

# Annual Report and Accounts 2011

Your Society. Your money. Your future.



With no shareholders  
our only focus is you



# Our difference and what it could mean to you

## Different because we are a 'mutual building society'

As a mutual building society, we are different from the banks, who were created to make money for their shareholders. We have members instead of shareholders and it is our members who benefit from our success. That will be you.

## Different because we put your needs first

Because we exist just for you, we are constantly looking for ways to improve our service and deliver products that better reflect your needs.

- Our new seven promises to savers are not just a nice warm set of words, you will find some real tangible benefits to help you get more from your savings.
- Our main current account holders now benefit from special deals on other products as well as free travel insurance.
- Our mortgage customers get more than just great rates, they also get access to over 160 years of mortgage expertise.



## Different because we are 'Your Nationwide'

And that means we listen and act on your views.

- Every working day we contact some of you who have had recent dealings with us and ask you for your views on our service and products.
- As a Nationwide member, you have access to the 'Your Nationwide' members only area of our website. There you'll find you can pick up on our latest news, have your say and take advantage of exclusive offers.
- Now, with our AGM, you can make your vote count on the big issues.

All these differences add up. All these differences set us apart from the big banks that we compete with. And all these differences can make a big difference to you.

## With no shareholders our only focus is you



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# Financial highlights

UNDERLYING PROFIT  
BEFORE TAX

**£276  
MILLION**

REPORTED PROFIT  
BEFORE TAX

**£317  
MILLION**

STRONG CAPITAL  
RATIOS WITH CORE  
TIER 1 RATIO OF

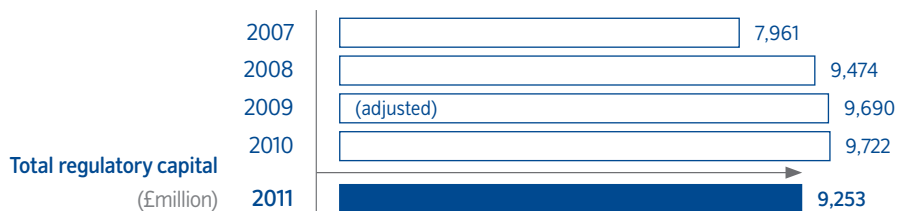
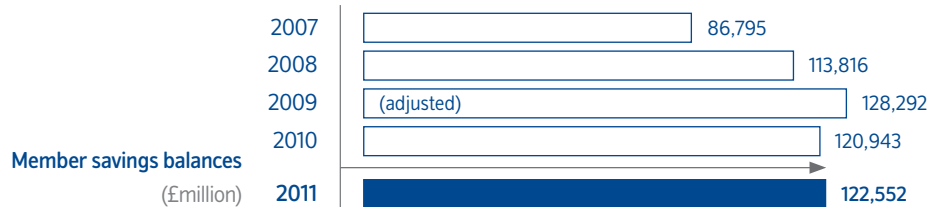
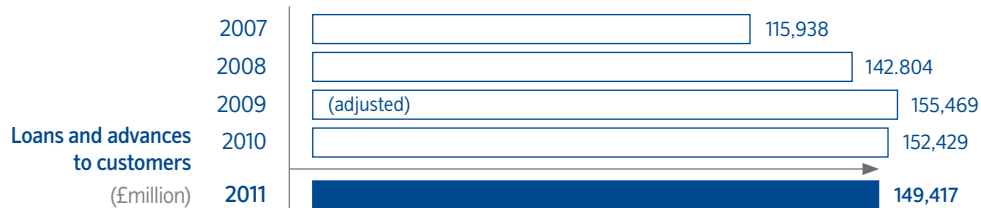
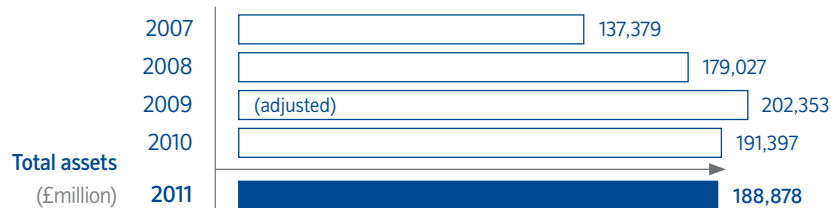
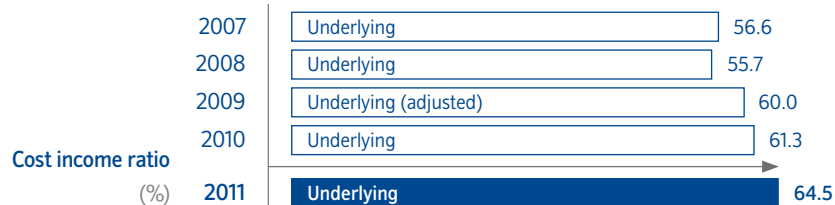
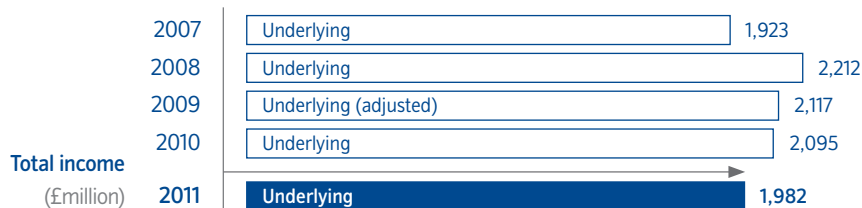
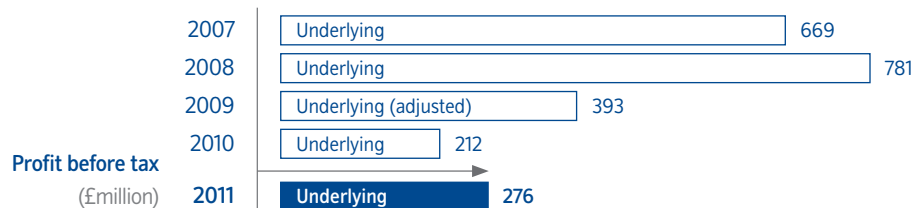
**12.5%**

| Group Results 2007-2011         |    | 2007    | 2008    | 2009<br>(adjusted) | 2010    | 2011    |
|---------------------------------|----|---------|---------|--------------------|---------|---------|
| Profit before tax (underlying)  | £m | 669     | 781     | 393                | 212     | 276     |
| Total income (underlying)       | £m | 1,923   | 2,212   | 2,117              | 2,905   | 1,982   |
| Cost income ratio (underlying)  | %  | 56.6    | 55.7    | 60.0               | 61.3    | 64.5    |
| Total assets                    | £m | 137,379 | 179,027 | 202,353            | 191,397 | 188,878 |
| Loans and advances to customers | £m | 115,938 | 142,804 | 155,469            | 152,429 | 149,417 |
| Member savings balances         | £m | 86,795  | 113,816 | 128,292            | 120,943 | 122,552 |
| Total regulatory capital        | £m | 7,961   | 9,474   | 9,690              | 9,722   | 9,253   |

## Underlying results

These results have been prepared in line with International Financial Reporting Standards accounting policies ('IFRS'). Where appropriate, certain aspects of the results are presented to reflect management's view of the underlying results in order to provide a clearer representation of the performance of the Group.

Underlying profit before tax equates to statutory profit before tax adjusted for a gain in the movements in the value of derivatives and hedge accounting of £120 million, a £50 million charge relating to the FSCS levies and transformation costs of £29 million. 2010 additionally included a gain of £40 million on the acquisition of the former Dunfermline Building Society social housing portfolio.



# Chairman's Statement

## THE CORE STRENGTHS THAT SUPPORT OUR BUSINESS

Although we have seen an improvement in global confidence over the past year, the fragile recovery in the UK economy has continued to pose challenges for the retail financial services industry. House prices have stabilised, but the housing market has continued to see transactions at a level well below historic norms, and the Bank of England Base Rate has remained at 0.5% for the entire year.



Alongside a flat mortgage market, a combination of low base rates and falling disposable real income have combined to generate only very slow growth in the savings market.

However, against this background we have delivered an excellent financial performance for our members. In addition to maintaining strong capital and liquidity ratios, we have recorded an underlying profit of £276 million, an increase of £64 million on 2010. Our asset quality remains strong, underlying costs are flat despite elevated levels of inflation in the UK and we have grown our non-interest income in line with our strategy of diversifying the Group's income base.

### DEVELOPMENTS IN THE FINANCIAL SERVICES INDUSTRY

Our financial performance has been based on a foundation of safety, security and provision of excellent products and services for our members, as the interests of our members always come first. Although the business is strongly positioned and well placed to deal with ongoing challenges from the economy, we continue to face other challenges.

The ongoing pressure to impose new and expanded regulation on the financial services sector is understandable, but it is important that the Government's stated aim to 'foster diversity, promote mutuals and create a more competitive banking industry' is not compromised by the creation of an environment that fails to account for the low risk business model traditionally adopted by building societies. There is a very real concern that mutuals will be hit proportionately harder than banks by concurrent changes to capital and liquidity requirements, the UK bank levy and changes to depositor protection.

In addition to proportionate, risk based regulation, it is also important that mutuals are able to access capital markets in order to support future business growth. We continue to work with the UK authorities and the European Commission to ensure that the new rules governing capital permit instruments which are consistent with our business model, which is run in the interests of our membership as a whole.

We fully support the aims of improving stability and competition in UK banking, and welcomed the Government's appointment of the Independent Commission on Banking to consider how these could best be achieved. We have engaged constructively with the Commission, taking the opportunity to share our views on the issues of importance to Nationwide. We will continue to work with the Commission and the Government to ensure that the diversity and competition which building societies can contribute to the financial services marketplace are recognised in the final report, due in September.

### DELIVERING BEST VALUE FOR OUR MEMBERS

Our aim is to deliver consistently good value products and services to our members.

In addition to those members who are continuing to benefit from our very low Base Mortgage and Standard Mortgage rates, we have sought to help all borrowers by offering a range of simple, good value mortgages. During the year we launched our innovative 'Switch and Fix' mortgage, which allows members to move from a variable to a fixed rate product without having to pay early redemption charges, and have provided a range of mortgages which are exclusive to those members who hold their main current account with Nationwide. We have also sought to support the crucial first time buyer market through the launch of our online First Time Buyers' Guide and the recent launch of our new Save to Buy product.

Against the background of the low base environment, which naturally favours borrowers, we also recognise the importance of looking after our savers. In addition to our existing 'Champion Saver' range, we delivered a market leading online savings product which attracted strong inflows of funds during the year. We have demonstrated our commitment to transparency and fairness by launching our 'Savings Promises', providing clarity over our long term commitment to our saving members.



“OUR FINANCIAL PERFORMANCE HAS BEEN BASED ON A FOUNDATION OF SAFETY, SECURITY AND PROVISION OF EXCELLENT PRODUCTS AND SERVICES FOR OUR MEMBERS, AS THE INTERESTS OF OUR MEMBERS ALWAYS COME FIRST.”

04-05

Chairman's Statement

In line with our strategy of diversifying our income and providing more products for our members, we opened almost half a million new current accounts during the year, launched a popular new credit card in February and improved our personal loan sales by almost a quarter compared with 2010, with market leading rates on offer.

We have continued to offer our customers a range of investment options through our partnership with Legal & General, and now have over £5 billion of investment assets under administration. Our Protected Equity Bonds have continued to prove popular throughout the year, allowing customers to benefit from potential stock market linked growth whilst minimising the risks of direct stock market investment. In addition, during the year we introduced free European travel insurance for customers who hold FlexAccount as their main current account, another example of how we seek to deliver excellent value to our loyal members.

As a member owned business, we take pride in the quality of service we offer to all of our customers. There will inevitably be instances where we fall short of our own high standards, but we always investigate and resolve any complaints as quickly as we can with the aim of satisfying our customers. Our positive and proactive approach has meant that in those instances where a complaint is ultimately referred to the Financial Services Ombudsman, the percentage of cases where our original decision is overturned is currently less than half of the industry average.

#### SUPPORTING OUR COMMUNITIES

Our commitment to communities and charities across the UK remains as strong as ever, with our focus continuing to be on areas central to our business: housing and finance.

As the issue of debt management continues to pose challenges to households, our three year MoneyActive partnership with Citizens Advice has exceeded all expectations in only its second year. Through our support, over 1,000 financial capability volunteers have been recruited, with Citizens Advice estimating that more than 120,000 people have been provided with vital education aimed at preventing those at risk from experiencing issues with debt.

Our award winning, free educational website **NationwideEducation.co.uk** has now received over 15 million visits since its launch in 2007. September 2010 saw the launch, in partnership with the examining body Edexcel, of a new financial literacy qualification 'Money and Finance Skills' aimed at 14-19 year olds, and which uses resources on the website. Over 2,200 people have so far signed up for the qualification.

Our partnership with Shelter has continued to grow, with funding for its services in Bristol, Dorset and Hertfordshire having supported over 2,400 people since November 2008. We also sponsored Shelter's World Cup themed fundraiser Strip4Shelter, which raised over £50,000 for the charity.

Our employees and members have once again shown their overwhelming generosity over the past year by raising over £1 million in support of campaigns including Comic Relief, Children in Need, Macmillan Cancer Support and a number of international disaster relief appeals.

Nationwide's involvement in local communities goes beyond financial support, and in October 2010 we launched our commitment to employee volunteering, offering every employee two days paid leave each year to use their skills in support of local communities and charities.

Underlining our reputation for safe and responsible lending, for the fourth successive year we won the Responsible Credit Card Award, backed by our 'More Than Words' campaign.

#### ENGAGING WITH OUR MEMBERS

Providing the opportunity for our members to let us know their views is vital, as we can often act on helpful comments and suggestions, and it is clear that members are keen to be involved. Over the past year we have seen record attendances at a majority of this year's Member TalkBacks, which have been held in Newcastle, Bournemouth, Glasgow, Southampton and Reading. At each event members were able to meet face to face with Society directors and were able to make suggestions or comment about policies and service.

In a new development, all those who attend TalkBack events are now able to feed back their opinion using a keypad voting system, and a full report is produced at each event and made available to management. This is just one way by which we deliver sound corporate governance and provide members with the opportunity to make a real difference to how the Society is run.

For those members who are unable to attend a TalkBack event, there is an opportunity to post questions or suggestions in our Online TalkBack, and we are also speaking to more people than ever before via telephone research. Each month an external accredited research company calls 10,000 customers to gather feedback for the Society's Customer Service Tracker and it invites a further 5,000 customers to take part in an online survey.

# Chairman's Statement

continued

## AGM

Members have the opportunity to demonstrate their support for Nationwide by voting for the Board and the resolutions detailed in the AGM notice of meeting. Voting takes only a few minutes and can be carried out online at [nationwide.co.uk](http://nationwide.co.uk), through the post, or at any branch of Nationwide, Derbyshire, Cheshire or Dunfermline. I would also encourage those members who are able to attend the Society's Annual General Meeting at The Queen Elizabeth II Conference Centre in London on 21 July.

## BOARD CHANGES

In the last twelve months two of our longstanding non-executive directors have retired from the Board: Stella David and Derek Ross both stepped down in July 2010 after having served on our Board for a number of years, and we wish them well for the future. Bill Tudor John, one of our two Deputy Chairmen, will also be retiring from the Board at the 2011 AGM. Bill joined us in 2007 from the Portman Building Society where, as Chairman, he helped steer through the merger with Nationwide, and we have greatly valued his contribution over the past four years.

In June 2010 we welcomed Alan Dickinson to our Board as a non-executive director. Alan brings significant financial services experience, having worked in the banking industry for over forty years.

## THE CONTRIBUTION OF OUR EMPLOYEES

The significant achievements of the past year have been made possible by the hard work and focus of our employees, who share the commitment to deliver consistently excellent value and outstanding service to our members. I would like to offer my personal thanks to all Nationwide employees for their contribution to our success, and I know that they will continue to ensure that our members remain at the heart of everything we do in the years ahead.

## OUTLOOK

Nationwide has demonstrated its ability to withstand the most challenging of business and economic environments. Our mutual model enables us to put the interests of our members first at all times. I am confident that our existing business strategy, utilising the benefits of mutuality, leaves us well positioned for the future.



GEOFFREY HOWE  
CHAIRMAN

24 May 2011

# Chief Executive's Review

## STRONG PERFORMANCE IN A CHALLENGING ECONOMIC ENVIRONMENT

I am pleased to report the Group's results for the year ended 4 April 2011. Nationwide has performed strongly during the past year, despite facing the ongoing challenges posed by the economy, low interest rates and mortgage and savings markets that grew by only £6.5 billion and £18.6 billion, down 36% and 39% respectively.



06-07

Chief Executive's Review

Our financial performance has improved, whilst our members have continued to benefit from excellent products and services. We have produced market leading products in the mortgage and savings markets, maintained a prudent approach to lending, improved our retail funding and have progressed our strategy of expanding our share of the banking market. In addition, this has been achieved while underlying costs have been reduced by £5 million. The business has emerged from the financial crisis in good shape, with strong capital ratios, high levels of liquidity and a flexible funding base, and we are well positioned for the future.

|                              | Year to<br>4 April 2011 | Year to<br>4 April 2010 |
|------------------------------|-------------------------|-------------------------|
|                              | £m                      | £m                      |
| Underlying profit before tax | 276                     | 212                     |
| Statutory profit before tax  | 317                     | 341                     |

### STRONG FINANCIAL PERFORMANCE

- Underlying profit of £276 million, up 30% despite difficult trading conditions, low interest rate environment and margin compression
- The fall in statutory profit from £341 million to £317 million in 2010/11 is primarily due to a one-off credit in the prior year of £117 million due to a change in the basis of accounting for FSCS costs to align with general industry practice. An analysis of items excluded from underlying profit is shown on page 13
- Strong growth in other income (excluding hedge adjustments and prior year gain on acquisition), up 17% to £445 million in line with our strategy to diversify the Group's income base
- Continued focus on cost control resulting in a £5 million reduction in underlying costs despite substantial ongoing investment in the business
- Impairment charge on loans and advances to customers reduced by 35% to £359 million (2010: £549 million) reflecting our consistent and prudent lending strategy. Within this, commercial property impairment charges down 41% to £175 million (2010: £299 million)

- High quality assets with Nationwide originated residential mortgage accounts more than three months in arrears of 0.68% (2010: 0.68%) – less than a third of the Council of Mortgage Lenders (CML) industry average 2.09% (March 2011).

### STABLE AND STRONG BALANCE SHEET

- Strong capital ratios maintained through prudent balance sheet management: Core Tier 1 ratio of 12.5%, Tier 1 ratio of 15.7% and total solvency ratio of 19.5% (2010: 12.2%, 15.3% and 19.4% respectively) are amongst the highest in the financial services sector
- Core liquidity ratio has remained stable at 13.8% (2010: 13.8%)
- Positive retail flows reducing our requirement for wholesale funding, with the ratio falling to 25.9% (2010: 27.8%) combined with a continued improvement in wholesale funding profile with 56.6% of balances due in more than one year (2010: 50.3%)
- Total of £5.8 billion long term wholesale funding, including €750 million lower Tier 2 subordinated notes, raised during the year with a weighted average life of over eight years
- We have repaid the major part of our SLS drawings and are well ahead of both our contractual repayments and our bilateral agreement with the Bank of England.

### OUR BUSINESS

#### Support for our borrowing members

As a building society our core purpose is to help new and existing members to manage their savings, enter the housing market and to support them with their ongoing housing finance requirements. I am pleased to say that we have been successful in all of these areas over the past twelve months. In the early part of the year we simplified our entire mortgage range to provide greater transparency for all customers, and have focused our efforts on supporting the first time buyer market, both with excellent products and the provision of free and impartial information through our Nationwide Education website. Over the year we provided mortgages that allowed over 17,200 people to buy their first property, representing a market share of 9.1% of this crucial part of the housing market.

# Chief Executive's Review

continued

We also continued to provide our innovative 'Switch and Fix' option for existing mortgage members, allowing them the option of moving from a variable to fixed rate product with no redemption penalties or fees, thereby helping them to manage their future mortgage payments.

We have aimed to provide a consistently good value range of mortgages for all new and existing customers, but with a commitment to provide the best deals to our existing loyal customers. This has enabled us to support the market with total gross lending of £12.8 billion (2010: £12.0 billion), a market share of 9.5%. However, in common with all lenders, we have seen significant capital repayments as our members have sought to pay down their debts and take advantage of the prevailing low interest rate environment, so that over the full year we experienced a reduction in our total mortgage balances.

We have followed a consistent approach to margin management, seeking to balance the challenges of a low rate environment with our commitment to provide members with long term good value products. We have continued to support our borrowing members with our Base Mortgage Rate (BMR) pledge, ensuring that the majority of our existing mortgage customers have access to a rate which is capped at 2% above Bank of England (BoE) base rate. Since the base rate has remained at an historic low all year, our borrowers have little incentive to switch to alternative mortgage products, which has meant that our BMR balances have increased, with a consequent impact on our overall margin. We estimate the customer benefit of maintaining our BMR pledge has been in the region of £600 million over the past financial year. In addition, we have also continued to waive the contractual floor of 2.75% on tracker mortgages, instead applying the floor at 2%, representing a saving to our members of over £50 million in mortgage interest over the year. The tracker floor benefit will continue to reduce as borrowers roll off their tracker period.

## *Commitment to our savers*

Whilst mortgage holders continue to benefit from low interest rates, we recognise that the environment has posed challenges for many savers and have sought to provide a range of top quality savings products throughout the year. Our 'Champion ISA' and 'e-ISA' products, launched in February 2010, have achieved strong net inflows during the year and our market-leading 'MySave OnlinePlus', launched in September 2010, has proved extremely popular.

In addition to providing consistently good value products to members, we have also set a new standard in savings transparency through the launch in November 2010 of seven 'Savings Promises', demonstrating our long term commitment to offer a fair and transparent deal to all savers. Amongst our promises is a commitment to reward existing savers with exclusive products, and in November 2010 we launched our market leading 'Christmas Loyalty Bond' and 'Christmas Loyalty ISA', which together attracted significant net receipts in the run up to the festive period.

Despite the UK retail savings market remaining subdued, we delivered a strong retail funding performance in the year, with a growth in retail savings balances of £1.6 billion, compared with a net reduction of £7.3 billion in the previous year. Similarly, total net receipts for the Group were £0.6 billion, compared with an outflow of £8.2 billion last year. We continue to actively manage our flow of retail savings in order to ensure a balance between raising funds at an economic rate and providing long term good value products to our members.

## *Growing our Consumer Banking portfolio*

As a key part of our strategy to diversify our products and income streams, we have continued to expand our range of banking products. In August 2010 we relaunched our current account, FlexAccount, offering additional rewards to loyal customers. Those members who use FlexAccount as their main current account are now provided with free European travel insurance, and we launched a range of linked 'Flexexclusive' product offers throughout the year, including preferential personal loan rates, mortgages and credit cards. During the year we opened 353,000 new current accounts, an increase of 118% on the previous year, and we estimate that our market share of main accounts is now around 6.1%. We also offer a basic bank account to our customers, supporting the Government's agenda on financial inclusion; during the year we opened 89,000 such accounts, increasing our total base to over one million. Our total current account base now stands at more than five million.

We have also had significant success in attracting new credit card customers, with sales of 298,000 over the year, an increase of 173,000 on the previous year. In February 2011 we launched a new credit card, offering very competitive balance transfer and purchase offers and free foreign usage linked to spend in the UK. This has attracted positive customer and press reaction and we have achieved record sales in the period since launch. However, additional sales have not come at the expense of quality, a fact supported by Nationwide being recognised with the award for 'Most responsible credit card lending practices' at The Card & Payments Awards 2011 for the fourth successive year.

Our success is also reflected in the sale of over 82,000 personal loans, an increase of 23% on last year. Customers holding a main FlexAccount benefitted from the best high street rate, whilst our online volumes also rose.

Our protection and investment business has proved extremely successful in the year. We continue to offer a range of investment options through our partnership with Legal & General, and in October 2010 launched 'E-Buy', allowing our customers to access Legal & General investment products through our Nationwide corporate website. In total we sold over 313,000 investment and protection products during the year and now have in excess of £5 billion of investment assets under administration. We have also extended our relationship with Legal & General to provide access for our customers to unit trust and life protection products.

Over 560,000 new general insurance covers were sold during the year, representing a good performance in a very competitive and price driven market place, and our general insurance book now has over two million insurance covers. Our home insurance and car insurance products were rated with 5 Stars by financial research company *Defaqto* for being

“... WE HAVE ALSO SET A NEW STANDARD IN SAVINGS TRANSPARENCY THROUGH THE LAUNCH IN NOVEMBER 2010 OF SEVEN ‘SAVINGS PROMISES’, DEMONSTRATING OUR LONG TERM COMMITMENT ...”

08-09

Chief Executive's Review

excellent compared with the market, and our home insurance has received two prestigious Intelligent Choice awards, for Cover and Customer Service, as voted for by actual customers. Our relaunch of FlexAccount has also provided over 1.3 million customers with free travel insurance during the year.

#### *Providing market leading customer service*

Providing excellent products is only one part of the equation for Nationwide; the provision of top quality customer service is also critically important to the way we do business. Against our peer group of high street competitors we consistently outperform them in a range of customer satisfaction surveys. We are currently one of the top performers for combined product service satisfaction (current account, mortgage and savings) as measured by GfK NOP Financial Research Survey (FRS). In addition, we make every effort to check how our customers feel about the service they have received, and I am pleased that within the past year customer satisfaction levels in our branches and telephone services have increased, as measured by our own customer service survey.

We have been rated top for in-branch customer satisfaction in a *Which?* magazine mystery shopper survey carried out in February 2011, with 89% of those questioned satisfied with service in our branches. In 2010 Nationwide also finished top of the *PressWatch Financial Products* analysis, just as it did the previous year, after receiving favourable UK press coverage on a wide range of products throughout the year.

However, for an organisation with over 15 million members there will inevitably be occasions when things do go wrong, but when this does happen we always aim to investigate and resolve complaints as quickly as possible and to the customer's satisfaction. In the most recently published FSA complaints data, Nationwide had the ninth highest number of new complaints, with an approximate industry share of complaints of only 3%.

We monitor complaints very carefully and are very pleased that the level of complaints against us which are upheld in the customer's favour by the Financial Ombudsman Service (FOS) is only 25%, compared with the industry average of 53%; and in the tables published by the FOS, Nationwide has one of the lowest overturn rates in terms of the number of cases where the FOS has agreed with the customer.

#### MANAGING COSTS

Prudent management of our cost base is central to our strategy of providing consistent long term value to our members, and I am pleased to report that our performance in this area has been good. Excluding those associated with our transformation programme, costs for the year stand at £1,279 million, down £5 million from last year, despite the business facing significant cost increases from the VAT rise, inflation in third party expenditure and significant ongoing investment in the business. We are now in the second year of a three year programme aimed at reducing our annual running costs by over £200 million, which will offset inflationary pressures and further investment in key transformation projects.

In the year to 4 April 2011, this programme delivered significant cost reductions. A range of initiatives have been pursued, including improvements in processing efficiency, reducing third party spend through improved procurement, the integration of our Regional Brands network and the closure of Nationwide agencies.

We are conscious that our cost optimisation programme initiatives affect our customers and employees, and we consider these impacts very carefully before taking what are often difficult decisions. However, as a direct result of the initiatives already announced and others underway, we have been able to reinvest more in the business for the long term interests of all of our members.

Capital investment in the business to improve service, upgrade systems and meet new regulatory requirements amounted to over £300 million during the year, and we expect to invest a similar amount in 2011/12 as part of our ongoing commitment to build a modern business capable of continuing to provide market leading customer service.

#### ASSET QUALITY

The underlying quality of our balance sheet has been a major strength for Nationwide. Our continued policy of prudent lending has ensured that the quality of our assets has remained high. The overall charge for impairment losses on loans and advances is down 35% on last year at £359 million (2010: £549 million).

Whilst the average loan to value (LTV) of new residential lending has increased slightly year on year, overall it remains very low at 66% (2010: 63%), with the indexed LTV for the whole residential portfolio remaining relatively static at 49% (2010: 48%). Less than 1.4% of our new residential lending during the year was written at LTVs in excess of 90%.



# Chief Executive's Review

## continued

The proportion of Nationwide originated mortgage accounts three months or more in arrears has remained stable at 0.68% and is less than a third of the CML industry average of 2.09% (March 2011). The proportion of Nationwide originated prime mortgage accounts three months or more in arrears was even lower at only 0.53%.

In recent years the UK commercial property market has been badly hit by the recession with peak to trough falls in capital values of 44%. However, since July 2009, there has been a 17% increase in values as measured by the *Investment Property Databank* (IPD) Index, driven by properties primarily located in London and the South East. The proportion of Nationwide originated commercial loans in arrears by more than 90 days is 2.41% (2010: 2.77%), with arrears balances of £48 million, and there is continuing evidence that the arrears trends have stabilised. Following an assessment of all impaired cases we have booked a total commercial impairment charge of £175 million in the year, 41% lower than the charge in the previous year of £299 million. We believe that the commercial impairment charge has peaked and that we should continue to see a gradual downward trend in the future, although this is still a fragile market dependent on future progress of economic recovery in the UK.

### FUNDING, LIQUIDITY AND CAPITAL

We have one of the strongest balance sheets in the financial services sector:

|                           | 4 April 2011 | 4 April 2010 |
|---------------------------|--------------|--------------|
|                           | %            | %            |
| Solvency ratio (Basel II) | 19.5         | 19.4         |
| Tier 1 ratio              | 15.7         | 15.3         |
| Core Tier 1 ratio         | 12.5         | 12.2         |
| Core liquidity ratio      | 13.8         | 13.8         |
| Wholesale funding ratio   | 25.9         | 27.8         |

Our capital ratios continue to demonstrate the resilience of the business, with our strong capital position ensuring we are well equipped to respond to the additional capital requirements imposed by Basel III.

Over the period August to December 2010 the Group repaid the Sterling equivalent of £719 million of subordinated debt, refinancing this in part through our July 2010 issue of €750 million of lower Tier 2 subordinated notes. Demand for our capital from institutional investors was high and reflects strong market confidence in our business.

We maintain high levels of liquid assets and our core liquidity ratio has remained stable at 13.8% (2010: 13.8%).

Nationwide has a strong and diversified funding base, predominantly funded by retail savings. We have continued to extend the maturity profile of our wholesale funding and in September 2010 the Group issued a €1.25 billion 5 year covered bond. This was the first externally issued covered bond by the Group since September 2007 and was followed by two further public covered bond transactions. One of these was a landmark £0.75 billion 15 year covered bond, helping to reopen the Sterling covered bond sector.

In October 2010 the Group launched its second public secured issuance of residential mortgage backed securities (RMBS) through the Silverstone Master Trust Vehicle. The issuance, in both US dollar and Euro denominated notes, has raised £1.52 billion Sterling equivalent and has provided further investor diversification to complement our initial Sterling RMBS issuance in November 2009.

The table below summarises the residual maturity of the wholesale funding book. Over 56% of our portfolio now relates to balances due in more than one year (2010: 50%).

|                                  | 4 April 2011 |      | 4 April 2010 |      |
|----------------------------------|--------------|------|--------------|------|
|                                  | %            | £bn  | %            | £bn  |
| Balances due in less than 1 year | 43.4         | 20.0 | 49.7         | 24.5 |
| Balances due in more than 1 year | 56.6         | 26.1 | 50.3         | 24.8 |
| Total                            | 100          | 46.1 | 100          | 49.3 |

In line with other major UK institutions the Group made use of the Bank of England's (BoE) Special Liquidity Scheme (SLS) facility at the height of the market dislocation in 2008. We have repaid the major part of our SLS drawings and are well ahead of both our contractual repayments and our bilateral agreement with the BoE.

### REFORMING FINANCIAL SERVICES

There continues to be rapid change in the financial services sector; the Government has published its latest plans on reforming the regulatory architecture in the UK, the Independent Commission on Banking (ICB) has set out in its interim report proposals to improve competition and financial stability, and in addition significant developments continue apace at European level.

Policymakers remain focused on creating a more stable banking sector that ensures taxpayers do not bear the brunt of any future financial crises. They are also increasingly turning their attention to improving consumer outcomes through greater competition in the market and ensuring customers are better informed, empowered to switch providers easily and make better financial decisions.

A diverse financial services sector is essential to achieving both these stability and competition goals. Mutuals operate a resilient and risk-averse model based on foundations of long term relationships, trust, excellent customer service and value creation for members. As the UK's leading mutual, Nationwide's size and business model ensure we are in a unique position to offer consumers a genuine alternative to the banks on a national scale, and we fully support measures aimed at driving a more competitive market. The ICB recognises Nationwide as the only 'challenger brand' in the UK.

However, it is vital that policymakers and regulators ensure that the new regulatory environment supports and encourages this diversity through creating a level playing field on which mutuals and listed banks can compete effectively. Regulators and policymakers should tailor their approaches to a range of business models, and Nationwide has two main priorities:

- Firstly, risk-based regulation is needed. The more traditional, but lower risk, model that mutuals run should not be unfairly compromised by disproportionate regulatory costs. Taken in isolation, the individual impacts of new regulation may not appear excessive, but the cumulative burden is great; in addition to new capital and liquidity requirements, Nationwide faces additional costs relating to the Financial Services Compensation Scheme levies, the new bank levy and planned changes to the Deposit Guarantee Scheme Directive. We acknowledge our responsibility as a major financial institution in the UK to contribute to the cost of creating a more resilient financial services sector but this should be proportionate to our low risk profile.
- Secondly, building societies need access to an external capital instrument that satisfies regulatory requirements, meets investor appetite and does not compromise the mutual model. We continue to work with Government and regulators at both domestic and European levels, to ensure that the framework which implements Basel III in the EU takes account of the specific needs of the mutual sector, particularly in relation to the requirements for Core Tier 1 capital.

## STRATEGY

Nationwide's strategic ambition is to be the UK's leading retail financial services provider, delivering growth in our core franchise for the exclusive benefit of our members. Our aim is to offer a meaningful alternative to our publicly listed bank competitors by delivering fair and transparent products, long term good value and high levels of customer service. We do not seek to maximise our earnings; rather, we aim to generate sufficient profit to maintain a strong balance sheet and invest in our future and return value back to our membership through our customer proposition.

We will maintain our position as a leading provider of mortgage and savings products, and continue to extend our capability and market presence in current accounts, personal loans, credit cards, insurance, protection and investment products. Increasing scale in these areas will, in addition to supporting the needs of our customers, provide a more diversified business mix and reduce our reliance on margin income.

In line with our mutual ownership and ethos, Nationwide aims to provide industry-leading service to all of our customers. We are rated one of the top performers in customer service satisfaction, and we aim to become number one with a clear lead over the rest of the market.

To support our commitment to cost efficiency and customer service, we must operate modern, flexible systems supported by knowledgeable, well trained employees. In this context we continue to invest in our transformation programmes, which this year have included the delivery of a new data centre, launch of a new mortgage sales and originations system for mortgage intermediaries and ongoing improvements to our online bank. Looking forward, we will deliver an integrated banking platform that allows us to broaden our range of compelling current accounts for both new and existing customers.

We continue to make important steps towards meeting the requirements of the Retail Distribution Review (RDR), which becomes effective 1 January 2013. In January 2011 we signed a new distribution agreement with Legal & General for the provision of RDR systems, and we have implemented a qualification programme for all our senior financial consultants.

To ensure the success of our strategy, it is imperative that our employees are exceptionally motivated and empowered to deliver. This year our internal survey of employees demonstrated a high level of enablement to perform in their roles, and it is our goal to ensure employee enablement and engagement levels are above high performance industry benchmarks.

## SUPPORTING OUR COMMUNITIES

We place great emphasis on making a difference to all areas in which we operate, aiming to create a great place to work for our employees, contributing to the protection of the environment and supporting communities across the UK. Our commitment to communities and charities remains as strong as ever, with a continued focus on housing and finance.

For many across the UK, there remains a fear of falling into debt. We have helped to address these concerns with our three year £3 million MoneyActive partnership with Citizens Advice. Through Nationwide's support, over 120,000 people have received vital support and education aimed at preventing them from getting into financial difficulties.

Our commitment to financial education extends to the under 20s, with our award winning website: **NationwideEducation.co.uk**, which has received over 15 million visits since its launch in 2007. September 2010 saw the launch, in partnership with the examining body Edexcel, of a new financial literacy qualification 'Money and Finance Skills'. So far 2,200 young people have signed up for the qualification, which is supported through the website.

In the housing space our partnership with Shelter has continued to grow. Our funding of services has supported over 2,400 people since November 2008. We have also launched a new First Time Buyers' Guide, with help and advice on how to get on the property ladder.

During the year over £1 million was raised for charity by our employees and members. We continue to support Macmillan Cancer Support, by hosting events and cancer awareness days, and by ensuring that any monies raised by local activities are donated to Macmillan services in that particular area. We are proud that Macmillan has been Nationwide's flagship charity for 18 years, and together we have raised over £6 million.

# Chief Executive's Review

## continued

This year has also seen Nationwide introduce a commitment to employee volunteering, allowing every employee two days annual paid leave to use their skills in support of local communities and charities.

We are proud to sponsor Disability Sport Events with £1 million over a seven year period, and this charity's important work will help identify talented individuals for the forthcoming 2012 London Paralympics.

The Nationwide Foundation awarded over 100 grants to small charities across the UK and provided more significant support to ten larger charities, which collectively helped thousands of vulnerable people with finance and housing issues. During the year the Foundation was shortlisted for four awards in recognition of its good work. We provided £1 million of funding to the Foundation over the past twelve months, taking the total since its inception in 1997 to over £29 million.

As a major business, we recognise we make an impact on the environment, and want to build a truly sustainable business for our members and employees. We are committed to a lower carbon future, recycle more than half of our waste and have helped over one million account holders to 'go paperless' by receiving statements and AGM packs electronically.

### OUTLOOK

The performance of our business is closely linked to how the overall UK economy performs. It is positive to see that the economy is beginning to recover, but this recovery remains fragile and the pace of the upturn is likely to be slow by historic standards.

Household debt levels remain relatively high and disposable incomes have been under sustained pressure, with unemployment well above pre-recession levels and wages not keeping pace with inflation. Against this backdrop of slow recovery, the process of returning interest rates to more normal levels is expected to be gradual.

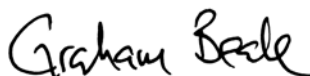
The housing market continues to pose challenges, with transaction levels remaining well below historic norms and house prices having been broadly flat for the past year. We expect buyer activity to remain subdued, with the potential to decline further should we see a sharp rise in interest rates. However, whilst a small decline in house prices is possible over the next twelve months, we do not think that large house price falls of the magnitude seen in 2008 are likely, given that the economic environment is expected to gradually strengthen, and that interest rates are likely to remain relatively low, limiting the level of mortgage arrears and distressed sales.

Our net interest margin stabilised during the second half of the year, as predicted, and we now expect a steady increase in the margin in the next few years as the interest rate environment returns to normality. In addition, we aim to increase our non-margin income through increased product sales in line with our strategy to diversify our income base and improve the quality of our earnings.

We have developed a strong cost management focus and will maintain a tight control on our cost base in order to achieve our medium term cost income ratio target of 50%.

We will continue to support the UK's economic recovery through new mortgage lending, whilst maintaining our prudent approach to lending overall. Although we anticipate credit conditions will remain tight in the next few years, the strong asset quality of our lending books will help to limit the impact of the adverse economic conditions. We therefore expect next year's total charge for loss provisions to remain broadly in line with the current year.

Nationwide has reported a strong performance despite the uncertain market conditions. Our mutual business model and existing strategy has proved resilient and we have emerged from the financial crisis in good shape and well positioned for the future.



GRAHAM BEALE  
CHIEF EXECUTIVE

24 May 2011



# Business Review

## Income Statement Overview

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Business Review

Profit before tax on a statutory basis and an underlying basis are set out below. Certain aspects of the results are presented to reflect management's view of the Group's underlying performance.

Underlying profit before tax equates to statutory profit before tax adjusted for the positive impact of movements in the value of derivatives and

hedge accounting of £120 million, a charge of £50 million in respect of the Financial Services Compensation Scheme (FSCS) and transformation costs of £29 million. The comparative period additionally includes an adjustment for a gain of £40 million on the acquisition of the former Dunfermline Building Society social housing portfolio.

| Year to 4 April 2011                                 | Statutory    | FSCS costs | Statutory profit pre FSCS costs | Movements on derivatives and hedge accounting | Transformation costs | Underlying   |
|--|--------------|------------|---------------------------------|---|----------------------|--------------|
|  | £m           | £m         | £m                              | £m  | £m                   | £m           |
| Net interest income                                  | 1,537        | -          | 1,537                           | -   | -                    | 1,537        |
| Other income   | 445          | -          | 445                             | -   | -                    | 445          |
| Movement on derivatives and hedge accounting         | 120          | -          | 120                             | (120)   | -                    | -            |
| <b>Total income</b>                                  | <b>2,102</b> | <b>-</b>   | <b>2,102</b>                    | <b>(120)</b>                                  | <b>-</b>             | <b>1,982</b> |
| Administrative expenses                              | (1,158)      | -          | (1,158)                         | -   | 29                   | (1,129)      |
| Depreciation and amortisation                        | (150)        | -          | (150)                           | -   | -                    | (150)        |
| Impairment losses on loans and advances to customers | (359)        | -          | (359)                           | -   | -                    | (359)        |
| Provisions for liabilities and charges               | (52)         | 50         | (2)                             | -   | -                    | (2)          |
| Impairment losses on investment securities           | (66)         | -          | (66)                            | -   | -                    | (66)         |
| <b>Profit before tax</b>                             | <b>317</b>   | <b>50</b>  | <b>367</b>                      | <b>(120)</b>                                  | <b>29</b>            | <b>276</b>   |

| Year to 4 April 2010                                 | Statutory    | FSCS costs   | Statutory profit pre FSCS costs | Movements on derivatives and hedge accounting | Transformation costs | Gain on portfolio acquisition | Underlying   |
|--|--------------|--------------|---------------------------------|---|----------------------|-------------------------------|--------------|
|  | £m           | £m           | £m                              | £m  | £m                   | £m                            | £m           |
| Net interest income                                  | 1,714        | -            | 1,714                           | -   | -                    | -                             | 1,714        |
| Other income   | 421          | -            | 421                             | -   | -                    | (40)                          | 381          |
| Movement on derivatives and hedge accounting         | 34           | -            | 34                              | (34)  | -                    | -                             | -            |
| <b>Total income</b>                                  | <b>2,169</b> | <b>-</b>     | <b>2,169</b>                    | <b>(34)</b>                                   | <b>-</b>             | <b>(40)</b>                   | <b>2,095</b> |
| Administrative expenses                              | (1,195)      | -            | (1,195)                         | -   | 62                   | -                             | (1,133)      |
| Depreciation and amortisation                        | (151)        | -            | (151)                           | -   | -                    | -                             | (151)        |
| Impairment losses on loans and advances to customers | (549)        | -            | (549)                           | -   | -                    | -                             | (549)        |
| Provisions for liabilities and charges               | 103          | (117)        | (14)                            | -   | -                    | -                             | (14)         |
| Impairment losses on investment securities           | (36)         | -            | (36)                            | -   | -                    | -                             | (36)         |
| <b>Profit before tax</b>                             | <b>341</b>   | <b>(117)</b> | <b>224</b>                      | <b>(34)</b>                                   | <b>62</b>            | <b>(40)</b>                   | <b>212</b>   |

# Business Review

continued

## PROFIT

A Summary Income Statement on an underlying basis is as follows:

|   | Year to<br>4 April 2011 | Year to<br>4 April 2010 |
|---|-------------------------|-------------------------|
|   | £m                      | £m                      |
| Net interest income   | 1,537                   | 1,714                   |
| Other income  | 445                     | 381                     |
| <b>Total income</b>   | <b>1,982</b>            | <b>2,095</b>            |
| Expenses  | (1,279)                 | (1,284)                 |
| Impairment losses on loans and advances                         | (359)                   | (549)                   |
| Impairment losses on investment securities and other provisions | (68)                    | (50)                    |
| <b>Profit before tax</b>  | <b>276</b>              | <b>212</b>              |

Underlying profit for the year was £276 million, up 30% on the previous year. The impact of margin compression in the low rate environment has been partly offset by strong growth in other income and tight cost control.

The improved profit performance is driven by a significant reduction in the charge for impairment losses on loans and advances in consumer banking and particularly in commercial lending.

## Performance by Income Statement category

### NET INTEREST INCOME

Net interest income, at £1,537 million was £177 million lower than the previous year

|                               | Year to<br>4 April 2011 | Year to<br>4 April 2010 |
|-------------------------------|-------------------------|-------------------------|
|                               | £m                      | £m                      |
| Net interest income           | 1,537                   | 1,714                   |
| Weighted average total assets | 189,360                 | 197,320                 |
|                               | %                       | %                       |
| <b>Net interest margin</b>    | <b>0.81</b>             | <b>0.87</b>             |

The Group's net interest margin has declined 6 basis points to 0.81% in the year to 4 April 2011 compared with the prior year. The contraction in margin of 6 basis points largely arose in the first half of 2010/11 and was caused by an increased cost of retail funding and lower liquidity management gains. The margin stabilised in the second half of the year at around 0.81%.

The margin for the year includes £40 million of gains arising from the management of our liquidity portfolio (2010: £91 million).

The cost of funding continues to be the main factor causing margin compression, reflecting the competitive savings market and the progressive re-pricing of long term wholesale funding. Strong new business asset margins have partially offset the increased cost of funding including the significant positive impact of re-pricing deal maturities through customers either reverting to BMR or opting to take a new front book product. In the second half of 2010/11 the benefit of retail asset re-pricing has exceeded the cost of retail liability re-pricing, resulting in a stabilisation in the net interest margin.

**UNDERLYING OTHER INCOME**

Underlying other income, at £445 million, was £64 million higher than the previous year (2010: £381 million).

|                            | Year to<br>4 April 2011 | Year to<br>4 April 2010 |
|----------------------------|-------------------------|-------------------------|
|                            | £m                      | £m                      |
| Current account            | 125                     | 110                     |
| Protection and investments | 95                      | 71                      |
| General insurance          | 88                      | 87                      |
| Mortgage                   | 53                      | 38                      |
| Credit card                | 41                      | 41                      |
| Commercial                 | 20                      | 11                      |
| Other                      | 23                      | 23                      |
| <b>Total</b>               | <b>445</b>              | <b>381</b>              |

The increase in underlying other income reflects our strategic focus to diversify our income base. Current account income includes increased VISA interchange following the introduction of point of sale access for our basic bank account customers and overseas commission charges. There has been a strong growth in investment income in the year driven by increased sales of long term investments. In addition profit share from

mortgage payment protection insurance policies has increased, as a result of lower unemployment claims compared with the previous year.

A further increase in fee income has been derived from the commercial lending portfolio as a number of loans have been progressively restructured on maturity or on renegotiation of terms with borrowers.

**UNDERLYING EXPENSES**

|                               | Year to<br>4 April 2011 | Year to<br>4 April 2010 |
|-------------------------------|-------------------------|-------------------------|
|                               | £m                      | £m                      |
| Employee costs:               |                         |                         |
| • Wages and salaries          | 461                     | 469                     |
| • Social security costs       | 40                      | 44                      |
| • Pension costs               | 82                      | 71                      |
|                               | 583                     | 584                     |
| Other administrative expenses | 546                     | 549                     |
| Depreciation and amortisation | 150                     | 151                     |
|                               | 1,279                   | 1,284                   |

Underlying total expenses amounted to £1,279 million, representing a reduction of £5 million over the previous year.

We are now in the second year of our cost reduction programme and remain on track to deliver gross cost savings in excess of £200 million over the period to 2012/13. Our strong focus on cost management has delivered run rate cost savings of £80 million during the year and enabled the business to absorb significant cost increases from the VAT rise,

inflation in third party expenditure and costs associated with increased retail sales volumes, as well as costs directly associated with ongoing investment in the business of £71 million (2010: £57 million).

The underlying cost income ratio for the year was 64.5% (2010: 61.3%). The increase reflects the pressure on income as a consequence of operating in a low interest rate environment.

# Business Review

continued

## IMPAIRMENT LOSSES ON LOANS AND ADVANCES

|                        | Year to<br>4 April 2011 | Year to<br>4 April 2010 |
|------------------------|-------------------------|-------------------------|
|                        | £m                      | £m                      |
| Prime residential      | 32                      | 10                      |
| Specialist residential | 69                      | 79                      |
| Residential lending    | 101                     | 89                      |
| Consumer banking       | 83                      | 126                     |
| Commercial lending     | 175                     | 299                     |
| Other lending          | -                       | 35                      |
|                        | 359                     | 549                     |

Overall the charge for impairment losses on loans and advances is down 35% on last year at £359 million (2010: £549 million). This reflects improving credit conditions across all loan types coupled with a continuing prudent lending policy.

Whilst the total charge for residential impairments of £101 million is £12 million higher than last year (2010: £89 million) the underlying arrears rate has remained stable at 0.68%. The increase in residential charge in the year is wholly driven by the charge for prime mortgages which has increased to £32 million for the year (2010: £10 million), and is largely attributable to more conservative default assumptions reflecting the current macro economic environment. In addition, impairment calculations have been updated to include a provision in relation to forbearance cases. The charge for specialist lending has reduced to £69 million (2010: £79 million) reflecting an improvement in the arrears rate to 1.96% (2010: 2.28%), as a result of continuing stability in payment performance supported by the low interest rate environment.

Residential impairment provisions held on the balance sheet increased by 26% to £201 million over the year, giving a coverage ratio (for Nationwide originated assets) against total balances of 0.17% (2010: 0.13%) and against balances more than three months in arrears of 17.6% (2010: 13.7%). In the same period balances more than three months in arrears decreased by 2%.

Nationwide recognises that arrears are typically caused by temporary changes in customer circumstances, and therefore offer a range of forbearance and account management options to customers. On secured lending options include payment holidays, temporary conversion to interest only, term extension and arrears capitalisation. With respect to unsecured lending, credit card customers meeting required criteria may make reduced payments as part of an agreed payment plan or have their arrears consolidated.

Across both the secured and unsecured portfolios, all account management/forbearance options are low in materiality and fully recognised within provisioning.

In our Commercial Lending division, ongoing difficult market conditions resulted in further commercial loan defaults and a charge for the year of £175 million. Signs of improvement have been seen as the growth in impairments began to slow, resulting in a second half charge of £80 million, moderately lower than the £95 million in the first half and 33% lower than the £119 million reported for the six months to 4 April 2010. Defaults continue to be triggered by tenant failures and our borrowers' subsequent inability to service loans, along with covenant breaches on LTVs and business failures on owner occupied properties.

The overall level of provision for commercial lending as a percentage of Nationwide originated assets is 2.18% (2010: 1.97%) and the provision coverage ratio against balances more than three months in arrears is 69% (2010: 48%).

The performance of consumer banking remains strong and reflects our cautious approach and prudence in underwriting. Delinquent balances across all of our unsecured products have reduced and this, coupled with enhancements in our collection operational capability, has significantly improved the charge for the year to 4 April 2011.

## IMPAIRMENT LOSSES ON INVESTMENT SECURITIES AND OTHER PROVISIONS

|                                    | Year to<br>4 April 2011 | Year to<br>4 April 2010 |
|------------------------------------|-------------------------|-------------------------|
|                                    | £m                      | £m                      |
| Treasury investments               | 66                      | 36                      |
| Payment protection insurance (PPI) | 16                      | 9                       |
| Other provisions                   | (14)                    | 5                       |
|                                    | 68                      | 50                      |

The Treasury investments impairment charge of £66 million includes £22 million for a small number of US residential mortgage backed securities (RMBS) exposures, £15 million on a UK commercial mortgage backed security (CMBS) and £11 million on notes of a restructured Structured Investment Vehicle (SIV). The remaining £18 million has arisen from restructuring of subordinated debt from Irish banks (also acquired through SIV restructurings). The prior year charge of £36 million was driven by a £29 million impairment of a number of US RMBS exposures and £7 million in respect of our private equity portfolio.

Following the recent High Court judgment on payment protection insurance (PPI), a charge of £16 million has been recognised in the year for customer redress in respect of PPI. We have had no significant sales of single premium PPI since 2007, our volume of PPI product sales was relatively low and we had a rigorous sales process in place. Based on current experience we expect our total balance sheet provision in respect of PPI at 4 April 2011 of £19 million to be sufficient to meet any obligations that might arise in connection with providing redress in accordance with FSA guidelines.

The release of other provisions of £14 million principally relates to a provision for historic customer bonus schemes which is no longer required.

## DERIVATIVES AND HEDGE ACCOUNTING

Nationwide uses derivative financial instruments to manage various aspects of risk. However, in doing so it complies with the Building Societies Act 1986 which limits the use of derivatives to the mitigation of consequences predominantly arising from changes in interest rates, exchange rates or other market indices.

The £120 million credit (2010: £34 million credit) from derivatives and hedge accounting represents the change in fair value during the year of derivative instruments that are matching risk exposures on an economic basis offset, where applicable, by the change in fair value of the underlying asset or liability attributable to the hedged risk. Even though the Group uses derivatives exclusively for risk management purposes income statement volatility arises due to accounting ineffectiveness of designated hedges, as a result of strategy changes or because hedge accounting has not been adopted or is not achievable.

The overall impact of derivatives will remain volatile period to period as new derivative transactions replace those which mature to ensure that risks are continually managed. Management believes that this volatility arises from application of the accounting rules, which do not reflect the economic reality at a particular point in time, and consequently it is excluded from underlying performance.

Additional information on derivatives and hedge accounting is included in note 8.

# Business Review

continued

## TAXATION

The statutory reported tax charge for the year is £69 million (2010: £77 million). This represents an effective tax rate of 21.8% (2010: 22.6%), which is lower than the statutory rate in the UK of 28%. The lower rate is due principally to adjustments with respect to prior periods, the effect of the change in the UK corporation tax rate from 28% to 26% and the recovery of prior year tax losses not recognised in the opening balance sheet.

### Total Tax Contribution

During 2011 the Group incurred taxes of £200 million (2010: £163 million). In addition, the Group collected and remitted on behalf of HM Revenue & Customs a further £409 million (2010: £484 million). Taxes borne by the group totalled £200 million (2010: £163 million) and included £103 million (2010: £82 million) of irrecoverable VAT which represents a cost to the Group. It is anticipated that the increase in the VAT rate

to 20% will result in additional costs to the group of approximately £13 million per annum.

Corporate taxes paid were £33 million (2010: £17 million). The cash tax rate based on these payments was 10.4% (2010: 5.0%). The reason for the low cash tax rate in both periods relates to the Group's ability to offset the majority of current year profits against corporation tax losses from prior years. The losses arose principally in 2009 when the value of available for sale (AFS) assets fell by £2.2 billion. A deferred tax asset was recognised at the time to reflect the future benefit of these losses and relates to specific tax legislation which taxes or allows as a deduction from taxable profits, the movements in value of AFS assets. Further information about losses carried forward is contained in note 24. Once the losses brought forward are fully utilised the Group expects the cash tax rate and the effective tax rate to be broadly similar.

### Total taxes paid directly by the Group:

|                                     | Year to<br>4 April 2011 | Year to<br>4 April 2010 |
|-------------------------------------|-------------------------|-------------------------|
|                                     | £m                      | £m                      |
| <b>Taxes paid</b>                   |                         |                         |
| • Corporate income taxes            | 33                      | 17                      |
| • Taxes on property                 | 22                      | 21                      |
| • Employment taxes                  | 42                      | 43                      |
| • Indirect taxes                    | 103                     | 82                      |
| <b>Total</b>                        | <b>200</b>              | <b>163</b>              |
| <b>Taxes collected and remitted</b> |                         |                         |
| • Payroll taxes                     | 127                     | 130                     |
| • Indirect taxes                    | 16                      | 17                      |
| • Tax withheld at source            | 266                     | 337                     |
| <b>Total</b>                        | <b>409</b>              | <b>484</b>              |
| <b>TOTAL</b>                        | <b>609</b>              | <b>647</b>              |

### Bank Levy

On 22 June 2010 the Government announced its intention to introduce a new bank levy which came into force on 1 January 2011 for certain UK banks, building societies and the UK operations of foreign banks. The new levy will apply to chargeable equity and liabilities. Certain liabilities are excluded, for example Tier 1 capital, insured retail deposits, repurchase agreements (repos) secured on sovereign debt and policyholder liabilities of retail insurance businesses within banking groups. The levy will not be charged on the first £20 billion of chargeable equity and liabilities.

On 8 February 2011, the Chancellor announced an increase in the rates for 2011 in order to collect the full policy amount of £2.5 billion from the industry as a whole. Previously the amount to be collected for 2011 was intended to be lower than for subsequent years.

