the continuing independence and objectivity of the non-executive director. Jane Kibbey has completed more than nine years as a non-executive director and will now seek re-election. The Board considers that her experience and contribution continue to be extremely valuable and she continues to be independent in character and judgement and recommends her re-election to members.

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

Accountability and audit

Financial and business reporting

The Directors' report on pages 20 to 22 details the responsibilities of the directors in preparing the Group's accounts.

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

The Board has responsibility to present a fair, balanced and understandable assessment of the Group's performance and financial position, business model and strategy, consideration of which is contained within the Chief Executive's review on pages 6 to 7, the Strategic report on pages 8 to 15 and within the report and accounts taken as a whole.

Viability statement

In accordance with the requirements of the Code, the Board have assessed the prospects of the Society over a period longer than the 12 months required by the going concern provision. The viability statement is considered on page 22 within the Directors' report.

Risk management and internal control

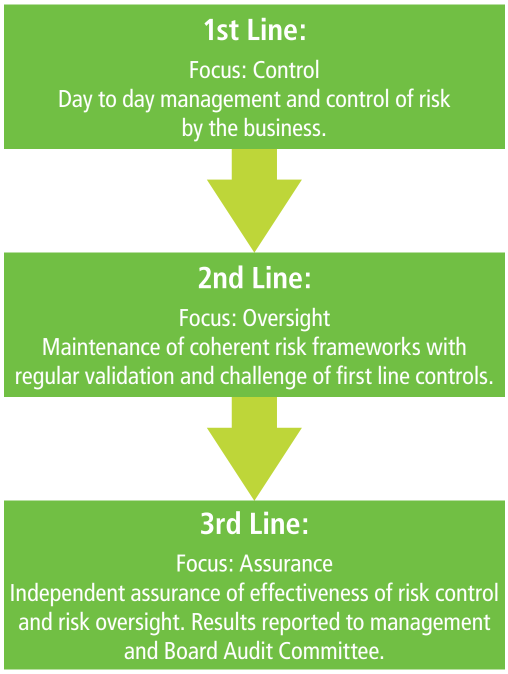
The Board Risk Committee oversees the entire risk management framework of the Group. It advises the Board on determination of risk appetite and setting of risk limits. The Committee fulfils its obligations through two approaches. Firstly it is responsible for monitoring operational risks to ensure they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

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

To assist in monitoring the risk management framework, the Assets and Liabilities, Retail Credit, Conduct & Regulatory Risk, Operational Risk, Information and Project & Change Committees report into the Board Risk Committee. As a result of continued enhancement to the governance structure, these committees are transitioning to report into the Executive Committee, who will then report into the Board Risk Committee. The Committee meets at least quarterly.

The Board have carried out a robust assessment of the principal risks facing the Group, including those that would threaten the business model, future performance, solvency and liquidity. These principal risks are detailed on page 15 of the Strategic report and further information on risk management is given in the report commencing on page 23.

In accordance with the Code, the Society's Board is committed to maintaining a sound system of internal controls to safeguard both its own assets and those of its members and there is an annual review of risk management and internal control systems. During prior years, the Board invested to enhance the governance and risk management and to formalise the lines of risk identification and acceptance. These improvements have been fully operational throughout 2017.



The operation of these three lines of defence is embodied in the terms of reference of the Society's seven risk committees (Executive, Assets and Liabilities, Retail Credit, Conduct & Regulatory, Operational, Margin & Income and Project & Change) along with the Board Risk Committee as well as a range of policies and procedures that relate to the identification, assessment, monitoring and control of all the main areas of risk that the Group faces.

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

Remuneration

Policy and procedures

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

The Remuneration Committee's work and the Society's compliance with the Code principles relating to remuneration is covered in the directors' remuneration report on pages 34 to 39.

Membership

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

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

Relations with members

Dialogue with members

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

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

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

Constructive use of the AGM

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

All postal and proxy votes are counted using independent scrutineers.

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

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

On behalf of the Board of directors,

John Edwards
Chairman

21 February 2018

BOARD AUDIT COMMITTEE REPORT

Board Audit Committee

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

- Monitor the integrity of the financial statements of the Society, including significant financial reporting issues and judgements within;
- Review the financial statements;
- Review the integrity of the Society's systems of internal control and risk management;
- Monitor and review the performance of the internal audit function;
- Oversee the relationship with the external auditor; monitor the independence of the external auditor; and consider the effectiveness of the external audit process;
- Review and approve the annual internal and external audit plans;
- Monitor the provision of non-audit services by the external auditor; and
- Review the adequacy and security of the Society's arrangements for handling concerns raised through the Society's whistleblowing policy.

Membership and attendance

The Board Audit Committee consists of four non-executive directors. The members of the Committee are Andrew Neden (Chairman), Jane Kibbey, Kavita Patel and Kerry Spooner, who as a whole have competence relevant to the building society sector. Guy Thomas also served on the Committee during the year.

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

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

Meeting frequency and reporting

The Committee met six times during 2017 and the main activities during the year were:

- Reviewed the results and draft annual report and accounts for the year ending 31 December 2016;
- Reviewed the going concern assumptions and all key issues and areas of judgement relating to the financial statement reporting;
- Considered reports by the external auditor on its audit and review of the financial statement reporting;
- Reviewed the year-end and interim financial statements and draft press releases, with consideration of the fair, balanced and understandable requirements of the Corporate Code;
- Considered the internal audit strategy for 2017;
- Received and reviewed reports from internal audit;
- Reviewed and approved the Society's risk-based internal audit plan for the next year;
- Reviewed the adequacy and effectiveness of the Society's arrangements for handling matters raised through the whistleblowing policy;
- Reviewed the adequacy and effectiveness of the Society's internal financial controls, internal control and risk management systems; and
- Carried out a review of the Committee's own effectiveness.

Significant issues in relation to the financial statements

The Committee considers a wide range of issues in relation to the financial statements, which relate mainly to judgements and estimates which management have to make during the preparation of the statements. During 2017, the significant issues considered by the Committee included:

- **Loan loss provisioning – residential and SBL mortgages**
  The Society estimates the level of provisions required in the residential and commercial book using historical default and loss experience and applying judgement. The Committee reviewed and challenged the approach to calculating the provisions and confirmed that the assumptions made are appropriate. The Committee is satisfied with the approach adopted to calculate the provision for impairment and the overall level of provision recognised.
- **Effective Interest Rate ('EIR') methodology**
  The Society recognises interest income using a constant level of interest over the expected behavioural life of the loan. The Committee reviewed the basis of the EIR calculations as well as the results from the testing performed by the external auditor and concluded it was appropriate.
- **Provisions**
  The Committee reviewed and challenged the estimates and assumptions made by management when calculating the level of provisions at the reporting period and concluded it was appropriate.
- **Hedge accounting**
  The Committee reviewed the Society's approach to hedge accounting, including valuation techniques, accounting ineffectiveness and key movements during the year. The Committee concluded that the approach adopted was appropriate and the hedging activity had been effective in mitigating the underlying risk.
- **Calculation of the defined benefit pension plan position**
  The Society has a defined benefit pension scheme which was closed to new entrants in 1997 and closed to future service accrual from 31 January 2009. The Committee reviewed the methodologies and acceptable ranges from which assumptions had been selected in calculating the latest estimate of the scheme's assets and liabilities. This review was supported by a report provided by the Society's advisors. Noting that the assumptions adopted by management were consistent with this report, the Committee is satisfied with the position reported in the accounts.
- **Carrying value of investment in subsidiary undertakings**
  The Society purchased the Harrison Murray estate agency business in 2013 and the Committee considered the carrying value of the investment and intercompany loan balances held in the Society books as well as the level of consolidated goodwill recognised at a Group level. Having reviewed forecast profitability and cash flows for the business unit, the Committee is satisfied that the carrying value is appropriate and there was no impairment arising.

- **Going concern assumption**
  The Committee evaluated whether the going concern basis of accounting was appropriate by considering forecast profitability, liquidity position, funding availability and regulatory capital positions. The review also took into account the detailed stress testing scenarios completed as part of the annual liquidity and capital adequacy assessments.
- **Implementation of IFRS 9, financial instruments**
  The Committee evaluated the model and governance outputs from the implementation project to review and challenge the approach, estimates and assumptions in developing the requirements of the new accounting standard for financial instruments, effective from 1 January 2018.
- **Fair, balanced and understandable**
  The Committee reviewed the integrity of the financial statements and any formal announcements. The content of the annual report and accounts was reviewed and the Committee advised the Board that, in its view, and taken as a whole, it is fair, balanced and understandable and provides the information necessary for members to assess the Society's performance, business model and strategy. The Committee therefore recommended that the Board approve the annual report and accounts.
- **Viability statement**
  The Committee reviewed the requirements of the Corporate Governance Code to provide the medium-term viability statement in the annual report and accounts and agreed the definition of the medium-term period.
- **New accounting standards**
  Regular updates on financial reporting developments were presented to the Committee during the year to enable it to provide effective oversight of the financial reporting within the interim and full year accounts, including the implementation of IFRS 9.
- **External audit findings**
  The external auditor did not highlight any material control weaknesses arising from their review of key financial reporting processes and systems.

Internal controls

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

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

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

Further details on the risk management framework are provided in the corporate governance report on pages 28 to 31.

Independence and effectiveness of external auditor

In 2014, the Society tendered its external audit relationship in line with best practice and Ernst & Young LLP were engaged during 2015 and have therefore been in post for three years at 31 December 2017.

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

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

The Committee considered the performance of Ernst & Young LLP as external auditor for 2017, and is satisfied with their objectivity, independence and effectiveness and therefore recommended that they be re-appointed at the AGM for the current year.

Oversight and effectiveness of internal audit

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

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

Audit committee performance and effectiveness

As outlined in the corporate governance report on page 29, the Board and each of the committees formally evaluate their own performance and effectiveness annually. The Committee therefore considers itself to be effective.

On behalf of the Board of directors,

Andrew Neden
Chairman of the Board Audit Committee

21 February 2018

DIRECTORS' REMUNERATION REPORT

For the year ended 31 December 2017

Statement by the Chairman of the Remuneration Committee

On behalf of the Committee, I am pleased to present the annual directors' remuneration report, which sets out the remuneration policy, and details of the directors' remuneration in the year to 31 December 2017.

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

- The Remuneration Policy which sets out the Society's remuneration policy for directors; and
- The Annual Remuneration Report which outlines how the policy was implemented in 2017.

The Remuneration Committee has undergone a period of change in 2017. During the year I took over as Chairman of the Committee from Jane Kibbey, who stepped down as Chairman in June 2017. I would like to thank Jane personally for her significant contribution to the development and implementation of Remuneration Policy within the Society during her time as a member and the last two years as Chairman of the Committee. Also during the year, Guy Thomas stepped down from the Board and was replaced on the Remuneration Committee by Andrew Neden. The members of the Remuneration Committee during the period were:

Kerry Spooner	Non-Executive Director and Chairman of the Committee from 21 June 2017
Jane Kibbey	Non-Executive Director and Chairman of the Committee until 21 June 2017
John Edwards	Chairman of the Board
Guy Thomas	Non-Executive Director (resigned 21 June 2017)
Andrew Neden	Non-Executive Director (appointed 17 October 2017)

2017 performance and awards

The Chairman's statement, Chief Executive's review and Strategic report on pages 4 to 15 describe 2017 as a year of excellent strategic progress with the footprint of the Society extended further with seven new locations opened; the launch of 'Member Rewards' to encourage increased membership; strong trading performance with regard to mortgage lending and increased assets in the year. There has also been continued growth in the area of branch savings balances. During the year, we have also ensured that sufficient profit has been generated to cover our regulatory capital requirements and continue to invest in the Society whilst maintaining competitive levels of return for our savers.

In the 2017 performance year, there has been continued focus on sustainability for The Nottingham and its members. The asset size has grown by 8.6%, savings balances by 5.6% and the additional new locations were opened bringing the total number of branches in the network to 67.

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

The Directors Annual Bonus Plan - the Directors received 40% of the total bonus payment for 2017 following the end of the performance year with 60% being deferred for 3 years and subject to malus[1] and clawback rules in line with Regulatory best practice.

The 2014 -2016 LTI payments made to directors during 2017 reflect the significant progress made over the period with regard to the key measures of cost income ratio, profit after tax ratio against the comparator peer group and delivery of strategic objectives.

Remuneration Committee

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

The Committee met six times in 2017 and is made up of a minimum of three non-executive directors, as detailed on page 19. The Chief Executive, Head of HR, Head of Finance and Group Secretary attend the meetings.

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

The Remuneration Committee's activities in 2017 also included:

- Reviewing regulatory updates and assessing the impact on The Nottingham;
- Reviewing and recommendation to the Board for approval of the Remuneration Policy for 2017;
- Reviewing and approving the Remuneration Policy Statement ensuring its compliance with the Remuneration Code;
- Oversight of the activities undertaken by the Reward Management Committee;
- Agreeing the appointment, salary and benefits for the new Finance Director, Daniel Mundy, who joined the Board in April 2017;
- Consideration of the annual pay review and bonus scheme approval and payment;
- Reviewing and approving of executive variable pay for the 2017 financial year; and
- Set the direction and principles for all variable pay schemes for 2018.

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

Remuneration policy

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

The policy is there to ensure that:

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

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

Recruitment policy for Executive Directors

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

Service contracts

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

Payment for loss of office of Executive Directors

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

Other directorships

None of the Executive Directors currently hold any paid external directorships. During 2017, David Marlow accepted a role as member of the FCA Small Business Practitioners Panel. He received a fee of £1,000 for his services during 2017 which he has elected to donate to charity.

Executive Director's total remuneration

Executive Directors' emoluments comprise a basic salary, variable pay, pension entitlement and other taxable benefits as outlined on pages 36 to 37.

The total remuneration received by Executive Directors is detailed on page 38. The information has been audited and shows remuneration for the years ending 31 December 2016 and 31 December 2017 as required under the Building Society's (Accounts and Related Provisions) Regulations 1998.

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

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

Non-executive directors

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

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

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

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

Remuneration Code Staff (Material Risk Takers)

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

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

Executive Directors

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

Component	Purpose	Operation	Performance measures	Opportunity
Basic salary	Fixed remuneration set to attract and retain executives of appropriate calibre and experience. Basic salary is assessed by reference to roles carrying similar responsibilities in comparable organisations. A comparator group is used that consists of executive director positions within building societies of a similar size and complexity.	Reviewed annually and linked to personal performance and market sector benchmarking.	Increases based on: • Role and experience; • Personal performance; • Benchmarking comparisons • Overall employee pay increases in the Group.	The base salaries of Executive Directors are reviewed as for any other employee in accordance with the reward matrix, except in circumstances where: • Market peer benchmarking indicates that remuneration is moving out of line of the appropriate peer group; • There has been a material increase in scope or responsibility to the Executive Director's role.
Variable pay Executive Bonus Plan	Linked to the delivery of the Society and personal objectives. Used to reward Executive Directors within the context of achieving the Society's goals and objectives. Payments under the variable pay schemes are not pensionable.	The bonus will only be awarded if the threshold criteria and Society and individual performance targets are met and a payment is triggered in the Society Core Bonus Scheme. 60% of the bonus is deferred for three years and payment is subject to meeting Society and individual performance threshold criteria in each of the years from award to payment. The Committee has the discretion to reduce or withhold the deferred element if it becomes apparent that the basis on which the variable pay award was made was wrong or that financial performance has deteriorated materially since the award. The deferred payment is also subject to clawback for a period of three years after payment.	The scheme is based upon three elements: • **The Building Society Core Scheme Balanced Scorecard** which has a 50% weighting. This scorecard measures Society financial performance, customer satisfaction, teamwork and risk & quality; • **Additional Group measures** which have a 20% weighting; and • **Individual performance** including achievement of strategic objectives with a 30% weighting. The weightings of each element of the bonus are agreed at the beginning of each performance year. Personal performance objectives, appropriate to the responsibilities of the director, including the achievement of appropriate strategic progress over a three year period are set at the start of each year. Objectives are set within board risk appetite and regulatory requirements.	On target of 30% and maximum of 50% of basic salary payable with 60% of the award deferred over a three year period.

Executive Directors (continued)

Variable pay Legacy Long Term Incentive (LTI)	Linked to the delivery of the Society and personal objectives. Used to reward Executive Directors within the context of achieving the Society's goals and objectives and designed to incentivise individuals to produce successful, sustainable business results. Payments under the variable pay schemes are not pensionable.	There is one remaining LTI scheme, 2015-17 which is payable in 2018. The scheme requires achievement of Society and individual performance threshold criteria. Payment under this legacy scheme is made in the July following the year-end when all comparator societies' annual accounts are available. This remaining scheme is only applicable to DJ Marlow and SJ Taylor as MA Piranie forfeited any right to payment upon his resignation and DW Mundy is not eligible for this scheme as he was not employed at the start of the scheme.	Payments under the remaining schemes are determined using a balanced scorecard and require achievement of: • Group cost income ratio targets; • Successful implementation of strategic initiatives; • The Society's profit after tax ratio relative to a comparator group of societies; and • Customer satisfaction targets for the period.	On target of 16% and maximum of 30% of eligible basic salary as at 31 December 2015 to reflect the previous reward structre.
Pension or pension allowance	A part of fixed remuneration to attract and retain executives of appropriate calibre and experience.	Executive Directors are invited to join the Society's defined contribution pension plan, or, as an alternative be provided with an equivalent cash allowance.	Not applicable	Contribution of 15% of base salary or paid as cash allowance.
Benefits	A part of fixed remuneration to attract and retain executives of appropriate calibre and experience.	The benefits received by Executive Directors are private medical insurance and a car allowance.	Not applicable	Set at a level considered appropriate for each Executive Director by the Committee in line with market practice.

Annual report on remuneration

Executive Director remuneration

Audited Society	2017 David Marlow £000	2017 Daniel Mundy £000	2017 Ashraf Piranie £000	2017 Simon Taylor £000	2017 Total £000	2016 David Marlow £000	2016 Daniel Mundy £000	2016 Ashraf Piranie £000	2016 Simon Taylor £000	2016 Total £000
Fixed remuneration										
Salary[1]	296	161	96	223	**776**	290	-	239	218	**747**
Benefits[2]	10	55	2	9	**76**	10	-	10	9	**29**
Variable remuneration										
Annual bonus[3]	43	21	-	31	**95**	31	-	-	22	**53**
Long term incentive plans	60	-	-	47	**107**	71	-	65	56	**192**
	409	237	98	310	**1,054**	402	-	314	305	**1,021**
Pension contribution	44	24	5	33	**106**	43	-	36	33	**112**
	453	**261**	**103**	**343**	**1,160**	**445**	**-**	**350**	**338**	**1,133**

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

[1] The salary of Ashraf Piranie includes £60,000 for an ex gratia payment made in lieu of notice, holiday pay and in recognition of his commitment and service to the Society.

[2] The benefits of Daniel Mundy include £48,000 for payments agreed under his contract of employment to enable his relocation to the East Midlands area.

[3] The annual bonus figure reflects the amount awarded in the year which is not subject to deferral and is the total paid. The remaining 60%, which is subject to deferral and the achievement of future performance measure, will be disclosed in the year of payment.

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

Executive Directors	Performance Year	Due 2019 £000	Due 2020 £000	Due 2021 £000	Total Deferred £000
David Marlow	2015	53	-	-	53
	2016	-	47	-	47
	2017	-	-	64	64
		53	**47**	**64**	**164**
Daniel Mundy	2017	-	-	32	32
				32	**32**
Simon Taylor	2015	38	-	-	38
	2016	-	33	-	33
	2017	-	-	47	47
		38	**33**	**47**	**118**
		91	**80**	**143**	**314**

Ashraf Piranie resigned from the Board as Deputy CEO and Finance Director on 23 February 2017. As a consequence he forfeited rights to any entitlements under the 2016 Executive Annual Bonus Scheme, rights to previously deferred elements of the annual bonus scheme and entitlements under the legacy 2014-16 and 2015-17 Long Term Incentive Schemes.

Daniel Mundy joined the Society and was appointed to the Board as Finance Director on 19 April 2017 receiving a standard Executive Director remuneration package which included an element for relocation. As an Executive Director, he participated in the 2017 Executive Bonus Plan and received a pro rata payment for his service during the year but does not participate in the Legacy Long Term Incentive (LTI) scheme.

Non-Executive Director remuneration

Audited Society		2017 £000	2016 £000
John Edwards (Chairman)		68	67
Jane Kibbey (Vice-Chairman from 29 March 2017)		44	42
Andrew Neden		47	46
Kavita Patel	(appointed 1 January 2017)	37	-
Mary Phibbs		-	9
Kerry Spooner		40	12
Guy Thomas	(resigned 21 June 2017)	23	46
Keith Whitesides (Vice-Chairman until retirement)	(retired 28 March 2017)	10	41
TOTAL EMOLUMENTS FOR SERVICES AS DIRECTORS		**269**	**263**

On behalf of the Board of directors,

Kerry Spooner
Chairman of the Remuneration Committee

21 February 2018

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

Opinion

In our opinion, the financial statements:

- Give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's and the Society's affairs as at 31 December 2017 and of the Group's and the Society's income and expenditure for the year then ended; and
- Have been prepared in accordance with the requirements of the Building Societies Act 1986, and, as regards the Group financial statements, Article 4 of the IAS Regulation.

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

Group	Society
Consolidated statement of financial position as at 31 December 2017	Statement of financial position as at 31 December 2017
Consolidated income statement for the year ended 31 December 2017	Income statement for the year ended 31 December 2017
Consolidated statement of comprehensive income for the year ended 31 December 2017	Statement of comprehensive income for the year ended 31 December 2017
Consolidated statement of changes in members' interests for the year ended 31 December 2017	Statement of changes in members' interests for the year ended 31 December 2017
Consolidated cash flow statement for the year ended 31 December 2017	Cash flow statement for the year ended 31 December 2017
Related notes 1 to 35 to the accounts, including a summary of principle accounting policies	Related notes 1 to 35 to the accounts, including a summary of principle accounting policies

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

Basis for opinion

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

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

Use of our report

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

Conclusions relating to principal risks, going concern and viability statement

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

- the disclosures in the annual report set out on page 15 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation set out on page 22 in the annual report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity;
- the directors' statement set out on page 22 in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements
- whether the directors' statement in relation to going concern required under the Listing Rules in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit; or
- the directors' explanation set out on page 22 in the annual report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Overview of our audit approach

Key audit matters	• Revenue recognition in relation to effective interest rate (EIR) accounting; • Valuation of loan impairment relating to commercial mortgages; • Valuation of goodwill.
Audit scope	• We performed an audit of the complete financial information of the Group and Society. • Our Group audit scope included all of the Society's subsidiaries. Our audit did not involve any component teams.
Materiality	• Overall Group materiality of £1.6m which equates to 0.75% of total reserves attributable to members of the Society.

GOVERNANCE

Key audit matters

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

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Revenue recognition in relation to effective interest rate (EIR) accounting		
Refer to the Audit Committee report (page 32) and Accounting policies (page 52) of the Consolidated financial statements. Effective interest rate accounting is a judgemental area driven by customer payment behaviours and management's assumptions. Changes in these variables and assumptions, notably the expected life of mortgages and prepayments rates within the EIR calculation, can have a material impact on income recognition in the year and therefore we have classified this as a significant audit risk.	We assessed the design effectiveness of internal controls operated by the Group over the EIR process. Our audit approach did not seek to rely on the controls identified. We tested the completeness and accuracy of data on a sample basis, from the Society's source system to the EIR models. We challenged assumptions regarding the expected lives of loans by comparing them to recent actual redemption behaviours, and compared assumptions about future changes in interest rates to current market data. We performed sensitivity analysis over the EIR models to assess the significance of individual assumptions. We verified the logic and accuracy of the EIR calculation across products and agreed the total EIR balance to the general ledger. We performed testing of journals recorded throughout the year and at the year-end using an approach based on risk of management override of controls. In each case we substantiated journals recorded to supporting evidence.	We concluded to the Audit Committee that the effective interest rate adjustments made to the Group's loan portfolios were materially correct at 31 December 2017. We gained assurance of the completeness and accuracy of data used within EIR models. We found that key assumptions in relation to behavioural lives of assets and prepayment rates were consistent with the underlying data and observed characteristics of the Society's portfolios and market trends. We found that the models were operating effectively in the calculation of EIR adjustments and that the results were accurately reflected in the general ledger. We found no significant errors or evidence of management override of controls from testing of journal entries.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Valuation of loan impairment relating to commercial mortgages		
Refer to Audit Committee report (page 32); Accounting policies (page 53); and Note 15 of the Consolidated financial statements. Valuation of loan impairment provisions is an area of estimation that requires significant management judgement. Whilst the vast majority of the Society's loan book is high quality with low arrears and low historical loss rates, impairment estimates are an inherently subjective area and involve a number of assumptions. Such assumptions include the probability of default, and the likely loss in the event of default. The loss in event of default depends on the value of the secured property, assumptions on forced sale discounts and the costs to sell. Given the amount of estimation involved and the value of the loan impairment provisions compared to audit materiality, we have classified this as a significant audit risk.	We assessed the design effectiveness of internal controls operated by the Group over the commercial mortgages loan impairment process. Our audit approach did not seek to rely on the controls identified. We tested the completeness and accuracy of data used within the impairment models, on a sample basis, through reconciliation to source systems and the general ledger. Our substantive audit procedures over the collective and specific provision models included assessing, challenging and substantiating model assumptions, such as: • Probabilities of default; • Collateral valuations; • Costs of sale; • Forced sale discounts; • Time to default, possess and sell. We assessed these assumptions through substantiating to historical data and with reference to our knowledge of the Society's portfolios and the industry. We independently determined a reasonable range and assessed whether Management's provision sat within.	We concluded to the Audit Committee that the provision levels held by the Group in relation to commercial mortgages loan impairment were conservative given a reasonable range using historical data and industry benchmarks. We gained satisfactory assurance from our testing of the completeness and accuracy of data, review of assumptions and recalculation of individual provision amounts. We noted that the provision has decreased compared to prior year and remains lower than general industry averages due to the Society's conservative lending policies and the small number of customers in arrears.
Valuation of goodwill		
Refer to Audit Committee report (page 32); Accounting policies (page 54); and Note 18 of the Consolidated financial statements. The valuation of goodwill is assessed by management through an annual impairment assessment. The nature of this assessment is judgemental and involves future projections of future cash flows that are inherently uncertain. There are a number of assumptions used in the goodwill impairment assessment which could materially impact the outcome, including growth rates and the selection of an appropriate discount rate. Given the carrying value of goodwill compared to audit materiality, we classified this as a significant audit risk.	We assessed the design effectiveness of the key controls in operation over the goodwill impairment assessment. Our audit approach did not seek to rely on the controls identified. We examined management's impairment assessment to assess compliance with IAS 36 *Impairment of assets*. We challenged the forecasts and assumptions used within the assessment. A core element of our challenge was to compare current forecasts and assumptions with those determined by the Society at the time of acquisition, to determine consistency in approach and basis of preparation of cash flow forecasts.	We concurred with management's assessment that the carrying value of goodwill did not require an impairment adjustment at 31 December 2017. We concluded that the discount rate used of 12.5% was reasonable and conservative. We observed that the cash flow forecasts for the acquired business had been prepared on a consistent basis with the original business case at the time of acquisition.

Our application of materiality

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

Audit Materiality

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

We determined materiality for the Group to be £1.6 million (2016: £2 million), which equates to 0.75% (2016: 1%) of total reserves attributable to members of the Society. We assessed that total reserves attributable to the members of Society provides us with an overall indicator of the financial strength of the Group and we consider total reserves attributable to members of the Society to be an appropriate basis for materiality given the Group focuses on its mutual status above maximisation of profit generation.

We determined materiality for the Society to be £1.6 million (2016: £2.0 million), which equates to 0.75% (2016: 1%) of total reserves attributable to members of the Society.

Performance materiality

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

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 75% (2016: 75%) of our planning materiality, namely £1.2 million (2016: £1.6 million). We have set performance materiality at this percentage based upon our recent experience of auditing the Group, from which we concluded that there is a lower expectation of undetected misstatement due to the effective control environment and only minor audit differences resulting from our work. As a result, we determined that the higher of our permissible thresholds for our performance materiality was appropriate.

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

Reporting threshold

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

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.08 million (2016: £0.1 million), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

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

Other information

The other information comprises the information included in the annual report set out on pages 4 to 39, including Chairman's Statements set out on pages 4 to 5, Chief Executive's Statement set out on pages 6 to 7, Strategic Report set out on pages 8 to 15, Corporate Responsibility Report set out on pages 16 to 17, Directors Report as set out on pages 20 to 22, Risk Management Report as set out on pages 23 to 27, Corporate Governance Report as set out on pages 28 to 31, and the Board Audit Committee Report as set out on pages 32 to 33, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

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

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

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

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

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

- **Fair, balanced and understandable set out on page 21** – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the group's performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or

- **Audit committee reporting set out on pages 32 to 33** – the section describing the work of the audit committee does not appropriately address matters communicated by us to the audit committee; or
- **Directors' statement of compliance with the UK Corporate Governance Code set out on page 21** – the parts of the directors' statement required under the Listing Rules relating to the Society's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

Opinion on other matters prescribed by the Building Societies Act 1986

In our opinion:

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

Matters on which we are required to report by exception

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

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

Other voluntary reporting matters

Directors' remuneration report

The Society voluntarily prepares a Report of the directors on remuneration in accordance with the provisions of the Companies Act 2006. The directors have requested that we audit the part of the Report of the directors on remuneration specified by the Companies Act 2006 to be audited as if the Society were a quoted company. In our opinion, the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 21, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor's responsibilities for the audit of the financial statements

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

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

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

Our approach in respect of irregularities, including fraud, was as follows:

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

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

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

Other matters we are required to address

Following the recommendation of the audit committee we were appointed by the Society at its annual general meeting on 24 March 2015 to audit the financial statements of the Company for the period ending 31 December 2015 and subsequent financial periods. Our total uninterrupted period of engagement is 3 years, covering periods from our appointment through to the period ending 31 December 2017.