No charge has been applied in the accounts to 4 April 2011. Given the expected timing of the 2011 Finance Bill being enacted, the liability will be recognised by the Group in the first half of 2011/12. Based on the current balance sheet position, and the draft legislation and guidance, it is estimated that the charge for 2011/12, which will also incorporate the charge for the three months to 4 April 2011, will be approximately £20 million.

## Balance Sheet

### LOANS AND ADVANCES TO CUSTOMERS

Lending remains predominantly concentrated on high quality secured products with residential mortgages accounting for 83% of our total

loans and advances to customers, commercial lending 15%, and consumer banking 2%. The composition of lending has remained broadly consistent with that reported at 4 April 2010.

| Loans and advances to customers              | 4 April 2011 |              | 4 April 2010 |              |
|--|--------------|--------------|--------------|--------------|
|  | £bn          | %            | £bn          | %            |
| Prime residential mortgages                  | 104.3        | 69.7         | 108.7        | 71.3         |
| Specialist residential mortgages             | 20.3         | 13.6         | 18.7         | 12.2         |
| <b>Total residential mortgages</b>           | <b>124.6</b> | <b>83.3</b>  | <b>127.4</b> | <b>83.5</b>  |
| Commercial lending                           | 22.0         | 14.7         | 22.2         | 14.6         |
| Other lending                                | 0.5          | 0.3          | 0.6          | 0.4          |
| Consumer banking                             | 2.5          | 1.7          | 2.3          | 1.5          |
| <b>Gross balances</b>                        | <b>149.6</b> | <b>100.0</b> | <b>152.5</b> | <b>100.0</b> |
| Impairment provisions                        | (0.8)        |              | (0.8)        |              |
| Fair value adjustments for micro hedged risk | 0.6          |              | 0.7          |              |
| <b>Total</b>                                 | <b>149.4</b> |              | <b>152.4</b> |              |

### Residential

Prime residential mortgages are primarily Nationwide branded advances made through our branch network and intermediary channels but also include prime advances made through The Mortgage Works (UK) plc (TMW) and £3.9 billion through our regional building society brands Derbyshire, Cheshire and Dunfermline.

Specialist residential mortgages are made up of £17.5 billion of advances made through our Specialist Lending brands, TMW and UCB Home Loans Corporation Ltd (UCB), and £2.8 billion through our regional building society brands Derbyshire, Cheshire and Dunfermline. Loans were advanced primarily in the Buy to Let and self-certification markets although no self-certification products were offered during this financial year. Buy to Let mortgages make up 72% of total specialist lending, 20% relates to self-certification mortgages, 6% relates to near prime,

and just 2%, amounting to approximately £0.4 billion, relates to sub prime which was primarily acquired as part of the mergers with Derbyshire and Cheshire and has been subject to rigorous fair value assessment at acquisition.

Gross prime lending in the year amounted to £9.8 billion (2010: £10.3 billion), this includes £0.2 billion advanced through TMW. Gross specialist lending in the year of £3.0 billion (2010: £1.7 billion) related solely to the Buy to Let sector, and was advanced primarily through TMW.

Although the average loan to value (LTV) of the portfolio has increased slightly, it still remains very low at 49%, with 83% of the book under 80% LTV and only 2% in negative equity. We have continued to focus on affordability and LTV ratios in underwriting loans during the year. The average LTV of new residential mortgages completed has marginally increased to 66%.

| Loan to value analysis:        | 4 April 2011 | 4 April 2010 |
|--------------------------------|--------------|--------------|
|                                | %            | %            |
| Total book:                    |              |              |
| <50%                           | 52           | 54           |
| 50% - 60%                      | 9            | 10           |
| 60% - 70%                      | 11           | 10           |
| 70% - 80%                      | 11           | 10           |
| 80% - 90%                      | 10           | 8            |
| 90% - 100%                     | 5            | 6            |
| >100%                          | 2            | 2            |
|                                | <b>100</b>   | <b>100</b>   |
| Average LTV of stock (indexed) | <b>49</b>    | <b>48</b>    |
| Average LTV of new business*   | <b>66</b>    | <b>63</b>    |

\* The average LTV for new business excludes further advances.

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The table below shows that, on Nationwide originated lending, we have seen a small increase in prime arrears and a reduction in specialist arrears though we continue to maintain our very favourable position to the industry on both originated business and lending including acquired loans. The modest increase in prime arrears has been driven primarily by book

contraction, with the underlying volume of cases in arrears actually reducing by 3% over the year. Our originated specialist mortgages continue to perform well and remain broadly in line with the industry measure that includes prime.

| Cases more than 3 months in arrears as % of total book | 4 April 2011 | 4 April 2010 |
|--|--------------|--------------|
|  | %            | %            |
| Nationwide self originated mortgages:                  |              |              |
| Prime  | 0.53         | 0.52         |
| Specialist   | 1.96         | 2.28         |
| <b>Nationwide self originated mortgages</b>            | <b>0.68</b>  | <b>0.68</b>  |
| Including effect of acquired societies:                |              |              |
| Prime  | 0.54         | 0.54         |
| Specialist   | 2.47         | 3.37         |
| <b>Group – including acquired loans</b>                | <b>0.77</b>  | <b>0.82</b>  |
| <b>Industry statistics*</b>                            | <b>2.09</b>  | <b>2.27</b>  |

\* Prior year restated by CML

Residential mortgage assets acquired with the Derbyshire, Cheshire and Dunfermline brands were fair valued on a basis which included a credit risk adjustment of £199 million for anticipated losses over the remaining life of the loans. To date, £65 million of losses have been written off, and during the financial year £33 million of surplus fair value credit risk adjustment on mortgage books has been released into margin. It is believed that the remaining £101 million is sufficient to cover all future losses. Accordingly, in evaluating the Group's exposure to losses, as well as the quality of its underwriting processes, it is relevant to focus on arrears levels excluding rather than including the effect of acquired assets.

We maintain close relationships with customers experiencing financial difficulties and work with them to agree the most appropriate course of action. In the case of short term difficulty, we will seek to agree revised payment schedules with the customer which may include a reduction to the contractual payment due. However, where revised payment schedules are not at a level sufficient to meet normal contractual terms (e.g. a currently available interest only mortgage) or where a customer

fails to meet the revised payment schedule, the case will continue to accrue arrears and be included in arrears numbers reported above.

If a customer demonstrates they are able to meet a payment schedule at a normal commercial rate for a period of six months, and only if they request it, we may capitalise the arrears on their account. This will result in an enlarged outstanding balance but no arrears and consequently these cases will no longer be reported as arrears.

The number of Group borrowers in possession at 4 April 2011, including acquired societies, of 938 (2010: 967) represents 0.07% of the total portfolio (2010: 0.07%). As Buy to Let landlords may have more than one property, possession measures are slightly higher on a property basis but, at 989 (2010: 1,088) properties, representing 0.07% of our book (2010: 0.08%), this still compares favourably with the industry measure of 0.12% (2010: 0.13%). Excluding the impact of acquired societies, our position relative to the industry is even more favourable. The table below shows possessions as a percentage of book for both originated and acquired residential mortgages.

| Possessions as % of total book (number of borrowers) | 4 April 2011        |             | 4 April 2010 |
|--|---------------------|-------------|--------------|
|  | Number of borrowers | %           | %            |
| Nationwide self originated mortgages:                |                     |             |              |
| Prime  | 300                 | 0.03        | 0.02         |
| Specialist   | 463                 | 0.34        | 0.41         |
| <b>Nationwide self originated mortgages</b>          | <b>763</b>          | <b>0.06</b> | <b>0.06</b>  |
| Including effect of acquired societies:              |                     |             |              |
| Prime  | 319                 | 0.03        | 0.02         |
| Specialist   | 619                 | 0.38        | 0.50         |
| <b>Group – including acquired loans</b>              | <b>938</b>          | <b>0.07</b> | <b>0.07</b>  |



| Possessions as % of total book (number of properties) | 4 April 2011         |             | 4 April 2010 |
|---|----------------------|-------------|--------------|
|   | Number of properties | %           | %            |
| Nationwide self originated:                           |                      |             |              |
| Prime   | 300                  | 0.03        | 0.02         |
| Specialist  | 514                  | 0.34        | 0.46         |
| <b>Nationwide self originated mortgages</b>           | <b>814</b>           | <b>0.06</b> | <b>0.06</b>  |
| Including effect of acquired societies:               |                      |             |              |
| Prime   | 319                  | 0.03        | 0.02         |
| Specialist  | 670                  | 0.38        | 0.53         |
| <b>Group – including acquired loans</b>               | <b>989</b>           | <b>0.07</b> | <b>0.08</b>  |
| <b>Industry statistics</b>                            | <b>13,600</b>        | <b>0.12</b> | <b>0.13</b>  |

Our approach to dealing with customers in financial difficulties, combined with our historically cautious approach to lending, means that we only take possession of properties as a last resort. This is illustrated by the number of properties taken into possession compared with the total for the industry. During the year, 1,264 (2010: 1,280) properties relating

to Nationwide originated lending have been taken into possession, representing only 3.58% (2010: 2.84% restated by CML) of properties taken in by the industry as a whole against our par share of all cases of 11.40% (2010: 11.58%).

| Possessions taken in during the year as % of total book (number of borrowers) | 4 April 2011        |             | 4 April 2010 |
|---|---------------------|-------------|--------------|
|   | Number of borrowers | %           | %            |
| Nationwide self originated mortgages:   |                     |             |              |
| Prime   | 598                 | 0.05        | 0.04         |
| Specialist  | 579                 | 0.42        | 0.52         |
| <b>Nationwide self originated mortgages</b>                                   | <b>1,177</b>        | <b>0.09</b> | <b>0.09</b>  |
| Including effect of acquired societies:                                       |                     |             |              |
| Prime   | 632                 | 0.05        | 0.05         |
| Specialist  | 937                 | 0.58        | 0.78         |
| <b>Group – including acquired loans</b>                                       | <b>1,569</b>        | <b>0.12</b> | <b>0.12</b>  |

| Possessions taken in during the year as % of total book (number of properties) | 4 April 2011         |             | 4 April 2010 |
|--|----------------------|-------------|--------------|
|  | Number of properties | %           | %            |
| Nationwide self originated:  |                      |             |              |
| Prime  | 598                  | 0.05        | 0.04         |
| Specialist   | 666                  | 0.44        | 0.59         |
| <b>Nationwide self originated mortgages</b>                                    | <b>1,264</b>         | <b>0.10</b> | <b>0.10</b>  |
| Including effect of acquired societies:  |                      |             |              |
| Prime  | 632                  | 0.05        | 0.05         |
| Specialist   | 1,024                | 0.58        | 0.81         |
| <b>Group – including acquired loans</b>  | <b>1,656</b>         | <b>0.12</b> | <b>0.13</b>  |
| <b>Industry statistics</b>   | <b>35,300</b>        | <b>0.31</b> | <b>0.39</b>  |

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## Commercial

Our commercial lending portfolio reduced slightly to £22.0 billion (2010: £22.2 billion) and consists of £20.8 billion (2010: £20.9 billion) of self originated lending and £1.2 billion (2010: £1.3 billion) of assets acquired from the Derbyshire, Cheshire and Dunfermline building societies. Our originated portfolio comprises £11.9 billion secured on commercial property ('Property Finance'), £7.4 billion advanced to Registered Social Landlords and £1.5 billion advanced under the Private Finance Initiative (PFI). There are currently no arrears of three months or more on the Registered Social Landlord and PFI portfolios and our Property Finance portfolio is well diversified by industry type and by borrower.

On self originated lending we have only modest exposure to development finance with total balances of £172 million, and a total further commitment of £29 million, to three high quality office developments in the centre of London. Of these, one development case with a total balance of £26 million is in the course of being sold with contracts exchanged in March and completion set for October 2011 which will result in full repayment of all debt. Another development case has been restructured with improved terms and an equity injection from the sponsors resulting in an improved security position for lenders.

The number of Nationwide originated commercial property cases more than three months in arrears decreased from 285 cases as at 4 April 2010 to 235 as at 4 April 2011. This equates to 2.41% of commercial originated accounts (2010: 2.77%). Total arrears balances on these cases at 4 April 2011 were £48 million (2010: £42 million). Robust arrears management is carried out by dedicated teams who, supported by daily arrears reporting, maintain a focus on early intervention to maximise economic value and mitigate losses.

Commercial mortgage assets originally totalling £1.3 billion acquired through mergers with Derbyshire and Cheshire and the acquisition of the Dunfermline's social housing portfolio have been fair valued in the same way as described for residential assets above, including a credit risk adjustment of £179 million for anticipated losses over the remaining life of the loans, none of which relates to Dunfermline's social housing

portfolio. A loan loss impairment charge of £3 million has been raised in the year (£4 million since acquisition) as a number of individually assessed cases have an impairment provision requirement in excess of the original fair value adjustment. To date, £37 million of losses have been written off and £4 million of surplus fair value credit risk adjustment on repaid facilities has been released. We continue to believe that the remaining acquired loans are unlikely to contribute any significant net losses to the Group over their lifetime.

Although we continue to expect difficult market conditions in the commercial property sector, and further impairment provisions, we remain confident that our book, which is primarily focused on low risk lending, will perform better than most. This, combined with proactive management including progressive re-pricing of facilities as they mature or experience technical covenant breaches, will ensure continued improvements in contribution in the coming years.

## Other lending

Other lending includes £235 million of secured European commercial loans and £246 million of unsecured lending relating to a student loan portfolio. The European commercial loan portfolio is spread across 65 separate entities and 11 countries, with the maximum individual exposure amounting to £10 million. During the year, impairments were raised for four entities, the majority of which related to asset disposals. Changes in the provision held for restructured loans in the portfolio, as well as a change in the collective provision, resulted in a release of £6.2 million, partially offsetting the full year new provisions charge of £7 million. Overall, with a small write back for the student loan portfolio, there is no significant net impairment charge. This lending is included within the Head Office functions business segment, as the portfolios were acquired by our Treasury division.

## Consumer banking

In consumer banking, the balance of accounts more than 30 days in arrears has improved and our performance compared with the industry remains favourable. For personal loans and credit cards, the table below shows our arrears levels are significantly better than averages for the industry (FLA and APACS):

| Percentage of accounts more than 30 days in arrears | 4 April 2011 |            | 4 April 2010 |            |
|---|--------------|------------|--------------|------------|
|   | NBS %        | Industry % | NBS %        | Industry % |
| Personal loans                                      | 5.45         | 20.00      | 7.07         | 19.60      |
| Credit cards  | 3.36         | 5.77       | 5.15         | 6.64       |

The percentage of accounts more than 30 days in arrears on overdrafts is 10.46% (2010: 16.74%). Of the improvement of over 6% in the year, 2% relates to improvements in underlying performance and approximately

4% relates to a change in methodology whereby all cases moving into litigation or being referred to debt collection agencies are immediately written off.

## FUNDING AND LIQUIDITY

### Overview

The Society has a strong and well diversified funding base, which continues to be predominantly funded by retail savings. Over the course of the financial year, we have continued to actively manage our balance sheet in response to conditions in both the retail and wholesale markets. However, in contrast to the position over the previous full financial year, balance sheet liabilities have only marginally decreased, with an increase in members' balances partly offsetting a modest reduction in wholesale funding.

As a building society, we have always maintained a high level of unencumbered liquid assets relative to our banking peers, and our core liquidity remains stable at 13.8% (4 April 2010 13.8%). The size of our liquidity buffer in combination with the improving profile of the wholesale funding portfolio, has continued to improve the Group's overall liquidity position.

### Liquidity

Liquidity, together with funding and capital, represents the cornerstone of financial risk management in a financial institution. In recent years there has been an increase in the focus and attention to this discipline by the regulatory authorities resulting in the FSA publishing a liquidity policy statement, PS 09/16 in 2009. The FSA also set out a separate risk management framework for building societies, PS 10/5. Compliance with these new policy statements, under tight timeframes, has been a key objective of the Group during the past year: PS09/16 required the completion of an Individual Liquidity Adequacy Assessment (ILAA) by June 2010, and PS10/5 required the Group to have communicated its financial risk management and lending approaches to the FSA by October 2010. While these timeframes have been successfully met there are additional enhancements (aspects of regulatory reporting and stress testing) which will necessitate further work into 2011.

In December 2010, the Basel Committee on Banking Supervision issued its proposals for liquidity risk management, standards and monitoring. These included a short term liquidity stress metric, the Liquidity Coverage Ratio (LCR), and a longer term liquidity metric, the Net Stable Funding Ratio (NSFR). These proposals are subject to ongoing refinement and have not yet been enacted into UK or European law. The Group monitors compliance against these internal metrics and as at 4 April 2011 the LCR was estimated at 125% and the NSFR at 106%. Estimations are made using Nationwide's interpretation of the draft directive, which has yet to be incorporated into the European and UK regulatory framework and therefore remains subject to change.

Additional information on funding and liquidity risk is disclosed in the Risk Management and Control section of the Business Review.

Liquid assets generally comprise cash deposits held with central banks or unencumbered securities that may be freely sold or are capable of financing through repurchase agreements ('repo') or other similar arrangements either direct with those central banks to which the Group has access, or with market counterparties. The stock of liquid assets managed by Nationwide's Treasury division fall into the following four categories:

### Core Liquidity

The Group has continued to focus on the growth and diversification of its core liquidity portfolio through investing in a greater volume of highly liquid sovereign securities. The core portfolio is aligned to the 'Liquid Assets Buffer' defined by the FSA in BIPRU 12 and comprises:

- Deposits held at, and securities issued by, the Bank of England (BoE);
- Highly rated debt securities of varying maturities issued by governments or multi-lateral development banks.

In line with other major UK institutions the Group made use of the Bank of England's (BoE) Special Liquidity Scheme (SLS) facility at the height of the market dislocation in 2008. We have now repaid the major part of our SLS drawings and are well ahead of the repayment profile required by the BoE which expires in January 2012.

As at 4 April 2011, the core liquidity portfolio as a percentage of adjusted share, deposit and loan liabilities was 13.8% (4 April 2010: 13.8%). This calculation is made net of any core liquidity holdings that are subject to repo arrangements and includes assets held under reverse repo arrangements and Treasury bills held under the Special Liquidity Scheme.

### Other Eligible Central Bank Assets

In addition to the core portfolio, as at 4 April 2011 the Group held a stock of unencumbered securities (excluding self issuance) that are eligible collateral for either the European Central Bank's (ECB) repo operations, for the BoE extended collateral repo operations or the BoE discount window facility. In terms of their relative liquidity characteristics, these assets may be viewed as the next tier below the core liquidity portfolio.

### Other Securities

Nationwide holds other third party liquid assets (such as Floating Rate Notes) that are not eligible at either the BoE's or the ECB's operations but may be capable of financing through third party repo agreements.

### Self Issued RMBS and Covered Bonds

The Group holds a stock of self issued AAA residential mortgage backed securities (RMBS) and covered bonds. These self issued securities are capable of repo financing either directly with the market or with central banks to which the Group has direct access, and therefore represent contingent liquidity available to the Group if necessary.

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The table below sets out the fair value – before any ‘haircut’ deduction – of each of the above liquidity types as at 4 April 2011. The table includes off balance sheet liquidity (including Treasury bills held under the Special Liquidity Scheme, reverse repos, self issued RMBS and covered bonds)

but excludes any encumbered assets. The increase in self issued RMBS and covered bonds arises from the release of collateral from repayment of central bank facilities and other repo arrangements.

|                                    | 4 April 2011 | 4 April 2010 |
|------------------------------------|--------------|--------------|
|                                    | £bn          | £bn          |
| Core liquidity                     | 23.5         | 23.4         |
| Other central bank eligible assets | 5.6          | 4.7          |
| Other securities                   | 3.2          | 3.4          |
| Self issued RMBS and covered bonds | 18.3         | 11.8         |
| <b>Total</b>                       | <b>50.6</b>  | <b>43.3</b>  |

## Funding profile

The retail savings market in the UK has remained subdued throughout the year, with market growth in balances of £18.6 billion driven mainly by interest capitalised. This contrasts with the extremely competitive conditions in the previous financial year, where a lack of access to wholesale markets led some institutions to compete aggressively for retail deposits resulting in balance growth of £30.6 billion.

We have continued to actively manage our flow of retail savings in order to secure funds at an economic rate whilst offering long term good value products to our members. In the year to 4 April 2011, we attracted a positive inflow of funds, and retail savings balances increased by

£1.6 billion to £122.6 billion. This compares with a net reduction in retail savings balances of £7.3 billion in the previous year.

The increase in retail savings balances combined with a marginal decrease in balance sheet size has resulted in a reduction in wholesale funding balances such that the wholesale funding level reduced to 25.9% (4 April 2010: 27.8%).

## Wholesale funding

An analysis of the Group's wholesale funding (made up of deposits from banks, other deposits and debt securities in issue as disclosed on the balance sheet) is set out in the table below:

| Wholesale funding mix               | 4 April 2011 |              | 4 April 2010 |              |
|-------------------------------------|--------------|--------------|--------------|--------------|
|                                     | £bn          | %            | £bn          | %            |
| Repo and other secured arrangements | 2.7          | 5.9          | 7.9          | 16.0         |
| Deposits, including PEB balances    | 6.9          | 15.0         | 6.1          | 12.4         |
| Certificates of deposit             | 4.7          | 10.2         | 6.1          | 12.4         |
| Commercial paper                    | 6.2          | 13.4         | 6.4          | 13.0         |
| Covered bonds                       | 12.3         | 26.7         | 9.1          | 18.4         |
| Medium term notes                   | 8.4          | 18.2         | 10.1         | 20.5         |
| Securitisations                     | 3.7          | 8.0          | 2.2          | 4.5          |
| Other                               | 1.2          | 2.6          | 1.4          | 2.8          |
| <b>Total</b>                        | <b>46.1</b>  | <b>100.0</b> | <b>49.3</b>  | <b>100.0</b> |

The reduction in the absolute amount of wholesale funding and in the wholesale funding ratio is a function of the overall management of the Group's balance sheet, as we have controlled the level and quality of lending undertaken. However, we have seen much improved access to wholesale funding as general market uncertainty has eased.

Following the increase in retail and long term wholesale funding balances, short term repo transactions were reduced and central bank facilities repaid. We continue to attract funds into Protected Equity Bonds (PEBs) and during the year we received new investment premiums of

£1.0 billion, increasing total PEB balances to £2.1 billion as at 4 April 2011 (2010: £1.1 billion).

During the 2010/11 financial year we remained active in the long term debt markets utilising all of our platforms and issuing £5.8 billion (including €750 million lower Tier 2 subordinated notes), far in excess of our more modest £1.8 billion equivalent of maturing long term debt. The focus has provided breadth and diversification to the previous year's unsecured deals.

The following term issuances during the year demonstrate both the strength of institutional support and this breadth of funding diversity for Nationwide:

- In September 2010 a €1.25 billion five year covered bond, our first external covered bond since September 2007;
- In October 2010, \$0.9 billion and €1.1 billion (£1.52 billion equivalent) funding through the issue of floating rate residential mortgage backed securities (RMBS) through the Silverstone Master Trust vehicle;
- £0.75 billion 15 year landmark covered bond in January 2011 which successfully reopened the Sterling benchmark covered bond market;
- Followed by €1.25 billion 10 year covered bond in February; and
- In addition to the public transactions we also issued £0.8 billion of long term private placements to institutional investors with a weighted average life of nine years.

In addition to wholesale funding and therefore not included in the portfolio mix and residual maturity tables included in this section, the Group issued €750 million of lower Tier 2 subordinated notes. This July 2010 issuance refinances the subordinated notes repaid in August 2010 and further demonstrates the strength of institutional support for the Group. On 17 December we also repaid £100 million of subordinated notes.

The Group has reduced the amount of short term funding it holds to £15 billion (2010: £16 billion and 2009: £20 billion), but still enjoys a strong franchise in these markets, which is reflected in the average term at issuance of the short term funding book, being 156 days at 4 April 2011 (2010: 155 days).

The Group has extended the residual maturity profile of its wholesale funding portfolio from 26 months to 33 months and increased the split between short and long term with a further reduction in the less than one year maturity category to 43.4% (2010: 49.7%).

The table below sets out the residual maturity of the wholesale funding book:

| Wholesale funding residual maturity | 4 April 2011 |              | 4 April 2010 |              |
|-------------------------------------|--------------|--------------|--------------|--------------|
|                                     | £bn          | %            | £bn          | %            |
| Less than one year                  | 20.0         | 43.4         | 24.5         | 49.7         |
| One to two years                    | 4.9          | 10.6         | 4.3          | 8.8          |
| Two to five years                   | 13.6         | 29.5         | 11.7         | 23.6         |
| More than five years                | 7.6          | 16.5         | 8.8          | 17.9         |
| <b>Total</b>                        | <b>46.1</b>  | <b>100.0</b> | <b>49.3</b>  | <b>100.0</b> |

Our short and long term credit ratings from the major rating agencies as at 24 May 2011 are as follows:

|                   | Long Term | Short Term   | Subordinated | Date of last rating action/confirmation* |
|-------------------|-----------|--------------|--------------|--|
| Standard & Poor's | A+        | A-1          | BBB+         | October 2010                             |
| Moody's           | Aa3       | P-1          | Baa3         | November 2010                            |
| Fitch             | AA-       | F1+          | A            | November 2010                            |
| DBRS              | AA        | R-1 (middle) | AA (low)     | December 2010                            |

\* The current outlook for Moody's is stable. The outlook for Standard & Poor's, Fitch and DBRS is negative.

On 24 May 2011 Moody's announced their intention to review the ratings of a number of UK financial institutions, including Nationwide, to reflect their expectation of lower levels of exceptional Government support going forward. In consequence our ratings with Moody's are currently under review with the possibility of a downgrade within the next three months. It is not possible at this stage to determine the likelihood or extent of any rating action.

#### Treasury asset quality

The amount of on balance sheet Treasury assets, viewed from an asset quality perspective, is different to the amount from a liquidity perspective, in that the former excludes off balance sheet liquidity but includes encumbered assets that do not count for liquidity purposes.

Group Treasury assets at 4 April 2011 were £31.9 billion (2010: £29.4 billion) and are held in two separate portfolios; the Treasury liquidity portfolio (previously known as prudential portfolio) and the investment portfolio. At 4 April 2011, the Treasury liquidity portfolio totalled £28.6 billion

(2010: £25.7 billion) with the investment portfolio totalling £3.3 billion (2010: £3.7 billion).

We have continued to manage the Treasury liquidity portfolio to increase the quality and liquidity of the assets with over 65% of the portfolio held in sovereign and supranational exposures (2010: 63%). The £2.9 billion increase in the portfolio comprises high quality, predominantly sovereign or government backed assets. 99% of the portfolio is rated A or better with 86% rated AA or above (2010: 99% rated A or better, 85% rated AA or better).

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The Treasury investment portfolio was originally established to generate additional income for the Group. 84% of the investment portfolio is rated A or better (2010: 87%) with over 63% rated AA or better (2010: 69%). The reduction in the portfolio during the year has been predominately driven by paydowns received relating to the asset and mortgage backed securities and maturing investments. We are managing the existing portfolio to minimise potential risk whilst reinvesting some of the paydowns into high quality secured assets. The portfolio has experienced some negative rating migration as a result of the ongoing implementation of rating agency methodology changes and continued asset quality

deterioration, particularly for financial institution subordinated debt, US student loans, CMBS and US RMBS. However, the overall credit quality remains strong with only a low level of impairment incurred.

We have no direct Sovereign exposure to peripheral Euro zone countries (Portugal, Ireland, Italy, Greece and Spain). Within the Treasury assets we have £2.1 billion non sovereign securities issued in these countries as detailed below. Of this 59% is rated AA or above and 72% is rated A or above. This exposure has reduced by 28% in the year and a further nominal £621 million, primarily senior debt, matures in the next year.

| 4 April 2011                                  | Greece   | Ireland    | Italy      | Portugal   | Spain        | Total        |
|---|----------|------------|------------|------------|--------------|--------------|
|   | £m       | £m         | £m         | £m         | £m           | £m           |
| Residential mortgage backed securities (RMBS) | -        | 155        | 149        | 64         | 442          | 810          |
| Covered bonds                                 | -        | 63         | -          | 19         | 373          | 455          |
| Senior debt                                   | -        | 98         | 117        | 63         | 485          | 763          |
| Subordinated bonds                            | -        | -          | 11         | 17         | -            | 28           |
| Other assets                                  | 3        | -          | 12         | -          | 6            | 21           |
| <b>Total</b>                                  | <b>3</b> | <b>316</b> | <b>289</b> | <b>163</b> | <b>1,306</b> | <b>2,077</b> |

| 4 April 2010                                  | Greece    | Ireland    | Italy      | Portugal   | Spain        | Total        |
|---|-----------|------------|------------|------------|--------------|--------------|
|   | £m        | £m         | £m         | £m         | £m           | £m           |
| Residential mortgage backed securities (RMBS) | -         | 194        | 196        | 80         | 519          | 989          |
| Covered bonds                                 | -         | 100        | -          | 23         | 405          | 528          |
| Senior debt                                   | 20        | 208        | 221        | 101        | 710          | 1,260        |
| Subordinated bonds                            | -         | 34         | 11         | 21         | -            | 66           |
| Other assets                                  | 3         | -          | 18         | -          | 12           | 33           |
| <b>Total</b>                                  | <b>23</b> | <b>536</b> | <b>446</b> | <b>225</b> | <b>1,646</b> | <b>2,876</b> |

Movements in our exposure to peripheral Euro zone countries above relate to disposals, maturities and fair value movements and there has been no new investment in the year.

An independent monthly review is undertaken by Risk Management division on the current and expected future performance of all Treasury assets. A governance structure exists to identify and review under-performing assets and highlight the likelihood of future losses. In accordance with accounting standards, assets are impaired where there is objective evidence that current events and/or performance will result in a loss.

Nationwide has £95 million of exposure to monoline insured transactions. Three holdings were impaired in 2010/11 (totalling £11 million) following coupon deferral (not covered by the terms of the insurance). We are reliant on the monoline insurance provider for one further holding (exposure £2 million) but in all other cases we anticipate full repayment without any assistance from the insurance provider. This is mainly as a result of the approach taken upon investment, where we placed no reliance on the monoline insurance, requiring the investment to stand up to credit analysis in its own right.

Additional information on the Treasury asset portfolio is disclosed in note 40.

**Available for sale reserve**

Out of a total of £31.9 billion of Treasury assets held in the Treasury liquidity and investment portfolios, £21.5 billion are held as available for sale (AFS) and under IFRS they are marked to market through other comprehensive income and fair value movements are accumulated in reserves.

The non AFS assets are predominantly short term loans to financial institutions or deposits with the Bank of England. Of the £21.5 billion of AFS assets only £95 million are classified as Level 3 (valuation not based on observable market data) for the purposes of IFRS 7.

The assets have been carefully reviewed based upon latest performance data and an impairment charge of £66 million has been booked against AFS assets. The fair value movement of AFS assets that are not impaired have no effect on the Group's profit for the period or its regulatory capital.

As at 4 April 2011, the balance on the AFS reserve had improved to £495 million negative, net of tax (2010: £715 million negative). The improvement in the AFS reserve is primarily a function of improvement in the pricing for various asset classes as market sentiment has improved.

|  | 4 April 2011                |                        | 4 April 2010                |                        |
|--|-----------------------------|------------------------|-----------------------------|------------------------|
|  | Fair Value on balance sheet | Cumulative AFS reserve | Fair Value on balance sheet | Cumulative AFS reserve |
|  | £bn                         | £bn                    | £bn                         | £bn                    |
| Gilts, non domestic bonds and Supranational bonds                | 12.6                        | (0.1)                  | 12.3                        | (0.3)                  |
| Residential mortgage backed securities (RMBS)                    | 2.3                         | 0.1                    | 2.7                         | 0.2                    |
| Covered bonds and floating rate notes                            | 3.3                         | 0.3                    | 4.7                         | 0.1                    |
| <b>Treasury liquidity portfolio</b>                              | <b>18.2</b>                 | <b>0.3</b>             | <b>19.7</b>                 | <b>0.0</b>             |
| Collateralised debt obligations (CDO)                            | 0.1                         | 0.1                    | 0.1                         | -                      |
| Collateralised loan obligations (CLO)                            | 0.6                         | -                      | 0.6                         | 0.1                    |
| Commercial mortgage backed securities (CMBS)                     | 0.6                         | 0.1                    | 0.6                         | 0.3                    |
| Corporate bond portfolio   | 0.1                         | -                      | 0.1                         | -                      |
| Credit card backed securities                                    | 0.2                         | -                      | 0.3                         | -                      |
| Financial institutions including sub debt                        | 0.4                         | -                      | 0.7                         | -                      |
| Residential mortgage backed securities (RMBS)                    | 0.5                         | 0.1                    | 0.3                         | 0.1                    |
| US student loan  | 0.7                         | 0.1                    | 0.8                         | 0.1                    |
| Other investments  | 0.1                         | -                      | 0.2                         | 0.1                    |
| <b>Investment portfolio</b>                                      | <b>3.3</b>                  | <b>0.4</b>             | <b>3.7</b>                  | <b>0.7</b>             |
| <b>Negative AFS reserve before hedge accounting and taxation</b> | <b>-</b>                    | <b>0.7</b>             | <b>-</b>                    | <b>0.7</b>             |
| Hedge accounting adjustment for interest rate risk               | -                           | -                      | -                           | 0.3                    |
| Taxation   | -                           | (0.2)                  | -                           | (0.3)                  |
| <b>Total value of AFS assets / negative AFS reserve (net)</b>    | <b>21.5</b>                 | <b>0.5</b>             | <b>23.4</b>                 | <b>0.7</b>             |

In October 2008, the IASB issued an amendment to IAS 39 allowing assets to be reclassified from AFS assets to loans and receivables. Nationwide has not reclassified any assets in this way.



# Business Review

continued

## Capital Structure

Capital is held by the Group to protect its depositors, to cover its inherent risks, to provide a cushion for unexpected losses and to support the development of the business. In assessing the adequacy of its capital resources, Nationwide considers its risk appetite, the material risks to which the Group is exposed and the appropriate strategies required to manage those risks.

The Group is required to manage its capital in accordance with prudential rules issued by the FSA and from 1 January 2008 the Group has complied with these rules which implement the EU Capital Requirements Directive (Basel II). Since 4 April 2009 the Group has principally calculated its capital requirement on an Internal Ratings Based (IRB) approach.

Risk weighted assets were 5.3% lower than the previous year, at £47.4 billion (2010: £50.1 billion), driven by strong management of risk, combined with a change to the credit risk measurement methodology of exposures to central banks and governments (including multilateral development banks). These assets are held by the Group as part of a

substantial liquidity portfolio. The capital requirements of these exposures are now calculated using the standardised approach resulting in a zero risk rating (previously Foundation IRB), in accordance with FSA guidance.

Total capital fell by 4.8% over the year to £9.3 billion (2010: £9.7 billion), following a commitment to make additional contributions to the Nationwide Pension Fund to remove the funding deficit (£99 million payment made in 2010/11, with a further contribution of £240 million to be paid in 2011/12) and a growth in intangible assets. The growth in intangible assets relates primarily to the Society's investment in a new systems platform to meet the future needs of the business. The Group issued €750 million of lower Tier 2 subordinated debt in July 2010 to refinance subordinated debt called in 2010.

As at 4 April 2011, the Group's total solvency ratio remained strong at 19.5% (2010: 19.4%). The Core Tier 1 solvency ratio stood at 12.5% (2010: 12.2%).

|   | 4 April 2011    | 4 April 2010    |
|---|-----------------|-----------------|
|   | Basel II<br>IRB | Basel II<br>IRB |
|   | £m              | £m              |
| <b>Tier 1</b>                                   |                 |                 |
| General reserve                                 | 6,679           | 6,363           |
| Permanent interest bearing shares (Note 1)      | 1,510           | 1,524           |
| Pension fund net deficit add back (Note 2)      | 33              | 355             |
| Intangible assets (Note 3)                      | (529)           | (353)           |
| Deductions from Tier 1 capital (Note 4)         | (256)           | (232)           |
|   | 7,437           | 7,657           |
| <b>Tier 2</b>                                   |                 |                 |
| Revaluation reserve                             | 70              | 68              |
| Subordinated debt (Note 1)                      | 1,884           | 2,132           |
| Collective impairment allowance                 | 118             | 97              |
| Deductions from Tier 2 capital (Note 4)         | (256)           | (232)           |
|   | 1,816           | 2,065           |
| <b>Total capital</b>                            | <b>9,253</b>    | <b>9,722</b>    |
| <b>Risk weighted assets – Pillar 1 (Note 5)</b> |                 |                 |
| Retail mortgages                                | 15,081          | 14,653          |
| Commercial loans                                | 17,610          | 18,316          |
| Treasury  | 4,088           | 8,351           |
| Other   | 6,420           | 4,375           |
| Operational Risk                                | 4,137           | 4,328           |
| Market Risk                                     | 72              | 50              |
|   | 47,408          | 50,073          |



|                            | 4 April 2011    | 4 April 2010    |
|----------------------------|-----------------|-----------------|
|                            | Basel II<br>IRB | Basel II<br>IRB |
| <b>Key capital ratios:</b> |                 |                 |
| Total capital              | £9,253m         | £9,722m         |
| Core Tier 1 (%) (Note 6)   | 12.5%           | 12.2%           |
| Tier 1 ratio (%) (Note 6)  | 15.7%           | 15.3%           |
| Total capital (%) (Note 6) | 19.5%           | 19.4%           |
| Tier 2 to Tier 1 ratio (%) | 24.4%           | 27.0%           |

## Notes

- (1) Permanent interest bearing shares and subordinated debt include fair value adjustments related to changes in market interest rates, adjustments for unamortised premiums and discounts that are included in the consolidated balance sheet and any amortisation of the capital value of lower Tier 2 instruments required by regulatory rules for instruments with less than five years to maturity.
- (2) The regulatory capital rules allow the pension fund deficit to be added back to regulatory capital and a deduction taken instead for an estimate of the additional contributions to be made in the next five years, less associated deferred tax.
- (3) Intangible assets do not qualify as capital for regulatory purposes.
- (4) Certain deductions from capital are required to be allocated 50% to Tier 1 and 50% to Tier 2 capital. Deductions are subject to different treatment under IRB in respect of net expected loss over accounting provisions and certain securitisation positions. These are calculated in accordance with FSA guidance.
- (5) The Basel II Pillar 1 capital requirements are calculated using the Retail IRB approach for prime mortgages (other than those originated by the Derbyshire, Cheshire and Dunfermline building societies) and unsecured lending; Foundation IRB for Treasury portfolios (other than sovereign and corporate exposures); and the Standardised approach for all other credit risk exposures.
- (6) Solvency ratios are calculated as relevant capital divided by Risk Weighted Assets. Core Tier 1 relates to Tier 1 capital excluding permanent interest bearing shares.

## Basel III overview

The Basel Committee on Banking Supervision (BCBS) issued its revised Basel III text in December 2010. The objective of the reform package is to improve the banking sector's ability to absorb shocks arising from financial and/or economic stress, thus reducing the risk of 'spill-over' from the financial sector into the 'real economy'. The reforms raise both the quality and quantity of the regulatory capital base and enhance

the risk coverage of the capital framework. This is supplemented by a leverage ratio that is intended to protect against model risk and measurement error. Basel III also introduces a number of macro-prudential elements into the capital framework to help contain systemic risks. The Basel III text has yet to be incorporated into the European and UK regulatory framework and therefore remains subject to change.

# Business Review

continued

## Impact of rules effective in full from 1 January 2013

An indicative impact assessment is contained below, providing an insight into the potential effect of the new rules on Nationwide's capital position:

- Securitisation exposures:
  - Securitisation positions that are currently deducted from capital will be risk-weighted at 1250%.
- Counterparty credit risk:
  - An additional capital charge for credit valuation adjustment risk is required. The majority of the charge is from the use of derivative instruments (with highly rated counterparts) to manage interest rate and foreign exchange risk associated with covered bond issuances; and
  - An additional capital charge is required for all financial transactions with firms that have total assets greater than or equal to US\$100 billion.
- Unrealised gains:
  - The revaluation reserve, which is currently an addition to Tier 2 capital, will be included in Core Tier 1 capital.

Recognising that the revised capital framework is subject to change, the combined impact of the above four items is expected to reduce our Core Tier 1 ratio by approximately 0.8% in 2013. Nationwide has a strong track record of robust capital ratios and is confident that it is well positioned to maintain its overall capital strength. Note, this impact assessment does not assume mitigating actions, but does allow for the amortisation/maturity of securitisation exposures.

## Impact of other rules

In addition to the changes effective in full from 1 January 2013, the BCBS has proposed a number of other reforms:

- 31 December 2011: amended rules for market risk and re-securitisations are implemented, commonly referred to as Basel II.5. The impact to Nationwide's capital position is negligible;
- 1 January 2013: permanent interest bearing shares (PIBS) and subordinated debt will be phased-out over ten years. The effect on the capital recognition of subordinated debt is minimal, with PIBS only materially impacted in the final years of the grandfathering period. Nationwide intends to maintain its strong core capital position, and expects an appropriate Core Tier 1 capital instrument for mutual organisations will be available, ensuring access to capital markets is maintained; and
- 1 January 2014-18: changes and additions to capital deductions will be phased-in at 20% per annum. The impact of these is expected to be manageable, as most of the drivers (e.g. unrealised losses on AFS assets and deferred tax assets) are forecast to reduce by 2014. However, this assessment is subject to potential change as regulators start to focus on the practical application and interpretation of the reforms.

In addition to the strengthened capital standards, the Basel III text requires firms to calculate a non-risk based leverage ratio. The BCBS is using the period to 2017 to test a minimum Tier 1 leverage ratio of 3%. Using the Basel III guidelines and the transitional arrangements outlined above, Nationwide's leverage ratio is comfortably in excess of the proposed 3% testing limit. The BCBS is considering implementing the ratio as a Pillar 1 measure by 2018. This would put in place a binding constraint that will tend to penalise those institutions whose business models principally comprise low risk assets. It will be important that its use as a regulatory tool recognises this limitation in its basis of calculation. The leverage ratio has yet to be incorporated into the European and UK regulatory framework and therefore remains subject to change.

## Pension Fund (Retirement Benefit Obligations)

The Group operates final salary and career average revalued earnings (CARE) defined benefit arrangements, primarily through the Nationwide Pension Fund (the Fund), as well as defined contribution

arrangements. The net retirement benefit liability for the defined benefit arrangements, measured under IAS 19, is £300 million (2010: £508 million).

The movement in the net liability over the year comprises:

|  | Year to<br>4 April 2011 |
|--|-------------------------|
|  | £m                      |
| Net retirement benefit liability at 5 April 2010 | 508                     |
| Pensions charge                                  | 76                      |
| Expected return on assets                        | (168)                   |
| Expected interest cost                           | 166                     |
| Net actuarial gain                               | (114)                   |
| Curtailment and past service                     | 1                       |
| Employer contributions                           | (169)                   |
| Net retirement benefit liability at 4 April 2011 | 300                     |

The Group has taken a number of steps to reduce the defined benefit liability over recent years, including the closure to new entrants in 2007. Furthermore, following the triennial valuation of the Fund at 31 March 2010 and following agreement with the Unions, the final salary section was closed on 31 March 2011. From 1 April 2011 accrual in the CARE section continues for existing members, with a revised benefit structure in operation. The impact of the changes will be a reduction in both the future service charge and in the future employer contributions to the Fund.

The Group paid additional contributions of £99 million into the Fund during the year and will pay a further contribution of £240 million in 2011/12 to remove the funding deficit. This is in addition to £200 million paid between 2005 and 2008 as a result of previous triennial valuations.

In addition to the contributions made during the year, the decrease in the net liability of the Fund also reflects an actuarial gain of £152 million in the measurement of the liabilities, partly offset by a £38 million actuarial loss on the Fund assets. The actuarial gain in liabilities reflects a reduction in the inflation and salary increase assumptions and a switch to the use of the consumer price index (CPI) from the retail price index (RPI) in measuring the liability to deferred pensioners. These impacts were partially offset by an increase in the mortality assumptions which has increased the value of the liabilities.

# Business Review

continued

## Performance by Business Stream

Nationwide classifies its business streams as follows:

### RETAIL

- Prime residential mortgage lending;
- Specialist residential mortgage lending;
- Consumer banking;
- Retail funding;
- Protection and investments;
- General insurance; and
- Distribution channels supporting these product divisions.

### COMMERCIAL

- Commercial lending.

### HEAD OFFICE FUNCTIONS

- Treasury group operations and income generation activities;
- Capital; and
- Items classified as being non-attributable to our core business areas.

### SEGMENTAL REPORTING CHANGES IN THE YEAR ENDED 4 APRIL 2011

During the year ending 4 April 2011, the Group revised the methodology for funds transfer pricing between segments. Accordingly, there have been certain changes in the measurement of business segment net interest receivable compared with the results reported in the 2010 Annual Report and Accounts. There is no impact on the Group income statement or balance sheet; comparative figures have been restated accordingly.

Funds transfer pricing is the mechanism by which the Group recognises the internal cost of funds and allocates this cost between different product groups and business segments to derive individual product margin and net interest receivable. Previously, funds transfer pricing was calculated using a methodology whereby a cost of funds was allocated to a product based on the Group's cost of retail funds ruling at inception of the product and was fixed for the life of the product. Under the new methodology, a single cost of funds representing the

weighted average cost of retail and wholesale funding is allocated across the Group and is updated on a quarterly basis, to better reflect the opportunity cost of funding and the relative performance of the different business segments, based on current market cost of funds.

However, within the Commercial division, the transfer price charged to long term social housing and PFI lending is set to reflect the lower market cost of wholesale funding which was available when this book was originated. This reflects the nature of this lending which did not envisage the current marginal cost of borrowing. Going forward, the transfer price applied to social housing and PFI loans will be assessed based on the movements in the Group's average historic cost of wholesale funding. All other assets in the Commercial division will continue to be charged the weighted average cost of retail and wholesale funds, in line with other assets.

The contribution to underlying profit before tax by each of these business streams is set out in the table below:

|                              | Year to<br>4 April 2011 | Year to<br>4 April 2010<br>Restated |
|------------------------------|-------------------------|-------------------------------------|
|                              | £m                      | £m                                  |
| Retail                       | 424                     | 438                                 |
| Commercial                   | (169)                   | (366)                               |
| Head office functions        | 21                      | 140                                 |
| Underlying profit before tax | 276                     | 212                                 |

## Retail Business

|                                 | Year to<br>4 April 2011 | Year to<br>4 April 2010<br>Restated |
|---------------------------------|-------------------------|-------------------------------------|
|                                 | £m                      | £m                                  |
| Total income                    | 1,754                   | 1,823                               |
| Expenses                        | (1,144)                 | (1,156)                             |
| Impairment and other provisions | (186)                   | (229)                               |
| Underlying profit before tax    | 424                     | 438                                 |

The underlying profit before tax from the Retail business has declined by £14 million in the year to £424 million (2010: £438 million).

Total income has fallen by 4% to £1,754 million compared with the previous year. Net interest fell by £120 million, due to margin compression in a low interest rate environment and the higher cost of liquidity, being partly offset by a release in the fair value adjustment of acquired portfolios of £33 million. Non-interest income grew by £51 million driven by strong performance from protection and investments, and current accounts.

The retail impairment and other provisions charge of £186 million represents a residential impairment charge of £101 million (2010: £89 million), a charge in relation to consumer banking of £83 million (2010: £126 million) and a charge of £2 million (2010: £14 million) in respect of various customer claims.

The residential charge of £101 million represents a prime residential charge of £32 million (2010: £10 million) and a specialist residential charge of £69 million (2010: £79 million). Asset quality remains strong, and the underlying arrears rate has remained stable at 0.68%. The prime residential charge has increased by £22 million and is largely attributable to more conservative default assumptions reflecting the current macro economic environment. In addition, impairment calculations have been updated to include a provision in relation to forbearance cases. The charge for specialist lending reflects an improvement in the arrears rate as a result of continuing stability in payment performance supported by the low interest rate environment. The charge for consumer banking has reduced by £43 million, driven by a reduction in delinquent balances.

### RESIDENTIAL MORTGAGE LENDING

#### Prime residential mortgage lending

The UK housing market remains subdued but stable with transaction levels at 46% of their peak. Future headwinds remain, most notably with regards to wider economic challenges and ongoing regulatory change. Despite these conditions the aspiration for home ownership in the UK remains as strong as ever.

Nationwide has focused heavily on the house purchase market this year and on two particular customer segments – first time buyers and our existing mortgage customers. First time buyers have benefitted from a range of offers throughout the year and in addition they can access impartial help and information through our Nationwide Education website.

We continue to support our existing customers moving house with a 5% deposit and provide additional support to existing customers

even where they are in negative equity where they are of good quality and there is a sound reason for moving.

Remortgaging remains subdued, although activity has begun to increase as borrowers consider their response to the impact of future increases in interest rates. The decision to move to a new product can be complex and we provide customers with a competitive range of switching and remortgage products – including our commitment to provide existing loyal customers with a better deal compared with an equivalent new customer.

We have continued to lend in a prudent and responsible manner, to support our core mortgage markets. Group gross residential lending, including specialist lending, was £12.8 billion (2010: £12.0 billion), representing a market share of 9.5%. Prime residential gross lending was £9.8 billion (2010: £10.3 billion).

Our long term commitment to prudent and responsible lending is reflected in our strong arrears performance. Nationwide originated prime residential mortgage cases 3 months or more in arrears was 0.53% (2010: 0.52%). Repossession remains a last resort and we provide individual support to customers in financial difficulties, even if they are not yet in arrears.

#### Specialist residential mortgage lending

The Buy to Let sector returned to growth throughout 2010 as landlords benefitted from falling void periods and rising rents. At the same time competition increased and the first new market entrants since the onset of the credit crisis moved to take advantage of the improvements which saw gross market lending increase to £11.2 billion, up 32% year on year. The outlook for the coming year remains broadly positive, gross lending is forecast to increase again and more mainstream lenders have indicated their intention to enter the sector in 2011.

The Group's Specialist Lending division continues to focus on originating high quality Buy to Let loans through The Mortgage Works (TMW). Gross lending through the brand during the financial year was £3.0 billion (2010: £1.7 billion) making TMW one of the most influential lenders in the sector.

The overall specialist book has grown during the last 12 months to £20.3 billion (2010: £18.7 billion); in the low base rate environment retention at maturity remains strong. These low rates, combined with the generally favourable conditions present in the Buy to Let market, have further reduced TMW's arrears levels, which continue to run well below the overall market level for specialist loans.

# Business Review

## continued

### CONSUMER BANKING

Our focus continues on growing a more diverse business through growth in our consumer banking portfolio. Consumer banking already provides a valuable income stream for the Society; however, there is opportunity to increase market share and challenge the larger high-street providers through creation of strong current account relationships.

During 2010/11 more than 353,000 new current accounts were opened, an increase of 118% on the previous year. The total current account base is in excess of 5 million accounts, of which around 51% are considered main accounts. Market share of current account stock (of main accounts) has increased to 6.1% from 5.6% at the end of the previous year.

In August 2010 FlexAccount was relaunched with a new proposition, offering increased value by rewarding main customers with free European travel insurance. Main current account customers have also benefitted from a range of linked 'Flexexclusive' products offers throughout the year. These include preferential loan rates, mortgages and credit cards. To encourage greater customer activity, over 1.3 million cash card customers were given a VISA 'Cash Card+', allowing them to use their accounts at point of sale. FlexAccount continues to be a *Which?* 'Recommended bank account provider' and has retained its *Defaqto* 5 star rating for 2011.

The Society continued to offer a strong credit card proposition during 2010/11. Success at the Card & Payments Awards saw the Society win the 'Most responsible credit card lending practices' for the fourth year running. New card sales totalled 298,000, which represents a significant increase over 2009/10 sales of 125,000. The new Nationwide Credit Card was launched in February 2011, offering competitive introductory balance transfer and purchase offers including the ability to earn free foreign usage. In the first full month since launch record sales of over 60,000 were recorded following a very positive press reaction. Market share of active accounts (stock) increased from 2.5% to 2.9% over the period, with total live accounts standing at nearly 1.5 million accounts, an increase of 0.1 million accounts on 2009/10.

Throughout the period we continued to offer competitively priced personal loans, including top high street pricing for much of the year, despite an increasingly competitive market place. Customers holding a main FlexAccount exclusively benefitted from our best high street rate, and we grew our online volume through an exclusive offer with a leading comparison website. Development of our risk based pricing approach continues, ensuring an appropriate price for a given risk profile. New loan sales for the year increased by 23% on the previous year totalling over 82,000.

### RETAIL FUNDING

Retail deposits continue to be the primary source of funding for our retail lending activity. Nationwide has significant scale in this market with customer balances of £122.6 billion.

Our status as a mutual, customer-owned organisation is central to our proposition and in November 2010 we articulated how this would tangibly affect the way we do business through our 'Savings Promises'. These have been well received by customers and other stakeholders and we believe that delivering on these promises will be at the heart of our future success.

Our commitment is to provide long term good value savings products to our members and we continuously manage our range to achieve the optimum balance between flow, margin and member benefit. Despite challenging economic and market conditions we achieved a net inflow of funds over the year.

We recognise that the current low rate environment is challenging for savers and have responded by launching a number of new and innovative products. Champion ISA and e-ISA were both launched in February 2010 and achieved significant net inflows in the year. We also brought a market-leading online product, MySave Online Plus, to market in September which has also attracted significant net inflows since launch.

Our second Savings Promise is to reward existing savers with exclusive products. The Christmas Loyalty Bond and Christmas Loyalty ISA launched in November 2010 were the first such products and a second, highly competitive ISA product was delivered for the 2011 ISA season.

Looking ahead we are planning a number of new product launches in the new financial year that will support our strategy of helping members at this time whilst also diversifying the Group's sources of funding.

### PROTECTION AND INVESTMENTS

Our Protection and Investments business has been extremely successful in the year. The performance for 2010/11 has been driven through the embedding of product and propositions over the last 12 months combined with a strong Retail performance. In total we sold over 313,000 investment and protection products during the year and now have in excess of £5 billion of investment assets under management.

We continue to regularly review the investment fund panel and will make further improvements at the start of 2011/12 with the addition of funds appealing to customers at both ends of the risk spectrum. Significant progress continues to be made across all workstreams including product and point of sale in preparation for the FSA's Retail Distribution Review (RDR) launch on 1st January 2013.

The Income Protection and Life and Critical Illness Cover products offered by Nationwide Building Society are rated 5 Star by Defaqto. The absolute number of complaints continues to fall despite a rapid rise in book size.

## GENERAL INSURANCE

Our household book of policies continues to grow through strong retention and effective member-focused propositions such as 'Double Discount', providing an increased discount for existing customers purchasing a new buildings and contents policy.

Nationwide's car insurance book size increased by 39% in the year following launch in the aggregator/price comparison channel.

## DISTRIBUTION CHANNELS SUPPORTING THESE PRODUCT DIVISIONS

Our distribution business delivered a strong performance during the year. Group Distribution maintained its focus on driving out surplus cost, increasing productivity, embedding a high performance culture and further enhancing the customer experience. Sales of current account products increased by 118% compared with 2009/10 and we saw impressive growth in our other income. Nationwide continues to evidence high levels of customer satisfaction with our branch network, internet bank and telephone channels. A high level of satisfaction was also evident amongst mortgage intermediaries.

The branch network remains the most popular channel of choice for our customers. During the period, a range of measures were

implemented to migrate certain types of transactions normally undertaken at the counter to alternative channels, increasing the time available for individual customers and reducing queue lengths. Customer usage of telephone and internet channels continues to grow, with monthly Internet Bank sign ons growing by 10%.

The Group continued to assess the structure and shape of its branch network. Whilst in some branch sites we have invested to increase capacity, we also announced the closure of 17 branches where local member usage failed to justify the costs. As part of the review of distribution strategy, Nationwide also withdrew from third party agencies as of 31 December 2010, having concluded that this model was no longer economically sustainable.

Investment continues in all channels, underpinning Nationwide's long standing commitment to its retail customers, combined with the need to maintain a focus on enhancing commercial performance. As part of our ongoing support to the mortgage intermediary market during these difficult times, we also began offering prime mortgages through our intermediary dedicated TMW brand. Our new online mortgage system for intermediaries has further improved our service delivery and reinforced our reputation for excellence.