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

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

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

21 February 2018

Notes:

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

INCOME STATEMENTS
for the year ended 31 December 2017

	Notes	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Interest receivable and similar income	3	82.2	89.3	83.5	89.9
Interest payable and similar charges	4	(33.9)	(43.7)	(35.1)	(44.4)
NET INTEREST INCOME		**48.3**	**45.6**	**48.4**	**45.5**
Fees and commissions receivable		9.1	9.8	3.2	3.3
Fees and commissions payable		(1.6)	(1.2)	(1.6)	(1.2)
Other income		-	0.3	0.3	0.3
Net losses from derivative financial instruments	5	(0.2)	(0.9)	(0.3)	(0.7)
TOTAL NET INCOME		**55.6**	**53.6**	**50.0**	**47.2**
Administrative expenses	6	(38.3)	(35.4)	(31.6)	(28.5)
Depreciation and amortisation	17,18	(3.0)	(3.3)	(2.9)	(3.0)
Finance cost	27	(0.3)	(0.2)	(0.3)	(0.2)
Impairment release on loans and advances	15	1.3	-	1.3	-
Provisions for liabilities - FSCS levy and other	26	(0.8)	(0.4)	(0.8)	(0.4)
(Loss)/profit on disposal of property, plant and equipment	17	-	(0.1)	-	(0.1)
PROFIT BEFORE TAX		**14.5**	**14.2**	**15.7**	**15.0**
Tax expense	8	(3.0)	(3.2)	(3.1)	(3.3)
PROFIT AFTER TAX FOR THE FINANCIAL YEAR		**11.5**	**11.0**	**12.6**	**11.7**

Profit for the financial year arises from continuing operations.

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

The notes on pages 51 to 94 form part of these accounts.

STATEMENTS OF COMPREHENSIVE INCOME
for the year ended 31 December 2017

	Notes	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Profit for the financial year		11.5	11.0	12.6	11.7
Items that will not be re-classified to the income statement					
Remeasurements of defined benefit obligation	27	2.1	(4.5)	2.1	(4.5)
Tax on items that will not be re-classified	8	(0.4)	0.7	(0.4)	0.7
Items that may subsequently be re-classified to the income statement					
Available-for-sale reserve					
Valuation (losses)/gains taken to reserves	12	(0.4)	0.2	(0.4)	0.2
Tax on items that may subsequently be re-classified	8	0.1	(0.1)	0.1	(0.1)
Other comprehensive income/(expense) for the period net of income tax		**1.4**	**(3.7)**	**1.4**	**(3.7)**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**12.9**	**7.3**	**14.0**	**8.0**

Both the profit for the financial year and total comprehensive income for the period are attributable to the members of the Society.

The notes on pages 51 to 94 form part of these accounts.

STATEMENTS OF FINANCIAL POSITION
as at 31 December 2017

	Notes	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
ASSETS					
Cash in hand and balances with the Bank of England	9	352.6	390.5	352.6	390.5
Loans and advances to credit institutions	10	33.1	39.1	24.6	33.6
Debt securities	12	109.2	97.4	109.2	97.4
Derivative financial instruments	13	7.3	4.7	7.3	4.7
Loans and advances to customers	14	3,368.8	3,032.6	3,368.8	3,032.6
Investments in subsidiary undertakings	16	-	-	28.7	21.7
Other assets		5.9	4.6	5.5	3.9
Property, plant and equipment	17	14.6	12.7	13.6	11.7
Intangible assets	18	7.2	7.7	2.7	3.1
Deferred tax assets	19	1.7	2.1	1.7	2.1
TOTAL ASSETS		**3,900.4**	**3,591.4**	**3,914.7**	**3,601.3**
LIABILITIES					
Shares	20	2,595.4	2,457.4	2,595.4	2,457.4
Amounts owed to credit institutions	21	703.7	557.6	703.7	557.6
Amounts owed to other customers	22	185.1	215.7	185.1	215.7
Amounts owed to subsidiary undertakings	23	-	-	158.5	101.6
Debt securities in issue	24	153.5	98.7	7.0	6.0
Derivative financial instruments	13	9.9	19.7	9.8	19.5
Other liabilities and accruals	25	4.9	4.7	4.3	4.0
Current tax liabilities		1.6	1.3	1.6	1.3
Provisions for liabilities	26	1.1	0.9	1.1	0.9
Retirement benefit obligations	27	6.9	9.4	6.9	9.4
Subscribed capital	28	25.6	26.2	25.6	26.2
TOTAL LIABILITIES		**3,687.7**	**3,391.6**	**3,699.0**	**3,399.6**
RESERVES					
General reserves		212.7	199.5	215.7	201.4
Available-for-sale reserves	29	-	0.3	-	0.3
Total reserves attributable to members of the Society		**212.7**	**199.8**	**215.7**	**201.7**
TOTAL RESERVES AND LIABILITIES		**3,900.4**	**3,591.4**	**3,914.7**	**3,601.3**

The notes on pages 51 to 94 form part of these accounts.

These accounts were approved by the Board of directors on 21 February 2018 and signed on its behalf:

John Edwards
Chairman

David Marlow
Chief Executive

Daniel Mundy
Finance Director

STATEMENTS OF CHANGES IN MEMBERS' INTERESTS
for the year ended 31 December 2017

	General reserves £m	Available-for-sale reserves £m	Total £m
GROUP 2017			
Balance as at 1 January 2017	199.5	0.3	199.8
Profit for the year	11.5	-	11.5
Other comprehensive income for the period (net of tax)			
Net losses from changes in fair value	-	(0.3)	(0.3)
Remeasurement of defined benefit obligation	1.7	-	1.7
Total other comprehensive income/(expense)	1.7	(0.3)	1.4
Total comprehensive income/(expense) for the period	13.2	(0.3)	12.9
BALANCE AS AT 31 DECEMBER 2017	**212.7**	**-**	**212.7**
GROUP 2016			
Balance as at 1 January 2016	192.3	0.2	192.5
Profit for the year	11.0	-	11.0
Other comprehensive income for the period (net of tax)			
Net gains from changes in fair value	-	0.1	0.1
Remeasurement of defined benefit obligation	(3.8)	-	(3.8)
Total other comprehensive (expense)/income	(3.8)	0.1	(3.7)
Total comprehensive income for the period	7.2	0.1	7.3
BALANCE AS AT 31 DECEMBER 2016	**199.5**	**0.3**	**199.8**

	General reserves £m	Available-for-sale reserves £m	Total £m
SOCIETY 2017			
Balance as at 1 January 2017	201.4	0.3	201.7
Profit for the year	12.6	-	12.6
Other comprehensive income for the period (net of tax)			
Net losses from changes in fair value	-	(0.3)	(0.3)
Remeasurement of defined benefit obligation	1.7	-	1.7
Total other comprehensive income/(expense)	1.7	(0.3)	1.4
Total comprehensive income/(expense) for the period	14.3	(0.3)	14.0
BALANCE AS AT 31 DECEMBER 2017	**215.7**	**-**	**215.7**
SOCIETY 2016			
Balance as at 1 January 2016	193.5	0.2	193.7
Profit for the year	11.7	-	11.7
Other comprehensive income for the period (net of tax)			
Net gains from changes in fair value	-	0.1	0.1
Remeasurement of defined benefit obligation	(3.8)	-	(3.8)
Total other comprehensive (expense)/income	(3.8)	0.1	(3.7)
Total comprehensive income for the period	7.9	0.1	8.0
BALANCE AS AT 31 DECEMBER 2016	**201.4**	**0.3**	**201.7**

The notes on pages 51 to 94 form part of these accounts.

CASH FLOW STATEMENTS
for the year ended 31 December 2017

	Notes	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
CASH FLOWS FROM OPERATING ACTIVITIES					
Profit before tax		14.5	14.2	15.7	15.0
Depreciation and amortisation		3.0	3.3	2.9	3.0
Loss/(profit) on disposal of property, plant and equipment		-	0.1	-	0.1
Interest on subscribed capital		2.0	2.0	2.0	2.0
Net gains on disposal and amortisation of debt securities		0.7	0.8	0.7	0.8
Decrease in impairment of loans and advances		1.3	-	1.3	-
		21.5	**20.4**	**22.6**	**20.9**
CHANGES IN OPERATING ASSETS AND LIABILITIES					
(Increase)/decrease in prepayments, accrued income and other assets		(3.9)	(2.3)	45.7	85.4
(Decrease)/increase in accruals, deferred income and other liabilities		(9.9)	9.6	(9.9)	9.2
Increase in loans and advances to customers		(337.5)	(236.1)	(337.5)	(236.1)
Increase in shares		138.0	24.2	138.0	24.2
Increase in amounts owed to other credit institutions and other customers		115.5	139.3	115.5	139.3
Decrease/(increase) in loans and advances to credit institutions		10.4	(15.7)	10.5	(15.7)
Increase/(decrease) in debt securities in issue		54.8	89.7	1.0	(3.0)
Decrease in retirement benefit obligation		(0.6)	(0.6)	(0.6)	(0.6)
Taxation paid		(2.6)	(3.9)	(2.6)	(4.0)
NET CASH (USED IN)/GENERATED BY OPERATING ACTIVITIES		**(14.3)**	**24.6**	**(17.3)**	**19.6**
CASH FLOWS FROM INVESTING ACTIVITIES					
Purchase of debt securities		(50.9)	(152.9)	(50.9)	(152.9)
Disposal of debt securities		38.0	157.3	38.0	157.3
Purchase of property, plant and equipment		(3.8)	(1.5)	(3.8)	(1.5)
Purchase of intangible assets		(0.6)	(1.0)	(0.6)	(1.0)
NET CASH (USED IN)/GENERATED BY INVESTING ACTIVITIES		**(17.3)**	**1.9**	**(17.3)**	**1.9**
CASH FLOWS FROM FINANCING ACTIVITIES					
Interest paid on subscribed capital		(1.9)	(1.9)	(1.9)	(1.9)
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS		**(33.5)**	**24.6**	**(36.5)**	**19.6**
Cash and cash equivalents at 1 January		393.8	369.2	388.3	368.7
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	11	**360.3**	**393.8**	**351.8**	**388.3**

The notes on pages 51 to 94 form part of these accounts.

1. ACCOUNTING POLICIES

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

Basis of preparation

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

The accounts have been prepared on the going concern basis as outlined in the Directors' report on page 22.

The accounting policies for the Group also include those for the Society unless otherwise stated.

The preparation of accounts in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. These estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results may differ from those estimates.

Changes in accounting policy

There were no IFRS prouncements, relevant to the Group, that have been adopted with effect from 1 January 2017.

Future accounting developments

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

- *IFRS 9 'Financial Instruments'* – effective from 1 January 2018 and will replace IAS 39 'Financial Instruments: Recognition and Measurement'. It includes requirements for the classification and measurement of financial instruments, impairment of financial assets and hedge accounting.

  Classification and measurement: The standard requires financial assets to be classified at amortised cost or at fair value (through either the income statement or through other comprehensive income) depending on the Group's business model and the contractual cash flow characteristics of the financial assets. Consequently, the available-for-sale category currently used will become void. There are no changes in measurement from the accounting treatment under IAS 39 which impacts the financial statements.

  Impairment of financial assets: In addition the standard will address impairment of financial assets, which will be based on expected credit losses rather than incurred losses as at present. The impact of the expected credit loss approach is material to the Group and during the current financial year, work has involved building and testing of new expected loss impairment models and validating outputs as well as implementing business process changes. The financial impact of implementing this accounting standard is estimated to be a benefit to reserves of £1.5m to £2.0m on transition, which relates predominately to its impact on impairment provisions against loans and advances to customers. The Society is expected to report a net release on adoption of IFRS 9 as a result of the creation of a forward-looking scenario model that utilises externally provided economic data that shows a more sustained benign economic environment than previously modelled. The Society is not expected to recognise a material impairment provision against its liquidity balances on transition.

  Hedge accounting: IFRS 9 allows the option to continue to apply the existing hedge accounting requirements of IAS 39 until the separate standard for macro hedge accounting is developed. No changes are currently being implemented to the Society's hedge accounting policies and methodologies.

- *IFRS 15 'Revenue from contracts with Customers'* – effective from 1 January 2018. The standard provides guidance on when revenue should be recognised. The standard has no impact to the Group;

- *IFRS 16 'Leases'* – effective from 1 January 2019. The standard provides a single lessee accounting model requiring lessees to recognise assets and liabilities for all leases. The financial impact of IFRS 16 will be considered by the Group during the next financial period.

Basis of consolidation

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

Subsidiaries are fully consolidated from the date on which control is transferred to the Group and de-consolidated from the date that control ceases. The Group accounts consolidate the assets, liabilities and results of the Society and all of its subsidiaries, eliminating intercompany balances and transactions. All entities have accounting periods ending on 31 December.

The results of subsidiary undertakings acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date that ownership ceases.

Special purpose funding vehicles

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

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

Business combinations between mutual organisations

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

1. ACCOUNTING POLICIES (CONTINUED)

Business combinations

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

Interest income and expense

Interest income and interest expense for all interest-bearing financial instruments are recognised in 'interest receivable and similar income' or 'interest payable and similar charges' using the effective interest rates of the financial assets or financial liabilities to which they relate. The effective interest rate is the rate that discounts the expected future cash flows, over the expected life of the financial instrument, to the net carrying amount of the financial asset or liability. This may include fees and commissions if they are an integral part of the effective interest rate of a financial instrument. Interest on impaired financial assets is recognised at the original effective interest rate of the financial asset applied to the carrying amount as reduced by an allowance for impairment.

Fees and commissions

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

Commission receivable from the sale of third party products is recognised upon fulfilment of contractual obligations, that is the inception date of the product or on completion of a mortgage.

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

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

Cash and cash equivalents

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

Derivative financial instruments and hedge accounting

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

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

If derivatives are not designated as hedges, then changes in fair values are recognised immediately in the Income Statement in the period in which the hedged item affects the Income Statement.

Fair value hedges

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

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

Financial assets

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

Loans and receivables

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

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

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

1. ACCOUNTING POLICIES (CONTINUED)

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

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

Available-for-sale assets

Available-for-sale assets are non-derivative assets that are intended to be held for an indefinite period of time. They may be sold in response to needs for changes in liquidity or changes in interest rates. The Group's debt securities are classified as available-for-sale assets. The Group measures debt securities at fair value, with subsequent changes in fair value being recognised through other comprehensive income except for impairment losses which are recognised in profit or loss. Further information regarding how fair values are determined can be found in note 30 to the accounts.

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

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

Assets carried at amortised cost

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

Objective evidence of impairment may include:

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

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

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

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

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

Available-for-sale assets

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

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

Forbearance strategies and renegotiated loans

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

The main options offered by the Society include:

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

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

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

1. ACCOUNTING POLICIES (CONTINUED)

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

Derecognition of financial assets and liabilities

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

Financial liabilities

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

Fair value of financial assets and liabilities

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

Level 1 – Valuation using quoted market process

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

Level 2 – Valuation technique using observable inputs

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

Level 3 – Valuation technique using significant unobservable inputs

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

Subscribed capital

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

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

Intangible assets

Computer Software

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

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

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

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

Goodwill

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

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

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

1. ACCOUNTING POLICIES (CONTINUED)

Other intangibles

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

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

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

Property, plant and equipment

Additions and improvements to office premises and equipment, including costs directly attributable to the acquisition of the asset, are capitalised at cost. The property, plant and equipment value in the statement of financial position represents the original cost, less cumulative depreciation.

The costs, less estimated residual values of assets, are depreciated on a straight-line basis over their estimated useful economic lives as follows:

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

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

Employee benefits

Long term incentive schemes

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

Pensions

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

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

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

Leases

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

Taxation

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

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

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

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

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

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

1. ACCOUNTING POLICIES (CONTINUED)

Provisions and contingent liabilities

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

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

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

Accounting estimates and judgements

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

Impairment losses on loans and advances to customers

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

To the extent that default rates differ from that estimated by 10%, the impairment provisions on loans and advances would change by an estimated £0.3 million.

Expected mortgage life

In determining the expected life of mortgage assets, the Group uses historical and forecast redemption data as well as management judgement. At regular intervals throughout the year, the expected life of mortgage assets is reassessed for reasonableness. Any variation in the expected life of mortgage assets will change the carrying value in the statement of financial position and the timing of the recognition of interest income.

A 10% increase in the life profile of mortgage assets would result in an increase in the value of loans on the statement of financial position by approximately £2.2 million.

Employee benefits

The Group operates a defined benefit pension scheme. Significant judgements (on such areas as future interest and inflation rates and mortality rates) have to be exercised in estimating the value of the assets and liabilities of the scheme, and hence of its net deficit. The assumptions are outlined in note 27 to the accounts. Of these assumptions, the main determinant of the liability is the discount rate. A variation of 0.1% in the discount rate will change liabilities by approximately £1.1 million.

Goodwill

The Group has recognised goodwill in the statement of financial position, in relation to the acquisition of subsidiary undertakings. Judgement is used in estimating the appropriateness of the carrying value of such balances, in particular the discount rate applied in testing for impairment. A 1% movement in the discount rate does not result in any impairment of the goodwill balance recognised.

2. SEGMENTAL REPORTING

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

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

The Group reports through three operating segments:

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

2017	Retail financial services £m	Estate Agency £m	Mortgage Broking £m	Consolidation adjustments £m	Total £m
Net interest income	48.3	-	-	-	48.3
Net fees and commission receivable	1.6	4.3	1.6	-	7.5
Other income	0.3	-	-	(0.3)	-
TOTAL INCOME	**50.2**	**4.3**	**1.6**	**(0.3)**	**55.8**
Administrative expenses	(31.0)	(5.4)	(1.2)	-	(37.6)
Depreciation and amortisation	(2.9)	-	-	(0.1)	(3.0)
Finance cost	(0.3)	-	-	-	(0.3)
Impairment losses on loans and advances	1.3	-	-	-	1.3
Provisions for other liabilities	(0.6)	-	-	-	(0.6)
Loss on disposal of property, plant and equipment	-	-	-	-	-
UNDERLYING PROFIT/(LOSS)	**16.7**	**(1.1)**	**0.4**	**(0.4)**	**15.6**
Net losses from derivative financial instruments	(0.2)	-	-	-	(0.2)
Provisions for liabilities – FSCS levy	(0.2)	-	-	-	(0.2)
Strategic investment costs	(0.6)	(0.1)	-	-	(0.7)
PROFIT/(LOSS) BEFORE TAX	**15.7**	**(1.2)**	**0.4**	**(0.4)**	**14.5**
Tax expense	(3.1)	0.2	(0.1)	-	(3.0)
PROFIT/(LOSS) AFTER TAX	**12.6**	**(1.0)**	**0.3**	**(0.4)**	**11.5**
Total assets	3,902.6	7.8	0.4	(10.4)	3,900.4
Total liabilities	3,687.2	10.6	0.3	(10.4)	3,687.7
Capital expenditure	4.4	-	-	-	4.4

2. SEGMENTAL REPORTING (CONTINUED)

2016	Retail financial services £m	Estate Agency £m	Mortgage Broking £m	Consolidation adjustments £m	Total £m
Net interest income	45.6	-	-	-	45.6
Net fees and commission receivable	2.1	5.2	1.3	-	8.6
Other income	0.3	-	-	-	0.3
TOTAL INCOME	**48.0**	**5.2**	**1.3**	**-**	**54.5**
Administrative expenses	(28.4)	(5.9)	(1.1)	-	(35.4)
Depreciation and amortisation	(3.1)	(0.1)	-	(0.1)	(3.3)
Finance cost	(0.2)	-	-	-	(0.2)
Impairment losses on loans and advances	-	-	-	-	-
Provisions for other liabilities	(0.2)	-	-	-	(0.2)
Loss on disposal of property, plant and equipment	(0.1)	-	-	-	(0.1)
UNDERLYING PROFIT	**16.0**	**(0.8)**	**0.2**	**(0.1)**	**15.3**
Net losses from derivative financial instruments	(0.9)	-	-	-	(0.9)
Provisions for liabilities – FSCS levy	(0.2)	-	-	-	(0.2)
PROFIT/(LOSS) BEFORE TAX	**14.9**	**(0.8)**	**0.2**	**(0.1)**	**14.2**
Tax expense	(3.3)	0.1	-	-	(3.2)
PROFIT/(LOSS) AFTER TAX	**11.6**	**(0.7)**	**0.2**	**(0.1)**	**11.0**
Total assets	3,592.6	8.1	0.2	(9.5)	3,591.4
Total liabilities	3,391.2	9.8	0.1	(9.5)	3,391.6
Capital expenditure	2.5	-	-	2.5	2.5

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

There are no further reportable segments or activities which are not presented above or in the primary statements on pages 46 to 50.

3. INTEREST RECEIVABLE AND SIMILAR INCOME

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
On loans fully secured on residential property	89.2	93.4	89.2	93.4
On other loans	2.4	2.5	2.4	2.5
On amounts due from group undertakings	-	-	1.1	0.6
On liquid assets	1.1	1.2	1.1	1.2
On instruments held at amortised cost	92.7	97.1	93.8	97.7
On debt securities	0.7	1.1	0.7	1.1
On derivative hedging of financial assets	(11.2)	(8.9)	(11.0)	(8.9)
	82.2	**89.3**	**83.5**	**89.9**

Interest on debt securities includes £0.6 million (2016: £0.7 million) arising from fixed income investment securities.

Included within interest income is £0.2 million (2016: £0.3 million) in respect of interest income accrued on impaired loans two or more months in arrears.

4. INTEREST PAYABLE AND SIMILAR CHARGES

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
On shares held by individuals	25.1	35.0	25.1	35.0
On amounts due to group undertakings	-	-	2.6	1.5
On deposits and other borrowings	7.5	7.4	6.0	6.6
On subscribed capital	2.0	2.0	2.0	2.0
On derivative hedging of financial liabilities	(0.6)	(0.7)	(0.6)	(0.7)
	33.9	**43.7**	**35.1**	**44.4**

5. NET LOSSES FROM DERIVATIVE FINANCIAL INSTRUMENTS

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Derivatives in designated fair value hedge relationships	12.9	(9.7)	12.9	(9.7)
Adjustments to hedged items in fair value hedge accounting relationships	(12.9)	9.1	(12.9)	9.3
Derivatives not in designated fair value hedge relationships	(0.2)	(0.3)	(0.3)	(0.3)
	(0.2)	**(0.9)**	**(0.3)**	**(0.7)**

The net loss from derivative financial instruments of £0.2 million (2016: £0.9 million) represents the net fair value movement on derivative instruments that are matching risk exposure on an economic basis. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting is not achievable on certain items. The movement is primarily due to timing differences in income recognition between derivative instruments and the hedged assets or liabilities. This gain or loss will trend to zero over time and this is taken into account by the Board when considering the Group’s underlying performance.

6. ADMINISTRATIVE EXPENSES

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Wages and salaries	20.3	19.4	16.0	15.3
Social security costs	1.8	1.6	1.5	1.3
Other pension costs	0.9	0.8	0.8	0.7
Total staff costs	**23.0**	**21.8**	**18.3**	**17.3**
Operating lease rentals	0.9	1.0	0.6	0.6
Other administrative costs	14.4	12.6	12.7	10.6
	38.3	**35.4**	**31.6**	**28.5**

	Group 2017 £000	Group 2016 £000	Society 2017 £000	Society 2016 £000
Other administrative costs include:				
Remuneration of auditors and associates (excluding VAT)				
Audit of these financial statements	119	128	119	128
Audit of subsidiary undertakings	44	42	-	-
Audit of associated pension schemes	10	15	10	15
Other assurance services	33	41	33	41

7. EMPLOYEES

	Group 2017 Number	Group 2016 Number	Society 2017 Number	Society 2016 Number
The average number of persons employed during the year was:				
Full time	512	501	406	378
Part time	195	195	119	106
	707	**696**	**525**	**484**
Building Society				
Central Administration	268	240	268	240
Branches	257	244	257	244
Subsidiaries	182	212	-	-
	707	**696**	**525**	**484**

The average number of employees on a full time equivalent basis in the Society was 498 (2016: 473) and all of these are employed within the United Kingdom.

8. TAX EXPENSE

		Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Current tax		2.9	3.0	3.0	3.2
Adjustments for prior years		-	0.1	-	-
TOTAL CURRENT TAX		**2.9**	**3.1**	**3.0**	**3.2**
Deferred tax	19	0.1	0.1	0.1	0.1
Adjustments for prior years		-	-	-	-
TOTAL DEFERRED TAX		**0.1**	**0.1**	**0.1**	**0.1**
		3.0	**3.2**	**3.1**	**3.3**

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

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Profit before taxation	14.5	14.2	15.7	15.0
Expected tax at 19.25% (2016: 20.0%)	2.8	2.8	3.0	3.0
Expenses not deductible for corporation tax	0.1	0.1	0.1	0.2
Effect of tax change in tax rate on deferred tax	-	0.1	-	0.1
Effective securitisation	-	0.1	-	-
Adjustment for prior years	0.1	0.1	-	-
	3.0	**3.2**	**3.1**	**3.3**

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Tax recognised directly in other comprehensive income				
Tax on available-for-sale assets	(0.1)	0.1	(0.1)	0.1
Deferred tax on pension scheme	0.4	(0.7)	0.4	(0.7)
TAX CHARGE/(CREDIT) FOR THE YEAR	**0.3**	**(0.6)**	**0.3**	**(0.6)**

Factors affecting future tax charges

The Finance Act 2015 reduced the future rate of UK corporation tax from 20% to 19% with effect from 1 April 2017. Furthermore, the Finance Act 2016, following its enactment in September 2016, reduced the future rate further to 17% with effect from 1 April 2020.

Deferred tax assets and liabilities are measured at whichever of these enacted tax rates are expected to apply when the related asset is realised or liability is settled.

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

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Cash in hand	1.5	1.3	1.5	1.3
Balances with the Bank of England	351.1	389.2	351.1	389.2
	352.6	**390.5**	**352.6**	**390.5**

Balances with the Bank of England includes cash ratio deposits of £3.3 million (2016: £3.0 million) which are not readily available for use in the Group's day to day operations and therefore are excluded from cash and cash equivalents.

10. LOANS AND ADVANCES TO CREDIT INSTITUTIONS

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Repayable on call and short notice	11.0	6.3	2.5	0.8
Other loans and advances to credit institutions	22.1	32.8	22.1	32.8
	33.1	**39.1**	**24.6**	**33.6**

At 31 December 2017 £22.1 million (2016: £30.8 million) of cash has been deposited by the Group and Society as collateral against derivative contracts.

11. CASH AND CASH EQUIVALENTS

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Cash in hand and balances with the Bank of England	349.3	387.5	349.3	387.5
Loans and advances to credit institutions	11.0	6.3	2.5	0.8
	360.3	**393.8**	**351.8**	**388.3**

12. DEBT SECURITIES

Group and Society	Notes	2017 £m	2016 £m
Securities available-for-sale			
Gilts		30.9	41.5
Treasury bills		-	10.0
Certificate of deposit		-	9.1
Fixed rate notes		28.6	20.6
Floating rate notes		16.2	16.2
Mortgage backed securities		33.5	-
		109.2	**97.4**
Movements on debt securities during the year may be analysed as follows:			
At 1 January		97.4	102.3
Additions		50.2	152.6
Disposals and maturities		(38.1)	(157.6)
Net (losses)/gains from changes in fair value recognised in other comprehensive income	29	(0.3)	0.1
		109.2	**97.4**

Of this total £93 million (2016: £81.2 million) is attributable to fixed income debt securities. Debt securities include items with a carrying value of £nil million (2016: £15.7 million) which have been pledged as collateral under Bank of England facilities.

13. DERIVATIVE FINANCIAL INSTRUMENTS

Group	2017 Contract/ notional amount £m	2017 Fair value of assets £m	2017 Fair value of liabilities £m	2016 Contract/ notional amount £m	2016 Fair value of assets £m	2016 Fair value of liabilities £m
Derivatives not in hedge accounting relationship						
Interest rate swaps	185.0	0.2	(0.5)	132.6	-	(0.6)
Derivatives designated as fair value hedges						
Interest rate swaps	2,013.8	7.1	(9.4)	1,774.7	4.7	(19.1)
	2,198.8	**7.3**	**(9.9)**	**1,907.3**	**4.7**	**(19.7)**

Society	2017 Contract/ notional amount £m	2017 Fair value of assets £m	2017 Fair value of liabilities £m	2016 Contract/ notional amount £m	2016 Fair value of assets £m	2016 Fair value of liabilities £m
Derivatives not in a hedge accounting relationship						
Interest rate swaps	185.0	0.2	(0.4)	132.6	-	(0.4)
Derivatives designated as fair value hedges						
Interest rate swaps	1,857.9	7.1	(9.4)	1,668.3	4.7	(19.1)
	2,042.9	**7.3**	**(9.8)**	**1,800.9**	**4.7**	**(19.5)**

14. LOANS AND ADVANCES TO CUSTOMERS

Group and Society	Notes	2017 £m	2016 £m
Loans fully secured on residential property		3,301.9	2,950.4
Other loans fully secured on land		66.6	69.0
		3,368.5	3,019.4
Provision for impairment losses on loans and advances	15	(3.2)	(4.5)
		3,365.3	3,014.9
Fair value adjustment for hedged risk		3.5	17.7
		3,368.8	**3,032.6**

Certain residential mortgages have been pledged to the Society's secured funding arrangements or utilised as mortgage loan pools for the Bank of England's Funding for Lending and Term Funding Schemes. The programmes have enabled the Society to obtain secured funding or to create additional collateral which could be used to source additional funding. The Funding for Lending Scheme, provides Treasury bills in return for eligible collateral but for accounting purposes the underlying collateral is retained on balance sheet and the Treasury bills are not.