# Business Review

continued

## Commercial Lending

|                                 | Year to<br>4 April 2011 | Year to<br>4 April 2010<br>Restated |
|---------------------------------|-------------------------|-------------------------------------|
|                                 | £m                      | £m                                  |
| Total income                    | 38                      | (31)                                |
| Expenses                        | (32)                    | (36)                                |
| Impairment and other provisions | (175)                   | (299)                               |
| Underlying profit before tax    | (169)                   | (366)                               |

The Commercial business made a £169 million loss in 2010/11 despite an improved income performance and a reduced impairment charge for the year. Changes to the Society's internal funds transfer pricing methodology resulted in net margin income for 2009/10 being restated from £213 million to negative £31 million.

Commercial lending income has improved by £69 million compared with last year, supported by the widening of margins and by fees, particularly the repricing of maturing loans and where restructures have been agreed with borrowers. Additionally, the business has continued to tightly control expenditure and delivered an ongoing reduction in the cost base.

Including assets acquired via the mergers with the Derbyshire, Cheshire and Dunfermline building societies, the commercial lending portfolio of £22.0 billion comprises £12.3 billion secured on commercial property (Property Finance), £8.2 billion advanced to Registered Social Landlords and £1.5 billion under the Private Finance Initiative.

The Property Finance portfolio is diverse both in terms of sectors and geographic spread and is considered to have a low risk profile within the industry, with no equity exposure or house builder exposure. Higher risk, Nationwide originated exposures to development is limited to £172 million. Development exposures are to three high quality London office projects, all of which are performing assets.

Since the July 2009 low point, prime UK commercial property values have increased 17% (IPD March 2011). However, market conditions have remained challenging as regional and secondary property performance has remained much more subdued both in terms of pricing and transaction activity.

Having tightened new lending criteria and reduced volume targets at the onset of the downturn in the property market, the Commercial division has primarily focused on loss mitigation through arrears management, debt restructures and accelerating loan reviews during 2010/11.

All new lending has been in lower risk sectors on a very selective basis to take advantage of widening margins. During the year, the business lent £1.6 billion gross, of which £640 million was lending for commercial property investment.

Over the last twelve months, the impairment charge was £175 million, compared with £299 million in the previous year. The principal drivers of provisions in the commercial portfolio are: covenant breaches on LTVs as a result of falls in capital values; reduced tenant demand, either as a result of tenant failure, or reduced ability to cure void periods at the end of lease terms; and business failures on owner occupied properties. The performance of the core Society originated loan portfolio has improved, with arrears levels stabilising and impairments improving in 2010/11, aided by the recovery in the UK economy. However, the fragility and slow pace of the economic recovery, along with deep public sector cuts, inevitably pose an ongoing risk to the sector. Notwithstanding these challenges, we continue to expect a continuing downward trend in impairments over the next few years.

Registered Social Landlords and Private Finance Initiative portfolios have not experienced any losses and there are no arrears at 4 April 2011. Both of these books are still deemed to be low credit risk due to the involvement of Government in regulating Registered Social Landlords and providing income streams to Private Finance Initiative projects.

During the second half of 2010/11 the Commercial business has developed a deposit product for existing customers in conjunction with Nationwide International. As at 4 April 2011, deposits of £98 million have flowed into Nationwide since launching the product in September 2010, thus broadening Commercial's product range and opening up a new source of balance sheet funding.



## Head Office Functions

|                                 | Year to<br>4 April 2011 | Year to<br>4 April 2010<br>Restated |
|---------------------------------|-------------------------|-------------------------------------|
|                                 | £m                      | £m                                  |
| Total income                    | 190                     | 303                                 |
| Expenses                        | (103)                   | (92)                                |
| Impairment and other provisions | (66)                    | (71)                                |
| Underlying profit before tax    | 21                      | 140                                 |

Contribution from Head Office Functions was £21 million (2010: £140 million).

Total income of £190 million is £113 million lower than the previous year and reflects the higher cost of wholesale funding and lower gains compared with prior year from the management of the liquidity portfolio.

Administrative expenses have increased by £11 million, reflecting higher corporate costs and increased investment spend on managing regulatory change.

Impairment and other provisions of £66 million relates to impairment losses on Treasury investments, as outlined on page 17. The prior year comparative also included a charge of £36 million in relation to loan losses on a portfolio of European commercial loans, acquired by our Treasury division. The Treasury investments impairment charge of £66 million includes £22 million for a small number of US RMBS exposures, £15 million on a UK CMBS and £11 million on notes of a restructured SIV.

## Risk Management and Control

### OVERVIEW

Nationwide seeks to manage appropriately all the risks that arise from its activities. The principal risks inherent within the business are credit risk, liquidity and funding risk, market risk, and operational risk.

There is a formal structure for monitoring and managing risks across the Group comprising a risk appetite agreed by the Board Risk Committee on behalf of the Board, detailed risk management policies, and independent governance and oversight of risk.

The statements of risk appetite set out the parameters within which the business activities of the Group are required to be conducted. These overarching parameters are reflected in the key processes of corporate management, which the Board oversees:

- corporate planning, strategy and performance review;
- capital and liquidity planning; and
- risk management for the Group.

Detailed risk management policies document Nationwide's approach to the management and appetite for specific risks. These policies, including associated limits, are owned by the Board. Policies are reviewed annually and are also subject to continuous monitoring by the Board Risk Committee, Executive Risk Committee and the sub-committees of the Executive Risk Committee. The principal committees set out overleaf are included in the Group's governance framework. The detail shows some of the principal areas of responsibility with respect to risk management set out within their terms of reference.

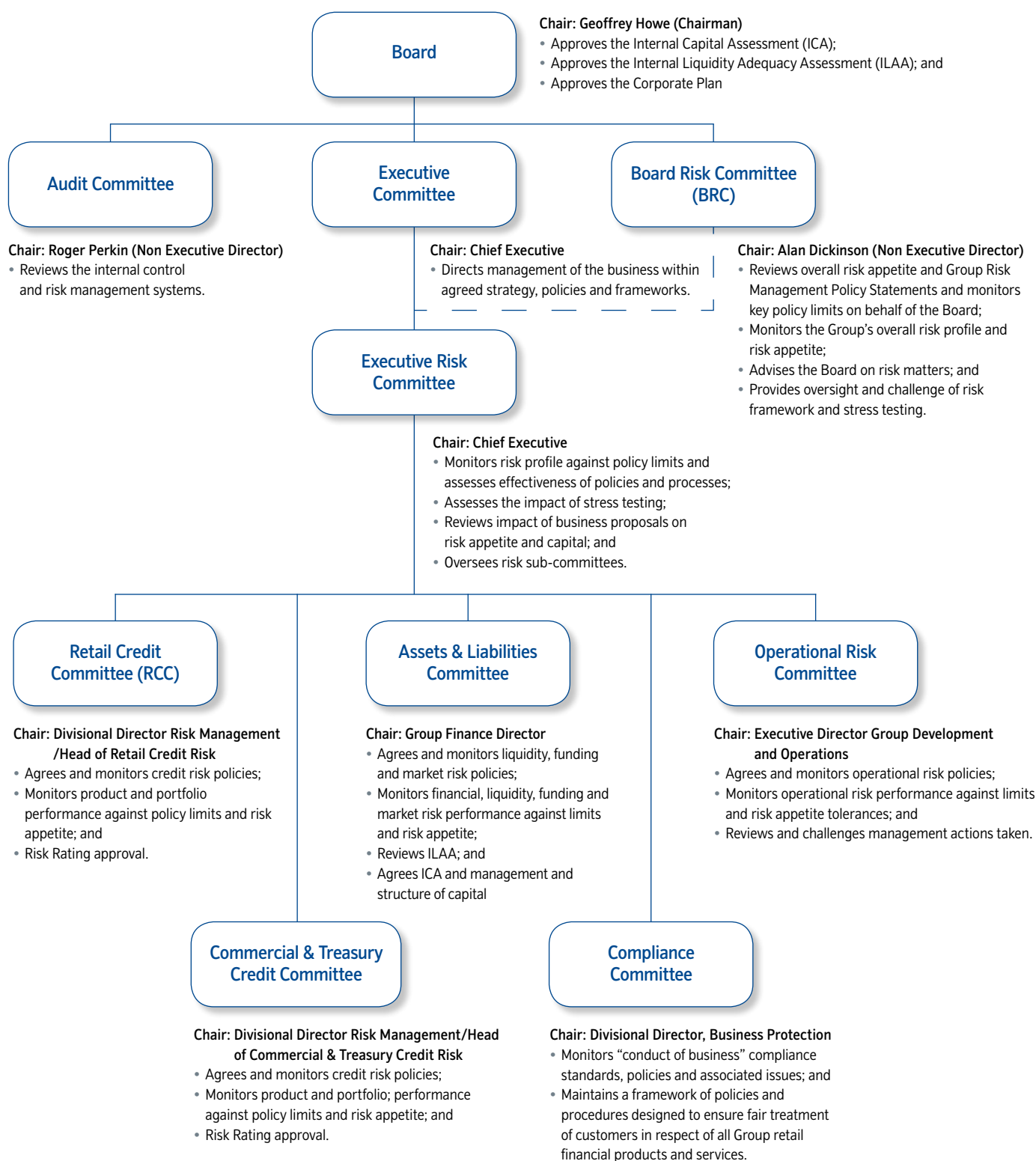
Risk governance is provided by a structure comprising seven key risk management committees. Each committee includes appropriate representation from amongst the non-executive (Board Risk Committee), executive and divisional directors, as well as from the Risk Management division:

- Board Risk Committee, which has responsibility for overseeing the risk framework, reviewing policies and risk appetite, and making recommendations to the Board;
- Executive Risk Committee, which has responsibility for ensuring a co-ordinated management approach across all risks and oversight of the risk committees listed below;
- Retail Credit Committee, which has responsibility for retail credit risks;
- Commercial and Treasury Credit Committee, which has responsibility for non-retail credit risks;
- Assets and Liabilities Committee, which has responsibility for market, liquidity, capital and funding risks;
- Operational Risk Committee, which has responsibility for operational risks; and
- Compliance Committee, which has responsibility for policies and procedures to ensure the fair treatment of customers and for compliance standards for the Group.

The Group operates with clear independence of responsibilities for risk governance and oversight in accordance with best practice within the industry. Primary responsibility for managing risk and ensuring controls are put in place lies within the business units themselves.

# Business Review

continued



The principal risks to which the Group is exposed are credit risks, market risks, funding and liquidity risks and operational risks. Oversight for these risks is provided by specialist functions within the Risk Management division, which are independent of the business units for the following risks:

- **Retail Credit Risk;**
- **Commercial and Treasury Credit Risk;**
- **Market, Liquidity and Funding Risk; and**
- **Operational Risk.**

The role of these functions is to maintain and review risk management policies, establish limits that are consistent with risk appetite, monitor and report on compliance with those limits, and to provide an oversight role in relation to the management of risk, including concentrations where appropriate.

A further specialist risk function focuses on capital planning, stress testing, Group risk management policies, risk appetite, and associated analysis and reporting for the Group.

Other risks may also affect the Group, including business risk, people risk, financial crime risk, regulatory compliance risk, legal risk and tax risk. Certain of these are managed within the operational risk framework and are detailed in that section, with business risk and tax risk covered separately. Insurance products are provided by a third party; the Group is not, therefore, exposed to insurance underwriting risks.

Group Internal Audit, which ultimately reports to the Audit Committee, provides independent assurance regarding the activities of business units and the specialist risk functions within Risk Management division. Information about the role of the Audit Committee can be found in the Corporate Governance section of this report.

Further detail of risk exposures will be available in the Pillar 3 Disclosures by August 2011 on the website:

**[nationwide.co.uk/about\\_nationwide/results\\_and\\_accounts/](http://nationwide.co.uk/about_nationwide/results_and_accounts/)**

## PRINCIPAL RISKS

### Credit risk

Credit risk is the risk of suffering financial loss should a borrower or counterparty default on their contractual obligations to the Group. Credit risk arises from residential mortgages, unsecured lending, commercial lending, liquidity and other investments, and derivatives used for hedging purposes by the Treasury division.

Comprehensive credit risk management methods and processes are established as part of the Group's overall governance framework to measure, mitigate and manage credit risk within its risk appetite. As a mutual, the Group maintains a low risk appetite evidenced by the quality of its balance sheet which is documented in the Balance Sheet section of the Business Review. Credit risk portfolios are managed within concentration limits and are subjected to stress testing and scenario analysis to simulate outcomes and calculate their associated impact.

### Market background

The key drivers of current retail credit risk for residential mortgages and unsecured lending include the slowdown in the UK economy

leading to higher unemployment, deterioration in household finances due to inflation or other pressures, and house price deflation. The extent of further economic slowdown, its impact upon arrears performance and falls in house prices affect the level of impairment losses.

Nationwide's principal commercial lending exposure is to the property investment sector. Other lending is to Registered Social Landlords and funding for accommodation and infrastructure projects originated under the Government's Private Finance Initiative. The historic focus of lending assessment based on the strength and robustness of the rental income streams derived from properties charged to Nationwide, rather than collateral values, has afforded the Group significant protection during a period of substantial falls in property values. Under difficult economic conditions, however, borrowers' ability to fulfil their commitments has been increasingly exposed to the risk of tenant failures, lower demand and occupancy levels, increased void periods and associated costs. These factors, when combined with reduced collateral values, have had a significant adverse effect on impairment losses.

Wholesale credit markets have improved consistently during the year and this is reflected in a further positive movement in mark-to-market adjustments in the Group's portfolio of available for sale assets year on year. The improvement supports our continued expectations that there will be only modest incidence of impairment in Nationwide's liquidity and investment portfolios.

### Risk management response

#### a) Retail credit risks

Retail credit risk is managed using automated decision systems that are provided centrally by the Retail Credit Risk function in Risk Management division. The decision systems differentiate between credit risks for residential mortgage loans and other consumer products and services. An underwriting unit also considers those applications for Society mortgages and unsecured loans that require individual underwriting. Underwriting for specialist mortgages is carried out within the relevant subsidiary, with oversight provided by Risk Management division. All risk management policies and limits in respect of retail credit risk are maintained by the Retail Credit Risk function and owned by the Retail Credit Committee. This committee receives regular reports from Retail Credit Risk about the performance of all retail credit portfolios.

In respect of residential mortgage businesses, the focus remains on the quality of the loans advanced. Nationwide will continue to monitor closely applicant quality defined in terms of credit, loan to value and affordability profile. In the light of current market conditions, tightened lending criteria have been maintained and this will continue to be reviewed. Nationwide remains cautious on unsecured retail lending, given economic conditions, and will continue to prioritise quality of lending ahead of volume.

Forbearance options are considered on a case-by-case basis and are in line with industry guidance and practice. These include capitalisation, interest only concession, payment holiday and term extension for secured products, and payment plans for credit cards. Across both the secured and unsecured portfolios, all account management / forbearance options are either low in materiality or fully recognised within provisioning. Further detail can be found in note 39.

# Business Review

## continued

The Group's collections and recoveries functions aim to provide a responsive and effective operation for the end-to-end arrears management process. This encompasses early two-way communication with borrowers, obtaining their commitment to maintain payment obligations and re-establishing a regular payment habit. Activity encompasses a multitude of functions, including, but not limited to: establishing repayment plans, including appropriate forbearance and managing Individual Voluntary Arrangements (IVAs) through to exiting of customers' relationships taking possession and selling mortgaged properties, and ultimately the closure of customers' accounts. Experience in these areas allows for continual feedback into the underwriting process across the overall credit lifecycle covering origination, account management and recovery.

### b) Commercial credit risks

Responsibility for new business generation, customer relationship management and account administration rests with Commercial division. Responsibility for the overall quality of the lending book and the adequacy of credit procedures and controls rests with the Commercial Credit Risk Function within Risk Management division and the Commercial and Treasury Credit Committee.

All commercial lending is approved and controlled via a system of hierarchical mandates held independently of the line management responsible for business development. Systems are in place to ensure that compliance with statutory and regulatory requirements is applied across the Group for all commercial lending activities.

Nationwide's commercial risk appetite remains under active consideration; it is regularly reviewed in the light of changing economic and market conditions and is also subject to annual review.

Nationwide remains cautious about commercial lending and will continue to prioritise quality of lending ahead of volume targets. As such, commercial lending is undertaken on a prudent basis, focusing activity on lower risk commercial sectors. The Group remains committed to providing finance to good quality businesses and, in particular, is attracted to high quality propositions secured on property and/or supported by long-term covenanted income. Nationwide continues to operate within a framework of conservative credit criteria, principally focusing upon the underlying income stream and debt servicing cover rather than property value.

Concentration risk within the commercial portfolio is controlled and monitored via a series of credit exposure limits, which are aimed at producing a diverse portfolio. Nationwide further reviews its concentration exposure in terms of industry category, geographical distribution, maturity profile and risk profile.

The Commercial Credit Risk team maintains the policy and limits in respect of commercial credit risk, and monitors compliance with the limits providing reports to the Commercial and Treasury Credit Committee about the performance of the commercial portfolios. Constraints may be imposed on any aspect of the Group's commercial lending activities in response to any concerns highlighted by the Group's portfolio monitoring, or in response to economic or market factors or changing business needs.

Commercial lending relationships are subjected to regular reviews, at least once a year, to ensure that facilities are fully performing in accordance

with the terms of original sanction and provide an opportunity to review Nationwide's exposure to each counterparty in the light of the most recently available financial and non-financial information and to refresh risk rating data.

Renewals and review frequencies are more intense for those borrowers perceived to be higher-risk. Watchlist procedures have been established which comprise four categories graded in line with the perceived severity of the risk. The watchlist is designed to identify cases of potential cause for concern, often before arrears arise, in order that mitigating action may be initiated at the earliest opportunity. The watchlist is monitored and updated on a daily basis and monthly meetings take place between Commercial division and the Commercial Credit Risk team to review all the watchlist cases. A watchlist summary is submitted for discussion and review at the Commercial and Treasury Credit Committee meeting. The emphasis is on the proactive management of existing exposures, portfolio management and stress testing capabilities to further enhance Nationwide's ability to identify and respond appropriately to emerging risk issues.

Under the arrears management policy, procedures remain in place that result in early identification of customer difficulties which are managed by appropriate mandated officers to enable requisite remedial action to be authorised and taken. Nationwide also has a specialist commercial recoveries team where accounts are transferred when certain, more severe trigger events occur. When accounts are in default, careful consideration is given to the most appropriate strategy likely to result in the best outcome for Nationwide and the customer. Nationwide's net risk position is always fully considered and assessed on an individual deal basis; where the lending is considered at risk that measurement is formalised so that if a potential expected loss position is identified, specific provision is always considered.

Actual commercial provision charges have reduced year on year reflecting stabilisation within the sector, after several difficult years. However, many challenges remain with the economy sluggish and property prices, especially for secondary assets, remain under pressure. The retail outlook is also subdued and likely to continue to put pressure on tenants, so it may be several years before impairment levels return to pre-crisis norms.

### c) Treasury credit risks

Treasury credit risk arises from the investments held by Treasury division in order to meet liquidity requirements and for income generation purposes. Treasury division is responsible for managing this aspect of credit risk within operational limits as set out in the Group's risk management policy, with oversight provided by the Treasury Credit Risk function within Risk Management division.

The approval and control of all Treasury credit lines within the Group takes place through a hierarchical system of delegated lending mandates, independent of Treasury division. Treasury Credit Risk underwrites all new facilities, monitors existing facilities, maintains the policy and limits, monitors compliance with the policy and limits, and provides reports to the Commercial and Treasury Credit Committee about the performance of the Treasury portfolios.

Nationwide's Treasury risk appetite remains under active consideration and is regularly reviewed in response to any concerns highlighted by portfolio monitoring, or in response to economic or market factors or changing business needs. In this respect, the Group has maintained the quality of its liquidity portfolio by increasing the weighting to a tightly restricted list of highly-rated sovereign exposures and this is expected to continue.

All credit lines and exposures are reviewed on at least an annual basis, which entails a comprehensive analysis of the counterparty's financial performance, their ratings status and recent developments to ensure that the agreed credit limits remain at appropriate levels. Review frequencies are more intense for those counterparties perceived to be of higher risk; this is daily in certain circumstances.

All assets in the Treasury portfolio are subject to continued monitoring and review. Adverse trends will result in the asset being placed on a watchlist, which crystallises dedicated attention from both Treasury and Risk Management divisions. Watchlists comprise three categories graded in line with the perceived severity of the risk and are presented to the Commercial and Treasury Credit Committee for ongoing, proactive management and consideration of the proposed risk mitigation strategies. Watchlist assets receive increased focus and enhanced monitoring and modelling techniques to enable forward-looking assessments of timing and magnitude of likely impairment or risk mitigation possibilities such as disposals.

Actual impairment decisions are based on the guidance given by IAS 39 and the type of instrument involved. A combination of fundamental credit analysis, stress testing and forward-looking cash flow analysis is used. Market information such as pricing and rating agency information is also taken into consideration in forming a view with regard to whether an impairment trigger has been evidenced.

The non-liquidity book is in run-off and subject to close daily monitoring. New discretionary investments are subject to very limited mandates and a rigorously defined risk appetite that only includes high-grade collateralised securities.

#### Liquidity and funding risk

Liquidity and funding risk is the risk that the Group is not able to maintain, or maintains at excessive cost, the capability to:

- meet its financial obligations as they fall due;
- smooth out the effect of maturity mismatches; or
- maintain public confidence.

#### Market background

In order to ensure that the Group continues to meet its funding obligations and to maintain or grow its business generally, the Group has developed comprehensive liquidity and funding policies. The Group's operations are funded primarily from retail sources, supported by a well-diversified wholesale funding capability. A high quality liquid asset portfolio is also maintained.

Since June 2010, the Group has reported its liquidity position against Backstop Individual Liquidity Guidance (BILG) provided by the FSA for regulatory purposes. The FSA announced in November 2010 its decision to calibrate the UK liquidity regime once it has received final guidance from Europe. The Basel Committee of Banking Supervisors (BCBS) issued guidelines for liquidity risk management in December 2010. These guidelines include a Liquidity Coverage Ratio (to promote the short term resilience of a bank's liquidity risk profile) and a Net Stable Funding Ratio (to provide a sustainable maturity structure of assets and liabilities).

Following extreme conditions in 2007-2008 the wholesale markets have improved although not to pre-2007 levels in terms of cost and availability. Sovereign and bank creditworthiness considerations, together with geo-political changes, create a new operating environment for banks and building societies.

The maturity and withdrawal of Government-guaranteed funding (Special Liquidity Scheme (SLS) and Credit Guarantee Scheme (CGS)) are expected to impact the availability and cost of both wholesale and retail funding in the forthcoming year.

Conditions in the wholesale market, along with an historically low interest rate environment, have led to increased competition and increased cost of retail savings, significantly influenced by institutions that are pursuing retail funding to replace potentially unavailable or expensive wholesale funding.

Nationwide, as a leading UK mortgage lender and savings institution, has been impacted by these developments. It has been appropriate for the Group to take a prudent and flexible approach in its continuing ability to raise funds in the wholesale and retail markets.

#### Risk Management response

Management has focused on its current and future funding strategy and embedding its revised liquidity risk appetite within the new regulatory framework. In line with internal risk appetite and regulatory requirements (including the new Basel framework), Nationwide has sought to further improve its systems for measuring and managing liquidity risk exposure, including management reporting systems, the pricing of risk and stress testing.

Liquidity risk is managed against limits using a number of stress scenarios. A number of these scenarios are provided by the regulators, while others are developed internally and cover a wide range of conditions aligned with the Society's programme of corporate stress testing.

The Group has actively managed its funding profile during the year and has issued in excess of £4 billion in the secured long-term debt markets through public issuances of Covered Bonds and RMBS. These issuances

# Business Review

continued

have provided breadth and diversification to the previous year's unsecured deals and have enabled the repayment of short-term repurchase transactions and prepayments to the Bank of England Special Liquidity Scheme. The public issuances included a second RMBS in Euros and US dollars that raised £1.5 billion Sterling equivalent and a landmark £0.75 billion 15-year Covered Bond, which successfully established the Sterling Covered Bond market.

The quality of the Group's liquidity has been increased to focus on the highest quality Government-issued debt. The proportion of short-term funding has been significantly reduced, whilst the duration of term funding has been extended, and the overall funding requirements have been actively managed. The subdued mortgage market and limited growth in retail savings markets, as a result of economic conditions, have tended to naturally restrict balance sheet growth.

Executive management meets on a frequent basis to review the business plans and liquidity position of the Group. The maturity profile and refinancing of funding transactions will continue to be a significant factor within business decisions.

The Group remains 70-75% funded from retail sources, maintains high levels of core liquidity, and continues to be perceived as a safe harbour for savings.

## Market risk

Market risk is the risk of changes in the value of, or income arising from, the Group's assets and liabilities as a result of changes in interest rates, exchange rates, or other market indices.

## Interest rate risk

### Market background

Interest rate risk arises from the mortgage, savings and other financial services products that Nationwide offers. The varying interest rate features and maturities of these products, and the use of wholesale funds to support lending, create exposures to interest risks. This is due to the imperfect matching of interest rates and timing differences on the re-pricing of assets and liabilities. The risk is managed through the use of derivatives and other appropriate financial instruments and through product design.

The contractual terms of products and transactions determine the flexibility to manage net interest margin. In the current low interest rate environment, this flexibility has been constrained by a natural floor, at zero percent, for banking and savings rates, and a contractual ceiling for Base Mortgage Rate (BMR), relative to the base rate. New mortgages written by the Society do not contain a contractual cap relative to Base Rate in order to increase flexibility in this regard.

The Group's balance sheet exposure to the mismatch between Base Rate and Libor-linked balances reflects current and forecast components of the mortgage and savings portfolios. Within the mortgage portfolio, there has been an increased customer preference for variable rate mortgages during the year, whilst within the saving portfolio demand for fixed-rate bonds has continued to be significant. These components result in a net Base Rate-linked asset position.

Fixed-rate sovereign debt securities are held for liquidity purposes. When swapped into Libor using an interest rate swap, the net market value of the security and swap is subject to changes in the relative credit spreads on sovereign debt and interest rate swaps. This risk is only realised if the debt is sold ahead of maturity (rather than being converted through repurchase agreements), and is subject to a monitoring trigger set by ALCO.

Lower interest rates and the relative easing of the mortgage market have exposed Nationwide to changes in customer behaviour, particularly with respect to early repayment of fixed-rate mortgages. The impact of this has been an increase in early redemption charges, whilst the incentive to remortgage has remained high in the persistent low rate environment.

### Risk Management response

The interest earned on the Group's free reserves has been protected through the policy of investing such balances with an interest rate maturity profile of several years.

Risks relating to products are mitigated through appropriate product terms and conditions, application and offer procedures, as well as close analysis of the product pipeline and early repayment behaviour. Derivative instruments are used to manage various aspects of interest rate risk including the net Base Rate/Libor basis position where appropriate. In doing so, Nationwide complies with the Building Societies Act (1986) restriction to the use of derivatives for the reduction in risk.

The sensitivity of Net Interest Income to changes in the level of interest rates is modelled dynamically for a series of scenarios. Risk appetite for earnings risk is reflected in a series of monitoring limits and triggers, which are applied to such scenario output.

## Currency risk

### Market Background

Foreign exchange risk arises from movements in the foreign exchange market adversely affecting the value of the Group's foreign currency holdings and planned future cash flows. A significant proportion of Treasury funding and investment activity is undertaken in foreign currencies. Some commercial loans, and savings balances taken through operations in Dublin, are denominated in Euros.

### Risk Management response

Foreign currency exposure is hedged through natural offset on the balance sheet or by using derivatives to reduce currency exposures to acceptable levels. After hedging, Nationwide has no substantial net exposure on an economic basis to foreign exchange rate fluctuations or changes in foreign currency interest rates. The Assets and Liabilities Committee sets and monitors limits on net currency exposure.

## Pension obligation risk

### Market Background

The Group has funding obligations for a number of defined benefit schemes, the most significant being the Nationwide Pension Fund ('the Fund'), which is closed to new entrants. Pension risk is the risk that the value of the Fund's assets, together with ongoing employer and member contributions, will be insufficient to cover the projected obligations of the Fund over time. The return on assets, which includes equities and bonds, will vary with movements in equity prices and interest rates.



The projection of the Fund's obligations includes estimates of mortality, inflation and future salary rises, the actual out-turn of which may differ from the estimates. The Fund is also exposed to possible changes in Pension legislation.

#### *Risk Management response*

To mitigate these risks, management, together with the Trustees of the Fund, regularly review reports prepared by the Fund's independent actuaries to assess these risks and take appropriate actions which may, for example, include adjusting the investment strategy and/or contribution levels. The triennial valuation of the Fund was undertaken during 2010/11. Agreement has been reached with the Trustees of the Fund regarding the funding level, cost of future benefits and additional contributions. As a consequence, the Society has committed to make additional contributions to the Fund to remove the funding deficit calculated in the triennial valuation as at 31 March 2010, the first instalment of which was paid during 2010/11. Changes have also been made to future benefit accrual to lower the cost of future benefits.

#### *Operational risk*

Operational risk is a result of the processes Nationwide operates to meet the needs of its members and generate sufficient profit to maintain a financially stable firm. The purpose of operational risk management is to ensure the business puts in place appropriate strategies to manage, avoid, transfer, mitigate and insure the risks that could impact the ability of the Group to meet its strategies and plans and damage its reputation.

Nationwide has adopted the standardised approach to operational risk and has applied the industry standard definition, namely: "the risk of loss arising from inadequate or failed internal processes, people and systems or from external events". This has been aligned to the Group's integrated corporate risk map and ensures that there is effective oversight, monitoring and reporting of the key operational risk exposures facing Nationwide as detailed below:

- **Third Party**
- **Business Continuity**
- **Change**
- **Customer Experience**
- **Financial Control, Payments and Information Management**
- **Financial Crime**
- **Information Security**
- **Information Technology**
- **Legal and Regulatory**
- **People**
- **Premises and Physical Assets**

#### *Operational Risk Framework*

Oversight and governance arrangements for the setting and management of a robust operational risk management appetite, policy and culture are the responsibility of the Board, Board Risk Committee, Executive Risk Committee and the Operational Risk Committee. Each committee has defined Terms of Reference allocating their accountability and responsibilities.

To ensure there is accountability for the effective management of operational risk Nationwide operates a 'three lines of defence' model. Each division, as the first line of defence, has a dedicated operational risk officer. In the second line of defence, the Group-wide network of operational risk officers is supported by a centralised Operational Risk Unit, whose role is to define and implement operational risk policies and processes consistent with corporate objectives, values and risk appetite. The third line of defence is provided through the Group Internal Audit function, which is responsible for reviewing the effectiveness of the operational risk framework.

In order to manage the Group's key operational risks, data is captured at a divisional and risk category level from a variety of sources. These include regular 'control risk self-assessments', internal and external incident analysis, material losses and control failures. The status of the Group risk appetite metrics, significant operational risk exposures, incidents, losses and emerging trends are regularly reported to the Operational Risk Committee, Executive Risk Committee, Board Risk Committee and the Board. This ensures transparency, robust and effective challenge to the business and enables effective strategies to be put in place to ensure risks remain within appetite.

A key objective of the framework is to ensure the Group makes decisions that strike an appropriate balance between risk and reward that is consistent with the Group's overall strategies and risk appetite. To provide additional protection, the Group purchases insurance against specific losses for key risks and to comply with statutory requirements.

#### *Key operational risk categories*

Responsibility for each of the key operational risk categories is allocated to a risk owner, all of whom are Directors or Senior Managers reporting to an Executive Director.

#### *Third Party*

The Group conducts its business in a fair and open manner and is committed to maximising customer value when undertaking expenditure on goods and services. Risks are monitored to ensure appropriate selection and management of third party suppliers and outsourced service providers, including compliance with contract law.

#### *Business Continuity*

The management of a crisis situation to ensure continuity of business is a key priority of the Risk function. The purpose of Business Continuity is to ensure plans are in place to maintain continuity of service for critical activities in the event of disruption caused by an unexpected event ensuring Nationwide:

- maintains a safe and secure business for the benefit of its customers;
- minimises the losses which arise from unexpected events;
- protects the reputation of the Nationwide brand; and
- contributes to the integrity of the UK financial services industry.

# Business Review

continued

## Change

It is recognised that effective change management is essential to meeting corporate objectives. Management of this risk ensures that the Group's project and programme portfolio is aligned to Nationwide's objectives, delivered efficiently, fit for purpose and sustainable.

## Customer Experience

It is essential that Nationwide delivers its customer promise by providing open, honest, good value, fair, safe and secure products and services that perform as customers have been led to expect. The purpose of this risk category is to ensure that customers can be confident that they are dealing with a firm where the fair treatment of customers is paramount, that an appropriate customer experience is consistently delivered and service levels are maintained.

## Financial Control, Payments and Information Management

This category covers management of the risk that would be associated with inefficient, ineffective and inappropriate controls over the Society's financial resources and money transmission. This includes the risks of inaccurate financial reporting and not complying with associated legal and regulatory requirements together with the risk associated with ineffective governance of information.

## Financial Crime

This is the risk of direct or indirect loss resulting from intentional actions or illegal activities by people within or outside the Group. Continuing success for Nationwide depends on maintaining the trust of its customers and controlling fraud losses to minimise the impact on costs and profit.

The Group's Fraud Strategy is designed to:

- minimise the impact of fraud losses on overall costs;
- provide cost-effective management of fraud prevention, detection and investigation;
- create a Group-wide anti-fraud culture that deters internal and external fraud; and
- meet regulatory requirements in respect of fraud management.

Nationwide combats fraud across all existing and emerging products, processes and channels, through the exploitation of technology and promoting awareness of fraud to customers and employees. This is supported by a portfolio of projects managed under the banner of the Strategic Fraud Initiative, which was established in 2005 to enhance the Group's fraud prevention approach. Key initiatives include enhancements to detection systems for card fraud and further development of systems and processes for mitigating employee and mortgage fraud.

## Information Security

Nationwide regards information as a highly valuable asset and the protection of its customers' information as a key priority. Accordingly, Nationwide strives to ensure that the confidentiality, integrity and availability of its information and business systems are maintained and controlled, limiting exposure to the risks arising due to loss, corruption, misuse or theft of its information assets.

## Information Technology

The risk associated with the failure (or inadequate management) of technology and the data captured, stored, processed and output via that technology. This risk is managed through the Information Technology division. Its objective is to ensure that a stable, secure and reliable IT environment is provided to support the business, and that both systems and data are secure from unauthorised access and usage.

## Legal and Regulatory

As a regulated firm, Nationwide places significant importance on managing the business in a way that effectively manages the risk of fines or censure through non-compliance with laws and regulations. Oversight of legal and regulatory risks comprises ensuring that laws and regulations are not breached.

Nationwide identifies all material legal and regulatory requirements and relevant voluntary codes and standards affecting the Group and works with business areas to determine how they apply. This is supported by review mechanisms to ensure compliance with material regulatory and legal obligations and a suite of Key Risk Indicators. This enables the business to monitor progress against the key legal and regulatory risk exposures and take action where we are operating outside of risk appetite.

This framework of support, challenge and monitoring:

- enables the Board and senior management to discharge their responsibilities and satisfy legal and regulatory requirements;
- supports the business to achieve the Corporate Plan in a compliant manner;
- ensures relevant legislation, regulations, codes and standards are fully complied with;
- ensures regulatory compliance is consistent and effective across the Group;
- prevents and minimises penalties and litigation arising from non-compliance; and
- ensures reliable professional advice is sought on legal matters in order to select the optimum solutions.

The Compliance Committee monitors retail 'conduct of business' compliance standards, policies and issues, across Group product areas, distribution channels and servicing teams.

## People

One key differentiator of Nationwide's strategy is its people. As such, Nationwide is committed to ensuring that it effectively manages the risks associated with recruiting, developing, motivating, rewarding and retaining the required number of people who are competent and have the right skills within their role. This also includes the risk of not complying with people-related legal and regulatory requirements.

## Premises and Physical Assets

Nationwide ensures appropriate premises and physical assets are available to fulfil business operational needs. This means ensuring adequate, safe and secure premises are in place that conform to all relevant regulatory bodies' rules and regulations and provide a safe and healthy environment.



## OTHER RISKS

### Reputational risk

A core part of the success of the operational risk framework is understanding and acting on the key causes and drivers of reputation and how these are managed and influenced across the business. Nationwide has defined reputation risk as “the risk to earnings, liquidity or capital arising from negative public / market opinion. This can affect the future prospect of growth / value generation, the ability to establish new relationships / services, or could cause the Group to be less able to service existing relationships. This can expose the firm to litigation, financial loss, or damage to its reputation and is inherent across the Group”.

### Business risk

Business risk is the potential loss due to changes in the competitive environment or events which damage the franchise or operating economics of the Group. The Group devotes substantial management and planning resources to the development of strategic plans for organic growth and identification of possible mergers and acquisitions which balance the generation of value for its members, the delivery of enhanced products and services and the need to generate sufficient profit to maintain a financially stable firm. This is encapsulated in the Group's Corporate Plan, which is approved by the Board. The Board is provided with regular reports on the Group's key strategies and plans to ensure progress is consistent with the Group's risk appetite.

If these strategic plans are not delivered as anticipated, the Group's earnings could grow more slowly or decline. In addition, potential sources of business risk include revenue volatility due to factors such as macroeconomic conditions, inflexible cost structures, uncompetitive products or pricing and structural inefficiencies.

### Tax risk

The Group is subject to the tax laws in all countries in which it operates, but principally this risk is UK based. Tax risk is the risk associated with changes in tax law or in the interpretation of tax law when applied to business activities. It also includes the risk of changes in tax rates and the risk of failure to comply with procedures required by tax authorities. Failure to manage tax risks could lead to additional tax charges and a corresponding reduction to profit after tax. It could also lead to financial penalties for failure to comply with required tax procedures or other aspects of tax law. Effective and well documented processes are in place to minimise the risk of tax compliance failure. If, as a result of a tax risk materialising, the tax costs associated with particular transactions are greater than anticipated, it could affect the value generated from those transactions.

The Group takes a responsible approach to the management, governance and oversight of its tax affairs. This is documented in a Tax Policy approved by the Audit Committee. Tax risks are assessed as part of the Group's formal governance processes and are reviewed by the Group Finance Director and the Audit Committee.

The Government introduced the Code of Practice on Taxation for Banks, which requires banks to have proper governance around tax, integrated into business decision making, to establish an appropriate working relationship with HMRC and to undertake tax planning only to support business operations and not to achieve unintended tax advantages. Nationwide has adopted the Code and will take into account the spirit of the law and the intent of Parliament in managing its tax affairs. It will continue to be co-operative and transparent in its dealings with the tax authorities and has embedded the terms of the Code into its Tax Policy. The governance and oversight of tax has been strengthened to ensure compliance with the Code.

### Capital management

The Group conducts an Internal Capital Adequacy Assessment Process covering all risks. This is used to assess the Group's capital adequacy and determine the levels of capital required going forward to support the current and future risks in the business. This analysis is collated into an Internal Capital Assessment (ICA) that is approved by the Board. The ICA incorporates expected future capital requirements from changes in business volumes, mix of assets and activities within the context of current and anticipated future risks, and stressed scenarios. The ICA is used by the FSA to set Nationwide's capital requirements as Individual Capital Guidance (ICG).

The Group has operated with Internal Ratings Based (IRB) models since May 2008. The Group currently adopts the following approaches to calculate the Basel II Pillar 1 minimum capital requirements: Retail IRB approach for prime mortgages and unsecured lending; Foundation IRB for Treasury portfolios (excluding corporates and selected sovereign/multilateral exposures); and the Standardised approach for all other credit risk exposures. The Standardised approach is adopted for operational risk. The Group will continue to develop its IRB ratings models in accordance with the roll-out plan included within its IRB Waiver approval from the FSA.

The amount and composition of the Group's capital requirement is determined by assessing the Basel II Pillar 1 minimum capital requirement, the Group's economic capital requirement, the impact of stress and scenario tests under Pillar 2, and the Group's ICG. Capital levels for the Group are reported to, and monitored by, the Executive Risk Committee and Board Risk Committee. The Group continues to be strongly capitalised and manages its capital above the ICG and Basel II transitional floors at all times.

The Basel Committee on Banking Supervision issued its final Basel III text in December 2010. The text outlines proposals to strengthen the regulation and supervision of liquidity and capital management across the banking sector. The reforms raise both the quality and quantity of the regulatory capital base and enhance the risk coverage of the capital framework. It also introduces a number of macro-prudential elements into the capital framework to help contain systemic risk. The Basel III text has yet to be incorporated into European and UK law and therefore remains subject to change. Based on current understanding of the reforms, the Group is confident it will continue to maintain a robust capital position, well in excess of current and emerging regulatory requirements.

# Corporate Responsibility Report

WE BELIEVE, AS A MEMBER OWNED MUTUAL, WE HAVE A DUTY TO BE A RESPONSIBLE CORPORATE CITIZEN; ALONGSIDE BEING PRUDENT WITH OUR MEMBERS' MONEY, DELIVERING LONG TERM GOOD VALUE PRODUCTS AND SERVICES, THIS EMBRACES THE WAY WE ENGAGE OUR EMPLOYEES, CREATES A GREAT PLACE TO WORK AND DELIVERS POSITIVE SOCIAL AND ENVIRONMENTAL IMPACTS.

## BEING A CORPORATE CITIZEN

Corporate Responsibility (CR) is owned by all of our employees and delivered through every day actions, from how we deal with one another to the products and services delivered to our members.

Within the business, overall responsibility lies with our Board of Directors. Individual accountability for each specific issue is listed below.

Responsibility for the promotion of equality of opportunity and diversity for all Nationwide employees and customers is managed through our

Diversity and Equality of Opportunity Committee (DEOC), chaired by the Divisional Director for Savings & Investments.

In 2010 we achieved silver in Business in the Community's 'Race for Opportunity' national benchmark and were placed as one of the Top 10 performers in the private sector.



| Issue                                      | Responsibility | Position   |
|--|----------------|--|
| Workplace – occupational health and safety | Graham Beale   | Chief Executive                                    |
| Workplace – employee issues*               | Graeme Hughes  | Group Director Human Resources & Corporate Affairs |
| Corporate Responsibility**                 | Graeme Hughes  | Group Director Human Resources & Corporate Affairs |
| Marketplace – customers/consumers          | Chris Rhodes   | Executive Director Group Product & Marketing       |
| Marketplace – supply chain                 | Mark Rennison  | Group Finance Director                             |
| Environment                                | Tony Prestedge | Executive Director Group Development & Operations  |

\* for the period until 1 March 2011 Tony Prestedge was accountable for Workplace employee issues.

\*\* for the period until 1 March 2011 Chris Rhodes was accountable for Corporate Responsibility.

The Corporate Responsibility Committee (CRC) meets quarterly and is chaired by Graeme Hughes. The CRC exists to promote the CR agenda and integration across the business to ensure continuous improvement, and to challenge the business in delivering on its Corporate Citizenship goals. Members include senior managers and directors from across the business including Human Resources, Business Services, Products and Marketing, Procurement, Lending Control, Retail and Corporate Affairs.

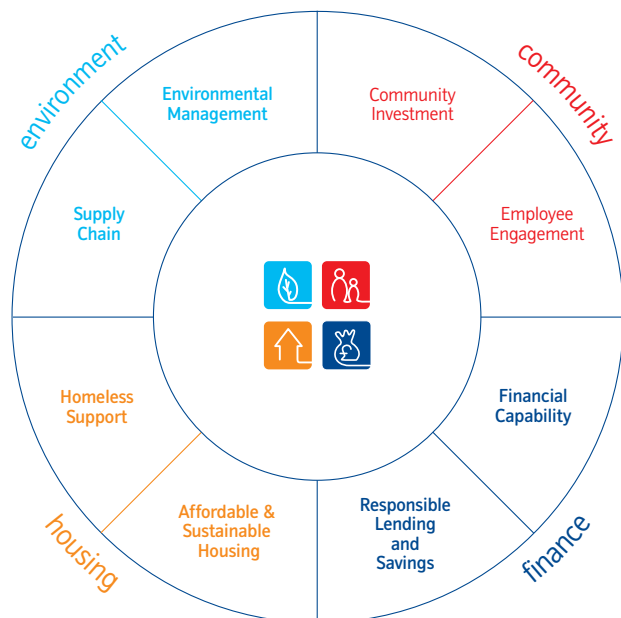
Nationwide has the benefit of over 160 years' experience in looking after our members' interests. The difficult economic climate has tested our business model and values and shown us to be in good health. Our responsible approach to lending is reflected in our arrears, which are almost one third of the national average.

Our 10 Guiding Corporate Responsibility Principles, set out in the 2009 Annual Report & Accounts, still stand true and the three selected principles listed below set the scene for the following summary of our successes over the past year.

**Financial Support.** We strive to help people in financial difficulty through our robust and fair policies and processes as well as our educational initiatives.

**Social Change.** We work effectively with charitable, community and industry partners as well as political stakeholders to address issues of mutual concern and strategic importance.

**Engagement.** We actively encourage employee and member involvement in community activities.



  
corporate  
responsibility

46-47

Corporate Responsibility



## FINANCE

*Offering simple, transparent products and supporting customers when they are in debt. Providing people with the skills and knowledge to manage their finances and avoid difficulty.*

Nationwide**Education**  
**MoneyActive**



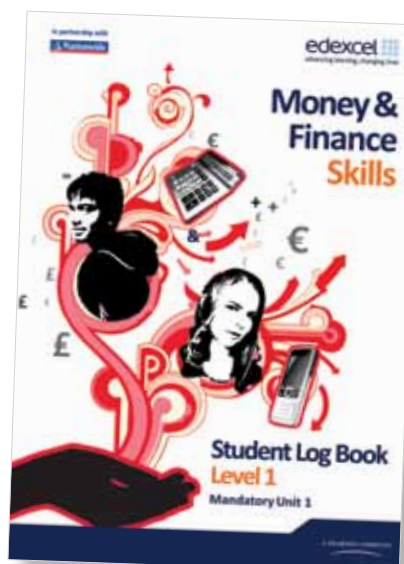
## NATIONWIDE EDUCATION

The ability to manage finance is at the heart of what we do and an essential life skill for everyone so it makes sense for us to focus on this area. Back in 2007 we launched **NationwideEducation.co.uk**, independent of our products and services, and since then our free to access website has received over 15 million hits. This interactive educational website provides a range of resources for young people aged 2-18+ linked to the National Curricula, as well as adults, teachers and parents.

**Key additions to the website over the past year have been:**

### Edexcel qualification

- NationwideEducation, in partnership with examining body Edexcel, launched the financial literacy qualification 'Money and Finance Skills'. Available since September 2010, the BTEC award is geared towards 14-19 year olds and equivalent to half a GCSE. The course encourages students to develop their personal finance skills to establish good life-long habits towards money and money management by using resources on **NationwideEducation.co.uk**. In the first six months over 2,200 students signed up to take the award.



# Corporate Responsibility Report

## continued

### First Time Buyers' Guide

- Deciding whether to buy or rent your first home is a daunting task, with so many things to consider making an educated choice can be difficult. To help we launched the First Time Buyers' Guide in July 2010, a step-by-step guide providing a comprehensive breakdown of everything you need to know to make the right decision. Independent of Nationwide's products and services it takes users through the pros and cons of buying and renting in straightforward, every day language.

### COMING SOON

- Following the success of the First Time Buyers' Guide we are introducing additional guides on buying, re-mortgaging and selling your home;
- To extend our adult learning offering we are also launching a series of 'Money' guides, informing users about debt, spending, borrowing and savings & investments; and
- A series of 'I can' mini-guides on early earnings, getting my first job and starting a savings plan.



*"The Parents' section allowed me to discuss some of the key financial issues and terminology with my sons in a simple way."*  
(Parent)

*"I have been able to integrate the resources into an industry related module, so the students could understand the impact their financial handling will have on their futures, and they also felt more confident applying for jobs."*  
(Teacher)

### MONEYACTIVE

Two years into our £3 million MoneyActive partnership with Citizens Advice we have seen significant progress in the numbers of volunteers recruited and trained to deliver proactive, community-based, financial education sessions helping people manage their money. The programme set out to increase the number of financial capability volunteers from 100 to 1,400 over the three years.

Sessions are run in partnership with local community groups to target the specific needs of those attending, including families, current and ex-service personnel, people with disabilities, ex-offenders, young people, refugees, single parents and jobseekers. It's not just about helping people manage their own affairs but also providing community workers with the tools, language and confidence to help their clients avoid debt in the future.

We are confident the MoneyActive training is building people's confidence with personal finances and giving them the skills to manage their money more effectively; 65% of participants have reported feeling more confident about their dealing with money following training sessions.

A mini training session in March provided MPs with the opportunity to learn more about the problems of debt and how to help their constituents. Sponsored by Greg Hands MP and using MoneyActive volunteers, this was the first event of its type in Westminster and we will be repeating it every six months.

**1,098 VOLUNTEERS** WERE RECRUITED UP TO THE END OF MARCH 2011 REACHING OVER **120,000 PEOPLE** AND 733 PARTNER ORGANISATIONS. THESE VOLUNTEERS MAKE A SIGNIFICANT TIME COMMITMENT TO THE PROJECT, EQUIVALENT TO OVER 80 FULL TIME WORKERS AND ADDING AN ESTIMATED VALUE OF £1.44 MILLION PER ANNUM TO THE CITIZENS ADVICE SERVICE.





1

1.  
The Strip4Shelter fundraising day raised over £25,000 for Shelter on the opening day of the 2010 World Cup.

2.  
Members of the Brand Strategy team in the Marketing division spent a day clearing a local canal as part of the employee volunteering programme supporting the Wilts & Berks Canal Trust.

3.  
Employees at the Swindon Head Office took part in a highly amusing rendition of YMCA in aid of Comic Relief.

4.  
Pupils at a London school learning all about money via the **NationwideEducation.co.uk** financial capability programme.



2



3



4

# Corporate Responsibility Report

continued

## SKILLFORCE

Nationwide's support of SkillForce is designed to make young people, in danger of financial exclusion through lack of understanding, better aware of how to deal with their finances. Students supported by SkillForce are at risk of exclusion or underachievement and the charity delivers units of a programme that enables them to gain recognised qualifications; supporting them to move into further education, employment or training.

TO SUPPORT SKILLFORCE IN THEIR EFFORTS WE DONATED OVER **70 LAPTOPS** TO SKILLFORCE INSTRUCTORS INCREASING THEIR CAPACITY TO DELIVER THE PROGRAMME.

ESTIMATES OF THE NUMBER AFFECTED BY FINANCIAL EXCLUSION (THOSE WHO CANNOT OR DO NOT ACCESS OR USE APPROPRIATE FINANCIAL PRODUCTS) RANGE BETWEEN 1.5 MILLION TO 3 MILLION IN THE UK.

Source: New Philanthropy Capital, research carried out on behalf of Nationwide – April 2011

## RESPONSIBLE LENDING

Our triage team continues to support customers approaching financial difficulties. Working together we explore options to alleviate customer worries. The phone support service has been successfully running since March 2010 and our Payment Difficulties section on [nationwide.co.uk](http://nationwide.co.uk) provides information and reference points for customers with money worries.

For the fourth successive year Nationwide won a top award at the prestigious Card and Payments Awards 2011 for **'Most Responsible Credit Card Lending Practices'**.



The award was for our *'More Than Words'* responsible lending programme, and recognised:

- Our ability to lend responsibly, yet still grow our customer base;
- Our successful campaigning to apply credit card repayments to the most expensive debts first – now required of all providers;
- Our continued support for NationwideEducation, and for our MoneyActive partnership with Citizens Advice.

The Judges said that the award *"builds on Nationwide's existing and extensive responsible lending practices, which seem to be part of the DNA of the organisation"*.

*'More Than Words'* can be seen online at [nationwide.co.uk/more\\_than\\_words](http://nationwide.co.uk/more_than_words)

Nationwide supported the launch of the largest All Party Parliamentary Group focusing on financial education for young people at the Houses of Parliament showcasing the importance of building financial understanding and awareness from a young age.

Nationwide is also part of the Northern Ireland Financial Capability Partnership – a strategic coalition of organisations working towards the agreed vision of *"together creating more financially capable people in Northern Ireland and being able to measure change"*.

Through our Dunfermline brand we are a member of the Financial Education Partnership (FEP), an initiative shared by several financial organisations in Scotland, dedicated to providing financial education for young people.

Employees of FEP members offer financial capability workshops and a range of other finance-related topics to pupils in schools throughout Scotland.

## HOUSING

*Supporting people who are homeless or experiencing housing issues. Supporting and promoting affordable housing. Encouraging and supporting sustainable living and housing.*

Shelter

Corporate Responsibility

### SHELTER

In 2008, we started working with Shelter and in the past year we've continued to build on the partnership with the following aims:

- Supporting housing and homelessness services in Bristol, Bournemouth and Hertfordshire, to help people facing a range of housing problems; and
- Continuing to develop a plan of joint working under the theme of 'affordability'.

Shelter Bristol's Housing Support Service offers free support services for homeless families making the transition into a settled home and community. It also helps children and young people overcome the disruption and trauma of homelessness.

Shelter Hertfordshire's Housing Advice Centre provides advice and advocacy on housing problems. The service, with Citizens Advice, also runs Court Duty Desks in Hertford, St Albans and Watford County Courts on possession hearing days for those facing repossession.

#### Key successes and milestones

288 families, 420 adults and 283 young people have been helped since June 2010 by:

- **Bristol Skills Support Service** – using volunteers to address the training, skills and employment needs of homeless families in Bristol;
- **Bristol Housing Support** – Child Support Service – delivering a wide range of both practical and emotional support for families and children in crisis; and
- **Hertfordshire Housing Advice Centre** – providing legal advice, debt and housing support.

To compliment our existing investment in education we are sponsoring Shelter's Teachers' Centre and development of two new teaching resources. The sponsorship will see Nationwide helping to develop



1

1. Projects supported by Nationwide include the Housing and Skills Support Services in Bristol and the Hertfordshire Housing Advice Centre.



2

2. Strip4Shelter supported one of our corporate charity partnerships helping to raise awareness of the issue of homelessness through Nationwide and across the UK.

Key Stage 4 and Youth Homelessness Classroom Kits to ensure teachers have access to, and young people receive, the correct information about homelessness and housing problems. These will link to resources on [NationwideEducation.co.uk](http://NationwideEducation.co.uk).

### AFFORDABLE HOUSING

Over the last year Nationwide provided almost £200 million of new loan facilities to ten registered housing associations, funding new affordable homes in various parts of the UK. This represents our highest amount of lending for three years. In nine cases we were providing additional funding to existing customers. Some of the funding provided was to finance the voluntary transfer of housing from Neath Port Talbot Council to a new housing association, enabling tenants to benefit from a range of improvements and repairs to their properties over the next few years.

Involvement goes beyond the loan facilities; three members of our Housing Finance team are board members of registered housing associations helping to support the sector and alongside our employee volunteering programme help to continually build our understanding of this specialist market.

"I HAVE BEEN SO GRATEFUL THAT THE SERVICE HAS SUPPORTED ME IN EVERY WAY POSSIBLE. THE ADVICE AND SUPPORT THAT I HAVE RECEIVED HAS TAKEN SO MUCH PRESSURE AWAY WHICH COULD HAVE HAD A BIG IMPACT ON MY HEALTH. ALTHOUGH THERE IS MORE TO BE DONE, I FEEL WITH THE SUPPORT OF SHELTER MY LIFE WILL BE WORTH LIVING AFTER ALL."

Shelter Service User



# Corporate Responsibility Report



*Being a responsible and fair employer. Making a difference in our local communities through meaningful charitable partnerships and employee volunteering.*

**WE ARE  
MACMILLAN.**  
CANCER SUPPORT



## COMMUNITY COMMITMENT FROM YOUR LOCAL MUTUAL

Supporting our local communities is at the centre of Nationwide's modern mutuality ethos. As a member of the local community we are proud to support local causes and continue to make a difference through our national charitable partnerships. With over 700 branches, our employee volunteering programme 'Nationwide Volunteers' gives us a platform to provide skills and support in communities at a local level across the country.

## NATIONWIDE VOLUNTEERS

In October 2010, we launched our volunteering programme offering employees two days paid leave to support charities and good causes. At regional launch events across our three main administration sites, supported by local MPs, we had an amazing response with over 500 employees pledging their support in just one morning.

**2 DAYS PAID LEAVE TO HELP  
EMPLOYEES SUPPORT THEIR  
LOCAL COMMUNITY  
THROUGH VOLUNTEERING.**

We believe that our talented people giving their time and expertise can be the most effective donation of all. Our mission is to enable at least 10% of our 16,000 employees to undertake volunteering activities within the first 12 months of the programme.

In March, our Norwich branch welcomed Chloe Smith MP in to promote Nationwide's employee volunteering programme and our free online financial education resources that teach key money management and life skills ([NationwideEducation.co.uk](http://NationwideEducation.co.uk)).