Bank of England funding

The table below summarises the mortgages pledged and encumbered assets.

	Mortgages pledged		Drawn	
	2017 £m	2016 £m	2017 £m	2016 £m
Bank of England funding				
Other whole mortgage schemes	1,025.4	790.3	604.0	837.1
Term Funding Scheme	709.6	206.3	680.0	176.9
	1,735.0	**996.6**	**1,284.0**	**1,014.0**

ACCOUNTS

14. LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

Other secured funding

At 31 December 2017, loans and advances to customers also includes £158.7 million (2016: £102.4 million) for both the Group and Society which have been used in secured funding arrangements, resulting in the beneficial interest of these loans being transferred to Arrow Mortgage Finance No.1 Limited, a special purpose vehicle consolidated into the Group Accounts. The carrying value of these loans at the date the beneficial interest was transferred was £166.7 million (2016: £111.5 million). All of the loans pledged are retained within the Society's Statement of Financial Position as the Society retains substantially all the risk and rewards relating to the loans. These loans secure £146.5 million (2016: £93 million) of funding for the Group (note 24).

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

Impairment provisions have been deducted from the appropriate asset values on the Statement of Financial Position. Movement in provision for impairment losses on loans and advances may be analysed as follows:

Group and Society	Notes	2017 Loans fully secured on residential property £m	2017 Other loans fully secured on land £m	2017 Total £m	2016 Loans fully secured on residential property £m	2016 Other loans fully secured on land £m	2016 Total £m
At 1 January							
Collective impairment		1.1	1.8	2.9	0.7	1.5	2.2
Individual impairment		0.4	1.2	1.6	0.4	1.9	2.3
		1.5	**3.0**	**4.5**	**1.1**	**3.4**	**4.5**
Income statement							
Charge/(release) for the year							
Collective impairment		0.4	(1.5)	(1.1)	0.4	0.3	0.7
Individual impairment		(0.2)	-	(0.2)	-	(0.7)	(0.7)
		0.2	**(1.5)**	**(1.3)**	**0.4**	**(0.4)**	**-**
Amount utilised in the year							
Individual impairment		-	-	-	-	-	-
At 31 December							
Collective impairment		1.5	0.3	1.8	1.1	1.8	2.9
Individual impairment		0.2	1.2	1.4	0.4	1.2	1.6
	14	**1.7**	**1.5**	**3.2**	**1.5**	**3.0**	**4.5**

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

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

Group and Society	2017 Loans fully secured on residential property £m	2017 Other loans fully secured on land £m	2017 Total £m	2016 Loans fully secured on residential property £m	2016 Other loans fully secured on land £m	2016 Total £m
Provision for impairment	0.2	(1.5)	(1.3)	0.4	(0.4)	-
Recoveries of debts previously written off	-	-	-	-	-	-
	0.2	**(1.5)**	**(1.3)**	**0.4**	**(0.4)**	**-**

16. INVESTMENTS IN SUBSIDIARY UNDERTAKINGS

Society	2017 Shares £m	2017 Loans £m	2016 Shares £m	2016 Loans £m
At 1 January	-	21.7	-	7.7
Additions/(repayments)	-	7.0	-	14.0
	-	**28.7**	-	**21.7**

Details of the loan balances outstanding with subsidiary undertakings is disclosed in the related parties transactions note 33.

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

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

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

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

The intercompany loans outstanding with Arrow Mortgage Finance No. 1 Ltd have a contractual maturity of three years and are expected to be repaid within this period in line with the secured funding term.

All other intercompany loans are payable on demand. The directors have reviewed the recoverability of outstanding loans and holdings in subsidiary undertakings and no impairment provision is deemed necessary.

17. PROPERTY, PLANT AND EQUIPMENT

2017	Group Land and buildings £m	Group Equipment, fixtures, fittings £m	Group Total £m	Society Land and buildings £m	Society Equipment, fixtures, fittings £m	Society Total £m
Cost						
At 1 January 2017	16.0	20.5	36.5	14.0	19.9	33.9
Additions	0.4	3.4	3.8	0.4	3.4	3.8
Disposals	-	-	-	-	-	-
At 31 December 2017	**16.4**	**23.9**	**40.3**	**14.4**	**23.3**	**37.7**
Depreciation						
At 1 January 2017	8.6	15.2	23.8	7.5	14.7	22.2
Charge for the year	0.3	1.6	1.9	0.3	1.6	1.9
On disposals	-	-	-	-	-	-
At 31 December 2017	**8.9**	**16.8**	**25.7**	**7.8**	**16.3**	**24.1**
Net Book Value						
At 31 December 2017	**7.5**	**7.1**	**14.6**	**6.6**	**7.0**	**13.6**

2016	Group Land and buildings £m	Group Equipment, fixtures, fittings £m	Group Total £m	Society Land and buildings £m	Society Equipment, fixtures, fittings £m	Society Total £m
Cost						
At 1 January 2016	16.1	19.1	35.2	14.1	18.5	32.6
Additions	0.1	1.4	1.5	0.1	1.4	1.5
Disposals	(0.2)	-	(0.2)	(0.2)	-	(0.2)
At 31 December 2016	**16.0**	**20.5**	**36.5**	**14.0**	**19.9**	**33.9**
Depreciation						
At 1 January 2016	8.3	13.8	22.1	7.2	13.5	20.7
Charge for the year	0.4	1.4	1.8	0.4	1.2	1.6
On disposals	(0.1)	-	(0.1)	(0.1)	-	(0.1)
At 31 December 2016	**8.6**	**15.2**	**23.8**	**7.5**	**14.7**	**22.2**
Net Book Value						
At 31 December 2016	**7.4**	**5.3**	**12.7**	**6.5**	**5.2**	**11.7**

17. PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
The net book value of land and buildings comprises:				
Freehold	6.9	6.8	6.1	6.0
Short Leasehold	0.6	0.6	0.5	0.5
	7.5	**7.4**	**6.6**	**6.5**
The net book value of land and buildings occupied for own use:				
Building Society	6.2	6.5	6.2	6.1
Subsidiaries	0.9	0.5	-	-
Non - Group	0.4	0.4	0.4	0.4
	7.5	**7.4**	**6.6**	**6.5**

18. INTANGIBLE ASSETS

Group 2017	Goodwill £m	Purchased Software £m	Developed Software £m	Other Intangibles £m	Total £m
Cost					
At 1 January 2017	4.5	7.3	12.7	0.7	25.2
Additions	-	0.2	0.4	-	0.6
Written off in the year	-	-	-	-	-
At 31 December 2017	**4.5**	**7.5**	**13.1**	**0.7**	**25.8**
Amortisation					
At 1 January 2017	-	6.9	10.0	0.6	17.5
Charge for the year	-	0.2	0.8	0.1	1.1
Written off in the year	-	-	-	-	-
At 31 December 2017	**-**	**7.1**	**10.8**	**0.7**	**18.6**
Net Book Value					
At 31 December 2017	**4.5**	**0.4**	**2.3**	**-**	**7.2**

18. INTANGIBLE ASSETS (CONTINUED)

Group 2016	Goodwill £m	Purchased Software £m	Developed Software £m	Other Intangibles £m	Total £m
Cost					
At 1 January 2016	4.5	7.0	12.0	0.7	24.2
Additions	-	0.3	0.7	-	1.0
Written off in the year	-	-	-	-	-
At 31 December 2016	**4.5**	**7.3**	**12.7**	**0.7**	**25.2**
Amortisation					
At 1 January 2016	-	6.8	8.7	0.5	16.0
Charge for the year	-	0.1	1.3	0.1	1.5
At 31 December 2016	**-**	**6.9**	**10.0**	**0.6**	**17.5**
Net Book Value					
At 31 December 2016	**4.5**	**0.4**	**2.7**	**0.1**	**7.7**

The goodwill relates to the 2013 acquisition of 100% of the ordinary share capital of Harrison Murray Ltd (£4.0m) and 100% of the lettings trade and assets of Harrison Murray Commercial Ltd (£0.5m). In accordance with the requirements of IAS 36, the Group completed an impairment review of the carrying value for goodwill as at 31 December 2017 to ensure that the carrying value is stated at no more than its recoverable amount. No impairment arose as a result of this review.

Society	2017 Purchased Software £m	2017 Developed Software £m	2017 Total £m	2016 Purchased Software £m	2016 Developed Software £m	2016 Total £m
Cost						
At 1 January	7.2	12.7	19.9	6.9	12.0	18.9
Additions	0.2	0.4	0.6	0.3	0.7	1.0
Written off in the year	-	-	-	-	-	-
At 31 December	**7.4**	**13.1**	**20.5**	**7.2**	**12.7**	**19.9**
Amortisation						
At 1 January	6.8	10.0	16.8	6.7	8.7	15.4
Charge for the year	0.2	0.8	1.0	0.1	1.3	1.4
Written off in the year	-	-	-	-	-	-
At 31 December	**7.0**	**10.8**	**17.8**	**6.8**	**10.0**	**16.8**
Net Book Value						
At 31 December	**0.4**	**2.3**	**2.7**	**0.4**	**2.7**	**3.1**

19. DEFERRED TAX

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
At 1 January	2.1	1.6	2.1	1.6
Charge to the income statement	(0.1)	(0.1)	(0.1)	(0.1)
Recognised directly in other comprehensive income	(0.3)	0.6	(0.3)	0.6
	1.7	**2.1**	**1.7**	**2.1**

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

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Pensions and other post tax retirement benefits	(0.1)	(0.1)	(0.1)	(0.1)
Intangible assets	-	0.2	-	0.2
Effect of change in tax rate	-	(0.1)	-	(0.1)
Other provisions	-	(0.1)	-	(0.1)
	(0.1)	**(0.1)**	**(0.1)**	**(0.1)**

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

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Deferred tax assets				
Pensions and other post-retirement benefits	1.2	1.6	1.2	1.6
Property, plant and equipment	0.4	0.4	0.4	0.4
Other provisions	-	0.1	-	0.1
Transfer of engagements – fair value adjustments	0.2	0.3	0.2	0.3
	1.8	**2.4**	**1.8**	**2.4**
Deferred tax liabilities				
Available-for-sale reserve	-	0.1	-	0.1
Intangibles	0.1	0.2	0.1	0.2
	0.1	**0.3**	**0.1**	**0.3**
Net deferred tax asset	**1.7**	**2.1**	**1.7**	**2.1**

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

20. SHARES

Group and Society	2017 £m	2016 £m
Held by individuals	2,595.4	2,457.4
	2,595.4	**2,457.4**

21. AMOUNTS OWED TO CREDIT INSTITUTIONS

Group and Society	2017 £m	2016 £m
Amounts owed to credit institutions	703.7	557.6
	703.7	**557.6**

At 31 December 2017 £nil (2016: £nil) cash has been received by the Group and Society as collateral against derivative contracts. Amounts owed to credit institutions include £103.7 million (2016: £244.0 million) secured against certain loans and advances to credit institutions and loans and advances to customers.

22. AMOUNTS OWED TO OTHER CUSTOMERS

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Demand accounts				
Retail customers	1.5	2.0	1.5	2.0
Other	3.6	4.6	3.6	4.6
	5.1	**6.6**	**5.1**	**6.6**
Term deposits				
Local Authorities	97.0	122.2	97.0	122.2
Pension Funds/ Insurers	15.0	20.0	15.0	20.0
Other	68.0	66.9	68.0	66.9
	180.0	**209.1**	**180.0**	**209.1**
	185.1	**215.7**	**185.1**	**215.7**

23. AMOUNTS OWED TO SUBSIDIARY UNDERTAKINGS

Society	2017 £m	2016 £m
At 1 January	101.6	-
Advance	98.3	111.5
Repayment	(41.4)	(9.9)
	158.5	**101.6**

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

24. DEBT SECURITIES IN ISSUE

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Senior secured debt	146.5	92.7	-	-
Certificates of deposit	7.0	6.0	7.0	6.0
	153.5	**98.7**	**7.0**	**6.0**

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

25. OTHER LIABILITIES AND ACCRUALS

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Trade creditors	0.1	0.1	0.1	0.1
Accruals and deferred income	3.1	2.9	2.7	2.5
Other creditors	1.7	1.7	1.5	1.4
	4.9	**4.7**	**4.3**	**4.0**

26. PROVISION FOR LIABILITIES

Group and Society	2017 FSCS £m	2017 Customer redress & other provisions £m	2017 Total £m	2016 FSCS £m	2016 Customer redress & other provisions £m	2016 Total £m
At 1 January	0.4	0.5	0.9	1.0	0.4	1.4
Charge for the year	0.2	0.6	0.8	0.2	0.2	0.4
Provision utilised	(0.4)	(0.2)	(0.6)	(0.8)	(0.1)	(0.9)
	0.2	**0.9**	**1.1**	**0.4**	**0.5**	**0.9**

FSCS levy

The levy represents the estimated amount payable under the FSCS for the 2017/2018 scheme year, which runs from March 2017 to March 2018, and is calculated with reference to the protected deposits held at 31 December 2016. The amount payable represents the Society's share of interest payable.

Customer redress and other related provisions

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

27. RETIREMENT BENEFIT OBLIGATIONS

a) Defined benefit obligations

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

The pension cost is assessed following the advice of a qualified independent actuary using the projected unit method. The latest funding review of the scheme was at 1 April 2014. This review showed that the market value of the scheme assets at 1 April 2014 was £40.8 million and that the actuarial value of those assets represented 85% of the benefits that had accrued to members after allowing for expected future increase in salaries. An update of the funding review is currently in the process of being finalised.

An updated actuarial valuation at 31 December 2017 was carried out on a market value basis by a qualified independent actuary, as follows:

Group and Society	2017 %	2016 %
The principal actuarial assumptions used were as follows:		
Discount rate	2.5	2.7
Rate of increase in salaries	3.4	3.4
Rate of increase in pensions	3.6	3.5
Inflation	3.4	3.4

The assumptions applied follow the requirements of IAS 19, which are different to the technical valuation approach. This requires the discount rate to be benchmarked against AA corporate rated bonds, which at 31 December 2017 were lower than the rate of inflation.

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

Group and Society	2017 Male Years	2017 Female Years	2016 Male Years	2016 Female Years
Expected life at retirement for a new pensioner	24.8	26.8	26.3	28.4
Expected life at retirement in 20 years' time	26.4	28.5	27.7	29.9

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

Group and Society	Change in assumption	2017 £m	2016 £m
Principal actuarial assumption			
Discount rate	+/- 0.25%	(2.6)	(2.9)
Rate of increase in salaries	+/- 0.25%	0.1	0.1
Rate of increase in pensions	+/- 0.25%	0.8	0.8
Mortality age adjustment	+/- 0.25%	0.6	0.8
Inflation	+/- 0.25%	1.1	0.8

27. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

Group and Society	2017 £m	2016 £m
Fair value of scheme assets:		
As at 1 January	50.4	45.3
Interest on pension scheme assets	1.3	1.7
Contributions by employer	0.7	0.8
Benefits paid	(2.1)	(1.6)
Expenses paid by trustees	-	(0.1)
Gain on asset returns	3.2	4.3
As at 31 December	**53.5**	**50.4**
Present value of defined benefit obligations:		
As at 1 January	(59.8)	(50.8)
Interest on pension scheme liabilities	(1.6)	(1.9)
Benefits paid	2.1	1.6
Experience gain/(loss) on liabilities	-	0.8
Gain/(loss) on changes in financial assumptions	1.0	(9.5)
As at 31 December	**(58.3)**	**(59.8)**
Deficit in scheme at 31 December	**(4.8)**	**(9.4)**
Impact of asset ceiling	**(2.1)**	**-**
LIABILITY IN THE STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER	**(6.9)**	**(9.4)**

The actual return on plan assets was a gain of £4.5 million (2016: £5.9 million gain).