Chloe Smith MP commented: *"Understanding money and debt is vital, especially in a recession, for young people and everyone. Nationwide's employees have financial skills and knowledge they can use to help the community, so I firmly welcome their local commitment."*

## OUR MISSION

As part of the new volunteering programme, employees can use their time to support local communities, charities and schools. They are able to select a cause of their choice or take up opportunities available through our local and national charity partners.

## SHARING OUR SKILLS

Steve Brayford of Newcastle-under-Lyme branch devotes some of his spare energy to volunteering in Chester as secretary and trustee of a charity called the Bren Project providing work placements for young people with learning difficulties. He also helps to raise funds for the charity. *"I first got involved six years ago when one of my customers said they needed someone with financial experience to help out at the charity".* The charity benefits from his knowledge of employment law and practice, and health and safety issues gained working for Nationwide. *"Without this charity these young people would not be getting the experience and confidence that they gain from the work experience placements the charity arranges and their parents would not be getting the joy of seeing them develop in this way. It is great to feel part of it all."*

## WORKPLACE PROGRAMMES

We are committed to promoting a supportive and inclusive culture for all our employees, members and business partners. Harnessing the strengths and talents of each of our employees creates a productive workforce that puts customers first. We strive for equal opportunities at all levels of our business and encourage employee diversity to eliminate discrimination and to reflect and understand the communities in which we operate.

**We work closely with a number of external organisations to promote diversity, including:**

- Employers' Forum on Age; we are a founding member, involved for 14 years;
- Business in the Community's Race for Opportunity programme;
- Employers' Forum on Disability; and
- Stonewall; of which Nationwide is a Diversity Champion.



**During the year:**

- We hosted 88 work experience placements totalling 120 weeks. Work experience is key to opening up financial services and the world of work, so young people can make informed choices about their future;
- Nationwide facilitated Job Club meetings in Northampton as a recruitment exercise to give unemployed people from the local community the opportunity to experience our interview process and receive quality feedback on their job application skills; and
- Nationwide led Plan 500, a Swindon based initiative to link 500 people between the ages of 16-24 who were not in employment, education or training (NEET) with local organisations or individuals on a range of work experience placements, mentoring and apprenticeships. Since October 2010 over 250 placements have been initiated.

**THANKS A MILLION!**

During the year employees and members raised a massive **£1 million** for good causes. Our ongoing support of campaigns like Comic Relief, Children in Need and Macmillan's World's Biggest Coffee Morning, in addition to our international disaster relief appeals (including Haiti and Pakistan), make a real difference to the people and communities who need our help most. Employee and member fundraising plays a significant role in our community investment agenda, but really it's just the start.

Each branch in the regional brands network (Derbyshire, Cheshire and Dunfermline) was challenged to raise £1,000. Collectively staff and customers helped raise over £67,000 through a number of fundraising activities including walks, quizzes and talent shows.

Our tax efficient payroll giving scheme was re-launched enabling employees to donate to charity through their salaries. We now have our highest number of payroll givers, with **£150,000** being donated in the past year to a range of charities and causes.



1



2

1. Stuart Campbell volunteers for the Salvation Army Social Enterprise running workshops on dealing with common problems with bicycles.

2. A team from Customer Operations volunteered their time to help with a garden project for Ruskins Primary School in Swindon.

# Corporate Responsibility Report

continued

## DISABILITY SPORT EVENTS

With just over 12 months to go until the 2012 London Paralympics, our support of Disability Sport Events (DSE) is as strong as ever with continued focus on individuals to qualify for the Paralympics.

It has been another great season with many records broken along the way. The three national swimming championships were complimented by regional qualifiers hosted in English regions as well as home nations. Swimmers included current and potential Paralympians. The international long course event in April hosted many countries and we witnessed a feast of record breaking world class swimming.

*“The support given by the Nationwide Building Society has been fundamental in helping people realise their potential and be the best that they can be. Without their support over recent years many of our current Paralympic stars would not be in such a strong position as they prepare to challenge for medals in London 2012.”*

Marc Woods, former Paralympic swimmer and winner of 12 Paralympic Medals



1. Nationwide support DSE with funding for Regional and National swimming and athletics events.

2. These events will allow participants to achieve the required times for qualification at major events including the 2012 Paralympics

THROUGHOUT THE YEAR OVER  
**9,000** COMPETITORS  
HAVE TAKEN PART IN DSE EVENTS

## MACMILLAN CANCER SUPPORT

Macmillan has been Nationwide's flagship charity for 18 years and together we have raised over £6 million. The partnership is unique due to the range of local and national activities undertaken in support of Macmillan and the way in which income from local activities is restricted to Macmillan services in that particular area.

Nationwide continues to be part of the 'Working Through Cancer' (WTC) programme, providing information for employees affected by cancer, their managers and carers. We also sit on Macmillan's Employer Forum providing advice and guidance on the direction of the WTC programme.

In addition, we look to create ways for members and employees to get involved with Macmillan. These opportunities have varied throughout 2010 – from leadership learning and development initiatives to employees supporting information centres within their local community.

During 2010 we raised over £350,000 for Macmillan including:

- **£45,760** collected through local branches and allocated to services in the local communities where the funds were raised;
- **£44,175** raised by taking part in Macmillan's flagship fundraising event, World's Biggest Coffee Morning; and
- **£239,300** from member voting in the 2010 AGM. Part of this is funding Macmillan welfare benefits advisers based at the Coventry and Grampian Citizens Advice Bureau.

*"Teams from Nationwide and Macmillan undertook a reciprocal development exercise in late 2010 and 2011 to investigate how each others' organisations work. It is an innovative and low cost approach to performance development, providing the following benefits for both organisations: insights to broader business awareness; opportunities to share learning across the organisations and to increase confidence in adopting new practices and creating value in different ways, opportunities to build external relationships and networks to support ongoing development and a further mechanism to create the will and the knowledge to challenge existing attitudes and to reduce complacency."*

Jonathan Luff, Head of Risk Analysis & Capital Planning

FOR EVERY £1 SPENT ON MACMILLAN SUPPORTED WELFARE BENEFITS ADVICE, £14.27 IS CLAIMED BACK IN BENEFITS

Macmillan Annual Report 2009



1.

Macmillan Cancer Support has been Nationwide's chosen charity for 18 years raising over £6 million.

2.

The annual World's Biggest Coffee Morning fundraising event saw employees raise £44,175 in one day!

ONE OF THE BIGGEST WORRIES THAT PEOPLE HAVE IS MONEY, WITH 91% OF CANCER PATIENTS' HOUSEHOLDS SUFFERING EITHER A LOSS OF INCOME AND/OR INCREASED COSTS AS A DIRECT RESULT OF CANCER

# Corporate Responsibility Report



## ENVIRONMENT

*Reducing our carbon footprint and having a wider positive impact through our people and suppliers.*



Nationwide is the world's largest building society and we recognise we have an impact on the communities and environments in which we operate. Our mutual status means we want to make sure we are doing the right thing in terms of building a truly sustainable business for our members and employees.

Over the last twelve months we've focused on improving our methods for identifying and measuring our environmental impacts and building internal capacity to lead Nationwide towards a lower carbon future. Working with the Carbon Trust, we have calculated our carbon footprint and are currently setting 10 year targets to reduce this.

Over the last year we:

- Continued to provide information and advice on our website **nationwide.co.uk** for our members on how to save energy, water (and money) at home;
- Helped over 1 million account holders reduce environmental and financial costs by opting to go paperless and receive statements/ AGM packs electronically;
- Launched an internal awareness campaign to help employees contribute to a more sustainable business;
- We have worked with our fleet vehicle supplier to reduce our vehicle emissions from an average 143 to 127 grams per kilometre; and
- Exploited telephone and video conferencing to reduce the need to travel.

Over the course of the next few months we will be asking members how far they want us to go to make a positive impact on the environment and in the community through the products and services we offer. We'll also continue to get our own house in order and invest in projects to reduce our carbon footprint and operating costs.

HAVE ACHIEVED A **9% ELECTRICITY** AND **35% WATER REDUCTION** ACROSS OUR MAIN ADMIN BUILDINGS

- Have taken steps to ensure we use our buildings as efficiently as possible, contributing to minimising our environmental impact, for example introducing flexible and agile working practices;
- Opened a new data centre in Newbury, designed to minimise energy consumption, which has achieved an 'Excellent' rating under the Building Research Establishment Environmental Assessment Method (BREEAM) Code for Sustainable Buildings;
- Have worked with sustainability consultants BG2 and the Royal Institute of Chartered Surveyors (RICS) on development of a retail pilot to provide more sustainable refurbishments in our UK retail properties;
- Recycled 53% of our waste, including all our used corporate clothing, paper and furniture;

### MEMBERS' ZONE

Members' Zone launched on **nationwide.co.uk** gives us another way to let members know about the work we're doing in corporate responsibility – see the 'relations with members' section in the Report of the Directors on Corporate Governance.

REDUCED ENERGY USE IN  
200 BRANCHES BY **14%** ON AVERAGE





1

1.  
The MoneyActive programme with Citizens Advice sees volunteers working with community groups to improve their financial skills.

2.  
Graham Beale, Nationwide's CEO, supports the launch of the 'Nationwide Volunteers' employee volunteering programme along with local Swindon MPs Justin Tomlinson and Robert Buckland.

3.  
Employees from many areas across the organisation come up with imaginative ways to support good causes including Comic Relief.

4.  
Pudsey Bear took part in a yoga class which was one of hundreds of fundraising initiatives raising money for Children in Need in November 2010.



2



3



4

# The Nationwide Foundation

The Nationwide Foundation is a registered charity (no. 1065552) which makes grants to charities across the UK. The Foundation has more than 10 years' experience of supporting causes which help people in need.



*Supporting communities nationwide*

The Nationwide Foundation's current strategy, 'Money Matters, Homes Matter, Families Matter' (operational 2009 – 2012) is supporting UK charities tackling housing and financial exclusion issues affecting disadvantaged people. By focusing its grant support on financial inclusion and housing related issues, the Foundation has been able to align more closely with Nationwide Building Society, its principal funder, and the Nationwide Foundation is grateful for Nationwide's ongoing support of its work.

The Nationwide Foundation has researched how best to focus its grants on groups which are less well supported than others. This research identified vulnerable older people and survivors of domestic abuse. The Foundation provides grants which address all sides of a social issue from research into root causes through to practical ways to tackle these, and finally raising awareness to promote change. All of the charities funded under this strategy tackle housing and finance issues affecting disadvantaged people and aim to improve their quality of life.

THE FOUNDATION IS SEEN TO BE A LEADING FUNDER ON THE TOPICS IT ADDRESSES; IT HAS A HIGH REPUTATION AMONGST STAKEHOLDERS AND APPLICANTS.

Cass Business School's Centre for Charity Effectiveness

The Nationwide Foundation works with large and small charities across the UK, operating two grant programmes.

The **Investor Programme** has shared £2.9 million between 10 charities tackling housing and finance issues. These are substantial three-year grants, enhanced by extra support interventions from the Foundation. By providing core, flexible and long term funding, charities have greater confidence and stability, enabling them to make more of a difference to beneficiaries. All the charities supported are visited quarterly to offer support and to track progress.

The charities are tackling housing and financial difficulties in a range of different ways – for example:

## Runnymede Trust

- The Runnymede Trust is the UK's leading thinktank on race relations. The Foundation is funding research into the financial needs of black and minority ethnic (BME) older people. Runnymede Trust will use the findings to inform and facilitate change in public policy. The research explores the financial implications of where BME older people retire to, their pension provision and financial matters from the perspective of grandparents.

## Age Concern Wirral

- This organisation's work addresses the very specific housing and finance needs of people over 50 living with dementia, in the Wirral. The charity supports sufferers and their families as the illness takes hold, to make decisions around dealing with significant decreases in income, maintaining homes and arranging power of attorney.

## Centre for Sustainable Energy (CSE)

- CSE is helping older people in rural isolated areas of Somerset to access home improvement and energy efficiency measures. The work tackles fuel poverty, provides debt and welfare advice and will help older people remain in their homes for longer.

## Adding Value

As a leading grant-maker, the Foundation seeks to leave the charities it funds with a legacy of support which extends beyond the three year grant. The Investor Programme has additional elements of support which go beyond simply funding the charities' work. For example, charities are offered exit strategy consultancy so they can prepare for the end of the grant term and the Foundation also brings funded charities together to share learning, expertise and explore opportunities to collaborate for greater outcomes. Charities are also provided with training and consultancy to help strengthen their organisations.

## Positive Outcomes

The past year has seen a number of positive outcomes for the charities which are being funded through the Investor Programme. Data has been gathered from routine grant monitoring reports and visits to the charities, which include:

- £60,000 raised in additional benefits for Somalis, thus improving their quality of life;
- 58 advocacy clinics have been held to support families of dementia sufferers with housing and finance issues;
- 2,024 older rural isolated people have received information on addressing fuel poverty and 77 have received further in-depth support; and
- 102 survivors of domestic abuse have been supported via a money and debt advice helpline.



The Nationwide Foundation also gives grants of up to £5,000 to small charities every two months from the **Small Grants Programme**. Charities appreciate the speed and simplicity of the Small Grants application process, which means money can quickly be put to good use. In 2010/11, 104 grants were made totalling £500,000, including:

## Tax Volunteers

- This charity is an independent, free tax advice service for pensioners on low incomes who cannot afford to pay for professional advice. Volunteers from the financial and accounting professions run free tax surgeries, make home visits to isolated clients, and run a telephone helpline staffed with experts in dealing with tax problems.

## The Women's Centre (Blackburn)

- The Women's Centre provides local accessible services to women who may require information on health, well-being, individual support, counselling, employment support and legal advice. The Foundation made a grant in support of its provision of debt and housing information to women survivors of domestic abuse.

### South East Sheffield Citizens Advice Bureau (SESCAB)

- SESCAB offers a free confidential and impartial service to people in South East Sheffield, giving advice on a wide range of issues including debt, benefits, employment and housing. The Foundation has supported the Home Visiting Service so that advisers can provide older people with face to face guidance in their own homes on housing and finance matters.

The past year has seen the Small Grants Programme help a large number of people through its grants. Routine monitoring reports, one year after each grant, enable the Foundation to see the positive impact this programme has on beneficiaries, for example:

- 2,789 survivors of domestic abuse were assisted with housing and finance matters;
- 1,290 older people were helped with a variety of housing issues;
- 6,857 older people received advice and assistance on financial issues, including debt and claiming of benefit entitlements; and
- 1,021 older people were able to address both housing and finance issues.

*"The small grant we received has had a tremendous impact in assisting us to do outreach work which takes our service into the homes of the elderly and/or infirm. Nationwide Foundation has enabled us to reduce the waiting time and to accommodate and assist more of our vulnerable, elderly clientele."*

East Finchley Advice Service

### Community Land Trust Fund

As part of a commitment to improving housing for disadvantaged people in the UK, the Nationwide Foundation has invested over £250,000 in the Community Land Trust Fund (CLTF), an initiative providing affordable homes. CLTF helps local community groups, often volunteers, to acquire land and build properties for low income residents from the local area. With this investment in CLTF, the Foundation along with three other funders, is helping to alleviate the lack of affordable housing, often a particular issue in rural areas and for younger adults. These houses are a realistic prospect to those who are otherwise forced to remain living with parents or move out of the area.

As one of the UK's leading funders, the Foundation works with independent evaluators to ensure its programmes are effective and to help improve its grant-making processes. It aims to listen to what charities say they need from a funder when developing grant-making processes. The evaluation also reviews the charities funded to provide them with a valuable resource on how effective their services are, the impact made on their beneficiaries and identifying any areas for improvement.



In recognition of its work, the Nationwide Foundation is pleased to have been shortlisted for a number of awards during 2010/11. These include:

- **Third Sector Excellence Awards 2010** – shortlisted in the category Innovation by Trusts and Foundations



- **Directory of Social Change Awards 2010** – shortlisted in the Great Giving Funders Award category



- **Charities Evaluation Services Awards** – highly commended in the Funder category
- **The Business Charity Awards 2011** – shortlisted in the Corporate Foundation category

The current economic climate continues to be challenging for the charity sector. Funders have a unique role to play and the Nationwide Foundation aims to support grantees to ensure its funding benefits the target groups as much as possible during these difficult times. The Nationwide Foundation is committed to continuing to help charities to tackle some of the issues which are at the heart of society.

**OUR SURVEY RESULTS DEMONSTRATE THAT THE FOUNDATION IS CONSIDERED BY ITS GRANTEES TO BE A RESPONSIVE, FLEXIBLE AND SUPPORTIVE FUNDER AND IS RATED HIGHLY AGAINST OTHER GRANT-MAKERS IN THE FIELD.**

Cass Business School's Centre for Charity Effectiveness

Email: [enquiries@nationwidefoundation.org.uk](mailto:enquiries@nationwidefoundation.org.uk)  
Website: [nationwidefoundation.org.uk](http://nationwidefoundation.org.uk)



# Board of Directors

As at 4 April 2011



## 1. GRAHAM BEALE (52)

### Chief Executive

Graham Beale joined the Society in 1985. He is a chartered accountant by training and was appointed to the Board as Group Finance Director in April 2003. He took up his current role as Chief Executive in April 2007. He is a former non executive director of Visa Europe Limited and Visa Europe Services. Prior to his appointment to the Board, he worked extensively in the Finance function and held a number of senior, general management positions within the Society.

## 2. GEOFFREY HOWE (61)

### Chairman

Geoffrey Howe joined the Board in 2005 and became Chairman of the Society in July 2007. He brings considerable regulatory, management and legal experience to the Board. He is currently Chairman of Jardine Lloyd Thompson Group plc and a director of Close Brothers Group plc. Geoffrey was formerly Chairman of Railtrack Group plc, a director of Investec plc, a director and General Counsel of Robert Fleming Holdings Limited and Managing Partner of international law firm Clifford Chance.

## 3. MARK RENNISON (50)

### Group Finance Director

Mark Rennison is a chartered accountant who joined the Society and was appointed to the Board in February 2007. He is responsible for Finance, Treasury, Risk Management, Strategy & Planning, Internal Audit and Business Protection. He is a director of various Society subsidiaries. Prior to his appointment, Mark was a partner at PricewaterhouseCoopers LLP where he worked in the financial services practice with a specific focus on retail and corporate banking. He has also worked extensively with group treasury operations, leasing and asset finance businesses.

## 4. ROBERT WALTHER (67)

### Joint Deputy Chairman and Senior Independent Director

Robert Walther joined the Board in 2002 and became Deputy Chairman in 2006. His background is in investment and insurance. Robert is a former Chairman of the Nationwide, Portman, Derbyshire and Cheshire Pension Funds, Fidelity European Values plc and JPM Claverhouse Investment Trust and a former non executive director of BUPA. He was Chief Executive of Clerical Medical from 1995 to 2001 which he joined in 1965.

## 5. ROGER PERKIN (62)

### Non Executive Director

Roger Perkin joined the Board as a non executive director in April 2010. Roger is a former partner at Ernst & Young LLP and has spent 40 years in the accounting profession. During his time at Ernst & Young he worked with many blue chip clients and advised boards across the spectrum of financial services, including banking, insurance, fund management and private equity. He is also a non executive director at Electra Private Equity plc and The Evolution Group plc, and chairs the audit committees of both companies. Additionally, he is a trustee of two charities, Chiddingstone Castle and Crime Reduction Initiatives.

## 6. MICHAEL JARY (47)

### Non Executive Director

Michael Jary joined the Board in January 2009. He is a Partner of OC&C Strategy Consultants, a global strategy consulting firm with 15 offices worldwide, and served as Worldwide Managing Partner of the firm from 2005 to 2011. He is an adviser to the boards of leading retail and consumer companies in Europe, the USA and Asia. He is a regular commentator on the retail industry, the co-author of a number of books including "Retail Power Plays" and a guest lecturer at INSEAD Business School. He is also the Chairman of Duchy Originals and of The Prince's Social Enterprises.





## 7. ALAN DICKINSON (60)

### Non Executive Director

Alan Dickinson joined the Board in June 2010. Alan has spent more than 40 years in banking, originally joining the Royal Bank of Scotland in 1973, having started his career with Westminster Bank in 1968. He is an experienced retail and corporate banker and a former Executive Committee member of the RBS Group and Chief Executive of both RBS UK and the bank's market leading UK Corporate Banking business. Alan is also a non executive director of Carpetright plc and Frogmore Property Company Limited, a governor of the charity Motability and Treasurer of Surrey County Cricket Club.

## 8. CHRIS RHODES (48)

### Executive Director Group Product and Marketing

Chris Rhodes is a chartered accountant who joined the Society in April 2009 from the Santander Group, where he was Director of Retail Distribution for Alliance & Leicester. Prior to that he held a number of Board positions at Alliance & Leicester, including Group Finance Director and Managing Director of Retail Banking. Chris is responsible for Mortgages and General Insurance, Savings and Investments, Banking (current account, credit cards and personal loans), Commercial and Lending Control, together with Group Marketing.

## 9. SUZANNA TAVERNE (51)

### Non Executive Director

Suzanna Taverne joined the Board in 2005. She brings expertise in strategy, finance and management. She is currently a director of FCE Bank plc, a trustee of the Foundation for Credit Counselling and the Design Museum. Suzanna was formerly Chair of Gingerbread, Operations Director of Imperial College London, Managing Director of the British Museum, Director of Strategy at Pearson plc and Finance Director of The Independent. She also worked for Saatchi and Saatchi plc and S.G. Warburg & Co Ltd.

## 10. MATTHEW WYLES (52)

### Executive Director Group Distribution

Matthew Wyles was appointed to the Board in August 2007 and was previously Executive Director, Group Development at Portman Building Society. Prior to joining Portman in 1997, Matthew's career was in general insurance, latterly as Executive Director, Global Reinsurance Division at Willis plc. Matthew is responsible for the branch network, the Group's call centres, online channels, and Group Intermediary Sales across all of the Group's brands. Matthew was Chairman of the Council of Mortgage Lenders during 2009 and 2010.

## 11. TONY PRESTEDGE (41)

### Executive Director Group Development and Operations

Tony Prestedge was appointed to the Board in August 2007 and was previously Executive Director Group Operations of Portman Building Society. He has held a number of senior executive roles at Barclays PLC, including Managing Director Home Finance and Retail Support and Operations Director. He was a member of both Woolwich PLC and Barclays Retail Banking Executive Committees. Tony is accountable for the Group's Operational Transformation and his divisional reports include Customer Operations, Technology, Transformation Delivery and Business Services.

## 12. BILL TUDOR JOHN (66)

### Joint Deputy Chairman

Bill Tudor John joined the Board in August 2007 as Joint Deputy Chairman and was previously Chairman of Portman Building Society. Between 1972 and 2000 he was a Partner in the international law firm Allen & Overy, the last six years of which he was the Senior Partner. He has considerable experience in the law and investment banking. He is currently a managing director of Nomura International plc and a director of Wales In London Limited and a former director of Lehman Brothers European Mezzanine 2004 SICAV and Grainger plc. He is a member of the Treasury appointed Banking Liaison Panel and a fellow of Downing College, Cambridge.

# Directors' Report

## For the year ended 4 April 2011

The directors have pleasure in presenting their Annual Report and Accounts for the year ended 4 April 2011.

As set out more fully in the Statement of Accounting Policies, this Annual Report and Accounts has been prepared in accordance with International Financial Reporting Standards (IFRS). All financial information given in this Directors' Report is taken solely from the statutory results prepared on this basis. Unaudited, like-for-like results which allow comparison between 2011 and 2010 are given in the Business Review on pages 13 to 45.

### Business objectives

The principal purpose of the Society and its subsidiaries (the Group) is to provide a diverse range of personal financial services, offering competitive pricing and excellent service. Underpinning this objective

are our core values, which are to be open, honest and fair in our dealings with customers, to deliver long term good value, and to provide a safe and secure home for our members' savings.

### Business Review and future developments

The Group's business and future plans are reviewed by the Chairman and Chief Executive on pages 4 to 12 and in the Business Review on pages 13 to 45.

### Key Performance Indicators

The Group's principal Key Performance Indicators (KPIs) have not significantly changed since the previous year and are set out below. Commentary on performance against these measures is provided in the Chief Executive's Review and Business Review as referenced:

| Measure                            | KPIs  | Why is it used?  | Our performance  |
|------------------------------------|---|--|--|
| Financial Performance and Strength | <ul style="list-style-type: none"> <li>Underlying profit before tax;</li> <li>Underlying costs;</li> <li>Net interest receivable and non-interest income; and</li> <li>Return on capital.</li> </ul>  | As a mutual we manage our costs and the amount of income we generate very carefully to make enough money to ensure the continuing financial strength of the Society. Return on capital informs us about whether we are growing profitably and maintaining the financial security for our members and investors.  | <p>Analyses of underlying profit before tax, underlying costs, net interest receivable and non-interest income are provided in the Business Review on pages 13 to 15.</p> <p>Return on capital is based on profit after tax as a percentage of average gross capital. The return on capital for the year was 3.2%.</p>   |
| Customer                           | <ul style="list-style-type: none"> <li>Value of core products and better long term value;</li> <li>Main customer relationships and cross holdings;</li> <li>Satisfaction – channel and product service and brand consideration of non-customers; and</li> <li>Complaint volumes.</li> </ul> | We exist to serve the needs of our members. To be successful we must deliver efficiently a broad range of financial products that meet members' needs whilst preserving the financial strength of the Society. It is important that we independently measure how successful we are in meeting members' needs in an effective way so that we are Treating Customers Fairly. We must also ensure that non-members are made aware of our brand to enhance the potential for them to come to the Society for services in the future. | <p>Movements in the value of our mortgages and savings books, which are considered our core products, and increases in the number of main customer relationships, are shown in the Business Review on pages 33 to 34.</p> <p>Details of our satisfaction measures and complaint volumes are given in the Chief Executive's Review on page 9.</p>   |
| Risk                               | <ul style="list-style-type: none"> <li>Wholesale funding ratio;</li> <li>Core liquidity &amp; Core Tier 1 solvency ratios; and</li> <li>Controls, risk &amp; compliance.</li> </ul>   | We monitor the levels of risk we take on and the quality of the control environment within the business to manage our exposure to unforeseen losses.   | <p>Analyses of the wholesale funding, core liquidity and Core Tier 1 ratios are provided in the Business Review on pages 23 to 25 and pages 28 to 30.</p> <p>The controls, risk &amp; compliance KPI covers the assessment, provided by our Internal Audit and Compliance functions, of the effectiveness of the Group's control environment. Further details are provided in the Audit Committee section of the Corporate Governance Report on pages 70 to 71. The KPI also measures the current assessment of operational risk across the Group, further details of which are provided in the Risk Management and Control section on pages 37 to 45.</p> |

| Measure        | KPIs  | Why is it used?  | Our performance   |
|----------------|---|--|---|
| Employees      | <ul style="list-style-type: none"> <li>• High performer retention;</li> <li>• Engagement index; and</li> <li>• Enablement index.</li> </ul>   | We know that having a committed workforce means we can deliver better customer service and therefore, retaining our best employees is important to us.   | <p>High performance retention: the retention of high performers in 2010/11 was better than plan, with the annual turnover of these employees at 3.8% at the end of March 2011.</p> <p>Employee commitment: Nationwide continued its focus on employee engagement and enablement in 2010/11, investing in its people to increase commitment and advocacy. We have been able to measure our performance by the use of staff surveys. An unprecedented 8% increase in employee engagement brought Nationwide closer to the financial services benchmark.</p> <p>Employee enablement measures the capability of employees to perform and remains above the financial services benchmark at 72%, an increase of 4%.</p> <p>Employee voluntary turnover: The resignation rate has risen to 13% in the last 12 months which is closer to the financial services benchmark than last year.</p> <p>Employee absence. Total absence and short term absence have both fallen during the year following improvements to the support for managers and employees returning to work.</p> |
| Transformation | <ul style="list-style-type: none"> <li>• Voyager core banking and other system platforms delivery;</li> <li>• New Data Centre;</li> <li>• Information management and regulatory; and</li> <li>• Cost Optimisation Programme.</li> </ul> | We need to be prepared for future challenging conditions. The business needs to deliver a modern systems platform (the Voyager project), data processing and enhanced management and regulatory information to meet the Society's and its members' future needs. To perform strongly in the future and maintain financial security, a series of initiatives have been introduced to balance cost levels to business needs. | <p>The delivery of the new core banking platform is discussed in the Chief Executive's Review on page 11.</p> <p>The new data centre, based at Newbury, was successfully delivered in the year.</p> <p>The information management and regulatory KPI covers several projects delivering both regulatory and internal information management requirements which are due to be delivered in 2012.</p> <p>The cost optimisation programme is discussed on page 9 in the Chief Executive's Review.</p>  |

### Profits and capital

Profit before tax was £317 million (2010: £341 million). The profit after tax transferred to the general reserve was £248 million (2010: £264 million).

Total Group reserves at 4 April 2011 were £6,254 million (2010: £5,716 million). Further details on the movements of reserves are given in the Group Statement of Movements in Members' Interests on page 89.

Gross capital at 4 April 2011 was £9,737 million (2010: £9,406 million) including £1,973 million (2010: £2,166 million) of subordinated debt and £1,510 million (2010: £1,524 million) of subscribed capital. The ratio of gross capital as a percentage of shares and borrowings at 4 April 2011 was 5.6% (2010: 5.4%) and the free capital ratio was 4.9% (2010: 4.8%). The Annual Business Statement on page 164 gives an explanation of these ratios.

### Mortgage arrears

The Group mortgage portfolios at 4 April 2011 included 2,799 mortgage accounts (2010: 2,857), including those in possession, where payments were more than 12 months in arrears. The total amount of principal loans outstanding in these cases was £429 million (2010: £493 million). The total amount of arrears in these cases was £32 million (2010: £33 million) or 0.03% (2010: 0.03%) of total mortgage balances. The mortgage arrears methodology is based on the CML definition, which calculates months in arrears by dividing the balance outstanding by the latest contractual payment.

# Directors' Report

## continued

### Charitable and political donations

Results for the year include charitable donations of £2,679,555 (2010: £3,463,912) including £1,015,000 (2010: £2,000,000) to the Nationwide Foundation, a report on which is given on pages 58 to 59. No contributions were made for political purposes. However, as a result of the Political Parties, Elections and Referendums Act 2000, time allowed to employees to carry out civic duties can amount to a donation. The Group supports a very small number of employees in this way.

### Participation in the unclaimed assets scheme

The Society has agreed to participate in Government-backed unclaimed assets scheme, whereby savings accounts that have been inactive for 15 years and are eligible to be transferred into a central reclaim fund. The central reclaim fund has the responsibility for retaining sufficient monies to meet the costs of future reclaims for any previously transferred dormant account members and to transfer any surplus to the Big Lottery Fund, for the benefit of good causes which have a social or environmental purpose. On 25 March 2011 the Society signed an agreement to transfer £32,323,110 to the Reclaim Fund Limited, the administrators of the unclaimed assets scheme, and these funds were transferred on 5 April 2011.

### Creditor payment policy

The Group's policy is to agree the terms of payment with suppliers at the start of trading, ensure that suppliers are aware of the terms of payment and pay in accordance with its contractual and other legal obligations. The Group's policy is to settle the supplier's invoice for the complete provision of goods and services (unless there is an express provision for stage payments), when in full conformity with the terms and conditions of the purchase, within the agreed payment terms.

The Society's creditor days were 18 days at 4 April 2011 (2010: 18 days).

### Risk management

The Group seeks to manage all the risks that arise from its activities. There is a formal structure for monitoring and managing risk across the Group comprising a risk appetite agreed by the Board, detailed risk management policies, and independent governance and oversight risk.

The financial risk management objectives and policies of the Group are shown in the Business Review on pages 37 to 45 and in notes 38 to 41 on pages 136 to 152.

As a result of its normal business activities, the Group is exposed to a variety of risks, the most significant of which are:

- Credit risk;
- Liquidity and funding risk;
- Market risk including interest rate risk, currency and pension obligation risk;
- Operational risk; and
- Other risks including reputational risk, business risk and tax risk.

The Group has established a number of committees and policies to manage these risks. These are set out in the Risk Management and Control Section

of the Business Review on page 37 to 39 and in the Report of the Directors on Corporate Governance on page 70.

In addition to these financial risks the Group is exposed to the effects of the economic cycle, particularly relating to the UK residential housing and commercial property markets, and the competitive nature of the UK personal financial services markets in which we operate. These are discussed in the Chief Executive's Review on pages 7 to 12.

### Employees

During the financial year the Society has maintained its focus on the engagement of employees. Our leadership team has presented a consistent, challenging vision of the future in order to motivate our employees to continue to champion Nationwide's values as the leading mutual financial services organisation.

The Society continues to consult actively with the Nationwide Group Staff Union and the Employee Involvement Committee, chaired by the Executive Director Group Development and Operations, and its sub-committees act as forums where representatives from the business and the Union consult and share information on a range of business and employment issues.

It is the Society's policy to afford access to training, career development and promotion opportunities equally to all employees regardless of their race, creed, sex, marital status, age, physical or mental disability. Should employees become disabled, it is the Society's policy to continue their employment where possible with appropriate training and redeployment where necessary.

The Society's recruitment policy is to attract and select talented people who support the delivery of our business objectives, in line with Equal Opportunities and Treating Customers Fairly policies and our PRIDE values (the behaviours we seek from employees to treat our customers fairly). It is our policy to treat all candidates fairly and consistently and to be responsive to their needs throughout the recruitment process. The Society supports the principles of equality and inclusion by attracting and recruiting individuals from all sections of the community. Procedures are in place to ensure that recruitment decisions are not influenced by factors including, but not limited to, gender identity or expression, race, ethnic origin, nationality, citizenship, disability, religion, beliefs, marital or domestic/civil partnership status, sexual orientation or age. It is the Society's policy to be positive towards and committed to the employment of people with disabilities and to ensure that reasonable support is offered to suit their requirements or disability. Reasonable adjustments will be made to the recruitment and selection process for those with disabilities.

### Directors' responsibilities in respect of the preparation of the Annual Accounts

This statement, which should be read in conjunction with the Independent Auditors' Report on page 84, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Accounts, the directors' emoluments disclosures within the Report of the Directors on Remuneration, the Annual Business Statement and the Directors' Report.

The directors are required by the Building Societies Act 1986 (the Act) to prepare, for each financial year, Annual Accounts which give a true and fair view of the income and expenditure of the Society and the Group for the financial year and of the state of the affairs of the Society and the Group as at the end of the financial year, and which provide details of directors' emoluments in accordance with Part VIII of the Act and regulations made under it. The Act states that references to IAS accounts giving a true and fair view are references to their achieving a fair presentation. In preparing those Annual Accounts, the directors are required to:

- Select appropriate accounting policies and apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the Annual Accounts; and
- Prepare the Annual Accounts on the going concern basis, unless it is inappropriate to presume that the Group will continue in business.

The directors are also required by the Disclosure and Transparency Rules of the Financial Services Authority to include a management report containing a fair review of the business and a description of the principal risks and uncertainties facing the Group.

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 Society and its connected undertakings.

In September 2010, the British Bankers' Association published a Code for Financial Reporting Disclosure (the BBA code). The BBA code sets out five disclosure principles together with supporting guidance. The principles are that UK financial institutions will:

- Provide high quality, meaningful and decision-useful disclosures;
- Review and enhance their financial instrument disclosures for key areas of interest;
- Assess the applicability and relevance of good practice recommendations to their disclosures acknowledging the importance of such guidance;
- Seek to enhance the comparability of financial statement disclosures across the UK banking sector; and
- Clearly differentiate in their annual reports between information that is audited and information that is unaudited.

The Group and other major UK banks have adopted the BBA code in their 2010/11 financial statements, having previously adopted a draft version of the code in 2009/10. The Group's 2010/11 financial statements have therefore been prepared in compliance with the code's principles.

A copy of the Annual Accounts is placed on Nationwide Building Society's website at [nationwide.co.uk](http://nationwide.co.uk) (results and accounts section). The directors are responsible for the maintenance and integrity of statutory and

audited information on the website. Information published on the internet is accessible in many countries with different legal requirements. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

#### Directors' statement pursuant to the Disclosure and Transparency Rules

The directors confirm that, to the best of each person's knowledge and belief:

- The financial statements, 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 Business Review includes a fair review of the development and performance of the business and the position of the Group and Society, together with a description of the principal risks and uncertainties that they face.

#### Directors' responsibilities in respect of Accounting Records and Internal Control

The directors are responsible for ensuring that the Society and its connected undertakings:

- Keep accounting records which disclose with reasonable accuracy the financial position of the Society and the Group and which enable them to ensure that the Annual Accounts comply with the Act; and
- Establish and maintain systems of control of its business and records, and of inspection and report.

The directors have general responsibility for safeguarding the assets of the Group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

#### Directors' responsibilities in respect of going concern

In preparing the financial statements the directors must satisfy themselves that it is reasonable for them to conclude it is appropriate to adopt the going concern basis.

The Group meets its day to day liquidity requirements through managing both its retail and wholesale funding sources and is required to maintain a sufficient buffer over regulatory capital requirements in order to continue to be authorised to carry on its business.

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Chief Executive's Review on pages 7 to 12. The financial position of the Group, its capital structure and risk management and control processes for managing exposure to credit, liquidity, funding, market, and operational



# Directors' Report

continued

risk are described in the Business Review on pages 13 to 45. In addition, note 38 to the financial statements includes further information on the Group's objectives, policies and processes for managing its exposure to interest, credit, foreign exchange and liquidity risk, details of its financial instruments and hedging activities.

The Group's forecasts and projections, taking account of possible changes in trading performance and funding retention, and including stress testing and scenario analysis, show that the Group will be able to operate at adequate levels of both liquidity and capital for the foreseeable future. Furthermore the Group's capital ratio is comfortably in excess of the FSA requirement.

After making enquiries the directors are satisfied that the Group has adequate resources to continue in business for the foreseeable future and that, therefore, it is appropriate to adopt the going concern basis in preparing the Annual Accounts.

## Directors

The following served as directors of the Society during the year:

**Geoffrey Howe** (Chairman)

**Bill Tudor John** (Joint Deputy Chairman)

**Robert Walther** (Joint Deputy Chairman and Senior Independent Director)

**Graham Beale** (Chief Executive)

**Tony Prestedge** (Executive Director Group Development and Operations)

**Mark Rennison** (Group Finance Director)

**Chris Rhodes** (Executive Director Group Product and Marketing)

**Matthew Wyles** (Executive Director Group Distribution)

**Alan Dickinson** (Appointed to the Board 15 June 2010)

**Michael Jary**

**Roger Perkin** (Appointed to the Board 20 April 2010)

**Suzanna Taverne**

Former Directors:

**Stella David** (Retired from the Board 22 July 2010)

**Kevin Loosemore** (Retired from the Board 21 April 2010)

**David Rigney** (Group Operations Director) (Stepped down from the Board 21 July 2010)

**Derek Ross** (Retired from the Board 22 July 2010)

The Board has agreed that in accordance with the revised UK Corporate Governance Code (see the Report of the Directors on Corporate Governance) that all the directors will stand for election or re-election on an annual basis. In accordance with these requirements Roger Perkin and Alan Dickinson will stand for election at the 2011 AGM and the remainder of the directors will stand for re-election except for Bill Tudor John who will retire from the Board on 21 July 2011.

None of the directors has any beneficial interest in shares in, or debentures of, any connected undertaking of the Society.

## The auditors

A resolution to re-appoint PricewaterhouseCoopers LLP as auditors will be proposed at the Annual General Meeting.

**Geoffrey Howe**

Chairman

24 May 2011

# Report of the Directors on Corporate Governance

66-67

For the year ended 4 April 2011

Dear Member

The Society remains fully committed to maintaining the highest standards of corporate governance and understands that our members expect the Board to manage the Group's interests in a prudent and effective manner.

There have been numerous changes to the corporate governance landscape in recent years and 2010/11 has been no different. In May 2010, a revised UK Corporate Governance Code (the Code, formerly the Combined Code) was issued, and applies to reporting years starting on or after 29 June 2010. Although the new Code is specifically addressed to public quoted companies, building societies are encouraged by the Financial Services Authority to have regard to it. The Code itself is not a set of rigid rules but consists of principles and provisions to which the Society either complies or explains any non-compliance.

The new Code will not be applied by the Society until the year commencing 5 April 2011 and the Board believes that it complied with the BSA Guidance for Building Societies on the Code which applied during 2010/11 and intends to be compliant with the new Code in 2011/12.

During the year the Board has reviewed a number of its corporate governance practices and procedures, which are highlighted below:

- The training and development programme for non executive directors;
- The ongoing competency of the non executive directors;
- The form and content of the Board's strategy conference;
- The timing and frequency of the Board committee meetings; and
- The size, composition and experience of the Board of directors.

I hope that you will endorse the approach taken by your Board and acknowledge the importance placed upon the implementation of best practice corporate governance for the benefit of all our members.

**Geoffrey Howe**

Chairman

## Board composition and responsibilities

As at 4 April 2011 the Board comprised the Chairman, five executive and six non executive directors. All of the non executive directors are considered to be independent based on the guidance contained within the Code. Details of changes during the year and those subsequent to the year end are set out in the Directors' Report on page 66. The Board considers that the range of skills and experience of the executive and non executive directors is appropriate to achieve Nationwide's goals and carry out its strategy. During the year consideration has been given to the size and balance of the Board.

The roles of the Chairman and Chief Executive are separate and clearly defined and have been set out in writing and approved by the Board. No individual has unfettered powers of decision making.

The Board focuses on formulation of strategy, control and review of business performance, and is also responsible for ensuring that risks are appropriately identified and managed, and that a sound system of internal controls is maintained. As Chairman of the Society, Geoffrey Howe is responsible for leading the Board. Graham Beale, in his role as Chief Executive, has responsibility for running the Society's business under delegated authority from the Board and for implementing the policies and strategy set by the Board, supported by a series of executive management and risk committees. The principal committee which assists the Chief Executive in his role is the Executive Committee (EC) (formerly the Executive Directors' Committee) which meets on a weekly basis and has detailed terms of reference and is comprised of the

executive directors and group directors (details of which are provided on page 168). The EC oversees management committees that focus on Group performance, business area strategy performance reviews, transformation projects, retail performance and risk.

The roles and responsibilities of the non executive directors are set out in their appointment letters. Their key responsibilities, which are mainly supervisory, are to monitor business performance and provide constructive challenge, advice and recommendations on matters relating to: the strategy and performance of the Society; present and future availability of resources; and standards of conduct, compliance and control throughout the Group generally. The non executive directors have a responsibility to bring independent judgement to discussions held by the Board, using their breadth of experience and understanding of the business to provide an effective challenge. Robert Walther, a Deputy Chairman, is the Senior Independent Director.

Nationwide's High Level Business Controls Manual sets out Board members' individual responsibilities, the Society's governance and management structure and delegated authorities to management. The manual is reviewed annually by the Audit Committee and updated for developments in Nationwide's governance and management structure.

The non executive directors are expected to commit a minimum of 30 days per annum in exercise of their duties; however, membership of the various board committees extends this time commitment, particularly in respect of the committee chairmen. The Chairman spends a minimum of two and a half days a week on the Society's business and details of his

# Report of the Directors on Corporate Governance

continued

other directorships are set out on page 166. During the year Mr Howe resigned as a director of Investec plc and Investec Limited and was appointed as a director of Close Brothers Group plc. The Board believes that the Chairman remains wholly committed to his role and allocates sufficient time to meet its demands.

The Board's terms of reference are available at [nationwide.co.uk](http://nationwide.co.uk) and include a number of specific matters reserved to the Board and further details of the range of issues discussed by the Board are set out on page 69 under Board activities in the year.

## Board Committees

The Board has four principal committees, all of whose members are non executive directors.

**The Audit Committee** is responsible for reviewing the adequacy of the systems of financial and business control maintained by the Group. Its activities in the year are set out on pages 70 to 71 below.

**The Remuneration Committee** determines and agrees with the Board the framework for the remuneration of the Chairman, the executive directors and the other senior executives of the Society. Its activities in the year are set out in the Report of the Directors on Remuneration on pages 73 to 83.

**The Board Risk Committee** reviews the Society's risk management framework to ensure that it is appropriate to manage and mitigate current and prospective risks arising from the Group's business activities and future agreed strategy, and to ensure that the Group operates in line with its stated risk appetite. Its activities are set out on page 71 to 72.

**The Nomination Committee** is responsible for reviewing the structure, size and composition of the Board, succession planning for the Board and identifying suitable candidates to fill Board vacancies. Its activities in the year are set out on page 70.

The terms of reference of the above Committees are available at [nationwide.co.uk](http://nationwide.co.uk) or on request from the Society's Secretary.

## Induction, professional development and Board performance evaluation

Nationwide offers a comprehensive and structured induction programme to enable new directors to make an early and effective contribution. The induction process was reviewed during the year by the Nomination Committee and following output from the Board evaluation process carried out in April 2010 the Board has put in place a more formal development and training programme for non executive directors to ensure that so far as possible they are provided collectively and/or individually with the inputs and information necessary for them to understand the business and raise effective challenge. Non executive directors are encouraged to spend time with executives and with relevant departments to acquire information about the Society.

Following the independent evaluation of the performance and effectiveness of the Board undertaken by Dr Tracy Long from the consulting firm Boardroom Review in 2009/10, the process adopted for 2010/11 was the completion of confidential questionnaires by each

of the directors, the output from which formed the basis of a discussion led by the Chairman.

During the year the directors attended sessions presented by a number of business areas including Treasury, Risk and Compliance. A schedule of presentations for 2011/12 has been agreed.

All Board members have access to independent, professional advice on matters relating to their responsibilities and the benefit of appropriate liability insurance, both at the Society's expense.

A new process for the evaluation of non executive directors' performance was introduced during the year and the Chairman carries out twice yearly reviews at which two way feedback is provided and any gaps in a director's knowledge base are identified and suitable training is then provided. An evaluation of the Chairman's performance was carried out by the Senior Independent Director, with input provided by the other Board members. Executive directors were assessed against predetermined performance targets by the Chief Executive, whose performance was in turn evaluated by the Chairman. There were two core elements to the executive directors' targets, namely, executive division and individual performance. Divisional performance was aligned to the strategic agenda items and quantitative and qualitative measures were used to determine the resultant outcome. Individual performance was based around a number of measures including leadership capability, corporate reputation, strategic contribution and response to business priorities.

## Board appointments and re-election

In recommending appointments to the Board, the Nomination Committee considers the mix of relevant skills, knowledge and experience of the candidate. All directors must meet the tests of fitness and propriety laid down by the FSA and are required to be registered with the FSA as an 'approved person' in order to fulfil their 'controlled function' as a director.

The Nomination Committee, working in conjunction with an independent executive search consultant, recommended the appointments of Roger Perkin and Alan Dickinson who joined the Board on 20 April and 15 June 2010, respectively.

Following a review of the Board's composition the Nomination Committee concluded that the Board was well balanced with considerable collective depth in finance, risk management, legal and general management as well as significant experience in financial services. However, in order to further strengthen the Board it was determined that in the light of forthcoming retirements it would be appropriate to consider the recruitment of two new non executive directors with financial services backgrounds, one of whom would have a strong operational and IT background.

Additionally, members of the Society have the right under the Society's Rules to nominate candidates for election to the Board. No such nominations had been received by 4 April 2011, which was the deadline for the 2011 AGM.



The Board has agreed that in accordance with the Code all the directors will stand for election or re-election on an annual basis and in accordance with these requirements. Roger Perkin and Alan Dickinson will stand for election at the 2011 AGM. The remainder of the directors will stand for re-election except for Bill Tudor John who will retire from the Board in July.

The terms and conditions of appointment of the non executive directors are available for inspection from the Society upon request.

Kevin Loosemore, a non executive director, resigned from the Board with effect from 21 April 2010 and David Rigney, executive director, stood down as a director on 21 July 2010. Derek Ross and Stella David, both non executive directors, retired from the Board at the AGM on 22 July 2010.

#### Conflicts of interest

During the year the Board formalised its conflicts of interest policy and implemented revised procedures for reviewing and as appropriate authorising situations where such conflict arises.

#### Board activities in the year

During the year the Board held eleven meetings, including a strategy conference and details of the directors' attendance record is shown below.

At its scheduled meetings the matters considered by the Board included the following items:

- Regular reports from the Chief Executive and Group Finance Director covering updates on business performance, customer service and financial position including capital, liquidity and funding;
- Papers on business strategy;
- Economic and market conditions and outlook;
- Reports on the Group's overall risk profile relative to its stated risk appetite and limits;
- Regulatory developments; and
- Minutes and reports from each of the board committees and governance issues.

#### Board and Committee Attendance

The attendance of individual Board members during the year, with the number of meetings each is eligible to attend shown in brackets, is set out below:

| Current Directors   | Board attendance | Audit Committee | Nomination Committee | Remuneration Committee | Board Risk Committee |
|---|------------------|-----------------|----------------------|------------------------|----------------------|
| Graham Beale*, Chief Executive  | 11 (11)          | -               | -                    | -                      | -                    |
| Alan Dickinson, Chairman of the Board Risk Committee (Appointed on 15 June 2010)                              | 9 (9)            | 5 (5)           | -                    | -                      | 6 (6)                |
| Geoffrey Howe, Chairman of the Board and the Nomination Committee   | 11 (11)          | -               | 7 (7)                | -                      | -                    |
| Michael Jary  | 11 (11)          | -               | -                    | 10 (10)                | -                    |
| Bill Tudor John, Joint Deputy Chairman  | 10 (11)          | -               | 6 (7)                | 9 (10)                 | 8 (8)                |
| Roger Perkin, Chairman of the Audit Committee (Appointed on 20 April 2010)                                    | 11 (11)          | 6 (6)           | -                    | -                      | 8 (8)                |
| Tony Prestedge*   | 10 (11)          | -               | -                    | -                      | -                    |
| Mark Rennison*  | 11 (11)          | -               | -                    | -                      | -                    |
| Chris Rhodes*   | 11 (11)          | -               | -                    | -                      | -                    |
| Suzanna Taverne   | 10 (11)          | 5 (6)           | -                    | 10 (10)                | -                    |
| Robert Walther, Joint Deputy Chairman, Senior Independent Director and Chairman of the Remuneration Committee | 11 (11)          | -               | 7 (7)                | 10 (10)                | 8 (8)                |
| Matthew Wyles*  | 11 (11)          | -               | -                    | -                      | -                    |

| Former Directors                         | Board attendance | Audit Committee | Nomination Committee | Remuneration Committee | Board Risk Committee |
|--|------------------|-----------------|----------------------|------------------------|----------------------|
| Kevin Loosemore (Resigned 21 April 2010) | 1 (1)            | -               | -                    | -                      | -                    |
| Derek Ross (Retired 22 July 2010)        | 4 (4)            | 2 (2)           | -                    | -                      | 3 (4)                |
| Stella David (Retired 22 July 2010)      | 4 (4)            | -               | 2 (3)                | 5 (5)                  | -                    |
| David Rigney* (Resigned 21 July 2010)    | 3 (4)            | -               | -                    | -                      | -                    |

\*Executive directors

# Report of the Directors on Corporate Governance

continued

## Risk management and internal control

Nationwide's system of internal control is designed to enable the Group to achieve its corporate objectives within a managed risk profile, not to eliminate risk. The principal categories of risk inherent in the Group's business are described in greater detail in the Business Review under the heading Risk Management and Control on page 39, together with an explanation of the structure adopted within the Group for managing risk (including the roles of the Executive Risk Committee, Credit Committees and the Assets and Liabilities Committee).

The Board has ultimate responsibility for risk management and control and has approved a risk appetite statement. In the context of the risk appetite statement, the Board Risk Committee has approved the supporting risk policies for the Group. The Board Risk Committee is the forum for non executive directors to provide focus and oversight on risk governance matters including risk appetite, stress testing, the risk management framework and the risk policies and to advise the Board of these. More detail about this Committee can be found on pages 71 to 72.

The Executive Risk Committee reports into the Chief Executive and is responsible for ensuring a co-ordinated approach across all risks and has oversight of the various risk committees of the Group (as described in the Business Review).

Performance against risk appetite is monitored monthly at the Executive Risk Committee, reported to the Board Risk Committee at each meeting, and reported to the Board on a quarterly basis. Risk appetite monitoring includes review of the Group's position against a number of key limits in relation to solvency, liquidity, funding, asset quality, quality of earnings and operational risks. In addition, a range of external, macroeconomic indicators are monitored to provide context. Risk appetite is also monitored in the context of strategy in the corporate plan and other reporting.

The Risk Management division ensures that appropriate risk management systems are in place across the Group's operations, and provides expertise and support to the business in its management of risk on a day-to-day basis and the specialist risk committees that support the Executive Risk Committee. The division also monitors regulatory, political and industry guidelines and indicators to ensure that the risk management framework develops in line with best practice.

The Operational Risk Committee provides independent oversight of operational risks, and management of compliance and regulatory risk is overseen by the Compliance Committee. Both of these committees report into the Executive Risk Committee, which is subject to oversight by the Board Risk Committee.

The Audit Committee, on behalf of the Board, is responsible for reviewing the adequacy and effectiveness of the Group's risk management and internal control processes. Following review by the Audit Committee, the Board is satisfied that the Society's systems for identifying, evaluating and managing risks are appropriate.

## Nomination Committee

The Nomination Committee comprises Geoffrey Howe (Chairman), Robert Walther and Bill Tudor John.

The Nomination Committee keeps under review the structure, size and composition of the Board, and considers succession planning for Board members, group directors and divisional directors. Before any Board appointments are made, the Committee evaluates the balance of skills, knowledge and experience required and identifies suitable candidates, using open advertising and external advisers to facilitate the search. See the section above headed 'Board appointments and re-election' for more information.

The Committee also reviews the time commitment required from non executive directors.

Annually the Committee reviews its own performance and terms of reference to ensure it is operating at maximum effectiveness, and recommends any changes considered necessary to the Board.

## Audit Committee and auditors

As at the date of this report the Audit Committee comprises three non executive directors: Roger Perkin (Chairman), Suzanna Taverne and Alan Dickinson. Kevin Loosemore and Derek Ross were members of the committee until 21 April and 22 July 2010 respectively. Roger Perkin, a former partner at Ernst & Young LLP has recent and relevant financial experience by virtue of his previous role, together with his other non executive directorships.

By invitation, Audit Committee meetings are also attended by the Chairman of the Board, the Chief Executive, the Group Finance Director, the divisional directors of Risk Management and Business Protection, Chief Internal Auditor and the external auditors.

The Audit Committee's terms of reference include responsibility for review of the financial statements, including accounting policies, methods and judgements; review of internal controls and risk management systems including regulatory compliance; responsibility for recommending to the Board on the appointment, reappointment and removal of external auditors; maintenance of an appropriate relationship with the Society's external auditors; and review of the effectiveness of the internal audit function. In order to satisfy itself that the risk and control framework is operating effectively, the Committee members received a range of reports and other information.

The Committee held six meetings during the year.

Meetings covered matters including:

- Discussion of papers detailing any significant accounting judgements and estimates, with particular focus on asset valuations and impairment provisions including significant assumptions made;
- Detailed review of the interim and year end financial statements and recommendation for approval by the Board;
- Discussion of reports and presentations from business areas on control and governance arrangements, and on Nationwide's whistle blowing arrangements;
- Approval of the annual plans for Group internal audit and for the Compliance function;
- Review of regular reports from the Chief Internal Auditor and the divisional director with responsibility for Compliance, setting out the results of work carried out, conclusions on the effectiveness of the control environment and progress made by management in addressing any issues raised;
- Review and discussion of reports from the external auditors following the interim and year end audit process, and of internal control reports from the external auditors;
- Approval of the audit fee for the external audit, approval of proposals for appointment of the external auditors for non-audit work, and regular review of non-audit fees paid to the external auditors;
- Formal assessments of the effectiveness of the external audit and internal audit functions; and
- Periodic updates on a wide range of issues including tax, hedge accounting, Pillar 3 disclosures, fraud and anti-money laundering initiatives.

In addition, the Audit Committee conducted a formal review of its effectiveness, by a detailed review of its activities and terms of reference against published guidance and best practice, and analysis of assessment questionnaires completed by Committee members, the Chairman of the Board, the Chief Executive, the Group Finance Director, the external auditors and a number of divisional directors who attended committee meetings.

The Audit Committee is the body responsible for overseeing the Society's relationship with the external auditors. The Audit Committee assesses annually the qualification, expertise and resources and independence of the external auditors and the effectiveness of the audit process. The assessment covers all aspects of the audit service they provided by the audit firm. The Audit Committee have concluded they should recommend to the Board that PricewaterhouseCoopers LLP should be re-appointed as the Society's external auditors.

The external auditors' plan for the audit of the Group was discussed with them and approved by the Committee. The auditors outlined the areas that they considered to be of most significant risk and how their work programme would ensure that these risks did not lead to a material misstatement of the financial statements. These assessments of risk were then revisited at the time of the review of the Half-Yearly Financial Report and at the conclusion of the audit of the Annual Report

and Accounts. Prior to the Committee recommending the approval of the Annual Report and Accounts, they considered a report from the external auditors setting out:

- The work carried out on the areas of most significant risk, in particular where accounting assumptions and estimates had been applied, and how they had satisfied themselves that these were reasonable;
- Their views on any judgements made in applying accounting policies; and
- A summary of any misstatements identified during the course of testing.

The most significant items discussed with the external auditors throughout the year were as follows:

- Loan impairment and provisions on residential mortgages, with particular focus on new, more sophisticated provisions models which were introduced during the year, and on the consideration of forbearance;
- Provisions in respect of certain commercial loans and Treasury assets;
- Volatility which arose due to hedge accounting, as described in note 8 on page 103;
- The Group's potential exposure to claims in respect of previous sales of payment protection insurance, as set out in note 31 on page 128;
- The residual level of credit risk adjustments which were made on the acquisition of the Derbyshire and Cheshire building societies and Dunfermline's social housing portfolio, as described on page 20.

The Committee also held private discussions with the external auditors, the Divisional Director Risk Management, the divisional director responsible for Compliance and the Chief Internal Auditor.

In order to safeguard auditor objectivity and independence, the Audit Committee has a formal policy for the engagement of external auditors for non-audit services and a schedule of fees for non-audit work was reviewed at each Committee meeting. This defines permitted services and work requiring Audit Committee pre-approval.

During the year the Financial Reporting Council published several documents including 'Guidance on Audit Committees' (for which adoption is encouraged with effect from 30 April 2011) and a discussion paper 'Effective Company Stewardship' – the implications of which are under review and our compliance status will be reported in next year's Annual Report and Accounts.

#### Board Risk Committee

The Board Risk Committee comprises four non executive directors: Alan Dickinson (Chairman), Robert Walther, Bill Tudor John and Roger Perkin. The Chairman of the Board and the Chief Executive are not members of the Committee although they usually attend meetings of the Committee by invitation. The Group Finance Director and the Chief Risk Officer who starts his role on 1 July 2011 are expected to attend Committee meetings, with other directors and senior managers invited to attend as appropriate. All members of the Board Risk Committee receive supplementary fees in recognition of their additional

# Report of the Directors on Corporate Governance

continued

responsibilities. Under its terms of reference, the Board Risk Committee's responsibilities include reviewing and making recommendations to the Board about risk appetite, strategies, frameworks, policies, models and limits for risk as defined in the risk management policies. The Board Risk Committee is also responsible for reviewing and challenging the Group's assessment and measurement of key risks, providing oversight and challenge to the design and execution of stress testing, and monitoring the performance of the Executive Risk Committee.

The Board Risk Committee met eight times during the year and is scheduled to meet at least six times in the coming year. During the year it monitored the Group's key risks and associated metrics and reviewed and recommended to the Board a revised risk appetite, revised risk policies and considered the results of a number of stress testing scenarios. Other areas of risk discussed include the Individual Liquidity Adequacy Assessment and Internal Capital Assessment submissions, potential impacts of changing regulation as a result of 'Basel III', asset quality reviews (Retail, Commercial and Treasury), a review of the Society's Pension Fund Investment Strategy and Risks, and progress on developing a Core Tier 1 Capital Instrument for the mutual sector. The Committee has also been informed about in-depth reviews of both Business Continuity and Operational Risk. Following these reviews, the Committee is satisfied that the risk appetite, risk management framework, risk policies and approach to stress testing are appropriate for the Group.

## Relations with members

As a mutual, the Society has a membership comprising around 15 million individuals, all of whom are the Society's customers. The Society actively seeks the views of members in various ways. Member TalkBack events (both face-to-face and via the internet) give members an opportunity to ask questions or express points to directors. During the year TalkBack sessions were held in Newcastle, Bournemouth, Glasgow, Bath, Southampton and Reading and were attended by directors and senior management. Such direct contact helps promote good corporate governance as it assists directors in their understanding of members' requirements, which are then discussed at Board level. Such engagement also helps to shape the products and services that members are offered.

In June 2009 the Society launched 'Members' Zone' (**nationwide-members.co.uk**), a multi-functional website service for members' news and views. Members' Zone engages, informs and involves members via a range of website features, including a members' feedback forum.

The Member Suggestion Scheme enables members to express their views on an ongoing basis and is available online and in branch.

An external accredited research company rings customers every month to gather feedback on their experiences for the Society's Service Tracker. Over the past year they have spoken to around 15,000 customers each month.

## Constructive use of the AGM

The Society will once again send out AGM packs to approximately 8 million members who are eligible to vote. Members are sent voting forms and are encouraged to vote or appoint a proxy to vote if they cannot, or choose not to, attend the AGM. Voting is available by post, in any of the Nationwide Group's branches, online at **nationwide.co.uk** or at the AGM. All votes and all proxy votes are counted under independent scrutiny.

At the AGM the Chief Executive will give a presentation on the main developments in the business and members present will have the opportunity to raise questions and put forward their views. All members of the Board are present at the AGM each year (unless exceptional circumstances prevent their attendance) and the chairmen of the principal Board Committees are available to answer questions.

**Geoffrey Howe**

Chairman

24 May 2011

# Report of the Directors on Remuneration

For the year ended 4 April 2011

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## Introduction

Dear Member

I am pleased to present the Remuneration Committee's report on directors' remuneration for the year to 4 April 2011.

The remuneration landscape in the financial services sector has evolved over the past year under continued scrutiny from the media, industry regulators and politicians. The Financial Services Authority (FSA) issued its revised Code on Remuneration Practices, which came into effect on 1 January 2011, and this now incorporates the requirements of the EU Capital Requirements Directive 3 in relation to executive remuneration.

We have delivered a strong financial performance for our members against the background of the fragile recovery in the UK economy. We have recorded an underlying profit of £276 million, an increase of £64 million on 2010 and a 30% year on year increase. In addition we have maintained strong capital and liquidity ratios, and have progressed against our other strategic priorities. Our financial performance has been based on a foundation of safety, security and provision of excellent products and services for our members, as the interests of our members always come first.

The Remuneration Committee has taken into account these factors, when considering the appropriateness of remuneration at Nationwide.

The key points for this financial year are as follows:

- Overall remuneration levels remain modest compared with most other financial services organisations;
- No executive director received a salary increase in 2010/11, the second consecutive year without an increase;
- A payment has been made under the Annual Performance Pay Plan (APPP) reflecting the Society's strong performance during the year – but not at the maximum level permitted under the plan; and
- Based on the Society's sustained strong performance over the three year plan period, a payment between 'target' and 'maximum' has been made under the Medium Term Performance Pay Plan (MTPPP) cycle for the 2008-2011 period.

In last year's Directors' Remuneration Report, we informed you of our intention to carry out a review to assess the effectiveness of our current executive remuneration structures and the balance of fixed and variable remuneration, to ensure that the relationship between risk and reward remains appropriate.

In this context, the key principles that have guided our review of executive directors' remuneration have been as follows:

- Individual directors' base salary should be set at around the market median;
- Total compensation for 'on target performance' should be positioned at slightly below the market median, but should not fall below lower quartile. For 'maximum performance' total compensation levels should be substantially below market median. This will be achieved by reducing the proportion of total compensation that is achievable through variable pay plans. This is consistent with our risk philosophy as a mutual society and the FSA Remuneration Code guidance; and
- Our incentive programmes should be aligned with the Corporate Plan and incorporate features to encourage sound risk management practices, in line with emerging best practice in the financial services market.

These principles have led us to make changes to our remuneration policies, which will come into effect from the start of the 2011/12 financial year.

The Committee recognises that executive directors' base salary has fallen significantly behind the market over time, and that this position is unsustainable from a competitive perspective. Accordingly, we have taken corrective action to position base salary at around the market median.

At the same time, the Committee has determined that the award levels that executive directors can earn under the APPP and MTPPP as a percentage of base salary should be reduced from 2011/12 onwards (following a reduction that was already applied in 2010/11 compared with previous years). This approach is consistent with the principle we have adopted that lower incentive opportunities are a better reflection of our low-risk appetite.

# Report of the Directors on Remuneration

continued

Finally, building on dialogue with the FSA regarding emerging industry practices, we have made some specific changes to the operation of our performance plans:

- We have adopted new deferral provisions in both the APPP and the MTPPP awards. This means that awards will be retained for a longer period and paid out conditional on sustained performance. This underlies our commitment to long term value and sustainability;
- We have brought the performance conditions for MTPPP awards where we are part-way through the cycles into alignment with the design for future cycles to ensure that performance measures adequately take risk issues into account; and
- We have incorporated an additional performance test for the MTPPP (which must be passed as a condition for payments being made), to provide our members with assurance that our Core Tier 1 capital ratio remains strong, which is a key measure of the resilience of our business.

The combination of changes we have made as a consequence of the review results in executive remuneration that is positioned conservatively against external market practice, and operates with reduced incentive opportunity for both target and maximum performance. This is considered appropriate for Nationwide and the Committee believes that this approach is in the best interests of our members.

On behalf of the Committee, I hope that you will endorse our report.

**Mr R Walther**

Chairman of the Remuneration Committee

## The Remuneration Committee

Nationwide adopts high standards of corporate governance so we provide full details of our directors' remuneration and ask our Members to approve the Remuneration Report at the Annual General Meeting (AGM). This report includes the key disclosure requirements of the UK Corporate Governance Code and follows market best practice in so far as it applies to Nationwide as a mutual building society.

The Remuneration Committee is responsible for:

- Determining the policy for the remuneration of the Chairman, the executive directors and group/divisional directors of the Society as well as any other employees who are deemed to fall within scope of the FSA Code ('Code Staff'). The objective of this policy is to ensure that the relevant individuals are provided with incentives to encourage enhanced performance within an appropriate risk framework and are rewarded, in a fair and reasonable manner, for their individual contributions to the success of the Society;
- Within the terms of the agreed policy, determining the specific remuneration packages for the Chairman, the executive directors, group/divisional directors and Code Staff both on appointment and on review;
- Approving the design of, and determining the performance targets for, any discretionary variable pay schemes operated by the Society for the benefit of employees within the Committee's remit, and approving the total annual payments under such schemes; and
- Overseeing the remuneration policy throughout the Society, with a specific focus on the risks posed by remuneration policies and practices.

The Committee's terms of reference were last reviewed and updated in April 2011. The full terms of reference are available on the Society's website.

The members of the Remuneration Committee are all independent non executive directors of the Society and include two members of the Board Risk Committee. During the year the Committee members were:

Robert Walther (Chairman of Remuneration Committee from the 2010 AGM onwards)

Stella David (Chairman of the Remuneration Committee until she stood down as a director following the 2010 AGM)

Suzanna Taverne

Bill Tudor John

Michael Jary

The Committee met 10 times during the year. Activities during the year included:

- Reviewing the structure of the total remuneration package for directors, with specific focus on the balance between fixed and variable reward. This review was made in the context of evolving industry practice, and with careful consideration of the links between risk and reward;
- Reviewing the impact of the further developments in the FSA Remuneration Code on Nationwide's remuneration policy and practices, building on dialogue with the FSA regarding emerging industry trends;
- Reviewing the approach taken for measuring performance under the APPP and MTPPP; and
- Agreeing the remuneration arrangements for new director appointments and the remuneration arrangements for departing directors.



The Committee is supported by Geoffrey Howe (Chairman of the Board), the Director of Human Resources and where appropriate the Chief Executive, who may also be invited to attend Committee meetings to provide further background information and/or context to assist the Committee in their duties. The Remuneration Committee is also supported by the Board Risk Committee on risk related matters including incentive plan design, the assessment of specific performance measures, and wider issues relating to risk and business protection. In no case is any person present when their own remuneration is discussed.

In performing its duties, the Remuneration Committee draws on the advice of independent external consultants. Ian Tinsley (formerly of Hay Group and retained as an independent adviser) and Hay Group provided independent advice during the year on market rates of pay, best practice and remuneration trends.

#### Remuneration policy

The Committee is guided by the following overarching principles:

1. Pay will support the attraction and retention of high quality people;
2. There will be a clear link between performance and remuneration;
3. Our approach to pay will be uncomplicated;
4. Levels of remuneration will be determined by reference to the market for similar jobs within the UK financial services sector;
5. Pay will reflect the market and decisions are based on what is appropriate for Nationwide;
6. The incentive opportunity at Nationwide will not 'lead the market';
7. No pay arrangements should directly or indirectly expose Nationwide to inappropriate risk.

There are three main elements of remuneration:

- Base salary;
- Variable pay (annual performance pay and medium term performance pay); and
- Benefits (pension, car and healthcare).

#### Management of risk

The Society manages the risk implications of its remuneration arrangements in a number of ways, including:

- Striking the optimal balance between 'fixed' elements of pay (base salary and pension), and 'variable' pay (annual and medium term performance incentives) to ensure variable pay overall and on an individual-by-individual basis remains an appropriate proportion of total pay;
- Establishing an appropriate balance between 'target' incentive outcomes and the 'maximum' opportunity in line with our low-risk appetite;
- Ensuring performance for all variable pay plans is measured by reference to a range of factors including non-financial objectives, which take into account risk, sustainability of performance and Nationwide's values in order to take a rounded view of performance;
- Setting limits on variable pay for senior employees that are low by sector standards and which place greater emphasis on long term rather than short term performance;
- Establishing a specific risk measure for the MTPPP, which would cause outstanding awards to be cancelled if our Core Tier 1 capital ratio, a key measure of the resilience of our business, falls below an acceptable level that is pre-determined by the Board/Remuneration Committee; and
- Retaining the discretion to change or cancel payments under Nationwide's incentive plans if it is felt that they do not properly reflect the Society's performance or are otherwise unaffordable.

The Chief Executive is the Society's most highly paid employee and no employee below executive director level earns more than the executive directors.

As we set out in last year's Remuneration Report, a fundamental review has been conducted during 2010/11 to assess the continued effectiveness of our current executive remuneration structures and to ensure that the relationship between risk and reward remains appropriate. As a direct consequence of this review, we have introduced a number of new measures to further align remuneration at Nationwide with risk considerations which are outlined in this report. These changes will come into effect from the start of the 2011/12 financial year.

# Report of the Directors on Remuneration

continued

## Main components of remuneration

The table below summarises the Society's policies in respect of the structure and each of the key elements of executive directors' remuneration.

| Element                                      | Policy   | Details  |
|--|--|--|
| Total compensation opportunity and structure | <ul style="list-style-type: none"> <li>The Committee takes a total compensation approach considering the pay package in terms of base salary in conjunction with the total potential incentive value.</li> <li>It is appropriate that this is competitive against the businesses with which we compete for talent, although we do not seek to 'lead' industry pay practice.</li> </ul> | <ul style="list-style-type: none"> <li>Our intention is that total compensation is set at a level that is slightly below median practice, while base salaries are set at a level that is broadly in line with median market practice.</li> </ul>   |
| Base salary                                  | <ul style="list-style-type: none"> <li>Base salary reflects the size of the role and what other similar companies would pay, as well as reflecting the individual's skills, experience and performance. Internal pay relativities are also taken into account in determining base salary.</li> </ul>   | <ul style="list-style-type: none"> <li>Base salary is designed to ensure Nationwide pays around the median market range for the job and our aim is to be neither the highest nor the lowest payer in base salary terms.</li> </ul>   |
| Annual Performance Pay Plan (APPP)           | <ul style="list-style-type: none"> <li>Rewards the achievement of challenging performance targets for a single financial year against a range of financial and non-financial measures.</li> </ul>  | <ul style="list-style-type: none"> <li>APPP awards are based on a combination of Group and individual performance measures, as appropriate for each role. These are a mixture of financial and non-financial measures.</li> <li>For the CEO and executive directors, the APPP is designed to represent c. 40% of variable remuneration.</li> </ul>   |
| Medium Term Performance Pay Plan (MTPPP)     | <ul style="list-style-type: none"> <li>The Medium Term Performance Pay Plan provides the deferred element of remuneration. It recognises sustained performance and achieving challenging financial targets over a three year performance cycle. A new three year performance cycle starts each year.</li> </ul>  | <ul style="list-style-type: none"> <li>MTPPP cycles are subject to a risk measure. If this condition is breached at any point, then all outstanding MTPPP cycles will be cancelled.</li> <li>MTPPP payouts are based on a combination of financial and non-financial performance measures to provide a robust assessment of overall performance over the three year performance cycle.</li> <li>For the CEO and executive directors, the MTPPP is designed to represent c. 60% of variable remuneration.</li> </ul>  |
| Benefits                                     | <ul style="list-style-type: none"> <li>Provides a market competitive package as part of fixed remuneration.</li> </ul>   | <ul style="list-style-type: none"> <li>Executive directors receive certain benefits in line with market practice, including a car allowance, healthcare and mortgage allowance.</li> </ul>   |
| Pension                                      | <ul style="list-style-type: none"> <li>Provides post-retirement benefits for participants in a cost efficient manner.</li> </ul>   | <ul style="list-style-type: none"> <li>The Society operates a number of approved pension arrangements in which individual executive directors participate.</li> <li>The policy for new appointments (since June 2007) is to provide a pension contribution as a fixed percentage of salary.</li> <li>From April 2011, all directors participating in defined benefit plans were moved into a CARE (Career Average Revalued Earnings) arrangement with 1/60th accrual for future service. All directors may opt out of the CARE arrangement and receive a pensions allowance in lieu of pension accrual.</li> </ul> |

### Base salary 2010/11

The Society's policy is to pay at around the median market rate for the job and our aim is to be neither the highest nor the lowest payer. The Committee normally reviews base salary on an annual basis, taking into account the size of the role and what other similar companies would pay, as well as the individual's skills, experience and performance. The pay and employment conditions in the wider organisation are also taken into account in determining executive directors' remuneration. Changes to base salary are normally effective from 1 April each year.

The executive directors have foregone any increase in base salaries for the past two years in light of the broader economic environment and despite Nationwide's strong performance in very challenging market conditions. It is now three years since the Chief Executive's last base salary increase.

The table below sets out the base salary levels for executive directors which were in effect during the year, compared against base salary levels in the previous two years.

| Base salary   | 2010/11  | 2009/10  | 2008/09  |
|---------------|----------|----------|----------|
|               | p.a.     | p.a.     | p.a.     |
| G J Beale     | £650,000 | £650,000 | £650,000 |
| T P Prestedge | £350,000 | £350,000 | £331,000 |
| M M Rennison  | £440,000 | £440,000 | £440,000 |
| C S Rhodes*   | £350,000 | £333,000 | -        |
| M P V Wyles   | £350,000 | £350,000 | £348,000 |

\* Reflects part year earnings for year of appointment to Board.

### Annual Performance Pay Plan 2010/11

The APPP comprises two performance elements:

- 60% relates to the performance of Nationwide against our Corporate Plan, measured using a balanced scorecard of five equally weighted Key Performance Indicators (KPIs):
  - Underlying profit;
  - Non-margin income;
  - Cost income ratio;
  - Customer satisfaction rating; and
  - Delivering transformation projects.

These cover a range of financial and non-financial measures to reflect the Society's progress in achieving its Corporate Plan; and

- 40% relates to individual performance objectives reflecting each individual's leadership and contribution towards delivery of the Corporate Plan.

This balanced scorecard approach ensures that participants cannot

generate significant additional reward by delivering very high levels of performance in a single area at the expense of other corporate priorities. The APPP is discretionary and the Remuneration Committee is able to amend payments if it believes that they are not representative of overall performance. The Remuneration Committee may also reduce, defer or withhold payments in the event of Nationwide making a loss.

To further support our reward principle that there will be a clear link between performance and remuneration an additional retention period for APPP payments has been introduced. Accordingly, the payment of 50% of the award will be delayed for 6 months, and may be subject to downwards performance adjustment.

Maximum award levels under the APPP were reduced in 2010/11 from the levels that have previously applied (from 105% to 90% of base salary for the CEO, and from 80% to 67.5% for other executive directors).

### APPP outcomes for 2010/11

The Remuneration Committee believes that the executive team has delivered a strong performance in 2010/11 in what continued to be challenging market conditions. The key achievements of the Group during 2010/11, with reference to the objectives set under the relevant balanced scorecard categories are as follows:

| Key performance indicator          | Performance outcome           |
|------------------------------------|-------------------------------|
| Underlying profit                  | Between on-target and maximum |
| Non-margin income                  | Between on-target and maximum |
| Cost income ratio                  | Maximum                       |
| Customer satisfaction rating       | On-target                     |
| Delivering transformation projects | Threshold                     |

Executive directors' performance against their individual objectives is assessed on a discretionary basis. A key element that has been taken into account in assessing their Leadership contribution for the year are the results of our annual employee survey 'Viewpoint'. This shows that significant progress has been made during the year in terms of employee engagement and employee enablement, both compared to previous years and external benchmarks.

# Report of the Directors on Remuneration

continued

The APPP payments made in respect of 2010/11 are shown in the table below, together with the awards made in the previous two years.

|               | 2010/11    |                          | 2009/10    |                          | 2008/09    |                          |
|---------------|------------|--------------------------|------------|--------------------------|------------|--------------------------|
|               | APPP award | % of 2010/11 base salary | APPP award | % of 2009/10 base salary | APPP award | % of 2008/09 base salary |
|               | £000       | %                        | £000       | %                        | £000       | %                        |
| G J Beale *   | 441        | 67.8                     | 231        | 35.5                     | nil        | -                        |
| T P Prestedge | 178        | 50.9                     | 224        | 63.9                     | nil        | -                        |
| M M Rennison  | 224        | 50.9                     | 259        | 58.9                     | nil        | -                        |
| C S Rhodes ** | 182        | 51.9                     | 198        | 58.9                     | -          | -                        |
| M P V Wyles   | 185        | 52.9                     | 199        | 56.9                     | nil        | -                        |

\* For 2009/10 the Remuneration Committee was minded to award the Chief Executive an APPP payment of £534,000 (82.1%) but taking into account the request of the Chief Executive, this was reduced to £231,000 (35.5%).

\*\* Appointed to the Board in April 2009.

## Medium Term Performance Pay Plan – outstanding plans in cycle

The MTPPP rewards sustained performance and the achievement of challenging financial targets over a three year performance cycle. A new three year performance cycle starts each year. Payouts under the plan are payable in cash and restricted to a percentage of base salary.

As described in last year's report, following an initial review of the MTPPP against the FSA Remuneration Code in 2010, and in agreement with the FSA, the Committee decided to review the performance measures and targets for outstanding and future award cycles. The intention has been to ensure that the vesting conditions represent an appropriately rounded assessment of business performance, with adjustments made where necessary to take risk issues sufficiently into account.

Following this review, the Committee has decided that awards under the 2010-2013 MTPPP cycle will be assessed against the following long term measures, which reflect the strategic priorities for the business in the Corporate Plan:

- Cumulative underlying profit over the MTPPP period;
- Cumulative non-margin income over the MTPPP period;
- Cost income ratio achieved for the last year of the MTPPP period; and
- Customer satisfaction rating achieved at the end of the MTPPP period.

A specific risk measure for the MTPPP has been introduced for all outstanding and future awards. Achievement of this measure will ensure that we maintain a strong capital base which is consistent with our risk appetite and regulatory requirements for the business. If Core Tier 1 capital falls below this minimum level at any point in time, which is a key measure of the resilience of our business, then all outstanding MTPPP awards would be cancelled.

The Remuneration Committee has also reviewed the targets for outstanding awards for the 2008-2011 and 2009-2012 cycles. The absence of a risk measure meant that the original scheme has become non-compliant with the new FSA Code. Also consolidation in the industry peer group has meant that the relative basis for assessing performance that was

originally proposed has become increasingly less stable as there are fewer companies in the group to measure against. The Committee has determined that these MTPPP cycles should be measured against the same measures agreed for the 2010-2013 cycle, with the exception of 'non-margin income' (which was not historically a business KPI and therefore does not lend itself to measurement over these time periods).

To ensure compliance with the deferral requirements introduced by the FSA Remuneration Code, for each cycle from 2009-2012 onwards two-thirds of the award earned will be paid following the end of the three year performance period and payment of the remaining one-third will be deferred for an additional year. During this further deferral period, awards may be subject to further performance adjustment if it emerges that the original assessment of performance was misleading or if performance against the MTPPP measures declines substantially over the following year.

The plan is discretionary and the Remuneration Committee has the discretion to amend payments if it believes that they are not representative of overall performance.

## MTPPP outcomes for 2008-2011 cycle

On the basis of Nationwide's strong performance in what continued to be challenging market conditions a payout will be made in respect of the 2008-2011 plan cycle, based on the following performance outcomes:

| Key performance indicator    | Performance outcome |
|------------------------------|---------------------|
| Cumulative underlying profit | On-target           |
| Cost income ratio            | Maximum             |
| Customer satisfaction rating | On-target           |

The MTPPP payments made in respect of the 2008-2011 cycle (payable in June 2011) are shown in the table below, together with the payments made in respect of the previous two cycles.

|               | 2008-2011   |                          | 2007-2010*  |                          | 2006-2009   |                          |
|---------------|-------------|--------------------------|-------------|--------------------------|-------------|--------------------------|
|               | MTPPP award | % of 2010/11 base salary | MTPPP award | % of 2009/10 base salary | MTPPP award | % of 2008/09 base salary |
|               | £000        | %                        | £000        | %                        | £000        | %                        |
| G J Beale     | 650         | 100.0                    | 521         | 80.2                     | 752         | 115.6                    |
| T P Prestedge | 266         | 76.0                     | 216         | 61.7                     | 296         | 89.4                     |
| M M Rennison  | 334         | 76.0                     | 272         | 61.8                     | 393         | 89.3                     |
| C S Rhodes    | 266         | 76.0                     | 150         | 45.0                     | -           | -                        |
| M P V Wyles   | 266         | 76.0                     | 216         | 61.7                     | 310         | 89.1                     |

\*The 2007-2010 MTPPP cycle was closed early in December 2009. In recognition of the shortened performance period and early payment of this plan cycle, payments under this scheme were reduced by one-third.

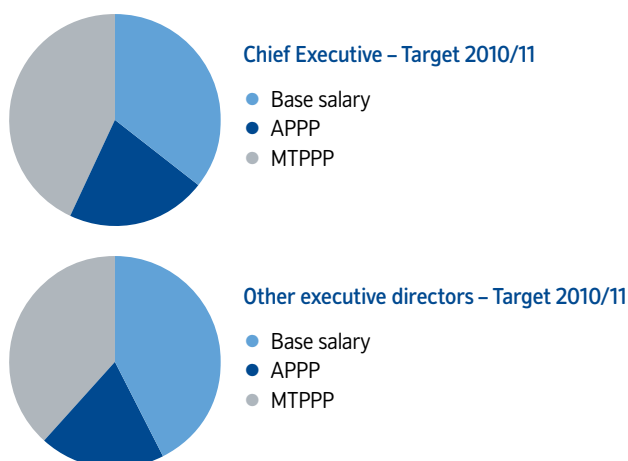
### Total cash compensation

The table below summarises the total cash compensation (base salary + APPP + MTPPP) received by executive directors for 2010/11, compared against the previous two years. This excludes any valuation for pension or other benefits.

|               | 2010/11<br>Total cash<br>compensation | 2009/10<br>Total cash<br>compensation | 2008/09<br>Total cash<br>compensation |
|---------------|---------------------------------------|---------------------------------------|---------------------------------------|
|               | £000                                  | £000                                  | £000                                  |
| G J Beale *   | 1,741                                 | 1,402                                 | 1,402                                 |
| T P Prestedge | 794                                   | 790                                   | 627                                   |
| M M Rennison  | 998                                   | 971                                   | 833                                   |
| C S Rhodes    | 798                                   | 681                                   | -                                     |
| M P V Wyles   | 801                                   | 765                                   | 658                                   |

\* For 2009/10 the Remuneration Committee was minded to award the Chief Executive an APPP payment of £534,000 (82.1%) but taking into account the request of the Chief Executive, this was reduced to £231,000 (35.5%).

The charts below illustrate the balance of fixed and variable and short and medium term reward for our executive directors at target levels of performance based on remuneration arrangements for 2010/11.



### Remuneration policy for 2011/12 onwards

Following a review of executive directors' remuneration carried out during the last year, the following changes to our remuneration policies will come into effect from the start of the 2011/12 financial year.

#### Base salary for 2011/12

The Committee recognises that base salary for our executive director roles has fallen below a market competitive range over time, and it is the Committee's view that this is not a sustainable position going forward. The table below sets out base salary levels that have been approved for 2011/12. These changes to base salary are required to ensure these remain at a level that is broadly in line with median market practice.

|               | 2011/12<br>Base salary |
|---------------|------------------------|
| G J Beale     | £825,000               |
| T P Prestedge | £470,000               |
| M M Rennison  | £560,000               |
| C S Rhodes    | £470,000               |
| M P V Wyles   | £470,000               |

These changes should be considered in the context of the significant reductions in the potential award levels under the APPP and MTPPP (described below). This approach is consistent with our principle that variable pay should form a smaller proportion of the overall total cash package as this is consistent with our conservative risk profile and business strategy.

#### Variable pay plans for 2011/12

The structure of the APPP for 2011/12 remains unchanged from the 2010/11 plan. Maximum award levels under the APPP were reduced in 2010/11 from the levels that have previously applied (from 105% to 90% of base salary for the CEO, and from 80% to 67.5% for other executive directors). As a consequence of the remuneration review we have completed this year, the maximum opportunity will be reduced further from 2011/12 (from 90% to 80% for the CEO, and from 67.5% to 54% for other executive directors).

# Report of the Directors on Remuneration

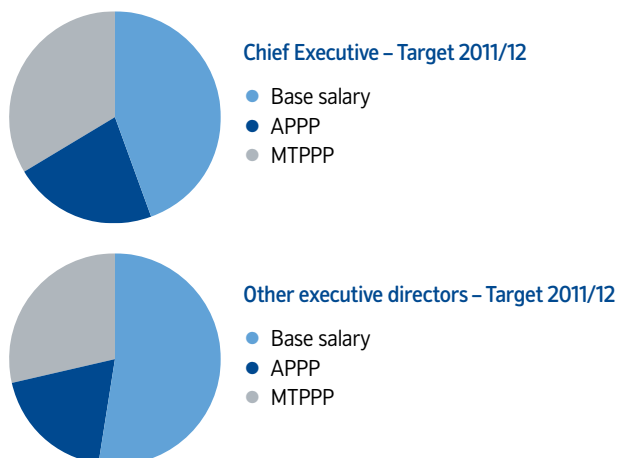
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The structure of the MTPPP 2011-2014 remains unchanged from the 2010-2013 cycle. As part of the changes to the remuneration framework, maximum award levels under the MTPPP are being reduced, for the second year in succession, so that the maximum payments available under the cycle beginning in 2011/12 will be 120% of base salary for the CEO (previously 180%), and 81% for other executive directors (previously 135%).

These changes are in keeping with the principle we have adopted for operating a remuneration framework with reduced incentive opportunity, and ensures that the combination of changes to the package are broadly neutral in total compensation terms.

## Overall structure of remuneration

Nationwide strongly believes in pay for performance, whilst ensuring that an appropriate proportion of the total package is fixed so as not to incentivise inappropriate risk taking. The charts below illustrate the balance of fixed and variable and short and medium term reward for our executive directors at target levels of performance based on remuneration arrangements for 2011/12.



## Executive director changes during 2010/11

### David Rigney

David Rigney retired from the Board on 20 July 2010 and left Nationwide on 21 July 2010. The Committee approved leaving terms for Mr Rigney that comprised a payment in respect of:

- Twelve months' base salary and benefits (including pension) in lieu of notice;
- Compensation for loss of office; and
- Payment in lieu of outstanding variable pay plan awards, pro-rated for time and performance up until the date of cessation.

All amounts were paid on or before 30 July 2010.

## Pensions and benefits

On 1 April 2011, all directors participating in defined benefit plans were moved into a CARE (Career Average Revalued Earnings) arrangement with 1/60th accrual for future service. These changes are consistent with the changes made to the pension provision for all defined benefit plan members in the Society. Following actuarial advice regarding the cost of providing defined benefit pensions under the various Nationwide Pension Fund schemes, the Society has established cash allowances for directors who wish to opt out of pension accrual. These cash allowances are set significantly below the cost of providing pension accrual and have been taken up by certain directors as described below.

Graham Beale was a member of the executive section of the Nationwide Pension Fund until opting out on 31 March 2011 (to which date he accrued a pension of one-thirtieth of pensionable salary for each year of pensionable service). With effect from 1 April 2011 Graham Beale receives a pensions allowance of 40% of base salary in lieu of pension accrual.

Tony Prestedge received a 30% employer's contribution into the Nationwide Group Personal Pension arrangement until opting out on 31 March 2011. From 1 April 2011 Tony Prestedge receives an allowance of 33% of base salary.

Mark Rennison is a member of the CARE scheme (accrual rate 1/54th to 31 March 2011; accrual rate of 1/60th after 1 April 2011). In addition to pension accrual, he also receives a monthly pension allowance.

Matthew Wyles was a member of the Portman Final Salary Executive section of the Nationwide Pension Fund until the closure of this section on 31 March 2011 (to which date he accrued a pension of 3% of pensionable salary for each year of service). With effect from 1 April 2011 Matthew Wyles is a member of the CARE scheme, which has an accrual rate of 1/60th. In addition to pension accrual, he also receives a monthly pension allowance.

Chris Rhodes receives a cash allowance of 33% of base salary to fund personal pension arrangements.

In addition, executive directors receive other benefits including a car allowance, healthcare and mortgage allowance.

## Service contracts

All current executive directors have a contractual notice period of 12 months.

## Chairman and non executive directors

The fees payable to non executive directors are set after reviewing the responsibilities of the non executive directors' roles compared with roles in similar organisations. The Chairman's fee is reviewed and approved by the Remuneration Committee. The fees of other non executive directors are reviewed and approved by the executive directors and by the Chairman. Non executive director fees are reviewed on an annual basis and these have remained unchanged between 2008 and 2010. The next review is due in March 2012.

Non executive directors are paid a basic fee, with an additional supplement paid for serving on or chairing a Board Sub-Committee. Non executive



directors do not take part in any performance pay plans or in any pension arrangement. The fee policy was reviewed during the year and changes have been made to the level of basic fees, and specific committee fees,

to ensure that these remain competitive in the context of increased regulatory requirements which impact the time commitment necessary for a non executive director in a financial services business to fulfil their duties.

|   | Fees for 2011/12 | Fees for 2010/11 |
|---|------------------|------------------|
| Chairman  | £300,000         | £250,000         |
| Basic fee   | £60,000          | £47,250          |
| Joint Deputy Chairman fee   | £30,000          | £30,000          |
| Chairman of the Audit Committee, Board Risk Committee or Chairman of the Pension Fund | £35,000          | £35,000          |
| Member of the Audit Committee or Board Risk Committee                                 | £10,000          | £10,000          |
| Remuneration Committee Chairman   | £25,000          | £20,000          |
| Remuneration Committee member   | £10,000          | £4,000           |
| Nomination Committee member   | £2,500           | £2,500           |

Non executive directors may be asked to attend additional ad hoc committees, for which fees may be payable.

#### Audited information

PricewaterhouseCoopers LLP have audited the information contained in the tables immediately below on pages 81 to 83.

| Non executive directors   | 2011                             | 2010                          |
|---|----------------------------------|-------------------------------|
|   | Society & Group Fees (Note 1, 2) | Society & Group Fees (Note 4) |
|   | £000                             | £000                          |
| G M T Howe (Chairman)   | 250                              | 250                           |
| Mrs S J David   | 23                               | 70                            |
| A P Dickinson   | 75                               | -                             |
| Ms S C Ellen  | -                                | 19                            |
| M K Jary  | 58                               | 51                            |
| K Loosemore   | 11                               | 57                            |
| M P Nicholls  | -                                | 46                            |
| R K Perkin  | 84                               | -                             |
| D A Ross  | 38                               | 94                            |
| Ms S Taverne  | 61                               | 61                            |
| W Tudor John (Joint Deputy Chairman)  | 102                              | 95                            |
| R P Walther (Joint Deputy Chairman)   | 138                              | 128                           |
| Total   | 840                              | 871                           |
| Pension payments to past directors in respect of services as directors (Note 3) | 381                              | 378                           |

#### Notes:

1. K Loosemore retired from the Board on 21 April 2010. Mrs S J David and D A Ross retired from the Board on 22 July 2010. R K Perkin and A P Dickinson were appointed to the Board on 20 April 2010 and 15 June 2010 respectively.
2. In addition to his non executive director fees, R P Walther also received additional fees as Chairman of the Investment Sub-Committee/Investment adviser of the Nationwide Pension Scheme (£20,000).
3. These are pension payments in respect of past non executive directors. The Society stopped granting pension rights to non executive directors who joined the Board after January 1990.
4. Ms S C Ellen retired from the Board on 16 July 2009 and M P Nicholls retired from the Board on 31 December 2009.

# Report of the Directors on Remuneration

continued

## Executive directors

The tables below show the remuneration received for the years ended 4 April 2011 and 4 April 2010.

| Executive directors | Salary (Note 1, 2, 3) | Pension allowance (Note 4) | Other Pension allowances (Note 5, 6) | Annual Performance Pay (Note 7) | Benefits | Medium Term Performance Pay | Increase in accrued pension | Total before contractual/ other settlements | Contractual/ other settlements (Note 8) | Total |
|---------------------|-----------------------|----------------------------|--------------------------------------|---------------------------------|----------|-----------------------------|-----------------------------|---|---|-------|
| 2011                | £000                  | £000                       | £000                                 | £000                            | £000     | £000                        | £000                        | £000  | £000                                    | £000  |
| G J Beale           | 650                   | 101                        | -                                    | 441                             | 28       | 650                         | 14                          | 1,884                                       | -                                       | 1,884 |
| T P Prestedge       | 350                   | -                          | 105                                  | 178                             | 28       | 266                         | -                           | 927   | -                                       | 927   |
| M M Rennison        | 440                   | 99                         | -                                    | 224                             | 29       | 334                         | 11                          | 1,137                                       | -                                       | 1,137 |
| C S Rhodes          | 350                   | -                          | 116                                  | 182                             | 29       | 266                         | -                           | 943   | -                                       | 943   |
| D J Rigney          | 107                   | 43                         | -                                    | -                               | 9        | -                           | -                           | 159   | 700                                     | 859   |
| M P V Wyles         | 350                   | 65                         | -                                    | 185                             | 12       | 266                         | 5                           | 883   | -                                       | 883   |
|                     | 2,247                 | 308                        | 221                                  | 1,210                           | 135      | 1,782                       | 30                          | 5,933                                       | 700                                     | 6,633 |

| Executive directors | Salary (Note 1, 2, 3) | Pension allowance (Note 4) | Other Pension allowances (Note 5, 6) | Annual Performance Pay (Note 7, 9) | Benefits (Note 6) | Medium Term Performance Pay | Increase in accrued pension | Total before contractual/ other settlements | Contractual/ other settlements (Note 8) | Total |
|---------------------|-----------------------|----------------------------|--------------------------------------|------------------------------------|-------------------|-----------------------------|-----------------------------|---|---|-------|
| 2010                | £000                  | £000                       | £000                                 | £000                               | £000              | £000                        | £000                        | £000  | £000                                    | £000  |
| G J Beale           | 650                   | 101                        | -                                    | 231                                | 23                | 521                         | 13                          | 1,539                                       | -                                       | 1,539 |
| S D M Bernau        | 139                   | -                          | -                                    | -                                  | 8                 | -                           | -                           | 147   | 1,772                                   | 1,919 |
| T P Prestedge       | 350                   | -                          | 107                                  | 224                                | 18                | 216                         | -                           | 915   | -                                       | 915   |
| M M Rennison        | 440                   | 108                        | -                                    | 259                                | 24                | 272                         | 10                          | 1,113                                       | -                                       | 1,113 |
| C S Rhodes          | 333                   | -                          | 110                                  | 198                                | 151               | 150                         | -                           | 942   | -                                       | 942   |
| D J Rigney          | 350                   | 76                         | -                                    | 136                                | 23                | 216                         | 5                           | 806   | -                                       | 806   |
| M P V Wyles         | 350                   | 66                         | -                                    | 199                                | 13                | 216                         | 7                           | 851   | -                                       | 851   |
|                     | 2,612                 | 351                        | 217                                  | 1,247                              | 260               | 1,591                       | 35                          | 6,313                                       | 1,772                                   | 8,085 |

## Notes:

- £252,000 of the salary of G J Beale has been paid in non-pensionable form. He received a pension allowance of 40% on this non-pensionable salary in lieu of an alternative pension benefit.
- All of D J Rigney's salary was paid in non-pensionable form. He received a pension allowance of 40% on this non-pensionable salary in lieu of an alternative pension benefit. D J Rigney stepped down from the Board on 20 July 2010.
- £215,000 of M P V Wyles' salary was paid in non-pensionable form. He received a pension allowance of 30% on this non-pensionable salary in lieu of an alternative pension benefit.
- M M Rennison receives a pension allowance of 12% on total salary in addition to 1/54th CARE accrual.
- T P Prestedge was a member of the Nationwide Group Personal Pension arrangement to which the Society made contributions at the rate of 30% of pensionable salary. He made contributions totalling £17,500 to the scheme in the year.
- C S Rhodes is not a member of a Society pension scheme. He has opted to receive a cash allowance of 33% of his salary in lieu of any pension accrual. C S Rhodes' benefits in 2010 included relocation assistance that was provided to enable him to take up his new role.
- 50% of each individual's award under the 2010/11 APPP is subject to a six month deferral period in line with the requirements of the FSA Code. The payment of this deferred element is not guaranteed and is subject to further consideration by the Remuneration Committee at the end of the deferral period and may be moderated downwards if the Committee judge that there have been any significant corporate or individual failings during this period.
- The contractual settlement is made up of salary and performance pay for the balance of the notice period for the departing director, earned Medium Term Performance Pay Plan payments (based on the Society's performance and reduced to take into account that the director left the Society before the end of the normal plan cycles) and other payments that the director is entitled to.
- The Remuneration Committee was minded to award G J Beale a payment of £534,000 in line with the achievement of targets under the 2009/10 APPP. G J Beale requested that any payment be reduced to £231,000 such that his total cash payments in 2009/10 would be no more than his earnings in the previous year. Consequently, G J Beale gave up potential value of £303,000.

The table below shows the defined pension benefits accrued for the year ended 4 April 2011.

| Executive directors | Accrued pension at 4.4.11 (Note 1, 2) | Accrued pension at 4.4.10 | Transfer value at 4.4.11 (Note 3) | Transfer value at 4.4.10 | Change in transfer value | Additional pensions earned in year | Transfer value of the increase | Directors' contributions in year |
|---------------------|---------------------------------------|---------------------------|-----------------------------------|--------------------------|--------------------------|------------------------------------|--------------------------------|----------------------------------|
|                     | £000 (a)                              | £000 (b)                  | £000 (c)                          | £000 (d)                 | £000 (c)-(d)             | £000 (e)                           | £000 (f)                       | £000 (g)                         |
| G J Beale           | 256                                   | 242                       | 4,624                             | 4,480                    | 144                      | 6                                  | 102                            | 28                               |
| M M Rennison        | 53                                    | 42                        | 896                               | 732                      | 164                      | 10                                 | 158                            | 22                               |
| D J Rigney          | 86                                    | 86                        | 1,366                             | 1,438                    | (72)                     | -                                  | -                              | 4                                |
| M P V Wyles         | 56                                    | 51                        | 1,079                             | 995                      | 84                       | 4                                  | 70                             | 7                                |

Notes:

1. T P Prestedge was a member of the Nationwide Group Personal Pension arrangement to which the Society makes contributions. He made contributions totalling £17,500 to the scheme in the year. He decided to opt out of the Group Personal Pension arrangement on 31 March 2011 and instead receives a cash allowance in lieu of future pension accrual.
2. D J Rigney opted out of the Nationwide Pension Fund on 31 May 2010 in exchange for a cash allowance in lieu of future pension accrual.
3. During 2010 the Government announced that statutory increases to deferred pensions will in the future be linked to the consumer prices index (CPI) rather than the retail prices index (RPI). This change reduces transfer values at 4 April 2011.

Explanations:

- (a) and (b) show deferred pension entitlements at 4 April 2011 and 2010 respectively.
- (c) is the transfer value of the deferred pension in (a) calculated at 4 April 2011.
- (d) is the equivalent transfer value at 4 April 2010 of the deferred pension in (b) on the assumption that the director left service on that date.
- (e) is the increase in pension built up during the year recognising the additional service completed and the effect of salary changes in 'real' (inflation adjusted) terms on the pension already earned at the start of the year.
- (f) is the capital value of the pension in (e).
- (g) contributions are inclusive of salary sacrifice contributions.

#### Other directorships

The Group supports executive directors who wish to take non executive directorships to contribute to industry-wide developments or broaden their experience. Directors are entitled to retain any fees they may receive. Graham Beale was a director of Visa Europe Limited and Visa Europe Services Incorporated until 4 March 2011 for which he has received fees of €25,000. These fees have been voluntarily assigned to the Group.

#### Robert Walther

Chairman of the Remuneration Committee

24 May 2011

# Independent Auditors' Report

## To the Members of Nationwide Building Society

We have audited the Group and Society Annual Accounts of Nationwide Building Society for the year ended 4 April 2011 which comprise the Income Statements, Statements of Comprehensive Income, Balance Sheets, Statements of Movements in Members' Interests and Cash Flow Statements for the Group and Society and the related notes. 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.

### Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on pages 64 to 66, the directors are responsible for the preparation of the Annual Accounts which give a true and fair view. Our responsibility is to audit and express an opinion on the Annual Accounts in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for, and only for, the Society's Members as a body in accordance with Section 78 of the Building Societies Act 1986 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

### Scope of the audit of the Annual Accounts

An audit involves obtaining evidence about the amounts and disclosures in the Annual Accounts sufficient to give reasonable assurance that the Annual Accounts are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and Society's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the Annual Accounts. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited Annual Accounts. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### Opinion on Annual Accounts

In our opinion the Annual Accounts:

- 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 4 April 2011 and of the Group's and the Society's income and expenditure and cash flows 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 Annual Accounts, Article 4 of the IAS Regulation.

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

In our opinion:

- the Annual Business Statement and the Directors' Report have 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 Annual Accounts are prepared is consistent with the accounting records and the Annual Accounts; and
- the information given in the Annual Business Statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given.

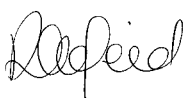
### Matters on which we are required to report by exception

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

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

### Other matter

At the request of the directors, we have also audited the part of the Report of the Directors on Remuneration that is described as having been audited. In our opinion, the part of the Report of the Directors on Remuneration to be audited has been properly prepared as if the Society was required to report in accordance with the Companies Act 2006.



**Richard Oldfield**  
**Senior Statutory Auditor**

For and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London  
24 May 2011

# Income Statements

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Income Statements

For the year ended 4 April 2011

|   | Notes | Group        |              | Society      |              |
|---|-------|--------------|--------------|--------------|--------------|
|   |       | 2011         | 2010         | 2011         | 2010         |
|   |       | £m           | £m           | £m           | £m           |
| Interest receivable and similar income  | 3     | 4,643        | 4,568        | 4,672        | 4,616        |
| Interest expense and similar charges  | 4     | (3,106)      | (2,854)      | (3,515)      | (3,226)      |
| <b>Net interest income</b>  |       | <b>1,537</b> | <b>1,714</b> | <b>1,157</b> | <b>1,390</b> |
| Fee and commission income   | 5     | 440          | 378          | 429          | 364          |
| Fee and commission expense  |       | (4)          | (5)          | (3)          | (4)          |
| Income from investments   | 6     | 4            | 1            | 66           | 353          |
| Other operating income  | 7     | 5            | 47           | 6            | 46           |
| Gains from derivatives and hedge accounting   | 8     | 120          | 34           | 117          | 31           |
| <b>Total income</b>   |       | <b>2,102</b> | <b>2,169</b> | <b>1,772</b> | <b>2,180</b> |
| Administrative expenses   | 9     | (1,158)      | (1,195)      | (1,126)      | (1,151)      |
| Depreciation and amortisation   |       | (150)        | (151)        | (149)        | (150)        |
| Impairment loss on loans and advances to customers  | 11    | (359)        | (549)        | (287)        | (450)        |
| Provisions for liabilities and charges  | 31    | (52)         | 103          | (54)         | 106          |
| Impairment losses on investment securities  | 15    | (66)         | (36)         | (66)         | (36)         |
| <b>Profit before tax</b>  |       | <b>317</b>   | <b>341</b>   | <b>90</b>    | <b>499</b>   |
| Analysed as:  |       |              |              |              |              |
| • Profit before tax, FSCS levies, transformation costs, gains from derivatives and hedge accounting and gain on portfolio acquisition |       | 276          | 212          | 52           | 373          |
| • FSCS levies – (charge)/release  | 31    | (50)         | 117          | (50)         | 117          |
| • Transformation costs  | 9     | (29)         | (62)         | (29)         | (62)         |
| • Gains from derivatives and hedge accounting   |       | 120          | 34           | 117          | 31           |
| • Gain on portfolio acquisition   |       | -            | 40           | -            | 40           |
| Profit before tax   |       | 317          | 341          | 90           | 499          |
| Taxation  | 12    | (69)         | (77)         | (3)          | (18)         |
| <b>Profit after tax</b>   |       | <b>248</b>   | <b>264</b>   | <b>87</b>    | <b>481</b>   |

The notes on pages 91 to 163 form part of these Accounts.

# Statements of Comprehensive Income

For the year ended 4 April 2011

|  | Notes | Group      |              | Society    |              |
|--|-------|------------|--------------|------------|--------------|
|  |       | 2011       | 2010         | 2011       | 2010         |
|  |       | £m         | £m           | £m         | £m           |
| <b>Profit after tax</b>  |       | <b>248</b> | <b>264</b>   | <b>87</b>  | <b>481</b>   |
| <b>Other comprehensive income:</b>                                   |       |            |              |            |              |
| Available for sale investments:                                      |       |            |              |            |              |
| • Fair value movements taken to equity                               |       | 308        | 1,834        | 294        | 1,788        |
| • Amount transferred to income statement                             |       | 12         | (55)         | 18         | (55)         |
| • Taxation   | 12    | (100)      | (485)        | (97)       | (486)        |
|  |       | 220        | 1,294        | 215        | 1,247        |
| Revaluation of property:   |       |            |              |            |              |
| • Revaluation before tax   |       | 3          | 1            | 3          | 1            |
| • Taxation   | 12    | 1          | -            | 1          | -            |
|  |       | 4          | 1            | 4          | 1            |
| Effect of tax rate change on other items through the general reserve |       | (6)        | -            | (4)        | -            |
| Adjustment to deferred tax transferred from acquisitions             |       | 5          | -            | -          | -            |
| Actuarial gain/(loss) on retirement benefit obligations:             |       |            |              |            |              |
| • Actuarial gain/(loss) before tax                                   | 35    | 114        | (169)        | 114        | (169)        |
| • Taxation (charge)/credit   | 12    | (47)       | 48           | (47)       | 48           |
|  |       | 67         | (121)        | 67         | (121)        |
| <b>Total comprehensive income</b>                                    |       | <b>538</b> | <b>1,438</b> | <b>369</b> | <b>1,608</b> |

The notes on pages 91 to 163 form part of these Accounts.



# Balance Sheets

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Balance Sheets

At 4 April 2011

|   | Notes | Group          |                | Society        |                |
|---|-------|----------------|----------------|----------------|----------------|
|   |       | 2011           | 2010           | 2011           | 2010           |
|   |       | £m             | £m             | £m             | £m             |
| <b>Assets</b>                                   |       |                |                |                |                |
| Cash  |       | 6,130          | 3,994          | 6,130          | 3,994          |
| Loans and advances to banks                     | 14    | 4,181          | 2,017          | 4,104          | 1,960          |
| Investment securities – available for sale      | 15    | 21,540         | 23,385         | 21,449         | 23,294         |
| Derivative financial instruments                | 16    | 3,961          | 4,852          | 1,541          | 1,932          |
| Fair value adjustment for portfolio hedged risk | 17    | 1,563          | 2,798          | 1,563          | 2,798          |
| Loans and advances to customers                 | 18    | 149,417        | 152,429        | 128,350        | 133,133        |
| Investments in equity shares                    | 19    | 103            | 86             | 32             | 26             |
| Investments in group undertakings               | 20    | -              | -              | 20,397         | 18,853         |
| Intangible assets                               | 21    | 529            | 353            | 517            | 341            |
| Property, plant and equipment                   | 22    | 948            | 916            | 940            | 907            |
| Investment properties                           |       | 9              | 9              | 9              | 9              |
| Accrued income and expenses prepaid             | 23    | 215            | 77             | 2,441          | 2,803          |
| Deferred tax assets                             | 24    | 214            | 357            | 174            | 314            |
| Other assets                                    |       | 68             | 124            | 52             | 133            |
| <b>Total assets</b>                             |       | <b>188,878</b> | <b>191,397</b> | <b>187,699</b> | <b>190,497</b> |
| <b>Liabilities</b>                              |       |                |                |                |                |
| Shares  | 25    | 122,552        | 120,943        | 122,552        | 120,943        |
| Deposits from banks                             | 26    | 2,746          | 8,031          | 1,842          | 7,009          |
| Other deposits                                  | 27    | 5,511          | 4,509          | 13,113         | 11,359         |
| Due to customers                                | 28    | 6,060          | 5,085          | 1,315          | 973            |
| Fair value adjustment for portfolio hedged risk | 17    | (68)           | 106            | (68)           | 106            |
| Debt securities in issue                        | 29    | 37,808         | 36,802         | 32,080         | 32,184         |
| Derivative financial instruments                | 16    | 3,234          | 4,942          | 3,373          | 5,554          |
| Other liabilities                               | 30    | 376            | 529            | 3,819          | 2,708          |
| Provisions for liabilities and charges          | 31    | 113            | 118            | 113            | 115            |
| Accruals and deferred income                    | 32    | 428            | 376            | 422            | 369            |
| Subordinated liabilities                        | 33    | 1,973          | 2,166          | 1,973          | 2,166          |
| Subscribed capital                              | 34    | 1,510          | 1,524          | 1,510          | 1,524          |
| Current tax liabilities                         |       | 81             | 42             | 24             | 17             |
| Retirement benefit obligations                  | 35    | 300            | 508            | 299            | 507            |
| <b>Total liabilities</b>                        |       | <b>182,624</b> | <b>185,681</b> | <b>182,367</b> | <b>185,534</b> |
| General reserve                                 |       | 6,679          | 6,363          | 5,776          | 5,624          |
| Revaluation reserve                             |       | 70             | 68             | 70             | 68             |
| Available for sale reserve                      |       | (495)          | (715)          | (514)          | (729)          |
| <b>Total reserves and liabilities</b>           |       | <b>188,878</b> | <b>191,397</b> | <b>187,699</b> | <b>190,497</b> |

The notes on pages 91 to 163 form part of these Accounts.

Approved by the Board of Directors on 24 May 2011.

G M T Howe Chairman; G J Beale Director and Chief Executive; M M Rennison Group Finance Director

# Group Statement of Movements in Members' Interests

For the year ended 4 April 2011

|  | General reserve | Revaluation reserve | AFS reserve | Total      |
|--|-----------------|---------------------|-------------|------------|
|  | £m              | £m                  | £m          | £m         |
| At 5 April 2010  | 6,363           | 68                  | (715)       | 5,716      |
| Profit for the year  | 248             | -                   | -           | 248        |
| Net movement in available for sale reserve                           | -               | -                   | 220         | 220        |
| Revaluation of property  | -               | 4                   | -           | 4          |
| Reserve transfer   | 2               | (2)                 | -           | -          |
| Effect of tax rate change on other items through the general reserve | (6)             | -                   | -           | (6)        |
| Adjustment to deferred tax transferred from acquisitions             | 5               | -                   | -           | 5          |
| Net actuarial gain on retirement benefit obligations                 | 67              | -                   | -           | 67         |
| <b>Total comprehensive income</b>                                    | <b>316</b>      | <b>2</b>            | <b>220</b>  | <b>538</b> |
| At 4 April 2011  | 6,679           | 70                  | (495)       | 6,254      |

For the year ended 4 April 2010

|  | General reserve | Revaluation reserve | AFS reserve  | Total        |
|--|-----------------|---------------------|--------------|--------------|
|  | £m              | £m                  | £m           | £m           |
| At 5 April 2009 (adjusted)                           | 6,218           | 69                  | (2,009)      | 4,278        |
| Profit for the year                                  | 264             | -                   | -            | 264          |
| Net movement in available for sale reserve           | -               | -                   | 1,294        | 1,294        |
| Revaluation of property                              | -               | 1                   | -            | 1            |
| Reserve transfer                                     | 2               | (2)                 | -            | -            |
| Net actuarial loss on retirement benefit obligations | (121)           | -                   | -            | (121)        |
| <b>Total comprehensive income</b>                    | <b>145</b>      | <b>(1)</b>          | <b>1,294</b> | <b>1,438</b> |
| At 4 April 2010                                      | 6,363           | 68                  | (715)        | 5,716        |

The notes on pages 91 to 163 form part of these Accounts.