The major categories of plan assets are as follows:

Group and Society	2017 £m	2016 £m
Equities	23.2	22.3
Bonds	17.0	26.3
Liability driven investments	11.7	-
Cash	0.1	0.3
Secured pensioners	1.5	1.5
Fair value of scheme assets	**53.5**	**50.4**

The amounts recognised in finance income are:

	2017 £m	2016 £m
Interest cost	(1.6)	(1.9)
Interest on pension scheme assets	1.3	1.7
	(0.3)	**(0.2)**

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

Group and Society	2017 £m	2016 £m
Opening defined benefit obligation at 1 January	(9.4)	(5.5)
Amount recognised in the income statement	(0.3)	(0.2)
Employer contributions	0.7	0.8
Remeasurement gains/(losses)	2.1	(4.5)
CLOSING DEFINED BENEFIT OBLIGATION AS AT 31 DECEMBER	**(6.9)**	**(9.4)**

27. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

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

Group and Society	2017 £m	2016 £m
Actual return less expected return on plan assets	3.2	4.2
Experience gain arising on scheme liabilities	-	0.8
Changes in assumptions underlying the present value of the scheme liabilities	1.0	(9.5)
Change in impact of asset ceiling	(2.1)	-
REMEASUREMENT OF DEFINED BENEFIT OBLIGATION	**2.1**	**(4.5)**

The average duration of the defined benefit obligation at 31 December 2017 is 17 years (2016: 18 years). This number can be analysed as follows:

Group and Society	2017 Years	2016 Years
Active members	21	23
Deferred members	21	23
Retired members	13	14

During the year, the Group made additional contributions of £0.7 million (2016: £0.8 million) as part of its funding plan. The Group and Society have committed to contribute £0.7 million in 2018 under the agreed funding plan.

b) Defined contribution obligations

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

The pension charge for the period represents contributions payable by the Group and Society to the schemes and amounted for the Group to £0.8 million (2016: £0.8 million) and for the Society £0.7 million (2016: £0.7 million). There were no outstanding or prepaid contributions at either the beginning or end of the year.

28. SUBSCRIBED CAPITAL

Group and Society	2017 £m	2016 £m
7.875% sterling permanent interest bearing shares	23.9	23.9
Fair value adjustment for hedged risk	1.7	2.3
	25.6	**26.2**

The subscribed capital was issued for an indeterminate period and is only repayable in the event of the winding up of the Society. PIBS holders do not have any right to a residual interest in the Society.

29. AVAILABLE-FOR-SALE RESERVES

Group and Society	2017 £m	2016 £m
At 1 January	0.3	0.2
Net (loss)/gain from changes in fair value	(0.3)	0.1
	-	**0.3**

30. FINANCIAL INSTRUMENTS

Classification & Measurement

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

The Group has a formal structure for managing risk, including established risk limits, reporting lines, mandates, credit risk appetite and other control procedures. The Board Risk Committee (BRC) is tasked with monitoring the Group's overall exposure to risk, supported by the Executive Committee (ExCo). Six sub committees, the Assets and Liabilities Committee (ALCO), Margin and Income Committee (MIC). Retail Credit Committee (RCC), Operational Risk Committee (ORC), Conduct and Regulatory Risk Committee (CRRC) and the Project and Change Committee monitor the individual areas of risk and report to the Board Risk Committee quarterly.

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

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

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

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

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

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

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

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

The fair values of these hedges at 31 December 2017 are shown in note 13.

30. FINANCIAL INSTRUMENTS (CONTINUED)

Classification & Measurement (continued)

Below are the summary terms and conditions and accounting policies of financial instruments:

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

30. FINANCIAL INSTRUMENTS (CONTINUED)

Classification & Measurement (continued)

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

Carrying values by category	Held at amortised cost		Held at fair value			
Group As at 31 December 2017	Loans and receivables £m	Financial assets and liabilities at amortised cost £m	Available-for-sale £m	Derivatives designated as fair value hedges £m	Unmatched derivatives £m	Total £m
Financial assets						
Cash in hand and balances with the Bank of England	-	352.6	-	-	-	352.6
Loans and advances to credit institutions	33.1	-	-	-	-	33.1
Debt securities	-	-	109.2	-	-	109.2
Derivative financial instruments	-	-	-	7.1	0.2	7.3
Loans and advances to customers	3,368.8	-	-	-	-	3,368.8
Other assets	-	29.4	-	-	-	29.4
	3,401.9	**382.0**	**109.2**	**7.1**	**0.2**	**3,900.4**
Financial liabilities						
Shares	-	2,595.4	-	-	-	2,595.4
Amounts owed to credit institutions	-	703.7	-	-	-	703.7
Amounts owed to other customers	-	185.1	-	-	-	185.1
Debt securities in issue	-	153.5	-	-	-	153.5
Derivative financial instruments	-	-	-	9.4	0.5	9.9
Subscribed capital	-	25.6	-	-	-	25.6
Other liabilities	-	14.5	-	-	-	14.5
	-	**3,677.8**	**-**	**9.4**	**0.5**	**3,687.7**

30. FINANCIAL INSTRUMENTS (CONTINUED)

Classification & Measurement (continued)

Carrying values by category	Held at amortised cost		Held at fair value			
Group As at 31 December 2016	Loans and receivables £m	Financial assets and liabilities at amortised cost £m	Available-for-sale £m	Derivatives designated as fair value hedges £m	Unmatched derivatives £m	Total £m
Financial assets						
Cash in hand and balances with the Bank of England	-	390.5	-	-	-	390.5
Loans and advances to credit institutions	39.1	-	-	-	-	39.1
Debt securities	-	-	97.4	-	-	97.4
Derivative financial instruments	-	-	-	4.7	-	4.7
Loans and advances to customers	3,032.6	-	-	-	-	3,032.6
Other assets	-	27.1	-	-	-	27.1
	3,071.7	**417.6**	**97.4**	**4.7**	**-**	**3,591.4**
Financial liabilities						
Shares	-	2,457.4	-	-	-	2,457.4
Amounts owed to credit institutions	-	557.6	-	-	-	557.6
Amounts owed to other customers	-	215.7	-	-	-	215.7
Debt securities in issue	-	98.7	-	-	-	98.7
Derivative financial instruments	-	-	-	19.1	0.6	19.7
Subscribed capital	-	26.2	-	-	-	26.2
Other liabilities	-	16.3	-	-	-	16.3
	-	**3,371.9**	**-**	**19.1**	**0.6**	**3,391.6**

30. FINANCIAL INSTRUMENTS (CONTINUED)

Fair values of financial assets and liabilities carried at amortised cost

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

Group		2017 Book value £m	2017 Fair value £m	2016 Book value £m	2016 Fair value £m
Financial assets					
Cash in hand and Balances with the Bank of Engand	a	352.6	352.6	390.5	390.5
Loans and advances to credit institutions	b	33.1	33.1	39.1	39.1
Loans and advances to customers	c	3,368.8	3,375.9	3,032.6	3,042.6
Financial liabilities					
Shares	d	2,595.4	2,600.6	2,457.4	2,455.0
Amounts owed to credit institutions	d	703.7	704.0	557.6	559.0
Amounts owed to other customers	d	185.1	185.2	215.7	216.1
Debt securities in issue	e	153.5	153.5	98.7	98.8
Subscribed capital	f	23.9	30.6	23.9	29.4

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The estimated fair value of the financial assets and liabilities above has been calculated using the following valuation methodology:

a) Cash in hand – Level 1
The fair value of cash in hand and deposits with central banks is the amount repayable on demand.

b) Loans and advances to credit institutions – Level 2
The fair value of overnight deposits is the amount repayable on demand.

The estimated fair value of collateral loans and advances to credit institutions is based on its market price as at the period end.

c) Loans and advances to customers – Level 3
Loans and advances are recorded net of provisions for impairment together with the fair value adjustment for hedged items as required by IAS 39. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received taking account of expected prepayment rates.

Estimated cash flows are discounted at prevailing market rates for items of similar remaining maturity. The fair values have been adjusted where necessary to reflect any observable market conditions at the time of valuation.

d) Shares, deposits and borrowings – Level 3
The fair value of shares and deposits and other borrowings with no stated maturity is the amount repayable on demand.

The fair value of fixed interest bearing deposits and other borrowings without a quoted market price is based on expected future cash flows determined by the contractual terms and conditions discounted at prevailing market rates for items of similar remaining maturity.

e) Debt securities in issue – Level 2
The fair value is calculated using a discounted cash flow model. Expected cash flows are discounted at prevailing market rates for items of similar remaining maturity.

f) Subscribed capital – Level 1
The estimated fair value of fixed interest bearing debt is based on its active market price as at the period end.

30. FINANCIAL INSTRUMENTS (CONTINUED)

Fair values of financial assets and liabilities carried at fair value

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

Group	Notes	2017 Level 1 £m	2017 Level 2 £m	2017 Total £m	2016 Level 1 £m	2016 Level 2 £m	2016 Total £m
Financial assets							
Available-for-sale – Debt securities	12	109.2	-	109.2	88.3	9.1	97.4
Derivative financial instruments – Interest rate swaps	13	-	7.3	7.3	-	4.7	4.7
		109.2	**7.3**	**116.5**	**88.3**	**13.8**	**102.1**
Financial liabilities							
Derivative financial instruments – Interest rate swaps	13	-	(9.9)	(9.9)	-	(19.7)	(19.7)
		-	**(9.9)**	**(9.9)**	**-**	**(19.7)**	**(19.7)**

There are no level 3 financial instruments carried at fair value.

Valuation techniques

The following is a description of the determination of fair value for financial instruments which are accounted for at fair value using valuation techniques.

The fair value hierarchy detailed in IFRS 13: 'Fair Value Measurement' splits the source of input when deriving fair values into three levels, as follows:

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

The main valuation techniques employed by the Group to establish fair value of the financial instruments disclosed above are set out below:

Debt securities

- **Level 1** – Market prices have been used to determine the fair value of listed debt securities
- **Level 2** - Debt securities for which there is no readily available traded price are valued based on the 'present value' method. This requires expected future principal and interest cash flows to be discounted using prevailing LIBOR yield curves. The LIBOR yield curves are generally observable market data which is derived from quoted interest rates in similar time bandings which match the timings of the cash flows and maturities of the instruments.

Interest rate swaps

The valuation of interest rate swaps is also based on the 'present value' method. Expected interest cash flows are discounted using the prevailing SONIA yield curves. The SONIA yield curves are generally observable market data which is derived from quoted interest rates in similar time bandings which match the timings of the interest cash flows and maturities of the instruments. All swaps are fully collateralised and therefore no adjustment is required for credit risk in the fair value of derivatives.

Transfers between fair value hierarchies

Transfers between fair value hierarchies occur when either it becomes possible to value a financial instrument using a method that is higher up the valuation hierarchy or it is no longer possible to value it using the current method and it must instead be valued using a method lower down the hierarchy. There have been no transfers during the current or previously reported periods.

30. FINANCIAL INSTRUMENTS (CONTINUED)

Fair values of financial assets and liabilities carried at fair value (continued)

Credit risk

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

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

Group and Society	2017 £m	2016 £m
Credit risk exposure		
Cash in hand and Balances with the Bank of England	352.6	390.5
Loans and advances to credit institutions	33.1	39.1
Debt securities	109.2	96.9
Derivative financial instruments	7.3	4.7
Loans and advances to customers	3,365.3	3,032.6
Total statement of financial position exposure	**3,867.5**	**3,563.8**
Off balance sheet exposure – mortgage commitments	190.6	182.2
	4,058.1	**3,746.0**

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

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

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

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

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

Group	2017 £m	2017 %	2016 £m	2016 %
Industry sector				
Banks	84.3	17.0	120.6	22.9
Building Societies	-	-	2.0	0.3
Multilateral Development Banks	28.6	5.8	15.2	2.9
Central Government	382.0	77.2	389.2	73.9
	494.9		**527.0**	

Group	2017 £m	AAA %	AA %	A %	Other %	2016 £m
Geographic region						
United Kingdom	450.2	7.4	89.8	1.8	1.0	490.2
Multilateral Development banks	28.6	100	-	-	-	15.2
Canada	12.6	-	100.0	-	-	12.7
Australia	3.5	-	100.0	-	-	8.9
	494.9					**527.0**

ACCOUNTS

30. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk (continued)

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

The Group has no exposure to foreign exchange risk. All instruments are denominated in sterling. The Group also has no direct exposure to any sovereign states, other than the UK.

The Group's derivative financial instruments are fully collateralised with a central clearing house in the United Kingdom and as a result there is no exposure to the Group.

There are no impairment charges against any of the Group's treasury assets at 31 December.

b) Loans and advances to customers

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

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

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

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

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

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

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

The maximum credit risk exposure is disclosed in the table on page 81.

Loans and advances to customers are predominantly made up of retail loans fully secured against UK residential property (£3,301.9 million), split between residential and buy-to-let loans with the remaining £66.6 million being secured on commercial property.

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

30. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk (continued)

b) Loans and advances to customers (continued)

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

Group and Society	2017 %	2016 %
Geographical analysis		
Eastern	9.2	9.8
East Midlands	19.6	20.7
London	7.4	7.9
North East	5.2	4.7
North West	10.8	10.3
South East	13.8	13.9
South West	8.0	7.8
Wales	2.8	2.6
West Midlands	10.0	9.6
Yorkshire & Humberside	12.7	12.3
Other	0.5	0.4
	100.0	**100.0**

Retail loans (Loans fully secured on residential properties)

Loans fully secured on residential property are split between residential and buy-to-let. The average LTV is the mean LTV for the portfolio. Each individual LTV is calculated by comparing the value of the mortgage loan to the value of collateral held adjusted by a house price index. The simple average LTV of residential mortgages is 55% (2016: 53%). All residential loans above 80% LTV are insured against loss.

The indexed LTV analysis on the Group's residential mortgage portfolio is shown below:

Group and Society	2017 Residential %	2017 Buy-to-let %	2016 Residential %	2016 Buy-to-let %
Loan to Value analysis				
< 60%	34.8	51.0	37.1	54.1
60% - 80%	39.2	48.8	46.2	45.4
80% - 90%	21.2	0.1	13.6	0.4
> 90%	4.8	0.1	3.1	0.1
	100.0	**100.0**	**100.0**	**100.0**
Average loan to value of loans	55.1	57.9	53.5	58.3
Average loan to value of new business	78.6	67.2	75.9	63.6

The quality of the Group's retail mortgage book is reflected in the number and value of accounts in arrears. By volume 0.2% (2016: 0.2%) of loans are three months or more in arrears and by value it is 0.1% (2016: 0.1%).

30. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk (continued)

b) Loans and advances to customers (continued)

Retail loans (continued)

The main factor for loans moving into arrears tends to be the condition of the general economic environment. In general, the lower the loan-to-value percentage, the greater the equity within the property, and the lower the losses expected to be realised in the event of default or repossession.

The table below shows the fair value of collateral held for residential mortgages.

Group and Society	2017 Indexed £m	2017 Unindexed £m	2016 Indexed £m	2016 Unindexed £m
Value of collateral held:				
Neither past due or impaired	6,067.3	5,079.3	5,585.7	4,636.1
Past due but not impaired	31.8	23.7	29.3	22.3
Impaired	1.3	1.2	2.1	1.8
	6,100.4	**5,104.2**	**5,617.1**	**4,660.2**

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

With collateral capped to the amount of outstanding debt, the value of collateral held against loans 'past due but not impaired' at 31 December is £12.4 million (2016: £12.1 million) against outstanding debt of £12.4 million (2016: £12.1 million). In addition, the value of collateral held against 'Impaired' assets at 31 December is £0.9 million (2016: £1.6 million) against outstanding debt of £0.9 million (2016: £1.7 million).

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

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

Group and Society	2017 £m	2017 %	2016 £m	2016 %
Arrears analysis				
Not impaired:	3,301.0	99.98	2,948.7	99.94
Impaired:				
Not past due	0.1	-	0.2	-
Past due up to 3 months	0.6	0.02	0.5	0.02
Past due over 3 months	0.2	-	1.0	0.04
Possessions	-	-	-	-
	3,301.9	**100.0**	**2,950.4**	**100.0**

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

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

30. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk (continued)

b) Loans and advances to customers (continued)

Forbearance

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

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

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

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

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

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

Regular monitoring of the level and different types of forbearance activity are reported to the Retail Credit Committee (RCC) on a monthly basis. In addition the Conduct Risk Committee monitors the level of arrears and forbearance cases. In addition all forbearance arrangements are reviewed and discussed with the customer on a regular basis to assess the ongoing potential risk to the Society and suitability of the arrangement for the customer.

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

Group and Society	**2017 Number**	**2016 Number**
Type of forbearance		
Interest only concessions	6	12
Reduced payment concessions	2	1
Payment plans	26	42
Capitalisations	61	61
Mortgage term extensions	63	63
Less: cases with more than one form of forbearance	(54)	(56)
	104	**123**

These cases are covered by an individual impairment provision of £0.01 million (2016: £0.04 million). In total, £2.3 million (2016: £2.5 million) of loans that would be past due are subject to forbearance.

ACCOUNTS

30. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk (continued)

b) Loans and advances to customers (continued)

Secured Business Loans (Other loans fully secured on land)

Secured Business Loans ('SBL') are primarily made available to Small and Medium sized enterprises for either owner occupied or investment property purposes. Loans are also only granted against the 'bricks and mortar' of the property and not against working capital or machinery etc.

The make-up of the SBL book at 31 December is as follows:

Group and Society	2017 £m	2017 %	2016 £m	2016 %
Owner occupied	31.1	46.5	32.9	47.7
Investment property	35.5	53.5	36.1	52.3
	66.6	**100.0**	**69.0**	**100.0**

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

Group and Society	2017 %	2016 %
Loan to Value analysis		
< 60%	32.5	31.3
60% - 80%	49.4	48.8
80% - 90%	17.8	19.6
> 90%	0.3	0.3
	100.0	**100.0**
Average loan to value of loans	60.4	61.3
Average loan to value of new business	54.0	54.4

The table below shows the fair value of collateral held for SBL loans:

Group and Society	2017 Indexed £m	2017 Unindexed £m	2016 Indexed £m	2016 Unindexed £m
Value of collateral held:				
Neither past due or impaired	133.7	140.0	125.9	136.3
Past due but not impaired	2.0	2.1	2.3	3.1
Impaired	2.6	4.4	4.2	6.3
	138.3	**146.5**	**132.4**	**145.7**

Collateral reflects the latest valuation. If a property has had a desktop valuation since the latest full valuation, the collateral reflects the desktop valuation (81% of the SBL book has had a desktop valuation (2016: 82%)).

With collateral capped to the amount of outstanding debt, the value of collateral held against loans 'past due but not impaired' at 31 December is £0.7 million (2016: £1.5 million) against outstanding debt of £0.7 million (2016: £1.5 million). In addition, the value of collateral held against 'Impaired' assets at 31 December is £2.5 million (2016: £3.5 million) against outstanding debt of £2.7 million (2016: £3.8 million).

30. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk (continued)

b) Loans and advances to customers (continued)

Secured Business Loans (continued)

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

Group and Society	2017 £m	2017 %	2016 £m	2016 %
Arrears analysis				
Not impaired:	63.9	96.0	65.2	94.5
Impaired:				
Not past due	2.0	3.0	3.5	5.0
Past due up to 3 months	0.7	1.0	0.1	0.2
Past due over 3 months	-	-	0.2	0.3
Possessions	-	-	-	-
	66.6	**100.0**	**69.0**	**100.0**

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

In terms of SBL risk, the single largest borrower represents less than 1.6% (2016: 1.7%) of the SBL mortgage book. SBL assets totalling £2.7 million (2016: £3.8 million) have individual provisions against them.

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

Forbearance

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

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

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

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

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

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

Group and Society	2017 Number	2016 Number
Type of forbearance		
Interest only concessions	1	2
Re-negotiation of contractual payment	2	2
Active payment plan	4	-
	7	**4**

These loans are covered by the £0.3 million (2016: £1.7 million) collective provision.

£1.0 million (2016: £0.7 million) of loans that would be past due or impaired are subject to forbearance.

30. FINANCIAL INSTRUMENTS (CONTINUED)

Liquidity risk

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

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

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

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

The Society's liquid resources comprise high quality liquid assets, including a Bank of England reserves account, Gilts, time deposits and investment grade fixed and floating rate notes issued by highly rated financial institutions, supplemented by unencumbered mortgage assets. At the end of the year the ratio of liquid assets to shares and deposits was 13.6% compared to 15.8% at the end of 2016. When the FLS Treasury Bills are taken into account, the ratio of liquid resources to shares and deposits was 25.8% (2016: 20.7%).

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

The table below analyses the Group's assets and liabilities into relevant maturity groupings, based on the remaining period to contractual maturity at the statement of financial position date. This is not representative of the Group's management of liquidity. Loans and advances to customers rarely run their full course. The actual repayment profile is likely to be significantly different from that shown in the analysis. For example most mortgages have a contractual maturity of around 25 years but are generally repaid much sooner. The average life of a mortgage at the Group, currently in product, is 3.3 years (2016: 3.5 years). Conversely, retail deposits repayable on demand generally remain on the balance sheet much longer.

Group Residual maturity as at 31 December 2017	On demand **£m**	Not more than three months **£m**	More than three months but not more than one year **£m**	More than one year but not more than five years **£m**	More than five years **£m**	Total **£m**
Financial assets						
Liquid assets						
Cash in hand and balances with the Bank of England	349.3	-	3.3	-	-	352.6
Bank of England						
Loans and advances to credit institutions	11.0	22.1	-	-	-	33.1
Debt securities	-	12.7	18.7	74.8	3.0	109.2
Total liquid assets	360.3	34.8	22.0	74.8	3.0	494.9
Derivative financial instruments	-	0.1	0.2	7.0	-	7.3
Loans and advances to customers	0.6	27.4	84.5	483.7	2,772.6	3,368.8
Other assets	-	1.8	5.0	0.9	21.7	29.4
	360.9	**64.1**	**111.7**	**566.4**	**2,797.3**	**3,900.4**
Financial liabilities and reserves						
Shares	484.0	1,207.9	515.8	387.6	0.1	2,595.4
Amounts owed to credit institutions	-	144.9	63.5	495.3	-	703.7
Amounts owed to other customers	6.1	106.3	70.7	2.0	-	185.1
Debt securities in issue	-	2.0	5.0	146.5	-	153.5
Derivative financial instruments	-	0.2	0.9	8.8	-	9.9
Subscribed capital	-	-	-	-	25.6	25.6
Reserves	-	-	-	-	212.7	212.7
Other liabilities	0.8	2.6	3.2	1.1	6.8	14.5
	490.9	**1,463.9**	**659.1**	**1,041.3**	**245.2**	**3,900.4**
NET LIQUIDITY GAP	**(130.0)**	**(1,399.8)**	**(547.4)**	**(474.9)**	**2,552.1**	**-**

30. FINANCIAL INSTRUMENTS (CONTINUED)

Liquidity risk (continued)

Group **Residual maturity** **as at 31 December 2016**	On demand **£m**	Not more than three months **£m**	More than three months but not more than one year **£m**	More than one year but not more than five years **£m**	More than five years **£m**	Total **£m**
Financial assets						
Liquid assets						
Cash in hand and balances with the Bank of England	387.5	-	3.0	-	-	390.5
Loans and advances to credit institutions	6.3	30.8	2.0	-	-	39.1
Debt securities	-	17.1	27.5	52.8	-	97.4
Total liquid assets	393.8	47.9	32.5	52.8	-	527.0
Derivative financial instruments	-	1.1	-	3.6	-	4.7
Loans and advances to customers	1.0	26.1	78.1	449.3	2,478.1	3,032.6
Other assets	-	2.8	3.1	0.8	20.4	27.1
	394.8	**77.9**	**113.7**	**506.5**	**2,498.5**	**3,591.4**
Financial liabilities and reserves						
Shares	431.9	1,201.2	299.0	525.3	-	2,457.4
Amounts owed to credit institutions	-	281.6	56.6	219.4	-	557.6
Amounts owed to other customers	10.6	99.1	91.9	14.1	-	215.7
Debt securities in issue	-	3.0	3.0	92.7	-	98.7
Derivative financial instruments	-	0.1	2.4	17.2	-	19.7
Subscribed capital	-	0.1	-	-	26.1	26.2
Reserves	-	-	-	-	199.8	199.8
Other liabilities	0.8	2.6	2.5	1.0	9.4	16.3
	443.3	**1,587.7**	**455.4**	**869.7**	**235.3**	**3,591.4**
NET LIQUIDITY GAP	**(48.5)**	**(1,509.8)**	**(341.7)**	**(363.2)**	**2,263.2**	**-**

There is no material difference between the maturity profile for the Group and that for the Society. At 31 December 2017, £1,305.7 million (2016: £1,060.6 million) of the Group's assets were encumbered.

30. FINANCIAL INSTRUMENTS (CONTINUED)

Liquidity risk (continued)

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

Group 31 December 2017	Repayable on demand £m	Not more than three months £m	More than three months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Total £m
Shares	511.6	1,226.2	515.8	387.6	0.1	2,641.3
Amounts owed to credit institutions	0.1	143.9	64.8	495.5	-	704.3
Amounts owed to other customers	6.1	106.4	71.1	2.0	-	185.6
Debt securities in issue	-	8.7	10.0	15.9	119.0	153.6
Derivative financial instruments	-	0.7	1.8	28.3	0.4	31.2
Subscribed capital	-	0.5	1.5	7.9	23.9	33.8
TOTAL LIABILITIES	**517.8**	**1,486.4**	**665.0**	**937.2**	**143.4**	**3,749.8**
Group 31 December 2016						
Shares	463.5	1,222.3	299.0	525.3	-	2,510.1
Amounts owed to credit institutions	10.1	165.6	163.2	221.0	-	559.9
Amounts owed to other customers	10.6	88.8	102.7	14.3	-	216.4
Debt securities in issue	-	3.0	3.0	-	-	6.0
Derivative financial instruments	-	0.4	6.0	47.7	-	54.1
Subscribed capital	-	0.5	1.5	7.9	23.9	33.8
TOTAL LIABILITIES	**484.2**	**1,480.6**	**575.4**	**816.2**	**23.9**	**3,380.3**

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

30. FINANCIAL INSTRUMENTS (CONTINUED)

Market risk

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

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

The management of interest rate risk is based on a full statement of financial position gap analysis. The statement of financial position is subjected to a stress test of a 2% rise in interest rates on a weekly basis and the results are reported to the monthly ALCO meeting. In addition management review interest rate basis risk. Both sets of results are measured against the risk appetite for market risk which is currently set at a maximum of 4.0% of capital. These are in turn reviewed monthly by the ALCO and reported to the Board Risk Committee.

The table below summarises the Group's exposure to interest rate risk.

Group and Society	2017 £m	2016 £m
Changes in market value from a 2% parallel upward shift in interest rates	(6.7)	(5.3)

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

The Group is not exposed to foreign currency risk.

The Society does not have any financial assets or liabilities that are offset with the net amount presented in the statement of financial position as IAS32 'Financial Instruments – Presentation' requires both an enforceable right to set off and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously. Neither of these conditions are met by the Society.

All financial assets and liabilities are presented on a gross basis in the statement of financial position.

The Society centrally clears its derivatives instruments,which requires it to enter into Credit Support Annexes (CSA's) and which typically provide for the exchange of collateral on a daily basis to mitigate net mark to market credit exposure.

The following table shows the impact on derivative financial instruments and repurchase agreements after collateral :

Group and Society	2017 Gross* Amounts £m	2017 Financial collateral** £m	2017 Net amounts £m	2016 Gross* Amounts £m	2016 Financial collateral** £m	2016 Net amounts £m
Financial assets						
Derivative financial instruments	7.3	(7.3)	-	4.7	(4.7)	-
TOTAL FINANCIAL ASSETS	**7.3**	**(7.3)**	**-**	**4.7**	**(4.7)**	**-**
Financial liabilities						
Derivative financial instruments	9.9	(9.9)	-	19.7	(19.7)	-
Repurchase agreements	183.7	(183.7)	-	384.0	(384.0)	-
TOTAL FINANCIAL LIABILITIES	**193.6**	**(193.6)**	**-**	**403.7**	**(403.7)**	**-**

*As reported in the statement of financial position.

** Financial collateral disclosed is limited to the amount of the related financial asset and liability.

31. CAPITAL STRUCTURE

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

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

- **Lending and Business Decisions** – The Society uses application scorecards to help it assess whether mortgage applications fit within its appetite for credit risk. Once loan funds have been advanced behavioural scorecards are used to review the ongoing risk profile of both the portfolio's and individual customers. In addition, for residential and buy-to-let mortgages property values are updated on a quarterly basis.
- **Pricing** – Pricing models are utilised for all mortgage product launches. The models include expected loss estimates and capital utilisation enabling the calculation of a risk adjusted return on capital.
- **Concentration risk** – The design of retail products takes into account the overall mix of products to ensure that exposure to market risk remains within permitted parameters.
- **Counterparty risk** – Wholesale lending is only carried out with approved counterparties in line with the Society's lending criteria and is subject to a range of limits. The limits are monitored daily to ensure the Society remains within risk appetite.