# Society Statement of Movements in Members' Interests

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Movements in  
Members' Interests

For the year ended 4 April 2011

|  | General reserve | Revaluation reserve | AFS reserve | Total      |
|--|-----------------|---------------------|-------------|------------|
|  | £m              | £m                  | £m          | £m         |
| At 5 April 2010  | 5,624           | 68                  | (729)       | 4,963      |
| Profit for the year  | 87              | -                   | -           | 87         |
| Net movement in available for sale reserve                           | -               | -                   | 215         | 215        |
| Revaluation of property  | -               | 4                   | -           | 4          |
| Reserve transfer   | 2               | (2)                 | -           | -          |
| Effect of tax rate change on other items through the general reserve | (4)             | -                   | -           | (4)        |
| Net actuarial gain on retirement benefit obligations                 | 67              | -                   | -           | 67         |
| <b>Total comprehensive income</b>                                    | <b>152</b>      | <b>2</b>            | <b>215</b>  | <b>369</b> |
| At 4 April 2011  | 5,776           | 70                  | (514)       | 5,332      |

For the year ended 4 April 2010

|  | General reserve | Revaluation reserve | AFS reserve  | Total        |
|--|-----------------|---------------------|--------------|--------------|
|  | £m              | £m                  | £m           | £m           |
| At 5 April 2009 (adjusted)                           | 5,262           | 69                  | (1,976)      | 3,355        |
| Profit for the year                                  | 481             | -                   | -            | 481          |
| Net movement in available for sale reserve           | -               | -                   | 1,247        | 1,247        |
| Revaluation of property                              | -               | 1                   | -            | 1            |
| Reserve transfer                                     | 2               | (2)                 | -            | -            |
| Net actuarial loss on retirement benefit obligations | (121)           | -                   | -            | (121)        |
| <b>Total comprehensive income</b>                    | <b>362</b>      | <b>(1)</b>          | <b>1,247</b> | <b>1,608</b> |
| At 4 April 2010                                      | 5,624           | 68                  | (729)        | 4,963        |

The notes on pages 91 to 163 form part of these Accounts.

# Cash Flow Statements

For the year ended 4 April 2011

|  | Notes | Group         |                | Society       |                |
|--|-------|---------------|----------------|---------------|----------------|
|  |       | 2011          | 2010           | 2011          | 2010           |
|  |       | £m            | £m             | £m            | £m             |
| <b>Cash flows from operating activities</b>      |       |               |                |               |                |
| Profit before tax                                |       | 317           | 341            | 90            | 499            |
| Adjustments for:                                 |       |               |                |               |                |
| • Non-cash items included in profit before tax   | 44    | 317           | 580            | 309           | 582            |
| • Changes in operating assets                    | 44    | 5,770         | 5,377          | 6,052         | 4,966          |
| • Changes in operating liabilities               | 44    | (2,820)       | (11,305)       | (2,902)       | (11,099)       |
| • Interest paid on subordinated liabilities      |       | (90)          | (91)           | (90)          | (91)           |
| • Interest paid on subscribed capital            |       | (91)          | (87)           | (91)          | (87)           |
| • Income from the sale of an investment          |       | -             | -              | (2)           | -              |
| • Dividend income                                |       | (4)           | (1)            | (64)          | (353)          |
| • Taxation                                       |       | (33)          | (17)           | (3)           | (21)           |
| <b>Net cash flows from operating activities</b>  |       | <b>3,366</b>  | <b>(5,203)</b> | <b>3,299</b>  | <b>(5,604)</b> |
| <b>Cash flows from investing activities</b>      |       |               |                |               |                |
| Purchase of investment securities                |       | (13,525)      | (12,942)       | (13,525)      | (12,942)       |
| Sale and maturity of investment securities       |       | 14,898        | 11,283         | 14,884        | 11,325         |
| Purchase of property, plant and equipment        |       | (138)         | (153)          | (137)         | (152)          |
| Sale of property, plant and equipment            |       | 13            | 10             | 13            | 8              |
| Purchase of intangible assets                    |       | (219)         | (184)          | (219)         | (184)          |
| Sale of investment properties                    |       | 1             | -              | 1             | -              |
| Sale of investment                               |       | 2             | -              | 2             | -              |
| Purchase of Dunfermline social housing portfolio |       | -             | (377)          | -             | (377)          |
| Dividends received                               |       | 4             | 1              | 64            | 353            |
| <b>Net cash flows from investing activities</b>  |       | <b>1,036</b>  | <b>(2,362)</b> | <b>1,083</b>  | <b>(1,969)</b> |
| <b>Cash flows from financing activities</b>      |       |               |                |               |                |
| Maturity of subordinated liabilities             |       | (719)         | (15)           | (719)         | (15)           |
| Issue of subordinated liabilities                |       | 630           | -              | 630           | -              |
| <b>Net cash flows from financing activities</b>  |       | <b>(89)</b>   | <b>(15)</b>    | <b>(89)</b>   | <b>(15)</b>    |
| <b>Net increase/(decrease) in cash</b>           |       | <b>4,313</b>  | <b>(7,580)</b> | <b>4,293</b>  | <b>(7,588)</b> |
| Cash and cash equivalents at start of year       |       | 5,811         | 13,391         | 5,754         | 13,342         |
| <b>Cash and cash equivalents at end of year</b>  | 44    | <b>10,124</b> | <b>5,811</b>   | <b>10,047</b> | <b>5,754</b>   |

The notes on pages 91 to 163 form part of these Accounts.

# Notes to the Accounts

01

## Statement of accounting policies

### Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC), as adopted by the European Union, and with those parts of the Building Societies (Accounts and Related Provisions) Regulations 1998 (as amended) applicable to organisations reporting under IFRS. The financial statements have been prepared under the historical cost convention as modified by the revaluation of investment properties, land and buildings, available for sale assets, certain investments in equity shares and certain other deposits and derivatives. A summary of the Group's accounting policies is set out below.

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates. Further details on critical accounting estimates are given in note 2.

### Changes in accounting policy

The following IFRS and IFRIC pronouncements, relevant to the Group, have been adopted:

- IAS 27 (Revised) 'Consolidated and separate financial statements': The amendment requires the effects of all transactions with non controlling interests to be recorded in equity if there has been no change in control. It also specifies the accounting when control is lost. The amendment has had no impact on the results to 4 April 2011;
- IAS 39 & IFRIC 9 'Eligible hedged items' (July 2008): The amendment clarifies how existing principles underlying hedge accounting should be applied in two particular situations: a) one-sided risk in a hedged item; and b) inflation in a financial hedged item. The amendment has had no impact on the results to 4 April 2011; and
- 'Improvements to IFRSs' (April 2009): Several small amendments have been made to a number of standards. None of these amendments have had an impact on the results to 4 April 2011.

### Future accounting developments

The following pronouncements will be relevant to the Group but were not effective at 4 April 2011 and have not been applied in preparing these financial statements. The full impact of these accounting changes is being assessed by the Group. Our initial view is outlined in the following tables.

The following pronouncements, relevant to the Group, have been adopted by the European Union (EU) but are not yet effective:

| Pronouncement   | Nature of change  | Effective date   |
|---|---|--|
| IFRIC 14 Prepayments of a minimum funding requirement | The amendment applies when an entity makes an early payment of minimum funding requirements. The amendment permits such an entity to treat the benefit of an early payment as an asset. The IFRIC is not expected to have any significant impact for the Group. | Accounting periods (AP) beginning on or after 1 January 2011 |
| Improvements to IFRSs (May 2010)                      | Several small amendments with no significant impact for the Group.  | Various, earliest is AP beginning on or after 1 July 2010    |
| IAS 24 Related Party Disclosures                      | The revised standard simplifies the definition of a related party and provides a partial exemption from the disclosure requirements for government related entities. The revised standard is not expected to have a significant impact for the Group.           | AP beginning on or after 1 January 2011                      |

# Notes to the Accounts

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## Statement of Accounting Policies (continued)

The following pronouncements, relevant to the Group, are neither adopted by the EU nor effective for this financial year:

| Pronouncement   | Nature of change  | Effective date                          |
|---|---|---|
| IFRS 9 Financial Instruments – Classification and Measurement ('Phase 1') | <p>The new standard addresses Phase 1 of the IASB's project to replace IAS 39 <i>Financial Instruments: Recognition and Measurement</i> and requires financial assets to be classified as at amortised cost or at fair value. The available for sale (AFS) category for financial assets, currently used by the Group, will no longer be available under IFRS 9.</p> <p>Financial liabilities will be treated as at present under IAS 39, with the exception that where we opt to fair value, the movement in fair value due to own credit risk would be directly recognised in other comprehensive income. Where this would result in an accounting mismatch, however, the movement would be recognised in the income statement. With the exception of the protected equity bond product, the Group has not currently opted to fair value its liabilities.</p> <p>The derecognition requirements currently within IAS 39 have been transferred to IFRS 9 and remain unchanged from current requirements.</p> <p>IFRS 9 Phase 1 will have a significant impact for the Group, the full extent of which is currently being considered.</p> | AP beginning on or after 1 January 2013 |
| IFRS 7 Disclosures – Transfers of Financial Assets                        | The amendment requires additional and/or enhanced disclosures to help evaluate risk exposures relating to the transfer of financial assets and the effect of those risks on an entity's financial position, particularly those that involve securitisation of financial assets.   | AP beginning on or after 1 July 2011    |
| Amendment to IAS 12 Deferred Tax: Recovery of Underlying Assets           | The amendment provides a practical approach for measuring deferred tax liabilities and deferred tax assets when investment property is measured using the fair value model in IAS 40 <i>Investment Property</i> . The amendment is not expected to have a significant impact for the Group.   | AP beginning on or after 1 January 2012 |
| IFRS 10 Consolidated Financial Statements                                 | The new standard replaces IAS 27 <i>Consolidated and Separate Financial Statements</i> and SIC-12 <i>Consolidation – Special Purpose Entities</i> by introducing a single consolidation model for all entities based on control. The new standard is currently being reviewed by the Group but is not expected to have a significant impact.  | AP beginning on or after 1 January 2013 |
| IFRS 11 Joint Arrangements  | The new standard introduces new accounting requirements for joint arrangements, replacing IAS 31 <i>Interests in Joint Ventures</i> . The Group currently has no joint arrangements in place. The new standard, therefore, is not expected to impact the Group.   | AP beginning on or after 1 January 2013 |
| IFRS 12 Disclosure of Involvement with Other Entities                     | The new standard requires enhanced disclosures regarding both consolidated and unconsolidated entities in which an entity has involvement. The new standard is currently being reviewed by the Group and is expected to have disclosure implications.   | AP beginning on or after 1 January 2013 |
| IAS 27 Separate Financial Statements                                      | IAS 27 has been amended to remove the consolidation requirements previously forming part of the standard. Consolidation requirements are now contained in IFRS 10. The amendment is currently being reviewed by the Group but is not expected to have a significant impact.   | AP beginning on or after 1 January 2013 |
| IAS 28 Investment in Associates and Joint Ventures                        | IAS 28 has been amended to conform to the changes arising from the issuance of IFRS 10, IFRS 11 and IFRS 12. The amendment is currently being reviewed by the Group but is not expected to have a significant impact.   | AP beginning on or after 1 January 2013 |
| IFRS 13 Fair Value Measurement  | The new standard replaces guidance on fair value measurement in existing IFRS accounting literature with a single standard. The standard does not change the requirements regarding which items should be measured or disclosed at fair value but does require enhanced disclosures. The new standard is currently being reviewed by the Group and, with the exception of enhanced disclosures, is not expected to have a significant impact.   | AP beginning on or after 1 January 2013 |



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## Statement of Accounting Policies (continued)

**Basis of consolidation**

The Group accounts consolidate the assets, liabilities and results of the Society and all of its subsidiaries.

Subsidiaries are all entities, including special purpose entities, over which the Society has the power to govern the financial and operating policies generally. Subsidiaries are fully consolidated from the date on which control is transferred to the Group and are de-consolidated from the date that control ceases. Upon consolidation, inter-company transactions, balances and unrealised gains on transactions are eliminated.

Investments in subsidiary undertakings are stated in the Society accounts at cost less provisions for any impairment in value. The Directors consider it appropriate for administrative and commercial reasons that subsidiary undertakings have financial years ending on 31 March. Certain special purpose entities have year ends other than 31 March and are therefore consolidated using internal management accounts prepared to that date. Adjustment is made for individually significant transactions arising between 31 March and the Society's year end.

**Securitisation transactions**

The Group has securitised certain mortgage loans by the transfer of the loans to special purpose entities (SPEs) controlled by the Group. The securitisation enables a subsequent issuance of debt, either by the Society or the SPEs, to investors who gain the security of the underlying assets as collateral. The SPEs are fully consolidated into the Group's accounts.

The transfers of the mortgage loans to the SPEs are not treated as sales by the Society. The Society continues to recognise the mortgage loans on its own balance sheet after the transfer because it retains their risks and rewards through the receipt of substantially all of the profits or losses of the SPEs. In the accounts of the Society, the proceeds received from the transfer are accounted for as a deemed loan repayable to the SPEs.

As explained in note 18, the Group has also entered into self issuances of debt to be used as collateral for repurchase ('repo') and similar transactions. Investments in self issued debt and the equivalent deemed loan, together with the related income, expenditure and cash flows are not recognised in the Society's financial statements. This avoids the 'grossing-up' of the financial statements that would otherwise arise.

To manage interest rate risk, the Society enters into derivative transactions with the SPEs, receiving a rate of interest based on the securitised mortgages and paying a rate inherent in the debt issuances. In accordance with IAS 39, these internal derivatives are treated as part of the deemed loan and not separately fair valued because the relevant mortgage loans are not derecognised. Cash flows arising from these internal derivatives are accounted for on an accruals basis. All other derivatives relating to securitisations are treated as explained in the derivatives and hedge accounting policy below.

**Interest receivable and interest expense**

For instruments measured at amortised cost the effective interest rate (EIR) method is used. The EIR method is 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 effective interest rate is the rate that exactly discounts estimated future cash payments or

receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

In calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument (for example, early redemption penalty charges) but does not consider future credit losses. The calculation includes all fees received and paid and costs borne that are an integral part of the effective interest rate and all other premiums or discounts above or below market rates.

Interest income on available for sale assets, derivatives and other financial assets at fair value through the income statement is included in interest receivable and similar income. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

**Fees and commissions**

Fees and commissions not directly attributable to generating a financial instrument are recognised on the accruals basis as services are provided, or on the performance of a significant act.

**Segmental reporting**

Operating segments are reported in a manner consistent with the internal reporting provided to the Executive Committee. The Executive Committee, which is responsible for allocating resources and assessing performance of operating segments, has been identified as the chief operating decision maker. For further information see note 13.

No segmental analysis is presented on geographical lines because substantially all of the Group's activities are in the United Kingdom, the Isle of Man and the Republic of Ireland.

**Intangible assets***(a) Goodwill*

Goodwill represents the excess of the consideration transferred for an acquisition over the fair value of the Group's share of the net identifiable assets (including the fair value of contingent liabilities) of the acquired business at the date of acquisition. Goodwill on acquisitions is carried at cost less accumulated impairment losses and is included as an intangible asset.

Goodwill is tested for impairment at least annually. For the purpose of impairment testing, goodwill is allocated to cash-generating units. If the carrying value of the cash-generating unit exceeds its recoverable value, goodwill is considered impaired. The estimation of recoverable value is based on value-in-use calculations incorporating forecasts by management of post-tax profits for the subsequent 5 years, discounted at a risk-adjusted interest rate appropriate to the cash-generating unit. While forecasts are compared with actual performance, expected profits naturally reflect management's view of future performance.

*(b) Computer software*

IAS 38 *Intangible Assets* requires the capitalisation of certain expenditure relating to software development costs. Software development costs are capitalised if it is probable that the asset created will generate future

# Notes to the Accounts

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## Statement of Accounting Policies (continued)

economic benefits. Costs incurred to establish technological feasibility or to maintain existing levels of performance are recognised as an expense.

Web development costs are capitalised where the expenditure is incurred on developing an income generating website.

Where software costs are capitalised, they are amortised using the straight line method over their estimated useful lives (3 to 10 years). The amortisation periods used are reviewed annually.

Computer application software licences are recognised as intangible fixed assets and amortised using the straight line method over their useful lives (3 to 10 years).

### (c) Other intangibles

Other intangibles, which largely represent core deposit intangibles acquired by the Group, are amortised using the straight line method over their estimated useful lives of between 5 and 10 years. The amortisation period is reviewed annually.

### Leases

The Group has entered into operating leases for land and buildings. Operating leases are leases that do not transfer substantially all the risks and rewards incidental to ownership to the lessee.

#### (a) As lessee

Operating lease payments are charged to the income statement on a straight line basis over the life of the lease.

#### (b) As lessor

Lease income receivable under operating leases is credited to the income statement on a straight line basis over the life of the lease.

### Taxation including deferred tax

Corporation tax payable on profits, based on the applicable tax law in each jurisdiction, is recognised as an expense in the period in which profits arise. The tax effects of tax losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is determined using tax rates and laws that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred tax is provided on temporary differences arising from investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future.

Tax related to the fair value re-measurement of available for sale assets, which is charged or credited to other comprehensive income, is also credited or charged to other comprehensive income and is subsequently reclassified from other comprehensive income to the income statement together with the deferred gain or loss.

Tax related to movements in the valuation of property, which are charged or credited to other comprehensive income and accumulated in the revaluation reserve, is also credited or charged to other comprehensive income and accumulated in the revaluation reserve. Tax related to actuarial losses or gains on retirement benefit obligations, which are charged or credited to other comprehensive income, is also credited or charged to other comprehensive income.

### Property, plant and equipment

Freehold and long leasehold properties comprise mainly branches and office buildings.

Branches and non specialised buildings are stated at revalued amounts, being the fair value, determined by market based evidence, at the date of the valuation less any subsequent accumulated depreciation and subsequent impairment. Valuations are completed annually by independent surveyors.

Increases in the valuations of branches and non specialised buildings are credited to other comprehensive income except where they reverse decreases for the same asset previously recognised in the income statement, in which case the increase in the valuation is recognised in the income statement. Decreases in valuations are recognised in the income statement except where they reverse amounts previously credited to other comprehensive income for the same asset, in which case the decrease in valuation is recognised in other comprehensive income.

Other property, plant and equipment, including specialised administration buildings and short leasehold buildings, are included at historical cost less accumulated depreciation and impairment. Historical cost includes expenditure that is directly attributable to the acquisition of the items, major alterations and refurbishments. Where applicable, directly attributable borrowing costs incurred in the construction of qualifying assets are capitalised.

Land is not depreciated. Depreciation on other assets commences when the assets are ready for their intended use and is calculated using the straight line method to allocate their cost or valuation over the following estimated useful lives:

|  |                              |
|--|------------------------------|
| Branches and non specialised buildings | 60 years                     |
| Specialised administration buildings   | up to 60 years               |
| Short leasehold buildings              | over the period of the lease |
| Other equipment                        | 3 to 15 years                |

Estimated useful lives are reviewed annually and adjusted, if appropriate, in the light of technological developments, usage and other relevant factors. Other equipment now includes newly acquired assets with a 15 year estimated useful life. Previously, the assets in this category had useful lives of 3 to 10 years.

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## Statement of Accounting Policies (continued)

Assets are reviewed for impairment 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.

Gains and losses on disposals are determined by comparing the net disposal proceeds with the carrying amount of the asset and are included in the income statement within other operating income.

**Investment properties**

Investment properties, which comprise properties held for rental, are stated at fair value. The properties are revalued annually by independent surveyors supported by market evidence. Changes in fair value are included in the income statement. Depreciation is not charged on investment properties.

**Employee benefits***(a) Pensions*

The Group operates a number of defined benefit and defined contribution pension arrangements. The majority of the Group's employees are members of the defined benefit plans. A defined benefit plan is one that defines the benefit an employee will receive on retirement, depending on such factors as age, length of service and salary.

The liability recognised in the balance sheet in respect of the defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets. The defined benefit obligation is calculated by the independent actuary using the projected unit credit method and assumptions agreed with the Group. The present value of the defined benefit obligation is determined by discounting the estimated future cash flows using interest rates of high-quality corporate bonds that have terms to maturity approximating to the terms of the related pension liability.

Actuarial gains and losses arise from experience adjustments (the effects of differences between previous actuarial assumptions and what has actually occurred) and changes in actuarial assumptions. Actuarial gains and losses are recognised in full, in the year they occur, in other comprehensive income.

The Group also operates defined contribution arrangements. A defined contribution arrangement is one into which the Group and the employee pay fixed contributions, without any further obligation to pay further contributions. Payments to defined contribution schemes are charged to the income statement as they fall due.

Past service costs are recognised immediately in the income statement, unless the changes to the benefits are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs are amortised on a straight line basis over the vesting period.

*(b) Other post-retirement obligations*

The Group provides post-retirement healthcare to a small number of former employees. The Group recognises this obligation and the actuarial gains and losses in a similar manner to the defined benefit pension plans.

*(c) Other long term employee benefits*

The cost of bonuses payable twelve months or more after the end of the year in which they are earned is recognised in the year in which the employees render the related service.

*(d) Short term employee benefits*

The cost of short term employee benefits, including wages and salaries, social security costs and healthcare for current employees is recognised in the year of service.

**Provisions**

A provision is recognised where there is a present obligation as a result of a past event, it is probable that the obligation will be settled and it can be reliably estimated.

Nationwide 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 based on information provided by the FSCS, forecast future interest rates and our historic share of industry protected deposits in accordance with IFRIC 6.

**Financial assets**

The Group classifies its financial assets at inception into the following four categories:

*(a) Financial assets at fair value through the income statement*

This category consists of derivative financial assets. The Group does not hold any financial assets classified as held for trading.

Financial assets at fair value through the income statement are carried at fair value. The fair values of derivative instruments are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from counterparties.

Gains and losses arising from the changes in the fair values are recognised in the income statement.

During the first half of the year the Group ceased electing to fair value its mortgage commitments as doing so would have created an accounting mismatch. As a result at 4 April 2011 there are no items relating to mortgage commitments carried in the balance sheet.

*(b) 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's residential and commercial mortgage loans, unsecured lending and loans to banks are classified as loans and receivables.

Loans are recognised when the funds are advanced to customers. Loans and receivables are carried at amortised cost using the effective interest rate method less provisions for impairment.

# Notes to the Accounts

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## Statement of Accounting Policies (continued)

Loans and receivables acquired through business combinations have been recognised at fair value at the acquisition date. This fair value at acquisition becomes the new amortised cost for acquired loans and receivables. Fair value adjustments have been made to reflect both credit and interest rate risk associated with the acquired loan assets.

The fair value adjustment in relation to interest rate risk is amortised to the income statement over the remaining life of the assets. In the case of the fair value adjustment for credit risk, the balance is reduced by actual write offs of loans during the period. Additionally, a review is performed to ensure that the amount of the credit loss fair value adjustment still held is adequate to cover future expected losses. This review identifies any additional amount of provision to be immediately recognised where the remaining adjustment is less than incurred losses on the loans, or any surplus amount of fair value adjustment which can be released to the income statement as it is no longer required to cover future expected losses.

### (c) Available for sale (AFS)

AFS assets are non-derivative financial assets that are not classified into either of the two categories above. AFS assets are measured at fair value. Details of the methodology for the fair value measurements are given in note 42.

Interest on available for sale assets is recognised using the effective interest rate method (see interest receivable above).

Unrealised gains and losses arising from changes in the fair values are recognised in other comprehensive income, except for impairment losses and foreign exchange gains and losses, which are recognised in the income statement. Gains and losses arising on the sale of AFS assets, including any cumulative gains or losses previously recognised in other comprehensive income, are reclassified to the income statement.

### (d) Investments in equity

Investments in equity include certain investments which are held at fair value. Movements in fair value, except impairments, are recognised in other comprehensive income and accumulated in the AFS reserve.

The Group has not classified any financial assets into the held to maturity category.

Purchases and sales of financial assets are accounted for at trade date.

Financial assets are derecognised when the rights to receive cash flows have expired or where the assets have been transferred and substantially all of the risks and rewards of ownership have been transferred.

The impact of hedging on the measurement of financial assets is detailed in the derivatives and hedge accounting policy below.

### Impairment of financial assets

#### (a) Assets carried at amortised cost

The Group assesses at each balance sheet date whether, as a result of one or more events that occurred after initial recognition, there is objective evidence that a financial asset or group of financial assets is impaired. Evidence of impairment may include:

- i) indications that the borrower or group of borrowers is experiencing significant financial difficulty;
- ii) default or delinquency in interest or principal payments; or
- iii) debt being restructured to reduce the burden on the borrower.

The Group first assesses whether objective evidence of impairment exists either individually for assets that are separately significant or individually or collectively for assets that are not separately significant. If there is no objective evidence of impairment for an individually assessed asset it is included in a group of assets with similar credit risk characteristics and collectively assessed for impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. For the Group's secured mortgages this estimate necessarily includes our expectation of the value of collateral in the future. The resultant provisions are deducted from the appropriate asset values in the balance sheet.

In the case of commercial loans that are considered individually significant, we assess cash flows on a case by case basis considering the following factors:

- i) our aggregate exposure to the customer;
- ii) the viability of the customer's business model and their capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;
- iii) the amount and timing of expected receipts and recoveries;
- iv) the likely dividend available on liquidation or bankruptcy;
- v) the extent of other creditors' commitments ranking ahead of Nationwide's, and the likelihood of other creditors continuing to support the company;
- vi) the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- vii) the realisable value of security at the expected date of sale (or other credit mitigants) and likelihood of successful repossession;
- viii) the likely deduction of any costs involved in recovery of amounts outstanding; and
- ix) when available, the secondary market price of the debt.

In the case of loans that are not considered individually significant, cash flows are estimated based on past experience combined with our view of the future considering the following factors:

- i) our aggregate exposure to the customer;
- ii) based on the number of days in arrears at the balance sheet date, the likelihood that a loan will progress through the various stages of delinquency and ultimately be written off;

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## Statement of Accounting Policies (continued)

- iii) the amount and timing of expected receipts and recoveries;
- iv) the realisable value of any security at the estimated date of sale;
- v) the likely deduction of any costs involved in the recovery of amounts outstanding.

The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised the provision is adjusted and the amount of the reversal is recognised in the income statement.

Where a loan is not recoverable, it is written off against the related provision for loan impairment once all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the income statement.

Loans subject to collective impairment assessment and whose terms have been renegotiated are no longer considered to be past due or impaired, assuming that there is no change to the total estimated future cash flows, but are treated as new loans after the minimum required number of payments under the new arrangements have been received. Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired or are considered to be past due.

*(b) Available for sale assets*

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets are impaired. If any such evidence exists for available for sale financial assets, the cumulative loss, measured as the difference between the current amortised cost and the current fair value, less any impairment loss on that asset previously recognised, is recognised in the income statement.

A subsequent decline in the fair value of an investment security classified as available for sale is recognised in the income statement when there is further objective evidence of impairment as a result of further decreases in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised in other comprehensive income. If the fair value of an investment debt security classified as available for sale increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement to the extent of the increase in fair value.

### Financial liabilities

Borrowings, including shares, deposits, debt securities in issue and subordinated liabilities are recognised initially at fair value, being the issue proceeds net of premiums, discounts and transaction costs incurred.

With the exception of deposits relating to the sale of protected equity bonds all borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is adjusted for the amortisation of any transaction costs premiums and discounts. The amortisation is recognised in interest expense and similar charges using the effective interest rate method. The Group does not hold any financial liabilities classified as held for trading.

Permanent interest bearing shares (subscribed capital) are classified as financial liabilities.

Financial liabilities are derecognised when the obligation is discharged, cancelled or has expired.

Borrowings that are designated as hedged items are subject to measurement under the hedge accounting requirements described in the derivatives and hedge accounting policy below.

### Protected equity bonds (PEBs)

Certain non-derivative financial liabilities relating to the sale of PEBs by the Group on behalf of Legal & General, included within other deposits, have been designated at fair value upon initial recognition in the balance sheet. Changes in fair value are recognised through the income statement in gains from derivatives and hedge accounting. The PEBs are economically matched using equity-linked derivatives, which do not meet the requirements for hedge accounting. Recording changes in fair value of both the derivatives and the related liabilities through the income statement most closely reflects the economic reality of the transactions. In so doing, this accounting treatment eliminates a measurement inconsistency that would otherwise arise from valuing the PEBs at amortised cost and the derivatives at fair value.

Income received from Legal & General upon inception of the PEB transaction is deferred and recognised in interest expense and similar charges in the income statement on an effective interest basis over the term of the product where it partially offsets interest incurred on the equity-linked derivatives.

### Derivatives and hedge accounting

Derivatives are entered into to reduce exposures to fluctuations in interest rates, exchange rates, market indices and credit risk and are not used for speculative purposes.

*(a) Derivative financial instruments*

Derivatives are carried at fair value with movements in fair values recorded in the income statement. Fair values are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations from counterparties.

In the first instance fair values are calculated using mid prices. With the exception of derivatives hedging liabilities relating to the sale of PEBs, an adjustment is then made to derivative assets and liabilities to value them on a bid and offer basis respectively. The bid-offer adjustment is calculated on a portfolio basis and reflects the costs that would be incurred if substantially all residual net portfolio market risks were closed out using available hedging instruments or by disposing of or unwinding actual positions. The methodology for determining the bid-offer adjustments involves netting between long



# Notes to the Accounts

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## Statement of Accounting Policies (continued)

and short positions and the bucketing of risk by strike and term in accordance with hedging strategy. Bid-offer spreads are derived from market sources such as broker data and are reviewed periodically. An exception is for derivatives hedging PEBs. These derivatives are not traded in an active market and are therefore valued at mid price.

An assessment is also made as to whether an adjustment is required for counterparty or own credit risk. All derivatives are classified as assets where their fair value is positive and liabilities where their fair value is negative. Where there is the legal ability and intention to settle net, then the derivative is classified as a net asset or liability, as appropriate.

Where cash collateral is received, to mitigate the risk inherent in amounts due to us, it is included as a liability within deposits from banks. Where cash collateral is given, to mitigate the risk inherent in amounts due from us, it is included as an asset in loans and advances to banks.

### (b) *Embedded derivatives*

A number of complex contracts contain both a derivative and a non-derivative component, in which case the derivative is termed an embedded derivative. If the economic characteristics and risks of embedded derivatives are not closely related to those of the host contract, and the overall contract itself is not carried at fair value, the embedded derivative is accounted for separately and reported at fair value with gains and losses being recognised in the income statement.

For derivatives acquired through business combinations, the assessment of whether the contracts are treated as embedded derivatives or not is carried out at the acquisition date.

### (c) *Hedge accounting*

When transactions meet the criteria specified in IAS 39, the Group applies fair value hedge accounting so that changes in the fair value of the underlying asset or liability that are attributable to the hedged risk are recorded in the income statement to offset the fair value movement of the related derivative.

To qualify for hedge accounting at inception the hedge relationship must be clearly documented. At inception the derivative must be expected to be highly effective in offsetting the hedged risk, and effectiveness must be tested throughout the life of the hedge relationship.

The Group discontinues hedge accounting when:

- i) it is evident from testing that a derivative is not, or has ceased to be, highly effective as a hedge;
- ii) the derivative expires, or is sold, terminated or exercised; or
- iii) the underlying item matures or is sold or repaid.

The Group may also decide to cease hedge accounting even though the hedge relationship continues to be highly effective by ceasing to designate the financial instrument as a hedge.

If the derivative no longer meets the criteria for hedge accounting, the cumulative fair value hedging adjustment is amortised over the period to maturity of the previously designated hedge relationship.

If the underlying item is sold or repaid, the unamortised fair value adjustment is immediately reflected in the income statement.

In a micro hedge, the carrying value of the hedged item is adjusted for the change in value of the hedged risk. In the case of a portfolio hedge, the adjustment is included in fair value adjustments for hedged risk.

### **Offsetting financial instruments**

Financial assets and liabilities are offset and the net amount reported in the balance sheet if, and only if, there is a currently enforceable legal right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise an asset and settle the liability simultaneously.

### **Sale and repurchase agreements (including stock borrowing and lending)**

Investment and other securities may be lent or sold subject to a commitment to repurchase them (a 'repo'). Such securities are retained on the balance sheet when substantially all the risks and rewards of ownership remain within the Group, and the counterparty liability is included separately on the balance sheet as appropriate.

Similarly, where the Group borrows or purchases securities subject to a commitment to resell them (a 'reverse repo') but does not acquire the risks and rewards of ownership, the transactions are treated as collateralised loans, and the securities are not included in the balance sheet.

The difference between sale and repurchase price is accrued over the life of the agreements using the effective interest method.

### **Foreign currency translation**

The consolidated financial statements are presented in Sterling, which is the functional currency of the Society. Items included in the financial statements of each of the Group's entities are measured using their functional currency. Foreign currency transactions are translated into Sterling using the exchange rates prevailing at the dates of the transactions. Monetary items denominated in foreign currencies are retranslated at the rate prevailing at the year end.

Foreign exchange gains and losses resulting from the retranslation and settlement of these items are recognised in the income statement.

Exchange differences on equities held at fair value through the income statement are reported as part of the fair value gain or loss. Fair values are translated using the exchange rate at the date that the fair value was determined.

### **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, loans and advances to banks, other amounts due from banks and short term government securities.



## Judgements in applying accounting policies and critical accounting estimates

The Group has to make judgements in applying its accounting policies which affect the amounts recognised in the accounts. In addition, estimates and assumptions are made that could affect the reported amounts of assets and liabilities within the following financial year. The most significant areas where judgements and estimates are made are as follows:

### Impairment provisions on loans and advances

At 4 April 2011 loans and advances to customers totalled £149,635 million (2010: £152,527 million) against which impairment provisions of £765 million (2010: £750 million) have been made.

In accordance with the accounting policy on the impairment of financial assets carried at amortised cost, where objective evidence exists that a loss has been incurred, the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate.

Key assumptions included in the measurement of the incurred loss include data regarding the probability of any account going into default, the probability of defaulted accounts progressing to possession and the eventual loss incurred in the event of forced sale or write off. These assumptions are based on observed historical data and updated as management considers appropriate to reflect current conditions. The accuracy of the impairment provision would therefore be affected by unexpected changes in the above assumptions.

To the extent that actual cash flows differ from those estimated by 10%, the impairment provision on loans and advances would change by an estimated £127 million. On our residential mortgage books our estimate of future House Price Index (HPI) movements is also a key assumption. To the extent that future HPI movements were to differ from expectations by 5%, the impact on the impairment provision would be £20 million.

### Fair value adjustments in relation to acquired assets

Key assumptions in determining the amount of fair value adjustment that we require to hold in relation to expected future credit losses on acquired assets include probability of any account going into default, the probability of defaulted accounts progressing to possession and the eventual loss incurred in the event of forced sale or write off. These assumptions are based on observed historical data and updated where management considers appropriate to reflect current conditions. The calculation of the required fair value adjustment would therefore be affected by unexpected changes in the above assumptions. For our residential portfolio, the review of fair value is performed on a portfolio basis. For our commercial loan book, in addition to review on a portfolio basis, a number of loans are also assessed on an individual basis.

During the year we have released £33 million of excess credit fair value adjustment in relation to residential mortgages. A key assumption for our residential mortgage books is our estimate of future HPI movements. To the extent that future HPI movements were to differ from expectations by 5%, the impact on the expected loss would be £15 million.

### Impairment of available for sale assets

At 4 April 2011 the fair value of investment securities – available for sale assets totalled £21,540 million (2010: £23,385 million). In the year ended 4 April 2011 impairment losses of £66 million (2010: £29 million) have been charged to the income statement.

The Group determines that available for sale assets are impaired when it is considered that there is objective evidence of impairment. In determining whether this evidence exists, the Group evaluates, among other factors, the normal volatility in valuation together with consideration of the appropriateness of valuations under the current market conditions, evidence of deterioration in the financial health of the investee, industry and sector performance and operational and financing cash flows. This determination is supported by rigorous credit assessment undertaken by Risk Management division, independently of our Treasury division.

A watch list is used to categorise any available for sale assets showing signs of credit deterioration. Although it is not currently anticipated that any of the items on this list will become impaired in the next financial year, in stressed market conditions an impairment in a range of £20 to £60 million would be possible for these assets.

### Fair value of financial instruments

Derivative financial instruments and available for sale assets are stated at fair value.

Derivative financial instruments are principally valued by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from counterparties. For both collateralised and non-collateralised positions the Group continues to use discount curves based on term Libor rates.

Available for sale assets are, in the majority of cases, valued using market prices or, as markets become inactive, prices obtained from market participants. In sourcing valuations, the Group makes use of a consensus pricing service, in line with standard industry practice. In cases where market prices or prices obtained from market participants are not available, discounted cash flow valuation models are used. Changes in the assumptions used in the models could affect the reported fair value of available for sale assets. In addition, prices obtained from market participants in an illiquid market are inherently less reliable and therefore careful judgement is required in applying them. Further information is provided in note 42.

Our liability in relation to the protected equity bond product (PEB) is also fair valued. The calculation of the fair value of the PEB liability includes an estimate of the expected investment return payable on maturity of the product.

### Retirement benefit obligations (Pensions)

At 4 April 2011 net retirement obligations totalled £300 million (2010: £508 million).

The Group has to make assumptions on the discount rate, expected return on pension plan assets, mortality, inflation and future salary rises when valuing its net pension liability and the cost of benefits provided. Changes in assumptions could affect the reported liability, service cost and expected return on pension plan assets.

# Notes to the Accounts

continued

## 02

### Judgements in applying accounting policies and critical accounting estimates (continued)

The impact of a 0.1% increase in the inflation assumption would be to increase the carrying value of the pension obligations by approximately £55 million and vice versa. The impact of a 0.1% increase in the discount rate would be to reduce the value of the pension obligations by approximately £63 million and vice versa. The impact of a one year increase in the life expectancy at age 60 would be to increase the value of the pension obligations by approximately £74 million and vice versa. Further details on the assumptions used in valuing the retirement benefit obligations can be found in note 35.

#### Provisions for payment protection insurance (PPI) claims

At 4 April 2011, the Group holds a provision of £19 million, which it expects to be sufficient to meet any obligations in relation to previous sales of PPI. The level of provision is calculated based upon estimates of complaint volumes, the rate at which these claims are upheld and the level of redress paid on each complaint. A 1% increase in the expected level of complaints would increase the value of the required provision by £0.2 million.

#### Financial services compensation scheme (FSCS)

The Group's ultimate liability for levies payable to the FSCS in respect of failed financial institutions remains uncertain. The provided amount is dependent upon the following factors:

- Future interest rates; and
- The Group's share of industry protected deposits as at 31 December 2010.

The impact of a 1% increase in the interest rate assumption would be to increase the carrying value of the FSCS provision by approximately £19 million and vice versa. The impact of the Group's share of industry protected deposits at 31 December 2010 increasing by 1% would be to increase the carrying value of the FSCS provision by approximately £4 million and vice versa.

Further detail of the FSCS and the provision are included in note 31.

#### Effective interest rates (EIR)

The Group uses the EIR method to recognise income from certain financial assets (including Retail and Commercial mortgages) held at amortised cost. To calculate the appropriate EIR the Group makes assumptions of the expected lives of financial instruments and the anticipated level of early redemption charges. The most critical assumption is the anticipated level of early redemption penalty charges.

The impact of a 10% change in the anticipated level of future early redemption charges would be a change to the value of the loans on the balance sheet of £6 million.

## 03

### Interest receivable and similar income

|   | Group   |         | Society |         |
|---|---------|---------|---------|---------|
|   | 2011    | 2010    | 2011    | 2010    |
|   | £m      | £m      | £m      | £m      |
| On residential mortgages                            | 5,004   | 5,289   | 4,149   | 4,469   |
| On other loans:                                     |         |         |         |         |
| • Connected undertakings                            | -       | -       | 965     | 960     |
| • Other   | 1,148   | 1,150   | 1,061   | 1,007   |
| On investment securities                            | 1,029   | 1,056   | 1,028   | 1,060   |
| On other liquid assets                              | 32      | 47      | 29      | 101     |
| Foreign exchange differences                        | -       | 20      | 10      | 13      |
| Net expense on financial instruments hedging assets | (2,738) | (3,116) | (2,738) | (3,116) |
| Expected return on pension assets (note 35)         | 168     | 122     | 168     | 122     |
|   | 4,643   | 4,568   | 4,672   | 4,616   |

Included within interest receivable and similar income is interest accrued on loans 3 or more months in arrears: Group £58 million, Society £25 million (2010: Group £78 million, Society £40 million) and the

unwind of the discount on the impairment provisions: Group £38 million, Society £35 million (2010: Group £30 million, Society £25 million). Further detail is included in note 11.

## 03

## Interest receivable and similar income (continued)

Interest receivable on residential mortgages and interest receivable on other loans, which are primarily commercial loans and loans to Registered Social Landlords, are net of amortisation of fair value adjustments relating to the acquisitions of the Derbyshire and Cheshire building societies, core parts of the Dunfermline Building Society and the Dunfermline Registered Social Landlord loan portfolio. This category also includes

the impact of the release of excess credit risk fair value adjustments of £33 million (2010: £nil).

Interest receivable on investment securities includes £47 million (2010: £76 million) relating to the sale of investment securities, which includes a £40 million gain from the sale of gilts (2010: £91 million).

## 04

## Interest expense and similar charges

|   | Group |         | Society |       |
|---|-------|---------|---------|-------|
|   | 2011  | 2010    | 2011    | 2010  |
|   | £m    | £m      | £m      | £m    |
| On shares held by individuals                           | 2,510 | 2,326   | 2,510   | 2,326 |
| On subscribed capital                                   | 96    | 96      | 96      | 96    |
| On deposits and other borrowings:                       |       |         |         |       |
| • Subordinated liabilities                              | 110   | 95      | 110     | 95    |
| • Connected undertakings                                | -     | -       | 250     | 167   |
| • Other   | 258   | 384     | 165     | 299   |
| On debt securities in issue                             | 915   | 884     | 794     | 818   |
| Foreign exchange differences                            | 3     | -       | -       | -     |
| Net income on financial instruments hedging liabilities | (952) | (1,077) | (576)   | (721) |
| Pension interest cost (note 35)                         | 166   | 146     | 166     | 146   |
|   | 3,106 | 2,854   | 3,515   | 3,226 |

Interest expense on shares held by individuals, deposits and other borrowings, subscribed capital and debt securities in issue includes amortisation of fair value adjustments relating to the acquisitions of the Derbyshire and Cheshire building societies and core parts of the Dunfermline Building Society.

# Notes to the Accounts

continued

05

## Fee and commission income

|                            | Group |      | Society |      |
|----------------------------|-------|------|---------|------|
|                            | 2011  | 2010 | 2011    | 2010 |
|                            | £m    | £m   | £m      | £m   |
| Mortgage related fees      | 36    | 28   | 28      | 21   |
| Banking and savings fees   | 166   | 149  | 166     | 149  |
| General insurance fees     | 142   | 128  | 141     | 122  |
| Other insurance fees       | 32    | 33   | 32      | 31   |
| Other fees and commissions | 64    | 40   | 62      | 41   |
|                            | 440   | 378  | 429     | 364  |

06

## Income from investments

|   | Group |      | Society |      |
|---|-------|------|---------|------|
|   | 2011  | 2010 | 2011    | 2010 |
|   | £m    | £m   | £m      | £m   |
| Income from equity shares                     | 4     | 1    | 5       | 1    |
| Income from shares in subsidiary undertakings | -     | -    | 61      | 352  |
|   | 4     | 1    | 66      | 353  |

The 2010 income from shares in subsidiary undertakings primarily related to the repatriation to the Society of reserves held by subsidiaries that were no longer operationally active.

07

## Other operating income

|   | Group |      | Society |      |
|---|-------|------|---------|------|
|   | 2011  | 2010 | 2011    | 2010 |
|   | £m    | £m   | £m      | £m   |
| Gain on portfolio acquisition                               | -     | 40   | -       | 40   |
| Gain/(loss) on revaluation of property, plant and equipment | -     | (5)  | 1       | (3)  |
| Rental income   | 6     | 6    | 5       | 5    |
| Profit on sale of fixed assets                              | -     | 1    | -       | 1    |
| Income from subsidiary undertakings                         | -     | -    | -       | 1    |
| Other   | (1)   | 5    | -       | 2    |
|   | 5     | 47   | 6       | 46   |

The gain on portfolio acquisition relates to the former Dunfermline Building Society social housing portfolio which was acquired from DBS Bridge Bank Limited on 30 June 2009. The portfolio was not part of the original acquisition of the Dunfermline Building Society on 30 March 2009. The acquisition of the social housing portfolio has been treated as the purchase of a mortgage book in line with IAS 39 'Financial Instruments: Recognition and Measurement'.

## 08

## Gains from derivatives and hedge accounting

|  | Group   |       | Society |       |
|--|---------|-------|---------|-------|
|  | 2011    | 2010  | 2011    | 2010  |
|  | £m      | £m    | £m      | £m    |
| Derivatives designated as fair value hedges                        | 1,141   | 895   | 1,633   | 817   |
| Fair value movement attributable to hedged risk                    | (1,028) | (984) | (1,519) | (883) |
| Gains/(losses) from fair value hedges (note i)                     | 113     | (89)  | 114     | (66)  |
| Derivatives hedging mortgage commitments                           | -       | 108   | -       | 108   |
| Fair value movement attributable to mortgage commitments (note ii) | 10      | (51)  | 10      | (51)  |
|  | 123     | (32)  | 124     | (9)   |
| Other derivatives (note iii)                                       | (3)     | 66    | (7)     | 40    |
|  | 120     | 34    | 117     | 31    |

## Notes

- (i) Gains from fair value hedges can arise either where there is an IFRS hedge accounting relationship in place but the fair value of the derivative is not exactly offset by the change in fair value of the asset or liability that is being hedged (sometimes referred to as hedge ineffectiveness) or where, after an IFRS hedge relationship has been established, changes in the underlying hedged interest rate risk in the balance sheet may result in the recognition of one off gains or losses.
- (ii) As a result of structural balance sheet changes, the Group ceased electing to fair value its mortgage commitments during the first half of the year as doing so would have created an accounting mismatch.
- (iii) Other derivatives are those used for economic hedging but which are not in an IAS 39 hedge accounting relationship because hedge accounting has not been adopted or is not achievable.

Although the Group uses derivatives exclusively to hedge risk exposures, income statement volatility can still arise due to hedge accounting ineffectiveness and strategy changes or because hedge accounting has not been adopted or is not achievable. This was especially so in the first half of this financial year, with a more normal level of accounting volatility in the second half.

A gain of £120 million (2010: £34 million) has been reported by the Group. The material drivers of the gain during the year were as follows:

- a) The Group enters into derivatives to economically hedge forecast fixed rate savings. It is not possible to designate these derivatives as hedges until the forecast transactions have occurred. In May and June 2010 an accounting mismatch between the derivatives being entered into and recognition of the liability created a gain of £28 million due to a combination of high volumes in the main ISA season and material decreases in swap rates. These gains will reverse over the lives of the related savings.

- b) The Group recognised material hedge gains on the disposal of gilt assets of £30 million and on the early cancellation of a covered bond liability of £26 million in the first half of the year. These gains represent the reversal of losses previously recognised on these same items. In the second half of the year further gains of £30 million have been recognised as a result of ongoing gilt management activity.

- c) The Group recorded a £10 million gain from the fair valuation of mortgage commitments. As a result of structural changes in our balance sheet this practice ceased. These gains will reverse over the lives of the related mortgages.

The overall impact of derivatives will remain volatile from period to period as new derivative transactions replace those which mature to ensure that interest rate risk is continually managed. Management believe that this volatility arises from application of the accounting rules, which do not reflect the economic reality at a particular point in time.

# Notes to the Accounts

continued

09

## Administrative expenses

|   | Group |       | Society |       |
|---|-------|-------|---------|-------|
|   | 2011  | 2010  | 2011    | 2010  |
|   | £m    | £m    | £m      | £m    |
| Employee costs:                                     |       |       |         |       |
| • Wages and salaries                                | 461   | 469   | 447     | 449   |
| • Social security costs                             | 40    | 44    | 38      | 42    |
| • Pension costs (note 35)                           | 82    | 71    | 81      | 69    |
|   | 583   | 584   | 566     | 560   |
| Other administrative expenses                       | 575   | 611   | 560     | 591   |
|   | 1,158 | 1,195 | 1,126   | 1,151 |
| Other administrative expenses include:              |       |       |         |       |
| • Property operating lease rental                   | 38    | 43    | 37      | 42    |
| • Other property costs                              | 81    | 74    | 80      | 74    |
| • Postage and communications                        | 66    | 67    | 66      | 67    |
| • Computer costs                                    | 82    | 76    | 82      | 76    |
| • Marketing and advertising                         | 23    | 12    | 23      | 12    |
| • Money transmission and other bank costs           | 68    | 70    | 67      | 69    |
| • Legal, professional and consultancy               | 41    | 27    | 36      | 23    |
| • Training, education and other staff related costs | 81    | 119   | 79      | 117   |
| • Other   | 95    | 123   | 90      | 111   |
|   | 575   | 611   | 560     | 591   |

Administrative expenses include £29 million (2010: £62 million) of transformation costs, which include £11 million directly relating to business combinations (2010: £7 million), of which £4 million is an impairment charge against the value of the former head office buildings of the Derbyshire and Cheshire building societies. The impairment charge is also disclosed separately in note 22. The remaining transformation

costs primarily relate to restructuring parts of our business as part of our ongoing cost optimisation programme and other initiatives.

Directors' emoluments are shown as part of the Report of the Directors on Remuneration in accordance with Schedule 10A, paragraphs 1 to 9 to the Building Societies Act 1986.



## 09

## Administrative expenses (continued)

The remuneration of the auditors, PricewaterhouseCoopers LLP, is set out below:

|  | Group |      | Society |      |
|--|-------|------|---------|------|
|  | 2011  | 2010 | 2011    | 2010 |
|  | £m    | £m   | £m      | £m   |
| Audit fees for the Group and Society statutory audit | 1.7   | 1.4  | 1.7     | 1.4  |
| Fees payable for other services:                     |       |      |         |      |
| • Audit of subsidiaries pursuant to legislation      | 0.6   | 0.4  | -       | -    |
| • Other services pursuant to legislation             | 0.6   | 0.7  | 0.6     | 0.7  |
|  | 2.9   | 2.5  | 2.3     | 2.1  |
| • All other services                                 | 0.5   | 0.8  | 0.5     | 0.8  |
|  | 3.4   | 3.3  | 2.8     | 2.9  |

The Group policy in relation to the use of its auditors on non-audit engagements sets out the types of services they are generally precluded from performing. All non-audit services, where the fee is expected to exceed a de minimis limit, are subject to pre-approval by the Audit Committee.

Other services pursuant to legislation include regulatory reporting under listing rules for the Group's funding programmes.

## 10

## Employees

|   | Group  |        | Society |        |
|---|--------|--------|---------|--------|
|   | 2011   | 2010   | 2011    | 2010   |
| The average number of persons employed during the year was: |        |        |         |        |
| • Full-time   | 12,879 | 13,247 | 12,324  | 12,707 |
| • Part-time   | 4,813  | 5,283  | 4,741   | 5,207  |
|   | 17,692 | 18,530 | 17,065  | 17,914 |
| Society   |        |        |         |        |
| • Central administration                                    | 8,257  | 8,665  | 8,257   | 8,665  |
| • Branches  | 8,808  | 9,249  | 8,808   | 9,249  |
| Subsidiaries  | 627    | 616    | -       | -      |
|   | 17,692 | 18,530 | 17,065  | 17,914 |

The reduction in the average number of employees reflects the consolidation of head office functions and branches in some locations following the acquisitions.

Central administration employee numbers include employees engaged in direct customer-facing operations in administrative centres.

# Notes to the Accounts

continued

11

## Impairment provisions on loans and advances to customers

| 2011 Group                          | Prime residential | Specialist residential | Consumer banking | Commercial lending | Other lending | Total      |
|-------------------------------------|-------------------|------------------------|------------------|--------------------|---------------|------------|
|                                     | £m                | £m                     | £m               | £m                 | £m            | £m         |
| At 5 April 2010                     | 17                | 143                    | 148              | 422                | 20            | 750        |
| Charge for the year                 | 32                | 69                     | 83               | 175                | -             | 359        |
| Amounts written off during the year | (9)               | (51)                   | (156)            | (105)              | (13)          | (334)      |
| Amounts recovered during the year   | 1                 | 3                      | 20               | -                  | 4             | 28         |
| Unwind of discount                  | (1)               | (3)                    | (5)              | (29)               | -             | (38)       |
| <b>At 4 April 2011</b>              | <b>40</b>         | <b>161</b>             | <b>90</b>        | <b>463</b>         | <b>11</b>     | <b>765</b> |

| 2010 Group                          | Prime residential | Specialist residential | Consumer banking | Commercial lending | Other lending | Total      |
|-------------------------------------|-------------------|------------------------|------------------|--------------------|---------------|------------|
|                                     | £m                | £m                     | £m               | £m                 | £m            | £m         |
| At 5 April 2009                     | 20                | 101                    | 136              | 194                | 19            | 470        |
| Charge for the year                 | 10                | 79                     | 126              | 299                | 35            | 549        |
| Amounts written off during the year | (14)              | (33)                   | (120)            | (54)               | (38)          | (259)      |
| Amounts recovered during the year   | 2                 | 1                      | 13               | -                  | 4             | 20         |
| Unwind of discount                  | (1)               | (5)                    | (7)              | (17)               | -             | (30)       |
| <b>At 4 April 2010</b>              | <b>17</b>         | <b>143</b>             | <b>148</b>       | <b>422</b>         | <b>20</b>     | <b>750</b> |

The Group impairment provision of £765 million at 4 April 2011 (2010: £750 million) comprises individual provisions of £478 million (2010: £440 million) and collective provisions of £287 million (2010: £310 million).

Within consumer banking, additional write offs of £54 million were made during the year to fully extinguish previously provided Debt Collection Agency and litigation balances relating to our current account overdraft and credit card products.

| 2011 Society                        | Prime residential | Specialist residential | Consumer banking | Commercial lending | Other lending | Total      |
|-------------------------------------|-------------------|------------------------|------------------|--------------------|---------------|------------|
|                                     | £m                | £m                     | £m               | £m                 | £m            | £m         |
| At 5 April 2010                     | 17                | -                      | 148              | 413                | -             | 578        |
| Charge for the year                 | 32                | -                      | 83               | 172                | -             | 287        |
| Amounts written off during the year | (9)               | -                      | (156)            | (102)              | -             | (267)      |
| Amounts recovered during the year   | 1                 | -                      | 20               | -                  | -             | 21         |
| Unwind of discount                  | (1)               | -                      | (5)              | (29)               | -             | (35)       |
| <b>At 4 April 2011</b>              | <b>40</b>         | <b>-</b>               | <b>90</b>        | <b>454</b>         | <b>-</b>      | <b>584</b> |

The Society impairment provision of £584 million at 4 April 2011 (2010: £578 million) comprises individual provisions of £411 million (2010: £377 million) and collective provisions of £173 million (2010: £201 million).

## 11

## Impairment provisions on loans and advances to customers (continued)

| 2010 Society                        | Prime residential | Specialist residential | Consumer banking | Commercial lending | Other lending | Total      |
|-------------------------------------|-------------------|------------------------|------------------|--------------------|---------------|------------|
|                                     | £m                | £m                     | £m               | £m                 | £m            | £m         |
| At 5 April 2009                     | 20                | -                      | 82               | 194                | -             | 296        |
| Charge for the year                 | 10                | -                      | 96               | 290                | -             | 396        |
| Amounts written off during the year | (14)              | -                      | (89)             | (54)               | -             | (157)      |
| Amounts recovered during the year   | 2                 | -                      | 9                | -                  | -             | 11         |
| Transfer from subsidiary            | -                 | -                      | 57               | -                  | -             | 57         |
| Unwind of discount                  | (1)               | -                      | (7)              | (17)               | -             | (25)       |
| <b>At 4 April 2010</b>              | <b>17</b>         | <b>-</b>               | <b>148</b>       | <b>413</b>         | <b>-</b>      | <b>578</b> |

In 2010, the Society's impairment loss on loans and advances to customers in the income statement of £450 million included a £54 million provision relating to the Society's loan to a subsidiary undertaking, driven by the impairment of corporate loans held within the subsidiary. The 2010 figures

reported above for the Group include the impairment of the underlying corporate loans within other lending.

These provisions have been deducted from the appropriate asset values in the balance sheet.

## 12

## Taxation

|  | Group |      | Society |      |
|--|-------|------|---------|------|
|  | 2011  | 2010 | 2011    | 2010 |
|  | £m    | £m   | £m      | £m   |
| Current Tax:   |       |      |         |      |
| • UK corporation tax                                     | 65    | 38   | 9       | 11   |
| • Corporation tax – adjustment in respect of prior years | 1     | (24) | -       | (29) |
|  | 66    | 14   | 9       | (18) |
| Overseas income tax                                      | 2     | -    | -       | -    |
| Total current tax  | 68    | 14   | 9       | (18) |
| Deferred tax (note 24):                                  |       |      |         |      |
| • Current year   | 14    | 66   | 6       | 38   |
| • Adjustment in respect of prior years                   | (4)   | (3)  | (2)     | (2)  |
| • Effect of corporation tax rate change                  | (9)   | -    | (10)    | -    |
| Total deferred taxation                                  | 1     | 63   | (6)     | 36   |
|  | 69    | 77   | 3       | 18   |

The Society's tax charge for 2010 included charges in respect of the surrender of tax losses to subsidiary undertakings in earlier periods totalling £4 million. The 2010 items arose from a reassessment during the year of tax due to HMRC on funding and intra Group transactions in prior years.

Further information about deferred tax is presented in note 24.

# Notes to the Accounts

continued

12

## Taxation (continued)

The actual tax charge differs from the theoretical amount that would arise using the standard rate of corporation tax in the UK as follows:

|  | Group |      | Society |      |
|--|-------|------|---------|------|
|  | 2011  | 2010 | 2011    | 2010 |
|  | £m    | £m   | £m      | £m   |
| Profit before tax  | 317   | 341  | 90      | 499  |
| Tax calculated at a tax rate of 28%                        | 89    | 95   | 25      | 140  |
| Effect of different tax rates in other countries           | (6)   | (3)  | -       | -    |
| Expenses/(income) not taxable/deductible for tax purposes: |       |      |         |      |
| • Building depreciation                                    | 1     | 3    | 1       | 3    |
| • Non taxable dividend received                            | -     | -    | (14)    | (97) |
| • Other  | 7     | 9    | 3       | 3    |
| Adjustments in respect of prior years                      | (3)   | (27) | (2)     | (31) |
| Previously unrecognised losses                             | (10)  | -    | -       | -    |
| Effect of corporation tax rate change                      | (9)   | -    | (10)    | -    |
|  | 69    | 77   | 3       | 18   |

The tax on items through other comprehensive income is as follows:

|  | Group |      | Society |      |
|--|-------|------|---------|------|
|  | 2011  | 2010 | 2011    | 2010 |
|  | £m    | £m   | £m      | £m   |
| Available for sale investments   | 100   | 485  | 97      | 486  |
| Revaluation of property  | (1)   | -    | (1)     | -    |
| Actuarial gain/(loss) on retirement benefit obligations                          | 47    | (48) | 47      | (48) |
| Effect of corporation tax rate change on other items through the general reserve | 6     | -    | 4       | -    |
| Adjustment to deferred tax transferred from acquisitions                         | (5)   | -    | -       | -    |
|  | 147   | 437  | 147     | 438  |

The Group tax charge through the available for sale reserve of £100 million is made up of a charge of £96 million through deferred tax and a charge of £4 million through current tax.

13

## Operating segments

The following section analyses the Group's performance by business segment. For management reporting purposes, the Group is organised into the following business groupings, determined according to similar economic characteristics and customer base:

- Retail;
- Commercial; and
- Head office functions.

These business groupings reflect how management assesses performance and makes decisions on allocating resources to the business on the basis of product and customers. Revenues from external and internal customers are allocated to the appropriate business segment.

Goodwill is allocated to segments based on the underlying cash generating unit to which it relates. Goodwill includes that arising on the acquisition of The Mortgage Works (UK) plc by Portman Building Society and that

## Operating segments (continued)

arising on the acquisition of the Derbyshire Building Society and is therefore allocated to the Retail segment.

### Retail

Retail functions include prime residential lending, specialist residential lending, consumer banking, retail funding (savings products), insurance and investments. The distribution channels supporting these products are included in this segment.

### Commercial

This segment comprises the commercial lending business.

### Head office functions

Head office functions comprise Treasury operational and income generation activities, head office and central support functions. It includes the result arising from the transfer pricing methodology relating to the funding of other segments.

Head office and central support functions includes: executive management, corporate secretariat, legal services, human resources, strategy and planning, finance, risk management, capital management, corporate affairs, property services and internal audit.

### Segmental reporting changes in the year ended 4 April 2011

During the year ended 4 April 2011, the Group revised the methodology for funds transfer pricing between segments. Accordingly, there have been certain changes in the measurement of business segment net interest receivable compared to the results reported in the 2010 Annual Report and Accounts. There is no impact on the Group income statement or balance sheet; comparative figures have been restated accordingly.

Funds transfer pricing is the mechanism by which the Group recognises the internal cost of funds and allocates this cost between different product groups and business segments to derive individual product margin and net interest receivable. Previously, funds transfer pricing was calculated using a methodology whereby a cost of funds was allocated to a product based on the Group's cost of retail funds ruling at inception of the product and was fixed for the life of the product. Under the new methodology, a single cost of funds representing the weighted average cost of retail and wholesale funding is allocated across the Group and is updated on a quarterly basis, to better reflect the opportunity cost of funding and the relative performance of the different business segments, based on current market cost of funds.

However, within the Commercial division, the transfer price charged to long term social housing and PFI lending is set to reflect the lower average historic cost of wholesale funding which was available when this book was originated. This reflects the nature of this lending which did not envisage the current marginal cost of borrowing. Going forward, the transfer price applied to social housing and PFI loans will be assessed based on the movements in the Group's cost of wholesale funding. All other assets in the Commercial division will continue to be charged the weighted average current cost of retail and wholesale funds, in line with other assets.

The majority of revenue for the Group is derived from interest. Net interest income is used to assess the performance of each segment. Therefore, interest income is presented net of interest expense. The presentation shown below, whereby net interest income is adjusted for revenue from other segments, reflects how management receives information to assess performance and allocate resources.

| 2011  | Retail         | Commercial    | Head office functions | Total          |
|---|----------------|---------------|-----------------------|----------------|
|   | £m             | £m            | £m                    | £m             |
| Net interest income                         | 1,339          | 18            | 180                   | 1,537          |
| Other income (note i)                       | 415            | 20            | 10                    | 445            |
| <b>Total revenue</b>                        | <b>1,754</b>   | <b>38</b>     | <b>190</b>            | <b>1,982</b>   |
| Expenses (note ii)                          | (1,144)        | (32)          | (103)                 | (1,279)        |
| Impairment and other provisions (note iii)  | (186)          | (175)         | (66)                  | (427)          |
| <b>Underlying profit/(loss) before tax</b>  | <b>424</b>     | <b>(169)</b>  | <b>21</b>             | <b>276</b>     |
| FSCS levies – charge                        | (50)           | -             | -                     | (50)           |
| Transformation costs                        | (4)            | -             | (25)                  | (29)           |
| Gains from derivatives and hedge accounting | -              | -             | 120                   | 120            |
| <b>Profit/(loss) before tax</b>             | <b>370</b>     | <b>(169)</b>  | <b>116</b>            | <b>317</b>     |
| Taxation                                    |                |               |                       | (69)           |
| <b>Profit after tax</b>                     |                |               |                       | <b>248</b>     |
| <b>Total assets</b>                         | <b>126,864</b> | <b>22,074</b> | <b>39,940</b>         | <b>188,878</b> |
| <b>Total liabilities (note iv)</b>          | <b>128,647</b> | <b>-</b>      | <b>53,977</b>         | <b>182,624</b> |

# Notes to the Accounts

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## Operating segments (continued)

| 2010 (Restated)  | Retail  | Commercial | Head office functions | Total   |
|--|---------|------------|-----------------------|---------|
|  | £m      | £m         | £m                    | £m      |
| Net interest income/(expense)                          | 1,459   | (42)       | 297                   | 1,714   |
| Other income (note i)                                  | 364     | 11         | 6                     | 381     |
| Total revenue  | 1,823   | (31)       | 303                   | 2,095   |
| Expenses (note ii)                                     | (1,156) | (36)       | (92)                  | (1,284) |
| Impairment and other provisions (note iii)             | (229)   | (299)      | (71)                  | (599)   |
| Underlying profit/(loss) before tax                    | 438     | (366)      | 140                   | 212     |
| FSCS levies – release                                  | 117     | -          | -                     | 117     |
| Transformation costs and gain on portfolio acquisition | (62)    | 40         | -                     | (22)    |
| Gains from derivatives and hedge accounting            | -       | -          | 34                    | 34      |
| Profit/(loss) before tax                               | 493     | (326)      | 174                   | 341     |
| Taxation   |         |            |                       | (77)    |
| Profit after tax                                       |         |            |                       | 264     |
| Total assets   | 129,456 | 22,417     | 39,524                | 191,397 |
| Total liabilities                                      | 126,017 | -          | 59,664                | 185,681 |

### Notes

(i) Other income excludes gains from derivatives and hedge accounting and the 2010 gain on portfolio acquisition.

(ii) Expenses exclude transformation costs.

(iii) Impairment and other provisions includes impairment losses on loans and advances to customers, provisions for liabilities and charges (excluding FSCS) and impairment losses on investment securities.

(iv) Commercial deposits are included within head office functions, reflecting the way in which the balances are managed by the Group.



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## Loans and advances to banks

|   | Group |       | Society |       |
|---|-------|-------|---------|-------|
|   | 2011  | 2010  | 2011    | 2010  |
|   | £m    | £m    | £m      | £m    |
| Placements with banks:  |       |       |         |       |
| • Accrued interest  | 1     | 2     | 1       | 2     |
| • Balances with a maturity on acquisition of less than three months | 3,993 | 1,815 | 3,916   | 1,758 |
|   | 3,994 | 1,817 | 3,917   | 1,760 |
| Mandatory reserve deposits with the Bank of England                 | 187   | 200   | 187     | 200   |
|   | 4,181 | 2,017 | 4,104   | 1,960 |

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## Investment securities – available for sale

|   | Group  |        | Society |        |
|---|--------|--------|---------|--------|
|   | 2011   | 2010   | 2011    | 2010   |
|   | £m     | £m     | £m      | £m     |
| Government and supranational investment securities          | 12,563 | 12,346 | 12,563  | 12,346 |
| Other public sector investment securities                   | -      | 3      | -       | 3      |
| Private sector investment securities:                       |        |        |         |        |
| • Listed  | 8,977  | 11,036 | 8,886   | 10,945 |
|   | 21,540 | 23,385 | 21,449  | 23,294 |
| Investment securities have remaining maturities as follows: |        |        |         |        |
| • Accrued interest  | 146    | 196    | 146     | 196    |
| • In not more than one year                                 | 2,141  | 2,141  | 2,141   | 2,141  |
| • In more than one year                                     | 19,253 | 21,048 | 19,162  | 20,957 |
|   | 21,540 | 23,385 | 21,449  | 23,294 |

Investment securities, included in the table above, with a carrying value of £227 million (2010: £3,734 million), have been sold under sale and repurchase agreements. This comprises £227 million of private listed securities (2010: £3,303 million private listed securities and £431 million government securities). These assets have not been derecognised as the Group has retained substantially all the risks and rewards of ownership. The proceeds of all repurchase agreements of £1,249 million (2010: £6,441 million) are included within deposits from banks (note 26).

The Group holds collateral of £1.5 billion under reverse sale and repurchase agreements at 4 April 2011 (2010: nil).

The impairment loss on investment securities of £66 million in 2011 relates entirely to available for sale assets. The loss of £36 million in 2010 included a £29 million charge on investment securities available for sale and £7 million in respect of other securities managed by our Treasury division. The 2011 charge on investment securities available for sale relates to a small number of US RMBS (£22 million), restructured Structured Investment Vehicle notes (£11 million), UK CMBS (£15 million) and Irish bank subordinated debt (£18 million). The prior year charge of £29 million was in respect of a small number of US Alt A RMBS exposures. Further information on Treasury investment asset credit risk is included in note 40.

# Notes to the Accounts

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## Derivative financial instruments

All derivative financial instruments are held for risk mitigation purposes although not all derivatives are designated as hedging instruments under the terms of IAS 39 'Financial Instruments: Recognition and Measurement'.

The table below analyses derivatives between those designated as hedging instruments and those which, whilst in economic hedging relationships, are not designated as hedging instruments:

|   | 2011                     |              |                | 2010                     |              |                |
|---|--------------------------|--------------|----------------|--------------------------|--------------|----------------|
|   | Contract/notional amount | Fair value   |                | Contract/notional amount | Fair value   |                |
|   | £m                       | Assets £m    | Liabilities £m | £m                       | Assets £m    | Liabilities £m |
| <b>Derivatives held for hedging</b>                       |                          |              |                |                          |              |                |
| <b>(a) Society</b>  |                          |              |                |                          |              |                |
| Derivatives designated as fair value hedging instruments: |                          |              |                |                          |              |                |
| • Interest rate swaps                                     | 99,989                   | 990          | 2,964          | 126,283                  | 1,238        | 5,025          |
| Other derivatives:  |                          |              |                |                          |              |                |
| • Cross currency interest rate swaps                      | 10,088                   | 344          | 154            | 8,909                    | 621          | 370            |
| • Caps, collars and floors                                | 732                      | 2            | 3              | 703                      | 3            | 5              |
| • Forward foreign exchange                                | 3,692                    | 53           | 19             | 1,689                    | 34           | 3              |
| • Forward rate agreements                                 | 150                      | -            | -              | 3,428                    | 1            | -              |
| • Swaptions   | 464                      | 2            | 41             | 484                      | 1            | 26             |
| • Interest rate futures                                   | 2,299                    | -            | -              | 1,669                    | -            | -              |
| • Interest rate and equity index swaps                    | 48,600                   | 150          | 192            | 30,544                   | 34           | 124            |
| • Credit default swaps                                    | -                        | -            | -              | 87                       | -            | 1              |
|   | 166,014                  | 1,541        | 3,373          | 173,796                  | 1,932        | 5,554          |
| <b>(b) Subsidiaries</b>                                   |                          |              |                |                          |              |                |
| Derivatives designated as fair value hedging instruments: |                          |              |                |                          |              |                |
| • Interest rate swaps                                     | 14,895                   | 427          | 69             | 11,716                   | 953          | -              |
| Other derivatives:  |                          |              |                |                          |              |                |
| • Cross currency interest rate swaps                      | 14,991                   | 2,214        | 13             | 12,373                   | 2,579        | -              |
| Intra Group swap elimination                              | (19,571)                 | (221)        | (221)          | (11,007)                 | (612)        | (612)          |
| <b>Group</b>  | <b>176,329</b>           | <b>3,961</b> | <b>3,234</b>   | <b>186,878</b>           | <b>4,852</b> | <b>4,942</b>   |

Contract/notional amount indicates the amount on which payment flows are derived at the balance sheet date and does not represent amounts at risk. For collateralised and non-collateralised positions, the Group continues

to use discount curves based on term Libor rates. Further information on derivatives credit risk is included in note 40.

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## Derivative financial instruments (continued)

| Group   | 2011                     |            |                | 2010                     |            |                |
|---|--------------------------|------------|----------------|--------------------------|------------|----------------|
|   | Contract/notional amount | Fair value |                | Contract/notional amount | Fair value |                |
|   | £m                       | Assets £m  | Liabilities £m | £m                       | Assets £m  | Liabilities £m |
| Derivatives have remaining maturities as follows: |                          |            |                |                          |            |                |
| • In not more than one year                       | 79,719                   | 813        | 349            | 79,239                   | 551        | 532            |
| • In more than one year                           | 96,610                   | 3,148      | 2,885          | 107,639                  | 4,301      | 4,410          |
|   | 176,329                  | 3,961      | 3,234          | 186,878                  | 4,852      | 4,942          |

| Society   | 2011                     |            |                | 2010                     |            |                |
|---|--------------------------|------------|----------------|--------------------------|------------|----------------|
|   | Contract/notional amount | Fair value |                | Contract/notional amount | Fair value |                |
|   | £m                       | Assets £m  | Liabilities £m | £m                       | Assets £m  | Liabilities £m |
| Derivatives have remaining maturities as follows: |                          |            |                |                          |            |                |
| • In not more than one year                       | 76,193                   | 350        | 349            | 80,546                   | 551        | 709            |
| • In more than one year                           | 89,821                   | 1,191      | 3,024          | 93,250                   | 1,381      | 4,845          |
|   | 166,014                  | 1,541      | 3,373          | 173,796                  | 1,932      | 5,554          |

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## Fair value adjustment for portfolio hedged risk

As discussed in the statement of accounting policies, when specific criteria are met, the Group applies fair value hedge accounting. In a micro hedge, the carrying value of the hedged item is adjusted for the change in the fair value of the hedged risk. In the case of a portfolio hedge, the adjustment is included in this heading. The fair value adjustment for portfolio hedged risk for Group and Society at 4 April 2011 was £1,563 million for assets (2010:

£2,798 million) and £68 million debit adjustment for liabilities (2010: £106 million credit adjustment).

The prior year comparative has been adjusted for consistency with the current year's figures and an equivalent offsetting adjustment has been made to other assets. This adjustment does not affect total assets.

# Notes to the Accounts

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## Loans and advances to customers

|   | Group   |         | Society |         |
|---|---------|---------|---------|---------|
|   | 2011    | 2010    | 2011    | 2010    |
|   | £m      | £m      | £m      | £m      |
| Prime residential mortgages                 | 104,229 | 108,704 | 103,846 | 108,554 |
| Specialist residential mortgages            | 20,224  | 18,609  | 1,114   | 1,167   |
| Consumer banking                            | 2,376   | 2,143   | 2,376   | 2,143   |
| Commercial lending                          | 21,560  | 21,765  | 20,467  | 20,617  |
| Other lending                               | 481     | 556     | -       | -       |
|   | 148,870 | 151,777 | 127,803 | 132,481 |
| Fair value adjustment for micro hedged risk | 547     | 652     | 547     | 652     |
|   | 149,417 | 152,429 | 128,350 | 133,133 |

### Maturity analysis

Loans and advances to customers have remaining contractual maturities as follows:

|  | Group   |                    | Society |                    |
|--|---------|--------------------|---------|--------------------|
|  | 2011    | 2010<br>(Restated) | 2011    | 2010<br>(Restated) |
|  | £m      | £m                 | £m      | £m                 |
| Repayable on demand                                      | 1,460   | 1,297              | 1,400   | 1,296              |
| Other loans and advances by residual maturity repayable: |         |                    |         |                    |
| • In not more than three months                          | 2,104   | 2,037              | 2,067   | 1,905              |
| • In more than three months but not more than one year   | 5,070   | 4,764              | 4,972   | 4,647              |
| • In more than one year but not more than five years     | 25,295  | 24,542             | 24,372  | 23,828             |
| • In more than five years                                | 115,706 | 119,887            | 95,576  | 101,383            |
|  | 149,635 | 152,527            | 128,387 | 133,059            |
| Impairment provision on loans and advances (note 11)     | (765)   | (750)              | (584)   | (578)              |
| Fair value adjustment for micro hedged risk              | 547     | 652                | 547     | 652                |
|  | 149,417 | 152,429            | 128,350 | 133,133            |

The maturity analysis is produced on the basis that where a loan is repayable by instalments, each such instalment is treated as a separate repayment. Arrears are spread across the remaining term of the loan. The 2010 maturity analysis for Group and Society has been restated to correct the maturity of commercial loans which were previously allocated to maturity bands based only on their final redemption date.

The revised maturity for the commercial loans takes account of capital repayment instalments.

The maturity analysis is based on contractual maturity rather than actual redemption levels experienced by the Group or Society, which are likely to be materially different.

Certain loans and advances to customers are used to secure debt securities in issue (funding) as follows:

|   | 2011           |                 | 2010           |                 |
|---|----------------|-----------------|----------------|-----------------|
|   | Assets pledged | Secured funding | Assets pledged | Secured funding |
|   | £m             | £m              | £m             | £m              |
| Covered bonds                             | 33,051         | 12,264          | 39,917         | 9,050           |
| Securitisations and other secured lending | 34,891         | 5,246           | 32,371         | 3,749           |
|   | 67,942         | 17,510          | 72,288         | 12,799          |

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## Loans and advances to customers (continued)

Pledged assets include those available to Nationwide Covered Bonds LLP, Silverstone Master Trust and other funding vehicles, even where they have not yet been used to provide collateral to support external funding transactions. Secured funding disclosed above, however, is that obtained from issuance to external counterparties and does not include self issuances which may be used in the future as collateral for repo and other similar type operations. As a result, the relationship between pledged assets and secured funding above is not representative of the haircut applied to collateral values in determining the available level of funding.

The Society established Nationwide Covered Bonds LLP in November 2005. The LLP provides security for issues of covered bonds made by the Society to external counterparties and also for the purpose of creating collateral. There have been three public covered bond issues during the year. In September 2010 the Society issued a €1.25 billion five year deal (£1.04 billion Sterling equivalent), in January 2011 a

£0.75 billion fifteen year deal and in February 2011 a €1.25 billion ten year deal (£1.07 billion Sterling equivalent). In addition there have been a number of much smaller private placements.

The Society established the Silverstone Master Trust securitisation structure on 16 July 2008. Notes are issued by Silverstone Master Issuer plc to external counterparties and the Society, either for the purposes of creating collateral to be used for funding or for subsequent sale of notes to investors outside the Group. In October 2010 Silverstone Master Issuer plc issued a residential mortgage backed securitisation. US \$0.85 billion and €1.1 billion 3-5 year bonds were issued, raising £1.52 billion Sterling equivalent funding.

All of the assets pledged are retained in the Society's balance sheet as the Society substantially retains the risks and rewards relating to the loans.

## 19

## Investments in equity shares

|                        | Group |      | Society |      |
|------------------------|-------|------|---------|------|
|                        | 2011  | 2010 | 2011    | 2010 |
|                        | £m    | £m   | £m      | £m   |
| At 5 April             | 86    | 81   | 26      | 20   |
| Additions              | 25    | 8    | -       | -    |
| Disposals              | (11)  | (1)  | -       | -    |
| Increase in fair value | 3     | 5    | 6       | 6    |
| Impairment             | -     | (7)  | -       | -    |
| At 4 April             | 103   | 86   | 32      | 26   |

Investments in equity shares include investments of £102 million (2010: £85 million) carried at fair value. The equity shares investments include £15 million (2010: £17 million) as a result of our participation in industry wide banking and credit card service operations. The remaining investments, which are predominantly private equity holdings, are long term in nature.

The 2010 impairment of £7 million relates to one fund within our private equity portfolio. The impairment has been included in impairment losses on investment securities in the income statement.

# Notes to the Accounts

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## Investments in Group undertakings

|                                       | Shares | Loans   | Total   |
|---------------------------------------|--------|---------|---------|
|                                       | £m     | £m      | £m      |
| At 5 April 2010                       | 393    | 18,460  | 18,853  |
| Additions                             | 2      | 8,979   | 8,981   |
| Impairment                            | -      | (1)     | (1)     |
| Disposals, redemptions and repayments | (8)    | (7,428) | (7,436) |
| At 4 April 2011                       | 387    | 20,010  | 20,397  |

|                                       | Shares | Loans   | Total   |
|---------------------------------------|--------|---------|---------|
|                                       | £m     | £m      | £m      |
| At 5 April 2009 (adjusted)            | 645    | 20,340  | 20,985  |
| Additions                             | 134    | 1,341   | 1,475   |
| Impairment                            | -      | (61)    | (61)    |
| Disposals, redemptions and repayments | (386)  | (3,160) | (3,546) |
| At 4 April 2010                       | 393    | 18,460  | 18,853  |

The additions to investments in shares in the year ended 4 April 2010 predominantly related to the re-capitalisation of a mortgage subsidiary during the year.

The £1 million impairment on loans to group undertakings for the year ended 4 April 2011 relates to a subsidiary that holds a corporate loan portfolio (included in impairment loss on loans and advances to customers in the income statement). The £61 million impairment on loans to group undertakings for the year ended 4 April 2010 comprised £7 million

which related to a subsidiary with a portfolio of investment securities (included in impairment losses on investment securities in the income statement), together with £54 million relating to a subsidiary that holds a corporate loan portfolio (included in impairment loss on loans and advances to customers in the income statement).

The interests of the Society in its principal subsidiary undertakings, all of which are consolidated, as at 4 April 2011 are set out below:

| 100% held subsidiary undertakings    | Nature of business     |
|--------------------------------------|------------------------|
| Nationwide International Limited *   | Offshore deposit taker |
| Nationwide Syndications Limited      | Syndicated lending     |
| The Mortgage Works (UK) plc *        | Mortgage lender        |
| UCB Home Loans Corporation Limited * | Mortgage lender        |
| Derbyshire Home Loans Limited *      | Mortgage lender        |
| E-MEX Home Funding Limited *         | Mortgage lender        |

\* Regulated entities which are subject to regulations which require them to maintain capital at agreed levels and so govern the availability of funds for distribution as dividends.



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## Investments in Group undertakings (continued)

All of the above subsidiary undertakings are limited liability companies, which are registered in England and Wales and operate in the UK, except for Nationwide International Limited which is registered and operates in the Isle of Man.

The Group has interests in a number of entities which give rise to the

risks and rewards that are in substance no different than if they were subsidiary undertakings. As a consequence, these entities are consolidated in the Group accounts.

The interests of the Society in these principal entities as at 4 April 2011 are set out below:

| Other 100% held subsidiary undertakings                                    | Nature of business                                  | Country of registration | Country of operation |
|--|---|-------------------------|----------------------|
| Nationwide Covered Bonds LLP   | Mortgage acquisition and guarantor of covered bonds | England and Wales       | UK                   |
| Silverstone Master Issuer plc<br>(Securities 2008 -1, 2009 -1 and 2010 -1) | Funding vehicle                                     | England and Wales       | UK                   |
| Pride No. 1 LLP  | Funding vehicle                                     | England and Wales       | UK                   |

# Notes to the Accounts

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## Intangible assets

| 2011 Group             | Computer software   |                      | Total computer software | Other intangible assets | Goodwill  | Total      |
|------------------------|---------------------|----------------------|-------------------------|-------------------------|-----------|------------|
|                        | Externally acquired | Internally developed |                         |                         |           |            |
|                        | £m                  | £m                   | £m                      | £m                      | £m        | £m         |
| <b>Cost</b>            |                     |                      |                         |                         |           |            |
| At 5 April 2010        | 415                 | 49                   | 464                     | 42                      | 16        | 522        |
| Additions              | 194                 | 25                   | 219                     | -                       | -         | 219        |
| Disposals              | (26)                | -                    | (26)                    | -                       | -         | (26)       |
| <b>At 4 April 2011</b> | <b>583</b>          | <b>74</b>            | <b>657</b>              | <b>42</b>               | <b>16</b> | <b>715</b> |
| <b>Amortisation</b>    |                     |                      |                         |                         |           |            |
| At 5 April 2010        | 141                 | 22                   | 163                     | 6                       | -         | 169        |
| Charge for the year    | 27                  | 11                   | 38                      | 5                       | -         | 43         |
| Disposals              | (26)                | -                    | (26)                    | -                       | -         | (26)       |
| <b>At 4 April 2011</b> | <b>142</b>          | <b>33</b>            | <b>175</b>              | <b>11</b>               | <b>-</b>  | <b>186</b> |
| <b>Net book value</b>  |                     |                      |                         |                         |           |            |
| <b>At 4 April 2011</b> | <b>441</b>          | <b>41</b>            | <b>482</b>              | <b>31</b>               | <b>16</b> | <b>529</b> |

Additions of £219 million (2010: £184 million) relates predominantly to the Society's investments in new systems platforms to meet the future needs of the business. As the new systems platforms are not yet ready for use by the business no depreciation has been charged against these assets.

| 2010 Group             | Computer software   |                      | Total computer software | Other intangible assets | Goodwill  | Total      |
|------------------------|---------------------|----------------------|-------------------------|-------------------------|-----------|------------|
|                        | Externally acquired | Internally developed |                         |                         |           |            |
|                        | £m                  | £m                   | £m                      | £m                      | £m        | £m         |
| <b>Cost</b>            |                     |                      |                         |                         |           |            |
| At 5 April 2009        | 287                 | 57                   | 344                     | 42                      | 16        | 402        |
| Additions              | 159                 | 25                   | 184                     | -                       | -         | 184        |
| Disposals              | (31)                | (33)                 | (64)                    | -                       | -         | (64)       |
| <b>At 4 April 2010</b> | <b>415</b>          | <b>49</b>            | <b>464</b>              | <b>42</b>               | <b>16</b> | <b>522</b> |
| <b>Amortisation</b>    |                     |                      |                         |                         |           |            |
| At 5 April 2009        | 146                 | 45                   | 191                     | -                       | -         | 191        |
| Charge for the year    | 26                  | 10                   | 36                      | 6                       | -         | 42         |
| Disposals              | (31)                | (33)                 | (64)                    | -                       | -         | (64)       |
| <b>At 4 April 2010</b> | <b>141</b>          | <b>22</b>            | <b>163</b>              | <b>6</b>                | <b>-</b>  | <b>169</b> |
| <b>Net book value</b>  |                     |                      |                         |                         |           |            |
| <b>At 4 April 2010</b> | <b>274</b>          | <b>27</b>            | <b>301</b>              | <b>36</b>               | <b>16</b> | <b>353</b> |

## Intangible assets (continued)

| 2011 Society           | Computer software   |                      | Total computer software | Other intangible assets | Goodwill | Total      |
|------------------------|---------------------|----------------------|-------------------------|-------------------------|----------|------------|
|                        | Externally acquired | Internally developed |                         |                         |          |            |
|                        | £m                  | £m                   | £m                      | £m                      | £m       | £m         |
| <b>Cost</b>            |                     |                      |                         |                         |          |            |
| At 5 April 2010        | 415                 | 49                   | 464                     | 42                      | 4        | 510        |
| Additions              | 194                 | 25                   | 219                     | -                       | -        | 219        |
| Disposals              | (26)                | -                    | (26)                    | -                       | -        | (26)       |
| <b>At 4 April 2011</b> | <b>583</b>          | <b>74</b>            | <b>657</b>              | <b>42</b>               | <b>4</b> | <b>703</b> |
| <b>Amortisation</b>    |                     |                      |                         |                         |          |            |
| At 5 April 2009        | 141                 | 22                   | 163                     | 6                       | -        | 169        |
| Charge for the year    | 27                  | 11                   | 38                      | 5                       | -        | 43         |
| Disposals              | (26)                | -                    | (26)                    | -                       | -        | (26)       |
| <b>At 4 April 2011</b> | <b>142</b>          | <b>33</b>            | <b>175</b>              | <b>11</b>               | <b>-</b> | <b>186</b> |
| <b>Net book value</b>  |                     |                      |                         |                         |          |            |
| <b>At 4 April 2011</b> | <b>441</b>          | <b>41</b>            | <b>482</b>              | <b>31</b>               | <b>4</b> | <b>517</b> |

| 2010 Society           | Computer software   |                      | Total computer software | Other intangible assets | Goodwill | Total      |
|------------------------|---------------------|----------------------|-------------------------|-------------------------|----------|------------|
|                        | Externally acquired | Internally developed |                         |                         |          |            |
|                        | £m                  | £m                   | £m                      | £m                      | £m       | £m         |
| <b>Cost</b>            |                     |                      |                         |                         |          |            |
| At 5 April 2009        | 287                 | 57                   | 344                     | 42                      | 4        | 390        |
| Additions              | 159                 | 25                   | 184                     | -                       | -        | 184        |
| Disposals              | (31)                | (33)                 | (64)                    | -                       | -        | (64)       |
| <b>At 4 April 2010</b> | <b>415</b>          | <b>49</b>            | <b>464</b>              | <b>42</b>               | <b>4</b> | <b>510</b> |
| <b>Amortisation</b>    |                     |                      |                         |                         |          |            |
| At 5 April 2009        | 146                 | 45                   | 191                     | -                       | -        | 191        |
| Charge for the year    | 26                  | 10                   | 36                      | 6                       | -        | 42         |
| Disposals              | (31)                | (33)                 | (64)                    | -                       | -        | (64)       |
| <b>At 4 April 2010</b> | <b>141</b>          | <b>22</b>            | <b>163</b>              | <b>6</b>                | <b>-</b> | <b>169</b> |
| <b>Net book value</b>  |                     |                      |                         |                         |          |            |
| <b>At 4 April 2010</b> | <b>274</b>          | <b>27</b>            | <b>301</b>              | <b>36</b>               | <b>4</b> | <b>341</b> |

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## Property, plant and equipment

| 2011 Group               | Branches and non specialised buildings | Specialised administration buildings | Short leasehold buildings | Total land and buildings | Plant and machinery | Equipment, fixtures, fittings and vehicles | Total        |
|--------------------------|--|--------------------------------------|---------------------------|--------------------------|---------------------|--|--------------|
|                          | £m                                     | £m                                   | £m                        | £m                       | £m                  | £m   | £m           |
| <b>Cost or valuation</b> |  |                                      |                           |                          |                     |  |              |
| At 5 April 2010          | 267                                    | 142                                  | 46                        | 455                      | 105                 | 894  | 1,454        |
| Additions                | -                                      | 32                                   | 1                         | 33                       | 9                   | 111  | 153          |
| Transfers                | (11)                                   | 11                                   | -                         | -                        | -                   | -  | -            |
| Revaluation              | 3                                      | -                                    | -                         | 3                        | -                   | -  | 3            |
| Disposals                | (11)                                   | -                                    | -                         | (11)                     | (10)                | (69)                                       | (90)         |
| <b>At 4 April 2011</b>   | <b>248</b>                             | <b>185</b>                           | <b>47</b>                 | <b>480</b>               | <b>104</b>          | <b>936</b>                                 | <b>1,520</b> |
| <b>Depreciation</b>      |  |                                      |                           |                          |                     |  |              |
| At 5 April 2010          | -                                      | 60                                   | 30                        | 90                       | 57                  | 391  | 538          |
| Charge for the year      | -                                      | 3                                    | 2                         | 5                        | 12                  | 90   | 107          |
| Disposals                | -                                      | -                                    | -                         | -                        | (10)                | (67)                                       | (77)         |
| <b>At 4 April 2011</b>   | <b>-</b>                               | <b>63</b>                            | <b>32</b>                 | <b>95</b>                | <b>59</b>           | <b>414</b>                                 | <b>568</b>   |
| <b>Impairment charge</b> | <b>-</b>                               | <b>4</b>                             | <b>-</b>                  | <b>4</b>                 | <b>-</b>            | <b>-</b>                                   | <b>4</b>     |
| <b>Net book value</b>    |  |                                      |                           |                          |                     |  |              |
| <b>At 4 April 2011</b>   | <b>248</b>                             | <b>118</b>                           | <b>15</b>                 | <b>381</b>               | <b>45</b>           | <b>522</b>                                 | <b>948</b>   |

The £32 million of additions and £11 million of transfers to specialised administration buildings relate primarily to Nationwide's new data centre.

| 2010 Group               | Branches and non specialised buildings | Specialised administration buildings | Short leasehold buildings | Total land and buildings | Plant and machinery | Equipment, fixtures, fittings and vehicles | Total        |
|--------------------------|--|--------------------------------------|---------------------------|--------------------------|---------------------|--|--------------|
|                          | £m                                     | £m                                   | £m                        | £m                       | £m                  | £m   | £m           |
| <b>Cost or valuation</b> |  |                                      |                           |                          |                     |  |              |
| At 5 April 2009          | 274                                    | 142                                  | 45                        | 461                      | 156                 | 975  | 1,592        |
| Additions                | 2                                      | -                                    | 1                         | 3                        | 8                   | 141  | 152          |
| Revaluation              | (4)                                    | -                                    | -                         | (4)                      | -                   | -  | (4)          |
| Disposals                | (5)                                    | -                                    | -                         | (5)                      | (59)                | (222)                                      | (286)        |
| <b>At 4 April 2010</b>   | <b>267</b>                             | <b>142</b>                           | <b>46</b>                 | <b>455</b>               | <b>105</b>          | <b>894</b>                                 | <b>1,454</b> |
| <b>Depreciation</b>      |  |                                      |                           |                          |                     |  |              |
| At 5 April 2009          | -                                      | 56                                   | 28                        | 84                       | 104                 | 518  | 706          |
| Charge for the year      | -                                      | 4                                    | 2                         | 6                        | 12                  | 91   | 109          |
| Disposals                | -                                      | -                                    | -                         | -                        | (59)                | (218)                                      | (277)        |
| <b>At 4 April 2010</b>   | <b>-</b>                               | <b>60</b>                            | <b>30</b>                 | <b>90</b>                | <b>57</b>           | <b>391</b>                                 | <b>538</b>   |
| <b>Net book value</b>    |  |                                      |                           |                          |                     |  |              |
| <b>At 4 April 2010</b>   | <b>267</b>                             | <b>82</b>                            | <b>16</b>                 | <b>365</b>               | <b>48</b>           | <b>503</b>                                 | <b>916</b>   |

## Property, plant and equipment (continued)

| 2011 Society             | Branches and non specialised buildings | Specialised administration buildings | Short leasehold buildings | Total land and buildings | Plant and machinery | Equipment, fixtures, fittings and vehicles | Total        |
|--------------------------|--|--------------------------------------|---------------------------|--------------------------|---------------------|--|--------------|
|                          | £m                                     | £m                                   | £m                        | £m                       | £m                  | £m   | £m           |
| <b>Cost or valuation</b> |  |                                      |                           |                          |                     |  |              |
| At 5 April 2010          | 261                                    | 139                                  | 46                        | 446                      | 104                 | 891  | 1,441        |
| Additions                | -                                      | 32                                   | 1                         | 33                       | 9                   | 110  | 152          |
| Transfers                | (11)                                   | 11                                   | -                         | -                        | -                   | -  | -            |
| Revaluation              | 4                                      | -                                    | -                         | 4                        | -                   | -  | 4            |
| Disposals                | (11)                                   | -                                    | -                         | (11)                     | (10)                | (68)                                       | (89)         |
| <b>At 4 April 2011</b>   | <b>243</b>                             | <b>182</b>                           | <b>47</b>                 | <b>472</b>               | <b>103</b>          | <b>933</b>                                 | <b>1,508</b> |
| <b>Depreciation</b>      |  |                                      |                           |                          |                     |  |              |
| At 5 April 2010          | -                                      | 60                                   | 30                        | 90                       | 56                  | 388  | 534          |
| Charge for the year      | -                                      | 3                                    | 2                         | 5                        | 12                  | 89   | 106          |
| Disposals                | -                                      | -                                    | -                         | -                        | (10)                | (66)                                       | (76)         |
| <b>At 4 April 2011</b>   | <b>-</b>                               | <b>63</b>                            | <b>32</b>                 | <b>95</b>                | <b>58</b>           | <b>411</b>                                 | <b>564</b>   |
| <b>Impairment charge</b> | <b>-</b>                               | <b>4</b>                             | <b>-</b>                  | <b>4</b>                 | <b>-</b>            | <b>-</b>                                   | <b>4</b>     |
| <b>Net book value</b>    |  |                                      |                           |                          |                     |  |              |
| <b>At 4 April 2011</b>   | <b>243</b>                             | <b>115</b>                           | <b>15</b>                 | <b>373</b>               | <b>45</b>           | <b>522</b>                                 | <b>940</b>   |

| 2010 Society               | Branches and non specialised buildings | Specialised administration buildings | Short leasehold buildings | Total land and buildings | Plant and machinery | Equipment, fixtures, fittings and vehicles | Total        |
|----------------------------|--|--------------------------------------|---------------------------|--------------------------|---------------------|--|--------------|
|                            | £m                                     | £m                                   | £m                        | £m                       | £m                  | £m   | £m           |
| <b>Cost or valuation</b>   |  |                                      |                           |                          |                     |  |              |
| At 5 April 2009 (adjusted) | 266                                    | 139                                  | 45                        | 450                      | 154                 | 963  | 1,567        |
| Additions                  | 2                                      | -                                    | 1                         | 3                        | 8                   | 140  | 151          |
| Revaluation                | (2)                                    | -                                    | -                         | (2)                      | -                   | -  | (2)          |
| Disposals                  | (5)                                    | -                                    | -                         | (5)                      | (58)                | (212)                                      | (275)        |
| <b>At 4 April 2010</b>     | <b>261</b>                             | <b>139</b>                           | <b>46</b>                 | <b>446</b>               | <b>104</b>          | <b>891</b>                                 | <b>1,441</b> |
| <b>Depreciation</b>        |  |                                      |                           |                          |                     |  |              |
| At 5 April 2009            | -                                      | 56                                   | 28                        | 84                       | 102                 | 508  | 694          |
| Charge for the year        | -                                      | 4                                    | 2                         | 6                        | 12                  | 90   | 108          |
| Disposals                  | -                                      | -                                    | -                         | -                        | (58)                | (210)                                      | (268)        |
| <b>At 4 April 2010</b>     | <b>-</b>                               | <b>60</b>                            | <b>30</b>                 | <b>90</b>                | <b>56</b>           | <b>388</b>                                 | <b>534</b>   |
| <b>Net book value</b>      |  |                                      |                           |                          |                     |  |              |
| <b>At 4 April 2010</b>     | <b>261</b>                             | <b>79</b>                            | <b>16</b>                 | <b>356</b>               | <b>48</b>           | <b>503</b>                                 | <b>907</b>   |

In the year ended 4 April 2011 £11 million (2010: £6 million) of borrowing costs have been capitalised for the Group and Society using a capitalisation rate of 2.31% (2010: 2.15%).

An impairment charge of £4 million has been made in respect of the former head office buildings of the Derbyshire and Cheshire building societies.

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## Accrued income and expenses prepaid

|   | Group |      | Society |       |
|---|-------|------|---------|-------|
|   | 2011  | 2010 | 2011    | 2010  |
|   | £m    | £m   | £m      | £m    |
| Amounts owed by subsidiary undertakings | -     | -    | 2,227   | 2,728 |
| Treasury transactions awaiting clearing | 150   | 5    | 150     | 5     |
| Other                                   | 65    | 72   | 64      | 70    |
|   | 215   | 77   | 2,441   | 2,803 |

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## Deferred tax assets

Deferred tax is provided in full on temporary differences under the liability method at the standard UK corporation tax rate.

In addition to the changes in rates of corporation tax disclosed below and within note 12, a number of further changes to the UK corporation tax system were announced in the March 2011 UK Budget Statement. Legislation to reduce the main rate of corporation tax from 26% to 25% from 1 April 2012 is expected to be included in

the Finance Act 2011. Further reductions to the main rate are proposed to reduce the rate by 1% per annum to 23% by 1 April 2014. These further changes had not been substantively enacted at the balance sheet date and, therefore, are not included in these financial statements. The effect of these further changes on the Group's deferred tax balances cannot be reliably quantified at this stage.

The movements on the deferred tax account are as follows:

|   | Group |       | Society |       |
|---|-------|-------|---------|-------|
|   | 2011  | 2010  | 2011    | 2010  |
|   | £m    | £m    | £m      | £m    |
| At 5 April  | 357   | 866   | 314     | 785   |
| Income statement charge   | (10)  | (63)  | (4)     | (36)  |
| Income statement effect of corporation tax rate change              | 9     | -     | 10      | -     |
| Adjustment to amounts transferred from acquisitions                 | 5     | -     | -       | -     |
| Reclassification to current tax                                     | -     | 4     | -       | -     |
| Transfer of trade of subsidiary                                     | -     | -     | -       | 3     |
| Available for sale investments                                      | 1     | (3)   | -       | -     |
| Retirement benefit obligations                                      | (32)  | 48    | (32)    | 48    |
| Tax losses carried forward  | (88)  | (495) | (87)    | (486) |
| Effect of corporation tax rate change in other comprehensive income | (28)  | -     | (27)    | -     |
| Taxation on items through other comprehensive income                | (147) | (450) | (146)   | (438) |
| At 4 April  | 214   | 357   | 174     | 314   |



## Deferred tax assets (continued)

Deferred tax assets and liabilities are attributable to the following items:

|                                | Group |      | Society |      |
|--------------------------------|-------|------|---------|------|
|                                | 2011  | 2010 | 2011    | 2010 |
|                                | £m    | £m   | £m      | £m   |
| Retirement benefit obligations | 77    | 141  | 77      | 141  |
| Provisions for loan impairment | 21    | 30   | 9       | 11   |
| Other provisions               | 57    | 48   | 31      | 41   |
| Accelerated tax depreciation   | (15)  | (9)  | (15)    | (9)  |
| Property revaluation           | (16)  | (18) | (18)    | (21) |
| Tax losses carried forward     | 90    | 165  | 90      | 151  |
|                                | 214   | 357  | 174     | 314  |

The majority of deferred tax assets are anticipated to be recoverable after one year. The Group considers that there will be sufficient future trading profits in excess of profits arising from the reversal of existing taxable temporary differences to utilise the deferred tax asset.

As at the balance sheet date there are £5 million (Group and Society) of unused capital losses (2010: Group and Society £6 million) and £nil million of unused trading losses (2010: Group £36 million) for which no deferred tax asset is recognised.

Following changes to the taxation of foreign dividends there are no longer any unrecognised deferred tax liabilities in respect of unremitted earnings of overseas subsidiaries.

The deferred tax charge in the income statement comprises the following temporary differences (note 12):

|                                       | Group |      | Society |      |
|---------------------------------------|-------|------|---------|------|
|                                       | 2011  | 2010 | 2011    | 2010 |
|                                       | £m    | £m   | £m      | £m   |
| Accelerated tax depreciation          | 8     | 3    | 8       | 2    |
| Retirement benefit obligations        | 26    | (3)  | 26      | (3)  |
| Provisions for loan impairment        | 2     | 15   | 2       | 2    |
| Other                                 | 5     | 63   | 3       | 49   |
| Tax losses carried forward            | (31)  | (15) | (35)    | (14) |
| Effect of corporation tax rate change | (9)   | -    | (10)    | -    |
|                                       | 1     | 63   | (6)     | 36   |

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## Shares

|   | Group and Society |                    |
|---|-------------------|--------------------|
|   | 2011              | 2010<br>(Restated) |
|   | £m                | £m                 |
| Held by individuals   | 122,547           | 120,938            |
| Other shares  | 5                 | 5                  |
|   | 122,552           | 120,943            |
| Shares are repayable from the balance sheet date in the ordinary course of business as follows: |                   |                    |
| Accrued interest  | 578               | 470                |
| Repayable on demand   | 67,243            | 66,753             |
| Other shares by residual maturity repayable:  |                   |                    |
| • In not more than three months   | 7,237             | 12,578             |
| • In more than three months but not more than one year  | 19,944            | 19,336             |
| • In more than one year but not more than five years  | 27,171            | 21,507             |
| • In more than five years   | 379               | 299                |
|   | 122,552           | 120,943            |

The maturity analysis of the 2010 comparatives has been restated to reflect the correct classification of a category of savings products that

previously had been reported as on demand. This reduces the maturity mismatch reported in the 2010 financial statements.

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## Deposits from banks

|  | Group |       | Society |       |
|--|-------|-------|---------|-------|
|  | 2011  | 2010  | 2011    | 2010  |
|  | £m    | £m    | £m      | £m    |
| Deposits from banks are repayable from the balance sheet date in the ordinary course of business as follows: |       |       |         |       |
| Accrued interest   | 7     | 20    | 7       | 20    |
| Repayable on demand  | 1,048 | 1,154 | 144     | 132   |
| Other amounts owed to banks with residual maturity repayable:  |       |       |         |       |
| • In not more than three months  | 403   | 6,280 | 403     | 6,280 |
| • In more than three months but not more than one year   | 84    | 577   | 84      | 577   |
| • In more than one year but not more than five years   | 1,204 | -     | 1,204   | -     |
|  | 2,746 | 8,031 | 1,842   | 7,009 |

Deposits from banks include £1,249 million (2010: £6,441 million) in respect of sale and repurchase agreements. The carrying value of assets of £227 million (2010: £3,734 million) sold under sale and repurchase agreements are included within investment securities (see note 15).

## Other deposits

|   | Group |       | Society |        |
|---|-------|-------|---------|--------|
|   | 2011  | 2010  | 2011    | 2010   |
|   | £m    | £m    | £m      | £m     |
| Amounts owed to subsidiary undertakings   | -     | -     | 7,602   | 6,850  |
| Other   | 5,511 | 4,509 | 5,511   | 4,509  |
|   | 5,511 | 4,509 | 13,113  | 11,359 |
| Other deposits are repayable from the balance sheet date in the ordinary course of business as follows: |       |       |         |        |
| Accrued interest  | 13    | 21    | 13      | 21     |
| Repayable on demand   | 2     | 2     | 7,604   | 6,852  |
| Other amounts owed to depositors with residual maturity repayable:                                      |       |       |         |        |
| • In not more than three months   | 2,315 | 2,476 | 2,315   | 2,476  |
| • In more than three months but not more than one year  | 1,034 | 817   | 1,034   | 817    |
| • In more than one year but not more than five years  | 1,223 | 173   | 1,223   | 173    |
| • In more than five years   | 924   | 1,020 | 924     | 1,020  |
|   | 5,511 | 4,509 | 13,113  | 11,359 |

Other deposits comprise wholesale deposits placed with our Treasury department and amounts relating to the sale of PEBs by the Group on behalf of Legal & General.

The PEBs are held in the Group and Society at a fair value of £2,125 million (2010: £1,128 million), which is management's current best estimate of the amounts that will be paid at contractual maturity. Fair value includes the current value of the expected investment return payable.

Changes in fair value of the PEB liability are recognised in the income statement. A loss of £56 million was recognised by the Group and Society during the year (2010: gain of £52 million). This impact is offset by changes in fair value of associated derivatives which are also recognised in the income statement. None of the change in the fair value of the PEB liability during the year in the Group and Society has been attributable to changes in credit risk (2010: £nil).

The minimum amount on an undiscounted basis that the Group and Society are contractually required to pay at maturity for the PEBs is £2,232 million (2010: £1,231 million). The maximum additional amount which would also be payable at maturity in respect of additional investment returns on two tranches with a combined fair value of £76 million (2010: £76 million) is uncapped. The maximum additional amount which would also be payable at maturity in respect of additional investment returns on all other tranches is £748 million (2010: £500 million). The payment of additional investment returns is dependent upon performance of certain specified stock indices during the period of the PEB. The Group has entered into equity-linked derivatives with external counterparties which economically match the PEB's investment returns.

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## Due to customers

|   | Group |       | Society |      |
|---|-------|-------|---------|------|
|   | 2011  | 2010  | 2011    | 2010 |
|   | £m    | £m    | £m      | £m   |
| Amounts due to customers are repayable from the balance sheet date in the ordinary course of business as follows: |       |       |         |      |
| Accrued interest  | 29    | 26    | 2       | 1    |
| Repayable on demand   | 5,042 | 4,139 | 1,308   | 912  |
| Other amounts owed to customers with residual maturity repayable:   |       |       |         |      |
| • In not more than three months   | 362   | 352   | 3       | 14   |
| • In more than three months but not more than one year  | 459   | 430   | 2       | 45   |
| • In more than one year but not more than five years  | 168   | 138   | -       | 1    |
|   | 6,060 | 5,085 | 1,315   | 973  |

Group amounts due to customers include savings deposit balances held in our off-shore subsidiary Nationwide International Limited. These savings accounts do not confer membership rights.

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## Debt securities in issue

|  | Group  |        | Society |        |
|--|--------|--------|---------|--------|
|  | 2011   | 2010   | 2011    | 2010   |
|  | £m     | £m     | £m      | £m     |
| Certificates of deposit and commercial paper | 10,883 | 12,588 | 10,883  | 12,588 |
| Fixed and floating rate notes                | 22,571 | 20,996 | 20,850  | 19,251 |
| Other debt securities                        | 3,989  | 2,472  | 249     | 240    |
|  | 37,443 | 36,056 | 31,982  | 32,079 |
| Fair value adjustment for micro hedged risk  | 365    | 746    | 98      | 105    |
|  | 37,808 | 36,802 | 32,080  | 32,184 |

Debt securities in issue are repayable from the balance sheet date in the ordinary course of business as follows:

|   |        |        |        |        |
|---|--------|--------|--------|--------|
| Accrued interest                            | 261    | 178    | 229    | 155    |
| Residual maturity repayable:                |        |        |        |        |
| • In not more than one year                 | 14,881 | 14,398 | 14,881 | 14,398 |
| • In more than one year                     | 22,301 | 21,480 | 16,872 | 17,526 |
|   | 37,443 | 36,056 | 31,982 | 32,079 |
| Fair value adjustment for micro hedged risk | 365    | 746    | 98     | 105    |
|   | 37,808 | 36,802 | 32,080 | 32,184 |

Debt securities in issue include Group and Society £17,510 million (2010: £12,799 million) secured on certain loans and advances to customers. Further information is given in note 18.

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## Other liabilities

|  | Group |      | Society |       |
|--|-------|------|---------|-------|
|  | 2011  | 2010 | 2011    | 2010  |
|  | £m    | £m   | £m      | £m    |
| Third party income tax withheld        | 117   | 98   | 117     | 98    |
| Liabilities to subsidiary undertakings | -     | -    | 3,476   | 2,232 |
| Other liabilities                      | 259   | 431  | 226     | 378   |
|  | 376   | 529  | 3,819   | 2,708 |

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## Provisions for liabilities and charges

|                                       | Group |                  |       | Society |                  |       |
|---------------------------------------|-------|------------------|-------|---------|------------------|-------|
|                                       | FSCS  | Other Provisions | Total | FSCS    | Other Provisions | Total |
|                                       | £m    | £m               | £m    | £m      | £m               | £m    |
| At 5 April 2010                       | 93    | 25               | 118   | 93      | 22               | 115   |
| Provisions utilised                   | (49)  | (8)              | (57)  | (49)    | (7)              | (56)  |
| Charge for the year                   | 50    | 16               | 66    | 50      | 16               | 66    |
| Release for the year                  | -     | (14)             | (14)  | -       | (12)             | (12)  |
| Net income statement charge           | 50    | 2                | 52    | 50      | 4                | 54    |
| At 4 April 2011                       | 94    | 19               | 113   | 94      | 19               | 113   |
| At 5 April 2009                       | 258   | 13               | 271   | 258     | 13               | 271   |
| Provisions utilised                   | (48)  | (2)              | (50)  | (48)    | (2)              | (50)  |
| Charge for the year                   | -     | 14               | 14    | -       | 11               | 11    |
| Release for the year                  | (117) | -                | (117) | (117)   | -                | (117) |
| Net income statement (release)/charge | (117) | 14               | (103) | (117)   | 11               | (106) |
| At 4 April 2010                       | 93    | 25               | 118   | 93      | 22               | 115   |

**Financial services compensation scheme (FSCS)**

Based on its share of protected deposits, the Group pays levies to the FSCS to enable the scheme to meet claims against it.

The FSCS has initially met claims from depositors of a number of defaulted financial institutions by way of loans received from HM Treasury. The total of these facilities is approximately £19 billion. The FSCS recovers the interest cost, together with ongoing management expenses, by way of annual levies on member firms. While it is anticipated that the majority of these facilities will be repaid wholly from recoveries from the institutions concerned, there is the risk of a shortfall, such that the FSCS may place additional levies on all FSCS participants. Any levies in respect of shortfalls of capital will be recognised when they have been communicated by the FSCS and have been triggered by the reporting date. The most significant future potential exposure to such

capital shortfalls relates to Bradford & Bingley, Icelandic banks and the parts of Dunfermline Building Society not acquired by Nationwide.

The Group also pays FSCS levies in respect of claims from investment policyholders, during the year such claims arose in respect of the failure of Keydata Investment Services.

The amount provided by the Group of £94 million is in respect of the 2010/11 and 2011/12 scheme years (2010: £93 million in respect of the 2009/10 and 2010/11 scheme years), for which our liability to levies is confirmed.

As further information is provided by the FSCS scheme the Group will continue to update its estimate of the amount of FSCS levies it will ultimately be required to pay.