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

The Group's capital requirements are set and monitored by the Prudential Regulation Authority ('PRA'). During 2017, the Society has complied with the requirements included within the EU Capital Requirements Directive IV (Basel III). Further details of these requirements and their impact on the Society are provided in the Strategic report on page 14.

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

Under Basel III Pillar 3, the Society is required to publish further information regarding its capital position and exposures. The Society's Pillar 3 disclosures are available on our website **www.thenottingham.com**.

32. FINANCIAL COMMITMENTS

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Capital commitments				
Capital expenditure contracted for but not provided for in the accounts	0.1	1.1	0.1	1.1
Leasing commitments				
The total of future minimum lease payments under non-cancellable operating leases are payable as follows:				
Land and buildings:				
Commitments due:				
Less than one year	0.9	0.1	0.7	-
Between one year and five years	2.6	0.7	2.1	0.4
In more than five years	2.5	3.2	2.2	2.4
	6.0	**4.0**	**5.0**	**2.8**
Other:				
Commitments due:				
Less than one year	0.2	-	0.2	-
Between one year and five years	0.3	0.2	0.3	0.2
	6.5	**4.2**	**5.5**	**3.0**

33. RELATED PARTY TRANSACTIONS

Transaction with Group companies

Details of the Society's shares in group undertakings are given in note 16.

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

Society	2017 Nottingham Mortgage Services £m	2017 Nottingham Property Services £m	2017 Harrison Murray £m	2016 Nottingham Mortgage Services £m	2016 Nottingham Property Services £m	2016 Harrison Murray £m
Management charges paid	0.1	0.1	0.1	0.1	0.1	0.1

During the year, Nottingham Building Society has received £0.1 million (2016: £0.1 million in fees for providing cash manager and mortgage servicer fees to Arrow Mortgage Finance No.1 Ltd.

Movement on the intercompany loan are disclosed in note 16.

At the end of the year the following balances were outstanding between the Society and its subsidiaries:

	2017 Loans owed to subsidiaries £m	2017 Loans owed by subsidiaries £m	2016 Loans owed to subsidiaries £m	2016 Loans owed by subsidiaries £m
Arrow Mortgage Finance No. 1 Limited	(158.5)	20.1	(105.5)	13.9
Harrison Murray Ltd	-	0.9	-	0.6
HM Lettings Ltd	-	0.3	-	0.2
Nottingham Mortgage Services Ltd	-	0.1	(0.1)	-
Nottingham Property Services Ltd	-	7.3	-	7.0
	(158.5)	**28.7**	**(101.6)**	**21.7**

Interest accrues on the balances outstanding with Arrow Mortgage Finance at LIBOR plus a margin. The repayment of the loans will follow the collection of the principal and interest of the underlying mortgage assets, used as security and has a contractual maturity within three years.

No interest is charged on balances between the other Group companies.

33. RELATED PARTY TRANSACTIONS (CONTINUED)

Transactions with key management personnel

Transactions with key management personnel are on the same terms and conditions applicable to members and other employees within the Group. The directors are considered to be the only key management personnel as defined by IAS 24, which includes non-executive directors.

Compensation for key management personnel for the year totalled £1.4 million (2016: £1.4 million) and a breakdown is disclosed on page 38 in the Directors' remuneration report.

In addition,the following transactions were undertaken through the normal course of business:

Group and Society	2017 Number of key management personnel and their close family members Number	2017 Amounts in respect of key management personnel and their close family members £000	2016 Number of key management personnel and their close family members Number	2016 Amounts in respect of key management personnel and their close family members £000
Loans and advances				
Net movements in the year	-	(14)	-	(13)
Balances outstanding 31 December	2	168	2	182
Share accounts				
Net movement in the year	(3)	(149)	(1)	(40)
Balances outstanding 31 December	8	55	11	204
Interest receivable on loans & advances		5		6
Interest payable on share accounts		1		3

Directors' loans and transactions

At 31 December 2017 there was one (2016: one) outstanding secured mortgage loan made in the ordinary course of business at a normal commercial rate to directors and their connected persons. A register is maintained at the head office of the Society which shows details of all loans, transactions and arrangements with directors and their connected persons. A statement of the appropriate details contained in the register, for the financial year ended 31 December 2017, will be available for inspection at the head office for a period of 15 days up to and including the annual general meeting.

34. NOTES TO THE CASH FLOW STATEMENTS

Group and Society	Notes	Society 2017 £m	Society 2016 £m
Changes in liabilities arising from financing activities			
Subscribed capital at 1 January		23.9	23.9
Accrued interest		1.9	1.9
Interest paid		(1.9)	(1.9)
Subscribed capital at 31 December	28	**23.9**	**23.9**

35. REGISTERED OFFICE

Nottingham Building Society is a building society, incorporated and domiciled in the United Kingdom. The address of its registered office is: Nottingham House, 3 Fulforth Street, Nottingham, NG1 3DL.

ANNUAL BUSINESS STATEMENT
for the year ended 31 December 2017

1. Statutory percentages	2017 %	Statutory limit %
Lending limit		
Proportion of business assets not in the form of loans fully secured on residential property	2.51	25
Funding limit		
Proportion of shares and borrowings not in the form of shares held by individuals	28.65	50

The percentages are calculated in accordance with, and the statutory limits are those prescribed by, sections 6 and 7 of the Building Societies Act 1986 and are based on the Group statement of financial position.

Business assets are the total assets of the Society and its subsidiary undertakings as shown in the Group statement of financial position plus impairment for losses on loans and advances (note 15), less property, plant and equipment, intangible assets and liquid assets.

Loans fully secured on residential property are the amount of principal owing by borrowers and interest accrued not yet payable.

Total 'shares and borrowings' are the aggregate of 'shares', 'amounts owed to credit institutions', 'amounts owed to other customers' and 'debt securities in issue' in the Group statement of financial position. Shares held by individuals are found in note 20.

2. Other percentages	2017 %	2016 %
As a percentage of shares and borrowings		
Gross capital	6.55	6.79
Free capital	6.00	6.26
Liquid assets	13.60	15.83
As a percentage of mean total assets		
Profit after taxation	0.31	0.32
Management expenses (Group)	1.10	1.12
Management expenses (Society)	0.92	0.91
As a percentage of year end assets		
Return on assets	0.29	0.31

The above percentages have been calculated from the Group accounts.

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

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

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

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

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

'Management expenses' are the aggregate of administrative expenses (excluding acquisition and merger costs) and depreciation and amortisation taken from the Group/Society statements of comprehensive income.

3. Information about the directors at 31 December 2017:

Director's name	Date of appointment	Age	Business occupation	Other directorships (and offices)
John Edwards Chairman	10.01.12	62	Director	Saga Services Ltd GreyCastle Life Reinsurance (SAC) Ltd
Jane Kibbey BSc, MCIPD	01.05.06	67	Director	Governor Oundle School
David Marlow ACIB Chief Executive	16.01.06	52	Building Society Executive	Harrison Murray Limited HM Lettings Limited Nottingham Mortgage Services Ltd Nottingham Property Services Ltd Member of FCA Smaller Business Practitioner Panel
Daniel Mundy BA (Hons) Finance Director	19.04.17	41	Building Society Executive	Harrison Murray Limited HM Lettings Limited Nottingham Mortgage Services Ltd Nottingham Property Services Ltd
Andrew Neden MA, FCA	17.09.14	55	Director	ABC International Bank plc Aetna Insurance Company Ltd Ashmill Worcester Ltd Eltham College Grace Church Dulwich Ltd Northgate (Warwick) Developments Ltd The Great St Helen's Trust Ltd St Peter's Canary Wharf Trust Ltd Wesleyan Assurance Society
Kavita Patel	01.01.17	41	Building Society Executive	Shakespeare Martineau LLP Philsec Ltd Meaujo Incorporations Ltd
Kerry Spooner LLB (Hons)	01.09.16	56	Director	Scotiabank Europe plc
Simon Taylor ACIB, MBA Chief Operating Officer	01.02.11	47	Building Society Executive	Harrison Murray Ltd HM Lettings Ltd Nottingham Mortgage Services Ltd Nottingham Property Services Ltd

Correspondence to directors jointly or individually should be addressed 'Private and Confidential' and c/o Ernst & Young LLP, 1 Bridgewater Place, Water Lane, Leeds LS11 5QR.

Directors' service contracts:

David Marlow entered into his contract as Chief Executive on 21 February 2011, however, he has been a Director of the Society since 16 January 2006. Daniel Mundy entered into his contract as Finance Director on 19 April 2017. Simon Taylor entered into his contract as Chief Operating Officer on 1 January 2013, however he has been a Director of the Society since 1 February 2011.

All contracts are terminable at any time by the Society on 12 months' notice and by the individual on six months' notice. Unless notice to terminate is given by either party, the contracts continue automatically.

GLOSSARY

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

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 III	Basel III became effective in the UK on 1 January 2014 through CRD IV and sets out the details of strengthened global regulatory standards on bank capital adequacy and liquidity.
Buy to let loans	Buy-to-let loans are those loans which are offered to customers buying residential property specifically to let out and generate a rental income.
Common Equity Tier 1 capital (CET1)	CET1 capital consists of internally generated capital generated from retained profits, other reserves less intangible assets and other regulatory deductions. CET1 capital is fully loss absorbing.
Common Equity Tier 1 ratio	Common Equity Tier 1 capital as a percentage of risk weighted assets.
Contractual maturity	The date at which a loan or financial instrument expires, at which point all outstanding principal and interest has been paid.
Credit risk	This is the risk that a customer or counterparty fails to meet their contractual obligations.
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.
Debt securities	Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings excluding those issued by central banks.
Debt securities in issue	Transferable certificates of indebtedness of the Society to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit.
Derivative financial instruments	A derivative financial instrument is a contract between two parties whose value is based on an underlying price or index rate it is linked to, such as interest rates, exchange rates of stock market indices. The Society uses derivative financial instruments to hedge its exposure to interest rate risk.
Effective interest rate method (EIR)	The method used to measure the carrying value of a financial asset or liability and to allocate associated interest income or expense over the relevant period. The calculation includes all fees and penalties paid and received between parties which are integral to the contract.
Fair value	Fair value is the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
Financial Conduct Authority (FCA)	The statutory body responsible for conduct of business regulation and supervision of UK authorised firms.
Financial Services Compensation Scheme	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every firm authorised by the FCA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.
Forbearance strategies	Strategies to support borrowers in financial difficulty, such as agreeing a temporary reduction in the monthly payment, extending mortgage terms and a conversion to an interest-only basis. The aim of forbearance strategies is to avoid repossession.
Free Capital	The aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment and intangible assets.
Funding Limit	Measures the proportion of shares and borrowings (excluding the fair value adjustment for hedged risk) not in the form of shares held by individuals. The calculation of the funding limit is explained in the Annual Business Statement.

GLOSSARY (continued)

Funding for Lending Scheme (FLS)	A scheme launched by the Bank of England and HM Treasury, which provides funding to participating banks and building societies with the aim of stimulating lending within the economy.
General reserves	The accumulation of the Society's historic and current year profits which is the main component of Common Equity Tier 1 capital.
Gross capital	The aggregate of general reserves, available for sale reserves and subscribed capital.
Impaired loans	Loans where there is objective evidence that an impairment event has occurred, meaning that the Society does not expect to collect all the contractual cash flows or expect to collect them later than they are contractually due.
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.
Individually/collectively assessed impairment	Individual assessments are made of all mortgage loans where objective evidence indicates losses are likely or the property is in possession. A collective impairment provision is made against the remaining group of loans and advances where objective evidence indicates that it is likely that losses may be realised.
Interest rate risk	The risk of loss due to a change in market interest rates. Interest rate risk can have an impact on Society's mortgages and savings products.
Internal Capital Adequacy Assessment Process (ICAAP)	The Society's own assessment, as part of Basel III requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements for risks it faces under a business as usual scenario including stress events.
Individual Capital Guidance (IGG)	Guidance from the PRA on a firm's required level of capital.
Lending limit	Measures the proportion of business assets not in the form of loans fully secured on residential property.
Leverage ratio	The ratio of Tier 1 capital divided by the total exposures, which includes on and off balance sheet items.
Liquid assets	Total of cash in hand, loans and advances to credit institutions, and debt securities.
Liquidity resources	Assets held in order to manage liquidity risk. Liquidity resources comprises cash and balances with the Bank of England, UK Government securities and multilateral development banks, other securities and bank deposits and Bank of England approved mortgage portfolios.
Liquidity risk	Liquidity risk is the risk that the Society is unable to meet its financial obligations as they fall due, or can only secure them at excessive cost. This risk arises from timing mismatches of cash inflows and outflows.
Loan to value (LTV)	LTV expresses the amount of a mortgage as a percentage of the value of the property.
Loans past due	Loans on which a payment has not been made as of its due date.
Management expenses	The aggregate of administrative expenses, depreciation and amortisation. The management expense ratio is management expenses expressed as a percentage of mean total assets.
Market risk	The risk that movements in market risk factors, including foreign exchange rates, interest rates, credit spreads and customer-driven factors will create potential losses or decrease the value of the Society balance sheet.
Mean total assets	Represents the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
Member	A person who has a share investment or a mortgage loan with the Society.
Net interest income	The difference between interest receivable on assets and similar income and interest paid on liabilities and similar charges.
Operational risk	The risk of loss arising from inadequate or failed internal processes, people and systems, or from external events.
Permanent interest bearing shares (PIBS) / Subscribed capital	Unsecured, deferred shares of the Society that are a form of Additional Tier 1 capital under the transitional rules of CRD IV. PIBS rank behind the claims of all depositors, payables and investing members of the Society. PIBS are also known as subscribed capital.
Prudential Regulation Authority (PRA)	The statutory body responsible for the prudential supervision of banks, building societies, insurers and small number of significant investment firms in the UK .The PRA is a subsidiary of the Bank of England.

Renegotiated loans	Loans are classed as renegotiated where an agreement between a borrower and a lender has been made to modify the loan terms either as part of an on-going relationship or if the borrower is in financial difficulties. The renegotiated loan may no longer be treated as past due or impaired.
Residential loans	Loans that are loaned to individuals rather than institutions and are secured against residential property.
Risk appetite	The articulation of the level of risk that the Society is willing to accept (or not accept) in order to safeguard the interests of the Society's members whilst also achieving business objectives.
Risk weighted assets (RWA)	The value of assets, after adjustment, under the relevant Basel III capital rules to reflect the degree of risk they represent.
Secured business lending (SBL)	Loans secured on commercial property which is only made available to Small and Medium sized Enterprises.
Shares	Funds deposited by a person in a retail savings account with the Society. Such funds are recorded as liabilities for the Society.
Shares and borrowings	The aggregate of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.
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.
Term Funding Scheme (TFS)	A scheme launched by the Bank of England and HM Treasury, which provides funding to participating banks and building societies with the aim of stimulating lending within the economy.
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.
Underlying profit	Profit before tax adjusted to exclude derivative fair value movements and the FSCS levy charge.
Wholesale funding	Amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.

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