# Notes to the Accounts

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## Other provisions

Other provisions have been made in respect of various customer claims, including claims in relation to previous sales of payment protection insurance (PPI). The FSA released their Policy statement 10/12 *The assessment and redress of Payment Protection Insurance complaints* on

10 August 2010 and the Group has been monitoring the subsequent level of claims. At 4 April 2011, the Group holds a provision of £19 million, which it expects to be sufficient to meet any obligations in relation to previous sales of PPI. It is expected that the liability will predominantly crystallise over the next 12-24 months.

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## Accruals and deferred income

|  | Group |      | Society |      |
|--|-------|------|---------|------|
|  | 2011  | 2010 | 2011    | 2010 |
|  | £m    | £m   | £m      | £m   |
| Interest accrued on subordinated liabilities | 44    | 29   | 44      | 29   |
| Interest accrued on subscribed capital       | 17    | 17   | 17      | 17   |
| Accrued severance costs                      | 37    | 62   | 37      | 62   |
| Deferred income on PEBs                      | 94    | 65   | 94      | 65   |
| Other  | 236   | 203  | 230     | 196  |
|  | 428   | 376  | 422     | 369  |

The amounts above described as “other” represent standard operational accruals incurred during the normal course of business.

£26 million (2010: £51 million) of the accrual for severance costs was utilised during the year with a further charge of £18 million (2010: £63 million) and release of £17 million (2010: £14 million), resulting in accrued severance costs at 4 April 2011 of £37 million (2010: £62 million).

Deferred income on PEBs relates to income received which is deferred and recognised in the income statement on an effective interest basis over the term of the product. Changes in the balance are as follows:

|            | Group and Society |      |
|------------|-------------------|------|
|            | 2011              | 2010 |
|            | £m                | £m   |
| At 5 April | 65                | -    |
| Additions  | 49                | 71   |
| Releases   | (20)              | (6)  |
| At 4 April | 94                | 65   |



## Subordinated liabilities

|   | Group and Society |       |
|---|-------------------|-------|
|   | 2011              | 2010  |
|   | £m                | £m    |
| 5¼% Subordinated notes due 2014 (\$225m)          | 139               | 148   |
| 3⅜% Subordinated notes due 2015 (€750m)           | -                 | 665   |
| 5% Subordinated notes due 2015 (\$400m)           | 248               | 262   |
| 5.875% Fixed rate subordinated notes 2015 (£)     | -                 | 100   |
| Subordinated floating rate notes due 2016 (€300m) | 265               | 266   |
| 7.125% Subordinated notes due 2016 (£)            | 75                | 75    |
| 5¾% Callable reset subordinated notes 2016 (£)    | 35                | 35    |
| 5¼% Subordinated notes due 2018 (£)               | 200               | 200   |
| 8⅝% Subordinated notes due 2018 (£)               | 125               | 125   |
| 6.73% Subordinated loan due 2019 (£)              | 15                | 15    |
| 6.75% Subordinated loan due 2020 (€750m)          | 661               | -     |
| 5.25% Subordinated loan due 2020 (£)              | 150               | 150   |
| 6.5% Callable reset subordinated notes 2022 (£)   | 30                | 30    |
|   | 1,943             | 2,071 |
| Fair value adjustment for micro hedged risk       | 40                | 104   |
| Unamortised premiums and issue costs              | (10)              | (9)   |
|   | 1,973             | 2,166 |

All of the Society's subordinated liabilities are unsecured. The Society may, with the prior consent of the FSA, redeem some of the subordinated notes early as follows:

- All (but not some only) of the floating rate notes due 2016 at par (100%) on 22 December 2011, by giving not less than 15 nor more than 30 days' notice to the holders. In the event the Society does not redeem the notes on 22 December 2011 the initial interest margin of 0.22% over Euribor will increase by a further 0.5%;
- All of the 7.125% subordinated notes due 2016 may, with the prior consent of the FSA, be redeemed on 10 October 2011, five years before the final maturity date, by giving not less than 30 nor more than 60 days' notice to the holders. In the event that the Society does not redeem the notes early the interest rate will convert to a rate referenced to the then current 5 year gilt rate plus 3.2%;
- All of the 5¾% notes due 2016 on 6 December 2011 and every six months thereafter until the final maturity date of 6 December 2016. If the issue is not repaid on the first call date, the coupon will be reset to yield 1.62% over the prevailing five year gilt benchmark. These notes were acquired on the acquisition of the Cheshire Building Society;
- All (but not some only) of the 5¼% notes due 2018 at par (100%) on 12 February 2013, by giving not less than 15 nor more than 30 days' notice to the holders. In the event the Society does not redeem the notes on 12 February 2013 the fixed rate of interest will become an aggregate of 1.98% and the then current 5 year benchmark gilt rate;
- All or some of the 8⅝% notes due 2018 at the higher of par (100%) or the benchmark 8¾% 2017 gilt, by giving not less than 30 nor more than 60 days' notice to the holders;
- All of the 6.73% subordinated loan due 2019 may, with the prior consent of the FSA, be redeemed on 7 April 2014, five years before the final maturity date, by giving no less than 2 days' notice to the holders. In the event that the Society does not redeem the notes early the interest rate will convert to a rate referenced to the then current five year gilt rate plus 3.1%;
- All of the 5.25% subordinated loan due 2020 may, with the prior consent of the FSA, be redeemed on 23 November 2015, five years before the final maturity date, by giving not less than 30 days' notice to the holders. In the event that the Society does not redeem the notes early the interest rate will convert to a floating rate equal to the then current 3 month Libor plus 1.54%; and
- All or some of the 6.5% notes due 2022 on 1 March and 1 September 2017. If the issue is not repaid on the first call date, the coupon will be reset to yield 300 basis points over the prevailing five year gilt benchmark. These notes were acquired on the acquisition of the Cheshire Building Society.

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## Subordinated liabilities (continued)

The subordinated notes rank pari passu with each other and behind the claims against the Society of all depositors, creditors and investing members (other than holders of permanent interest bearing shares) of the Society.

The interest rate risk arising from the issuance of fixed rate subordinated debt has been mitigated through the use of interest rate swaps.

On 17 August 2010 the Group, with the consent of the FSA, redeemed early the €750 million 3¾% subordinated loan due 17 August 2015 at par at a Sterling equivalent cost of £619 million. On 17 December 2010 the Group, with the consent of the FSA, redeemed early the 5.875% fixed rate subordinated notes due 2015 at a cost of £100 million.

On 22 July 2010 the Group issued a €750 million 6.75% subordinated loan due June 2020 raising a net Sterling equivalent of £630 million.

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## Subscribed capital

|   | Group and Society |       |
|---|-------------------|-------|
|   | 2011              | 2010  |
|   | £m                | £m    |
| 6.024% Permanent interest bearing shares        | 350               | 350   |
| 6.875% Permanent interest bearing shares        | 30                | 30    |
| 7.971% Permanent interest bearing shares        | 200               | 200   |
| 7.25% Permanent interest bearing shares         | 60                | 60    |
| 6.25% Permanent interest bearing shares         | 125               | 125   |
| 5.769% Permanent interest bearing shares        | 400               | 400   |
| 7.859% Permanent interest bearing shares        | 100               | 100   |
| Floating rate permanent interest bearing shares | 10                | 10    |
| 6% Permanent interest bearing shares            | 140               | 140   |
|   | 1,415             | 1,415 |
| Fair value adjustment for micro hedged risk     | 137               | 155   |
| Unamortised premiums and issue costs            | (42)              | (46)  |
|   | 1,510             | 1,524 |

All permanent interest bearing shares (PIBS) are unsecured and denominated in Sterling. Repaying the PIBS requires the prior consent of the FSA.

- The 7.971% PIBS are repayable, at the option of the Society, in whole on 13 March 2015 or any fifth anniversary thereafter;
- The 7.25% PIBS are repayable, at the option of the Society, in whole on 5 December 2021 and every fifth successive 5 December thereafter;
- The 6.25% PIBS are repayable, at the option of the Society, in whole on 22 October 2024 and every fifth successive 22 October thereafter;
- The 5.769% PIBS are repayable, at the option of the Society, in whole on 6 February 2026 or any fifth anniversary thereafter;
- The 7.859% PIBS are repayable, at the option of the Society, in whole on 13 March 2030 or any fifth anniversary thereafter.

If the above five tranches of PIBS are not repaid on a call date then the interest rate is reset at a margin to the yield on the then prevailing five year benchmark gilt rate.

- The 6.024% PIBS are repayable, at the option of the Society, in whole on 6 February 2013 or any interest coupon date thereafter. If the 6.024% PIBS are not repaid on their first call date then the interest rate is reset at a margin of 50 basis points over 3 month Libor. If these PIBS have not been repaid by 6 February 2018, the interest rate is reset at a margin of 150 basis points over 3 month Libor;
- The 6.875% PIBS are repayable at the option of the Society, in whole on 10 January 2019, or any fifth anniversary thereafter. If the PIBS are not repaid on a call date, then the interest rate is reset at a margin of 300 basis points over the yield on the prevailing 5 year gilt benchmark. These PIBS were acquired on the acquisition of the Cheshire Building Society;

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## Subscribed capital (continued)

- Interest on the floating rate PIBS is at 2.4% above 6 month Libor. These PIBS are only repayable in the event of winding up the Society. These PIBS were acquired on the acquisition of the Cheshire Building Society;
- The 6% PIBS are repayable at the option of the Society, in whole on 15 December 2016, or any interest coupon date thereafter. If the PIBS are not repaid on their first call date then the interest rate is reset at a margin of 249 basis points over 3 month Libor. These PIBS were acquired on the acquisition of the Derbyshire Building Society.

PIBS rank pari passu with each other. They are deferred shares of the Society and rank behind the claims against the Society of all subordinated noteholders, depositors, creditors and investing members of the Society.

The interest rate risk arising from the issuance of fixed rate PIBS has been mitigated through the use of interest rate swaps.

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## Retirement benefit obligations

|                                       | Group   |         | Society |         |
|---------------------------------------|---------|---------|---------|---------|
|                                       | 2011    | 2010    | 2011    | 2010    |
|                                       | £m      | £m      | £m      | £m      |
| Present value of funded obligations   | 2,982   | 2,963   | 2,977   | 2,958   |
| Fair value of fund assets             | (2,695) | (2,468) | (2,691) | (2,464) |
|                                       | 287     | 495     | 286     | 494     |
| Present value of unfunded obligations | 10      | 10      | 10      | 10      |
| Total pension liabilities             | 297     | 505     | 296     | 504     |
| Post retirement healthcare            | 3       | 3       | 3       | 3       |
|                                       | 300     | 508     | 299     | 507     |

The Group operates both defined benefit and defined contribution arrangements. The principal defined benefit pension arrangement is the Nationwide Pension Fund. This is a contributory defined benefit arrangement, with both final salary and career average revalued earnings (CARE) sections. The Fund was closed to new entrants in 2007. Since that date new employees are able to join a defined contribution arrangement. The final salary section of the Fund was closed to future service on 31 March 2011. Service already built up in the final salary section will continue to be linked to final salary, future benefits will accrue within the CARE section. A separate pension fund is operated for one subsidiary company.

The assets of the pension funds are held and managed by the funds' trustees separately from the assets of the Group. Contributions to the funds are assessed in accordance with the advice of the independent actuaries, and are agreed between the trustees and the Group. The contribution rates for the year ended 4 April 2011, including employees' contributions paid under salary sacrifice arrangements, varied between 8.0% and 27.5%.

# Notes to the Accounts

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## Retirement benefit obligations (continued)

The amounts recognised in the income statement are as follows:

|  | Group |       | Society |       |
|--|-------|-------|---------|-------|
|  | 2011  | 2010  | 2011    | 2010  |
|  | £m    | £m    | £m      | £m    |
| Defined benefit current service cost       | 76    | 62    | 75      | 60    |
| Defined contribution cost                  | 11    | 9     | 11      | 9     |
| Past service cost                          | -     | 5     | -       | 5     |
| Curtailment                                | (5)   | (5)   | (5)     | (5)   |
| Included in employee costs (note 9)        | 82    | 71    | 81      | 69    |
| Expected return on pension assets (note 3) | (168) | (122) | (168)   | (122) |
| Pension interest cost (note 4)             | 166   | 146   | 166     | 146   |
|  | 80    | 95    | 79      | 93    |

Changes in the present value of defined benefit pension obligations (including unfunded obligations) are as follows:

|                                       | Group |       | Society |       |
|---------------------------------------|-------|-------|---------|-------|
|                                       | 2011  | 2010  | 2011    | 2010  |
|                                       | £m    | £m    | £m      | £m    |
| At 5 April                            | 2,973 | 2,264 | 2,968   | 2,261 |
| Current service cost                  | 76    | 62    | 75      | 60    |
| Past service cost                     | 6     | 24    | 6       | 24    |
| Curtailment                           | (5)   | (5)   | (5)     | (5)   |
| Pension interest cost                 | 166   | 146   | 166     | 146   |
| Employee contributions                | 1     | 2     | 1       | 2     |
| Subsidiary undertakings contributions | -     | -     | 1       | 1     |
| Actuarial (gains)/losses              | (152) | 562   | (152)   | 561   |
| Benefits paid                         | (73)  | (82)  | (73)    | (82)  |
| At 4 April                            | 2,992 | 2,973 | 2,987   | 2,968 |

Following a change in Government legislation to use the Consumer Price Index (CPI) to measure the statutory minimum rates of pension increases rather than the Retail Price Index (RPI), the indexation of deferred pensions before retirement are now measured by reference to CPI rather than RPI as previously. The impact of this change is to reduce the value of the obligation by an estimated £60 million. This represents a change in actuarial assumptions and is included in the actuarial gains of £152 million shown above.

The past service cost of £6 million (2010: £24 million) includes amounts that were provided for in previous years as part of the transformation costs relating to restructuring parts of our business.

The Group does not charge the net defined benefit cost to the subsidiary undertakings that participate in the defined benefit arrangements. The pension cost to the subsidiary undertakings equals the contributions payable to the Fund.

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## Retirement benefit obligations (continued)

Changes in the fair value of plan assets for the pension funds are as follows:

|                                       | Group |       | Society |       |
|---------------------------------------|-------|-------|---------|-------|
|                                       | 2011  | 2010  | 2011    | 2010  |
|                                       | £m    | £m    | £m      | £m    |
| At 5 April                            | 2,468 | 1,936 | 2,464   | 1,933 |
| Expected return on assets             | 168   | 122   | 168     | 122   |
| Actuarial (losses)/gains              | (38)  | 393   | (38)    | 392   |
| Contributions by employer             | 169   | 97    | 168     | 96    |
| Employee contributions                | 1     | 2     | 1       | 2     |
| Subsidiary undertakings contributions | -     | -     | 1       | 1     |
| Benefits paid                         | (73)  | (82)  | (73)    | (82)  |
| At 4 April                            | 2,695 | 2,468 | 2,691   | 2,464 |

The actual return on assets was 5.0% (2010: 23.4%). Contributions paid by the Group in the year included additional deficit contributions of £99 million (2010: £5 million). The Group will pay an additional £240 million of deficit contributions during 2011/12.

The major categories of plan assets for the pension funds, stated at fair value, are as follows:

|                  | Group |       | Society |       |
|------------------|-------|-------|---------|-------|
|                  | 2011  | 2010  | 2011    | 2010  |
|                  | £m    | £m    | £m      | £m    |
| Equities         | 1,364 | 1,210 | 1,361   | 1,208 |
| Government bonds | 850   | 377   | 850     | 376   |
| Corporate bonds  | 23    | 387   | 23      | 387   |
| Infrastructure   | 150   | 121   | 150     | 121   |
| Property         | 236   | 211   | 236     | 211   |
| Other            | 72    | 162   | 71      | 161   |
|                  | 2,695 | 2,468 | 2,691   | 2,464 |

None of the funds' assets are invested in the Nationwide Group (2010: £nil).

The amounts recognised in respect of pension obligations in the statements of comprehensive income are as follows:

|  | Group |       | Society |       |
|--|-------|-------|---------|-------|
|  | 2011  | 2010  | 2011    | 2010  |
|  | £m    | £m    | £m      | £m    |
| Cumulative actuarial losses at 5 April | (331) | (162) | (331)   | (162) |
| Actuarial gains/(losses) in the year   | 114   | (169) | 114     | (169) |
| Cumulative actuarial losses at 4 April | (217) | (331) | (217)   | (331) |

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## Retirement benefit obligations (continued)

Experience gains and losses in respect of pension obligations for the current and the previous years are as follows:

|   | Group |       |       |       |      | Society |       |       |       |      |
|---|-------|-------|-------|-------|------|---------|-------|-------|-------|------|
|   | 2011  | 2010  | 2009  | 2008  | 2007 | 2011    | 2010  | 2009  | 2008  | 2007 |
|   | £m    | £m    | £m    | £m    | £m   | £m      | £m    | £m    | £m    | £m   |
| Experience gains/(losses) on plan liabilities | 68    | 55    | 12    | (41)  | (6)  | 68      | 55    | 12    | (41)  | (6)  |
| Changes in actuarial assumptions              | 84    | (617) | 186   | 245   | 39   | 84      | (616) | 185   | 245   | 39   |
| Actuarial gains/(losses) on plan liabilities  | 152   | (562) | 198   | 204   | 33   | 152     | (561) | 197   | 204   | 33   |
| Experience (losses)/gains on plan assets      | (38)  | 393   | (519) | (143) | (32) | (38)    | 392   | (518) | (143) | (32) |
|   | 114   | (169) | (321) | 61    | 1    | 114     | (169) | (321) | 61    | 1    |

The present value of the defined benefit obligation and the fair value of plan assets including post retirement healthcare for the current and previous years are:

|   | Group |       |       |       |       | Society |       |       |       |       |
|---|-------|-------|-------|-------|-------|---------|-------|-------|-------|-------|
|   | 2011  | 2010  | 2009  | 2008  | 2007  | 2011    | 2010  | 2009  | 2008  | 2007  |
|   | £m    | £m    | £m    | £m    | £m    | £m      | £m    | £m    | £m    | £m    |
| Present value of defined benefit obligation | 2,995 | 2,976 | 2,267 | 2,172 | 1,953 | 2,990   | 2,971 | 2,264 | 2,169 | 1,951 |
| Fair value of plan assets                   | 2,695 | 2,468 | 1,936 | 2,132 | 1,781 | 2,691   | 2,464 | 1,933 | 2,129 | 1,779 |
| Total deficit                               | 300   | 508   | 331   | 40    | 172   | 299     | 507   | 331   | 40    | 172   |

The principal actuarial assumptions used were as follows:

|  | Group and Society |           |
|--|-------------------|-----------|
|  | 2011              | 2010      |
|  | %                 | %         |
| Discount rate                              | 5.6               | 5.6       |
| Expected return on plan assets (see below) | 6.9               | 7.0       |
| Future salary increases                    | 4.5               | 4.6       |
| Future pension increases                   | 2.1 - 3.8         | 2.2 - 3.8 |
| Retail price index (RPI) inflation         | 3.5               | 3.6       |
| Consumer price index (CPI) inflation       | 2.8               | n/a       |
| Medical cost trend rate                    | 4.4 - 8.0         | 4.4 - 8.0 |

To derive the expected rate of return on plan assets assumption, the Group considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for the future returns of each asset class. Assets with higher volatility are assumed to

generate higher returns consistent with widely accepted capital market principles. The expected overall return was then calculated based on the asset allocation at 4 April 2011. This resulted in the selection of the 6.9% assumption as at 4 April 2011 (2010: 7.0%). A deduction is made for the expenses of the Fund.

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## Retirement benefit obligations (continued)

The assumptions on mortality are based on standard mortality tables which allow for future mortality improvements. The assumptions made are illustrated by the following years of life expectancy at age 60:

|                        | 2011 | 2010 |
|------------------------|------|------|
| Retire at 4 April 2011 |      |      |
| • Males                | 28.4 | 27.1 |
| • Females              | 30.7 | 29.1 |
| Retire at 4 April 2031 |      |      |
| • Males                | 30.3 | 29.2 |
| • Females              | 31.4 | 30.3 |

The Group estimates that its contributions to the defined benefit pension funds during the year ended 4 April 2012 will be £291 million, including the additional deficit contributions of £240 million.

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## Capital and leasing commitments

| Capital commitments   | Group |      | Society |      |
|---|-------|------|---------|------|
|   | 2011  | 2010 | 2011    | 2010 |
|   | £m    | £m   | £m      | £m   |
| Capital expenditure contracted for but not provided for in the Accounts | 122   | 140  | 122     | 140  |

The Group leases various offices, branches and other premises under non-cancellable operating lease arrangements. The leases have various terms, escalation, renewal rights and in some cases contingent rent payable.

| Leasing commitments   | Group |      | Society |      |
|---|-------|------|---------|------|
|   | 2011  | 2010 | 2011    | 2010 |
|   | £m    | £m   | £m      | £m   |
| At the balance sheet date, future minimum payments under operating leases relating to land and buildings were as follows:   |       |      |         |      |
| Amounts falling due:  |       |      |         |      |
| • Within one year   | 31    | 33   | 28      | 33   |
| • Between one and five years  | 93    | 101  | 92      | 100  |
| • After five years  | 123   | 133  | 121     | 131  |
|   | 247   | 267  | 241     | 264  |
| <b>Leasing payments receivable as lessor</b>  |       |      |         |      |
| At the balance sheet date, subleasing payments receivable under non-cancellable subleases                                   | 8     | 15   | 8       | 15   |
| At the balance sheet date, future minimum lease payments receivable under non-cancellable operating leases were as follows: |       |      |         |      |
| Amounts falling due:  |       |      |         |      |
| • Within one year   | 5     | 6    | 5       | 6    |
| • Between one and five years  | 13    | 17   | 13      | 17   |
| • After five years  | 12    | 16   | 12      | 16   |
|   | 30    | 39   | 30      | 39   |



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## Contingent liabilities

During the ordinary course of business the Society is subject to threatened or actual legal proceedings. All such material cases are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of incurring a liability. The Society does not expect the ultimate resolution of any proceedings to have a

significant adverse effect on the financial position of the Society and has not disclosed the contingent liabilities associated with such claims, either because they cannot reasonably be estimated or because such disclosure could be seriously prejudicial to the conduct of the claims.

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## Financial instruments

### Strategy in using financial instruments

Financial instruments incorporate the vast majority of the Group and Society's assets and liabilities. Given the dominant position of the Society within the Group structure, the term 'Group' is used in the remainder of this note to cover the activities of both Group and Society. Furthermore, because the risks of the organisation are managed on a Group basis, the disclosures in notes 39 to 41 are presented only on a consolidated basis.

The Group accepts deposits from customers at fixed, floating and variable interest rates for various periods and seeks to earn an interest margin by investing these funds in high quality assets – predominantly mortgages. The principal risks which arise from this core activity, and which need to be managed by the Group, are interest rate risks (including basis risk), credit risks, foreign exchange risks and liquidity and funding risks.

The Group uses derivative instruments to manage various aspects of risk. However, in doing so it complies with the Building Societies Act 1986 which limits our use of derivatives to the mitigation of consequences arising from changes in interest rates, exchange rates or other factors defined by the Act.

### Derivatives

The principal derivatives used in balance sheet risk management are interest rate swaps, forward rate agreements, interest rate options, cross-currency interest rate swaps, interest rate futures, foreign exchange contracts, and equity index swaps. Derivatives are used to hedge balance sheet and income exposures arising, inter alia, from fixed rate mortgage lending, fixed rate savings products, funding and investment activities in foreign currencies or involving fixed rate instruments or instruments with embedded options. Group risk exposures are recorded on the Society's information systems and monitored accordingly.

The following table describes the significant activities undertaken by the Group, the risks associated with such activities and the types of derivatives which are used in managing such risks. Such risks may alternatively be managed using cash instruments as part of an integrated approach to risk management.

| Activity  | Risk   | Type of derivative instrument used   |
|---|--|--|
| Savings products and funding activities involving instruments which are fixed rate instruments with embedded options                | Sensitivity to changes in interest rates   | Interest rate swaps, interest rate futures, swaptions, forward rate agreements   |
| Mortgage lending and investment activities involving instruments which are fixed rate or which include explicit or embedded options | Sensitivity to changes in interest rates, including differential between base rate and Libor | Interest rate swaps including basis swaps, interest rate futures, swaptions, caps, collars and forward rate agreements |
| Investment and funding in foreign currencies  | Sensitivity to changes in foreign exchange rates   | Cross-currency swaps and foreign exchange contracts  |
| Protected equity bond (PEBs) savings products   | Sensitivity to changes in stock indices  | Equity index swaps   |

The accounting policy for derivatives and hedge accounting is described in the Statement of Accounting Policies. Where possible, fair value hedge accounting is employed but no use is currently made of cash flow hedge accounting.

The Board and the Assets and Liabilities Committee (ALCO) are responsible for setting certain parameters respectively over the Group exposure to interest rates, foreign exchange rates and other indices. The Commercial and Treasury Credit Committee sets Group credit policy and regularly

monitors and reviews credit exposures arising in all aspects of Group operations, including derivatives. All risk committees are overseen by the Executive Risk Committee, whilst the Board Risk Committee provides oversight of the risk framework for the Group including governance.

All exchange-traded instruments are subject to cash requirements under the standard margin arrangements applied by the individual exchanges. Such instruments are not subject to significant credit risk. Credit exposures arising on derivative contracts with certain counterparties are

## Financial instruments (continued)

collateralised (e.g. with cash deposits) to mitigate credit exposures. All Group derivatives activity is contracted with OECD financial institutions.

The principal financial risks to which the Group is exposed are interest rate, credit, foreign exchange, liquidity and funding risk. Each of these is considered below.

### Interest rate risk

The primary market risk faced by the Group is interest rate risk. The net interest income and market value of the Group's assets are exposed to movements in interest rates. This exposure is managed on a continuous basis, within parameters set by ALCO, using a combination of derivative instruments, cash instruments (such as loans, deposits and bonds) and contractual terms within products and associated procedures.

The Group does not run a trading book and therefore does not have the higher risk exposure run by many banking institutions. Given our policy of hedging fixed rate assets and liabilities back to floating rate, interest rate market value risk arises mainly from the Board's decision to invest the Group's reserves according to a specified fixed rate maturity profile. The level of risk can deviate from this, subject to limits, in particular as a result of decisions made by the Group's Treasury department to temporarily deviate from the specified fixed rate maturity profile in the light of market conditions.

Interest rate earnings risk arises mainly from the diversity of product terms and associated procedures adopted by the Group in originating and administering retail and commercial products. Should reported exposure approach internal risk parameters, action is initiated by ALCO to mitigate such exposure, through changes to these product terms and procedures, to product mix, or through the use of derivatives.

The Group uses several metrics to monitor interest rate risk and details of these are set out below. The controls around these metrics have been set by the Board or by ALCO and reflect the Group's low risk appetite.

**Value at Risk (VaR).** This is a technique that estimates the potential losses that could occur on risk positions as a result of future movements in market rates and prices over a specified time horizon and to a given

level of statistical confidence. In its day-to-day monitoring Nationwide uses a 10-day horizon and a 99% confidence level.

The VaR model used by Nationwide incorporates underlying risk factors based on interest rate volatilities and correlations. Potential movements in market prices are calculated by reference to daily market data from the last two years equally weighted. Exposures against limits are reviewed daily by management. Actual outcomes are monitored periodically to test the validity of the assumptions and factors used in the VaR calculation.

Although a valuable guide to risk, VaR needs to be viewed in the context of the following limitations:

- Historic data is not necessarily a good guide to future events;
- The use of a 99% confidence level, by definition, does not take account of changes in value that might occur beyond this level of confidence. The VaR numbers may not encompass all potential events, particularly those that are extreme in nature; and
- VaR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

**Sensitivity analysis (PV01 sensitivity).** This is used to assess the change in value of the Group's current net worth against a one basis point (0.01%) parallel shift in interest rates. As is the case with VaR, this analysis is done on a daily basis separately for each currency (but with the main risk arising from Sterling exposures) and in aggregate.

**Stress testing (PV200 sensitivity).** This is calculated in a similar manner to PV01 but against a much more severe 200 basis point (2.0%) parallel shift in interest rates. Both PV01 and PV200 numbers are generated and monitored daily.

Change in value of the Group's current net worth is also calculated against a range of non-linear stresses to the yield curve. This output is reported and monitored on a monthly basis.

The average gross exposures (before deduction of the above-mentioned specified fixed rate maturity profile for the Group's reserves) through the reporting period are as follows:

|  | 2011    |      |     | 2010    |      |     |
|--|---------|------|-----|---------|------|-----|
|  | Average | High | Low | Average | High | Low |
|  | £m      | £m   | £m  | £m      | £m   | £m  |
| VaR                                    | 74      | 81   | 66  | 83      | 88   | 79  |
| Sensitivity analysis (PV01)            | 2       | 2    | 2   | 2       | 2    | 2   |
| Stress testing (PV200: all currencies) | 409     | 438  | 373 | 390     | 463  | 362 |

All exposures include investment of the Group's reserves. VaR reflects the impact of the decrease of interest rate volatilities in the reference period.

**Earnings risk.** Earnings risks are calculated using a variety of stochastic and deterministic scenarios.

Interest rate earnings risks, such as basis risk (the risk of loss arising from changes in the relationship between interest rates which have similar but not identical characteristics, for example Libor and Bank of England base rate) and prepayment risk (the risk of loss arising from early repayment of

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## Financial instruments (continued)

fixed rate mortgages and loans) are also monitored closely and regularly reported to ALCO.

The sensitivity of Group net interest margin to changes in interest rate is measured monthly using a dynamic forecasting model and interest rate scenarios, and is calculated for a forward period of 12 months.

### Credit risk

The Group takes on exposure to credit risk, which is defined as the risk that a counterparty will be unable to pay amounts in full when due. Impairment provisions are provided for losses that have been incurred at the balance sheet date. Significant changes in the economy, or a sector that represents a concentration in the Group's portfolio, could result in losses that are different from those provided for at the balance sheet date. Management, therefore, carefully monitors its exposure to credit risk.

The Group's Credit Committees for Retail and Commercial and Treasury are responsible for approving and monitoring the Group's credit exposures which they do through formal annual review and approval of the Group's lending policies. Regular monitoring and review of lending is undertaken through detailed management information including the performance of credit scoring systems for all retail lending. Formal limits are set and reviewed at individual, segment and portfolio levels based on credit exposures split by individual counterparties, geographical location and industry sector. Summary minutes of the Credit Committees together with key risk monitoring metrics are reviewed by the Executive Risk Committee.

Prior to advancing funds, an assessment is made of the credit quality of borrowers and other counterparties for all lending to both retail and corporate customers. Retail lending is subject to credit scoring and lending policies. Corporate lending is based on counterparty assessment that includes the use of multiple rating methodologies.

Credit risk within our Treasury division arises primarily from the investments held by Treasury for liquidity and investment purposes and for income generation purposes. This aspect of credit risk is managed by our Treasury division and the Commercial and Treasury Risk function within Risk Management division. The Commercial and Treasury Risk team underwrites all new facilities and monitors existing facilities. They also set and monitor compliance with policy and limits, reporting to the Commercial and Treasury Credit Committee. In addition, counterparty credit risk arises from the Group's derivatives where the market values are positive.

The Treasury Credit Risk function monitors exposure concentrations against a variety of criteria including industry sector, asset class, and country of risk. The Treasury portfolio exposure is well spread across both industry sectors and jurisdictions. Nationwide has no exposure to emerging markets or hedge funds and only minimal exposure to non investment grade debt.

The following table presents the Group's maximum exposure to credit risk of on balance sheet and off balance sheet financial instruments, before taking into account any collateral held or other credit enhancements and after allowance for impairment where appropriate. The maximum exposure to loss for off balance sheet financial instruments is considered to be their contractual nominal amounts.

|   | 2011           |             |                              | 2010           |             |                              |
|---|----------------|-------------|------------------------------|----------------|-------------|------------------------------|
|   | Carrying value | Commitments | Maximum credit risk exposure | Carrying value | Commitments | Maximum credit risk exposure |
|   | £m             | £m          | £m                           | £m             | £m          | £m                           |
| Cash                                    | 6,130          | -           | 6,130                        | 3,994          | -           | 3,994                        |
| Loans and advances to banks             | 4,181          | 199         | 4,380                        | 2,017          | 149         | 2,166                        |
| Investment securities – AFS             | 21,540         | -           | 21,540                       | 23,385         | -           | 23,385                       |
| Derivative financial instruments        | 3,961          | -           | 3,961                        | 4,852          | -           | 4,852                        |
| FV adjustment for portfolio hedged risk | 1,563          | -           | 1,563                        | 2,798          | -           | 2,798                        |
| Loans and advances to customers         | 149,417        | 5,637       | 155,054                      | 152,429        | 4,953       | 157,382                      |
| Investment in equity shares             | 103            | -           | 103                          | 86             | -           | 86                           |
|   | 186,895        | 5,836       | 192,731                      | 189,561        | 5,102       | 194,663                      |

In addition to the figures shown above, the Group has, as part of its retail operations, commitments of £6,857 million (2010: £4,908 million) in respect of credit card and overdraft facilities. These commitments represent agreements to lend in the future, subject to certain

conditions. Such commitments are cancellable by the Group, subject to notice requirements, and given their nature are not expected to be drawn down to the full level of exposure.

## Financial instruments (continued)

**Foreign exchange risk**

Foreign exchange risk is the risk that the Sterling value of, or net income from, assets and liabilities that are denominated in foreign currency changes as a consequence of changes to foreign exchange rates.

In addition to commercial loans denominated in Euro, a significant proportion of Treasury funding and investment activity is undertaken in foreign currencies. Foreign currency exposure is hedged on the balance sheet or by using derivatives to reduce currency exposures to acceptable levels.

In line with the prudential guidance applying to all building societies and after taking account of foreign currency derivatives, the Group has no substantial net exposure to foreign exchange rate fluctuations or changes in foreign currency interest rates. ALCO sets limits on the level of exposure by currency which are monitored daily.

VaR is used to monitor the risk arising from open foreign currency positions. Open currency positions represent the net value of assets, liabilities and derivatives in foreign currency. The parameters of the VaR methodology, and frequency of reporting are exactly as described above under interest rate risk.

The average gross Sterling equivalent exposures for foreign exchange risk through the year are as follows:

|     | 2011    |      |     | 2010    |      |     |
|-----|---------|------|-----|---------|------|-----|
|     | Average | High | Low | Average | High | Low |
|     | £m      | £m   | £m  | £m      | £m   | £m  |
| VaR | 0.1     | 0.5  | -   | 0.2     | 0.6  | -   |

**Liquidity and funding**

Liquidity and funding risk is the risk that the Group is not able to meet its financial obligations as they fall due (including any unexpected adverse cash flow), to smooth out the effect of maturity mismatches, or to maintain public confidence.

The Group liquidity policy is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding, to retain full public confidence in the solvency of the Group and to enable it to meet all financial obligations. This is achieved through maintaining a prudent level of high quality liquid assets, through management and stress testing of business cash flows, and through management of funding facilities. The Group liquidity policy is approved by the Board.

Liquid assets are categorised according to their liquidity characteristics, and the most liquid category of assets is the focus of management attention. This portfolio predominantly comprises holdings of sovereign issued securities and deposits with the central bank and is aligned to the 'liquid asset buffer' defined in the FSA's policy statement on liquidity management PS 09/16. Assets may be acquired through direct purchase, through repurchase agreements or through collateral swaps. Encumbered assets are excluded from the calculation of liquid assets which is conducted on a daily basis.

The Board is responsible for setting limits over the level and composition of liquidity balances. A series of liquidity stress tests is performed daily to determine the required levels of liquidity.

The Board has also set limits for the funding mix of the balance sheet, for the maturity profile of wholesale and retail funding, and for the composition of the savings portfolio.

ALCO is responsible for setting more detailed limits within the context of overall Board limits, including the level and maturity profile of funding, and for monitoring the composition of the Group balance sheet.

Wholesale and retail funding maturities are monitored to ensure that future maturities are not concentrated on a calendar basis. This enhances the ability of the Group to refinance maturing liabilities throughout forward months and quarters. A consolidated cash flow forecast is maintained on a continuous basis and reviewed by ALCO. Limits regarding the maturity concentration and composition of the savings portfolio are regularly monitored.

Fixed rate sovereign debt securities are held for liquidity purposes. When swapped into Libor using an interest rate swap, the net market value of the security and swap is subject to changes in the relative spreads on sovereign debt and interest rate swaps. This risk is only realised if the debt is sold ahead of maturity (rather than being converted through repurchase agreements), and is subject to a trigger set by ALCO.

A Contingency Funding Plan has been approved by ALCO, and describes procedures and available actions to manage the Group's liquidity resources through a period of market disruption or heavy retail outflows. This is reviewed on a biannual basis and various components are tested on a scheduled basis.

Additional quantitative information on liquidity risk is contained in note 41.

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## Credit risk – loans and advances to customers

Our £149,635 million of loans and advances to customers continues to have a low risk profile when compared to industry benchmarks. The mix of lending has remained broadly consistent over the year.

Lending remains predominantly concentrated on high quality, secured products with residential mortgage lending making up 83% (2010: 83%), commercial loans 15% (2010: 15%) and consumer banking 2% (2010: 2%). Sub prime lending within specialist residential mortgages accounts for just 0.4% (2010: 0.4%) of the retail loan portfolio.

| Loans and advances to customers    | Notes | 2011           |            | 2010           |            |
|------------------------------------|-------|----------------|------------|----------------|------------|
|                                    |       | £m             | %          | £m             | %          |
| Prime residential mortgages        |       | 104,269        | 70         | 108,721        | 71         |
| Specialist residential mortgages   |       | 20,385         | 13         | 18,752         | 12         |
| <b>Total residential mortgages</b> |       | <b>124,654</b> | <b>83</b>  | <b>127,473</b> | <b>83</b>  |
| Consumer banking                   |       | 2,466          | 2          | 2,291          | 2          |
| <b>Retail loan portfolio</b>       | (a)   | <b>127,120</b> | <b>85</b>  | <b>129,764</b> | <b>85</b>  |
| Commercial lending                 | (b)   | 22,023         | 15         | 22,187         | 15         |
| Other lending operations           | (b)   | 492            | -          | 576            | -          |
| <b>Total gross balance</b>         |       | <b>149,635</b> | <b>100</b> | <b>152,527</b> | <b>100</b> |

The figures in the above table are before impairment provisions and fair value adjustments for micro hedged risks.

### (a) Retail loan portfolio

The retail portfolio is predominantly made up of £124,654 million of residential mortgages (2010: £127,473 million) with £2,466 million of consumer banking lending (2010: £2,291 million). By their nature, our retail lending books comprise a large number of smaller loans and have low volatility of credit risk outcomes and are intrinsically highly diversified.

Residential mortgages are only secured against UK properties. The Group operates across the whole of the UK with a bias towards the South East of England and Greater London, reflecting the concentration of branches in that region and historically higher asset value growth trends. As at 4 April 2011 around 34% (2010: 34%) of the retail mortgage book was made up of exposures concentrated in the South East and Greater London.

|                                       | 2011       | 2010       |
|---------------------------------------|------------|------------|
|                                       | %          | %          |
| South East England (excluding London) | 12         | 12         |
| Central England                       | 22         | 22         |
| Northern England                      | 19         | 19         |
| Greater London                        | 22         | 22         |
| South West England                    | 9          | 9          |
| Scotland                              | 9          | 9          |
| Wales and Northern Ireland            | 7          | 7          |
| <b>Total</b>                          | <b>100</b> | <b>100</b> |

The make up of specialist lending is as follows:

|                           | 2011          |            | 2010          |            |
|---------------------------|---------------|------------|---------------|------------|
|                           | £m            | %          | £m            | %          |
| Self-certified            | 4,058         | 20         | 4,559         | 24         |
| Buy to Let                | 14,633        | 72         | 12,305        | 66         |
| Near prime                | 1,250         | 6          | 1,427         | 8          |
| Sub prime                 | 444           | 2          | 461           | 2          |
| <b>Specialist lending</b> | <b>20,385</b> | <b>100</b> | <b>18,752</b> | <b>100</b> |

## Credit risk – loans and advances to customers (continued)

Specialist lending operates through The Mortgage Works (UK) plc (TMW), primarily in the Buy to Let market but also offers prime residential and guarantor mortgages. Near prime is defined as a borrower with a County Court Judgment (CCJ) or default less than or equal to £1,000 or one missed mortgage payment in the last 12 months. Sub prime lending is defined as a borrower with a CCJ or default in excess of £1,000 or more than one missed mortgage payment in the last 12 months. Specialist lending has not written any new self-certification, near prime or sub prime business during the financial year.

In addition, the portfolio contains assets acquired from the Derbyshire, Cheshire and Dunfermline building societies, along with assets originated under our UCB brand.

The quality of new residential mortgage lending remains strong as focus remains on affordability and loan to value (LTV) ratios. The overall number of residential mortgages three or more months in arrears as a proportion of the book has reduced to 0.77% (2010: 0.82%). Overall, our level of

arrears remains strong compared with the industry average of 2.09% (2010: 2.27%).

The number of Group borrowers in possession, including acquired societies, of 938 (2010: 967) represents 0.07% of the total portfolio (2010: 0.07%). As Buy to Let landlords may have more than one property, possession measures are slightly higher on a property basis but, at 989 (2010: 1,088) properties, representing 0.07% of our book (2010: 0.08%), this compares very well with the industry measure of 0.12% (2010: 0.13%). Excluding the impact of acquired societies, our position relative to the industry is even more favourable.

The average LTV of residential mortgages is 49% (2010: 48%) whilst the average LTV of new lending was 66% (2010: 63%). The value of residential property is updated on a monthly basis to reflect changes in the House Price Index (HPI). The percentage of cases per LTV band and an analysis of our gross residential mortgage lending during the year by borrower type are set out below:

|  | 2011 | 2010 |
|--|------|------|
|  | %    | %    |
| <b>Loan to value analysis:</b>           |      |      |
| <50%                                     | 52   | 54   |
| 50% - 60%                                | 9    | 10   |
| 60% - 70%                                | 11   | 10   |
| 70% - 80%                                | 11   | 10   |
| 80% - 90%                                | 10   | 8    |
| 90% - 100%                               | 5    | 6    |
| >100%                                    | 2    | 2    |
|  | 100  | 100  |
| Average loan to value of stock (indexed) | 49   | 48   |
| Average loan to value of new business    | 66   | 63   |
| <b>New business profile:</b>             |      |      |
| • First-time buyers                      | 23   | 26   |
| • Home movers                            | 34   | 38   |
| • Remortgagers                           | 12   | 18   |
| • Buy to Let                             | 31   | 18   |
|  | 100  | 100  |

The new business profile and average loan to value of new business above exclude further advances.

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## Credit risk – loans and advances to customers (continued)

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

|  | 2011          |                    |                  |         |     | 2010          |                    |                  |         |     |
|--|---------------|--------------------|------------------|---------|-----|---------------|--------------------|------------------|---------|-----|
|  | Prime lending | Specialist lending | Consumer banking | Total   |     | Prime lending | Specialist lending | Consumer banking | Total   |     |
|  | £m            | £m                 | £m               | £m      | %   | £m            | £m                 | £m               | £m      | %   |
| Not impaired:                            |               |                    |                  |         |     |               |                    |                  |         |     |
| Neither past due nor impaired            | 101,763       | 18,204             | 2,335            | 122,302 | 96  | 106,267       | 16,577             | 2,074            | 124,918 | 96  |
| Past due up to 3 months but not impaired | 1,934         | 1,348              | 37               | 3,319   | 3   | 1,889         | 1,169              | 45               | 3,103   | 3   |
| Impaired                                 | 572           | 833                | 94               | 1,499   | 1   | 565           | 1,006              | 172              | 1,743   | 1   |
|  | 104,269       | 20,385             | 2,466            | 127,120 | 100 | 108,721       | 18,752             | 2,291            | 129,764 | 100 |

The status 'past due up to 3 months but not impaired' includes any asset where a payment due is received late or missed. The amount included is the entire financial asset rather than just the payment overdue. Loans on interest only or payment holiday concessions are initially categorised according to their payment status as at the date of concession, with subsequent revisions to this category assessed against the terms of the concession.

Loans in the analysis above which are less than 3 months past due have collective impairment allowances set aside to cover credit losses on loans which are in the early stages of arrears. Loans acquired through the acquisition of the Derbyshire, Cheshire and Dunfermline building societies were fair valued on a basis which made credit loss adjustments for anticipated losses over the remaining life of the loans. These loans are categorised in the same way as originated loans in the analysis above.

Impaired retail assets are further analysed as follows:

|                         | 2011          |                    |                  |       |     | 2010          |                    |                  |       |     |
|-------------------------|---------------|--------------------|------------------|-------|-----|---------------|--------------------|------------------|-------|-----|
|                         | Prime lending | Specialist lending | Consumer banking | Total |     | Prime lending | Specialist lending | Consumer banking | Total |     |
|                         | £m            | £m                 | £m               | £m    | %   | £m            | £m                 | £m               | £m    | %   |
| Impaired status:        |               |                    |                  |       |     |               |                    |                  |       |     |
| Past due 3 to 6 months  | 271           | 290                | 50               | 611   | 41  | 280           | 342                | 60               | 682   | 39  |
| Past due 6 to 12 months | 187           | 228                | 44               | 459   | 30  | 174           | 282                | 67               | 523   | 30  |
| Past due over 12 months | 81            | 185                | -                | 266   | 18  | 81            | 222                | 45               | 348   | 20  |
| Possessions             | 33            | 130                | -                | 163   | 11  | 30            | 160                | -                | 190   | 11  |
|                         | 572           | 833                | 94               | 1,499 | 100 | 565           | 1,006              | 172              | 1,743 | 100 |

Possession balances represent loans against which Nationwide has taken ownership of properties pending their sale.

Nationwide offer secured customers in financial difficulty a range of account management and forbearance options including capitalisation, interest only concessions, payment holidays and terms extensions.

£276 million (2010: £329 million) of loans that would be past due or impaired have had their arrears capitalised in the last 12 months. Customers are only permitted to capitalise arrears where they have demonstrated their ability to meet a repayment schedule at normal commercial terms for a continuous six month period. Once capitalised, loans are categorised as not impaired as long as contractual repayments are maintained.

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 of the account will not increase. As at year end, 2,802 accounts were on an interest only concession. Payment holidays allow non-arrears customers meeting required criteria to make reduced or nil payments. As at year end, 2,313 accounts were on a payment holiday. Nationwide allow customers to extend their mortgage, both within and at the end of their term. Within term extensions typically meet standard lending criteria. End of term extensions are considered on an individual basis, and are typically low LTV and of limited exposure.

The provision methodology recognises previous arrears as a driver of future default and therefore capitalised accounts typically attract



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## Credit risk – loans and advances to customers (continued)

a higher provision than the rest of the not impaired portfolio for the 12 months following capitalisation. The underlying performance of interest only concessions and payment holidays are also reflected in

the provisioning methodology. Materiality is low on term extensions, therefore no specific provision treatment is applied.

## Collateral held against past due or impaired retail residential mortgages:

|                           | 2011          |     |                    |    | 2010          |     |                    |    |
|---------------------------|---------------|-----|--------------------|----|---------------|-----|--------------------|----|
|                           | Prime lending |     | Specialist lending |    | Prime lending |     | Specialist lending |    |
|                           | £m            | %   | £m                 | %  | £m            | %   | £m                 | %  |
| Past due but not impaired | 1,928         | 100 | 1,334              | 99 | 1,884         | 100 | 1,159              | 99 |
| Impaired                  | 535           | 99  | 676                | 96 | 532           | 99  | 829                | 98 |
| Possessions               | 31            | 94  | 116                | 89 | 29            | 97  | 150                | 94 |
|                           | 2,494         | 100 | 2,126              | 97 | 2,445         | 100 | 2,138              | 98 |

Collateral held in relation to secured loans that are either past due or impaired is capped to the amount outstanding on an individual loan basis. The percentage, in the table above, is the cover over the asset.

## Negative equity on retail residential mortgages:

|                           | 2011          |                    | 2010          |                    |
|---------------------------|---------------|--------------------|---------------|--------------------|
|                           | Prime lending | Specialist lending | Prime lending | Specialist lending |
|                           | £m            | £m                 | £m            | £m                 |
| Past due but not impaired | 6             | 14                 | 5             | 10                 |
| Impaired                  | 4             | 27                 | 3             | 17                 |
| Possessions               | 2             | 14                 | 1             | 10                 |
|                           | 12            | 55                 | 9             | 37                 |

In consumer banking personal loans and credit cards have arrears levels significantly lower than averages for the industry (FLA and APACS) as shown in the table below:

## Percentage of accounts more than 30 days in arrears:

|                | 2011 |          | 2010 |          |
|----------------|------|----------|------|----------|
|                | NBS  | Industry | NBS  | Industry |
|                | %    | %        | %    | %        |
| Personal loans | 5.45 | 20.00    | 7.07 | 19.60    |
| Credit card    | 3.36 | 5.77     | 5.15 | 6.64     |

The percentage of accounts more than 30 days in arrears on current account overdrafts is 10.46% (2010: 16.74%). Of the improvement of over 6% in the year, 2% relates to improvements in underlying performance and 4% relates to a change in methodology, whereby all cases moving into litigation or being referred to debt collection agencies are now immediately written off.

Fewer forbearance options are available to unsecured customers than are offered to secured customers. Credit Card customers may agree a payment plan, which is typically less than the minimum payment. Additionally, Credit Card customers that have maintained the required payment performance over a sustained period may be re-aged, and a similar policy has recently been introduced for Personal Loans. The materiality of payment plans and re-ageing is low, and therefore no specific treatment is made within provisioning.

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## Credit risk – loans and advances to customers (continued)

### (b) Commercial lending and other lending operations

Commercial lending comprises loans secured on commercial property, loans to Registered Social Landlords and loans advanced under Private Finance Initiatives. Other lending operations include a secured European

commercial loan portfolio of £241 million (2010: £299 million) and unsecured lending of £251 million (2010: £277 million) relating to a student loan portfolio. These investments were acquired by Treasury division and are therefore held within the Head office functions business segment.

Our Commercial loan portfolio of £22,023 million (2010: £22,187 million) comprises the following:

|                             | 2011   |     | 2010   |     |
|-----------------------------|--------|-----|--------|-----|
|                             | £m     | %   | £m     | %   |
| Property finance            | 12,282 | 56  | 12,951 | 58  |
| Registered Social Landlords | 8,210  | 37  | 7,909  | 36  |
| Private Finance Initiative  | 1,531  | 7   | 1,327  | 6   |
|                             | 22,023 | 100 | 22,187 | 100 |

Loans to Registered Social Landlords are secured on residential property and loans advanced under the Private Finance Initiative are secured on cash flows from Government backed contracts. We have never suffered losses on our lending in these markets and there are currently no arrears of three months or more on these portfolios. Our property finance

portfolio is well diversified by industry type and by borrower and we have no significant exposure to development finance. The proportion of property finance cases three months or more in arrears as at 4 April was 3.45%, and equates to 306 cases (2010: 3.64%, 334 cases).

An analysis of property finance lending is provided below:

|                          | 2011   |     | 2010   |     |
|--------------------------|--------|-----|--------|-----|
|                          | £m     | %   | £m     | %   |
| Retail                   | 3,860  | 31  | 4,058  | 31  |
| Office                   | 2,821  | 23  | 3,088  | 24  |
| Residential              | 2,366  | 19  | 2,389  | 18  |
| Industrial and warehouse | 2,059  | 17  | 2,136  | 17  |
| Leisure and hotel        | 1,164  | 10  | 1,222  | 9   |
| Owner occupied           | -      | -   | 7      | -   |
| Other                    | 12     | -   | 51     | 1   |
|                          | 12,282 | 100 | 12,951 | 100 |

Where possible loans within the “owner occupied” and “other” sectors have been reallocated across more appropriate categories during the year ended 4 April 2011 and prior year comparatives have been amended accordingly.

In terms of counterparty concentration, the largest single commercial customer, including undrawn commitments, represents only 1% (2010: 1%) of the total book.

The tables below provide further information on the commercial lending and other lending operations by payment due status:

|  | 2011       |     |                  |     | 2010       |     |                  |     |
|--|------------|-----|------------------|-----|------------|-----|------------------|-----|
|  | Commercial |     | Other operations |     | Commercial |     | Other operations |     |
|  | £m         | %   | £m               | %   | £m         | %   | £m               | %   |
| Not impaired:                            |            |     |                  |     |            |     |                  |     |
| Neither past due nor impaired            | 20,212     | 92  | 481              | 98  | 20,556     | 93  | 538              | 93  |
| Past due up to 3 months but not impaired | 391        | 2   | 4                | 1   | 297        | 1   | 5                | 1   |
| Impaired                                 | 1,420      | 6   | 7                | 1   | 1,334      | 6   | 33               | 6   |
|  | 22,023     | 100 | 492              | 100 | 22,187     | 100 | 576              | 100 |

## Credit risk – loans and advances to customers (continued)

The status 'past due up to 3 months but not impaired' includes any asset where a payment due under strict contractual terms is received late or missed. The amount included is the entire financial asset rather than just the payment overdue.

Loans in the analysis above which are less than three months past due have collective impairment allowances set aside to cover credit losses on loans which are in the early stages of arrears. This analysis includes commercial mortgage assets totalling £1.2 billion (2010: £1.3 billion) acquired through the acquisitions of the Derbyshire, Cheshire and Dunfermline building societies. These loans were fair valued on a basis

that made allowances for anticipated losses over the life of the loans. Impaired loans totalling £141 million (2010: £141 million) in the above analysis have thus been fair valued and are therefore unlikely to contribute any significant further losses to the Group.

Certain of the prior year comparatives in the tables above and below have been reclassified to conform to the current year's presentation.

Within other lending operations shown above, there are £11 million (2010: £38 million) past due or impaired balances. The full £11 million (2010: £11 million) relates to the unsecured student loan portfolio.

Impaired commercial and other operations assets are further analysed as follows:

|                         | 2011       |     |                  |     | 2010       |     |                  |     |
|-------------------------|------------|-----|------------------|-----|------------|-----|------------------|-----|
|                         | Commercial |     | Other operations |     | Commercial |     | Other operations |     |
|                         | £m         | %   | £m               | %   | £m         | %   | £m               | %   |
| Impaired status:        |            |     |                  |     |            |     |                  |     |
| Past due 0 to 3 months  | 695        | 49  | -                | -   | 408        | 30  | -                | -   |
| Past due 3 to 6 months  | 111        | 8   | 1                | 14  | 291        | 22  | 14               | 42  |
| Past due 6 to 12 months | 235        | 16  | 3                | 43  | 397        | 30  | 15               | 46  |
| Past due over 12 months | 378        | 27  | 3                | 43  | 238        | 18  | 4                | 12  |
| Possessions             | 1          | -   | -                | -   | -          | -   | -                | -   |
|                         | 1,420      | 100 | 7                | 100 | 1,334      | 100 | 33               | 100 |

Commercial assets totalling £1,152 million (2010: £960 million) not subject to fair value adjustments have individual provisions against them. The table above includes impaired cases which are not more than three months past due and the impaired balances for 4 April 2010 have been adjusted to reflect these loans.

Possession balances represent loans against which Nationwide has taken ownership of properties pending their sale.

A number of commercial property finance loans, characterised by either a covenant breach, payment default or loan maturity were restructured during the past 12 months. Of these loans, £745 million had debt restructure terms which fell outside our current lending policy or credit appetite, or the loan exposure post restructure generates a sub-optimal return on risk weighted capital. Once renegotiated the

restructured loans include a contractual capital amortisation profile or a full cash sweep of surplus rental income to pay-down debt after permitted deductions for asset management fees and irrecoverable property costs, and are categorised as not impaired as long as contractual repayments are maintained. In the year to 4 April 2010 there were £806 million of loans that were restructured due to covenant breaches or distress. Total loan exposures of £167 million (2010: £39 million) restructured during the year carry observed credit impairment provisions of £36 million (2010: £19 million). In addition loans of £62 million (2010: £135 million) reported as up to date have been renegotiated through repayment plans offering a concessionary payment to genuinely distressed borrowers or by consolidating arrears on to the balance of the loan.

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## Credit risk – loans and advances to customers (continued)

| Collateral held against past due or impaired commercial lending | 2011  |    | 2010  |    |
|---|-------|----|-------|----|
|   | £m    | %  | £m    | %  |
| Past due but not impaired                                       | 363   | 93 | 292   | 98 |
| Impaired  | 1,050 | 74 | 1,161 | 87 |
|   | 1,413 | 78 | 1,453 | 89 |

Collateral held in relation to secured loans that are either past due or impaired is capped to the amount outstanding on an individual loan basis. The percentage, in the table above, is the cover over the asset.

| Negative equity on commercial lending | 2011 | 2010 |
|---------------------------------------|------|------|
|                                       | £m   | £m   |
| Past due but not impaired             | 28   | 5    |
| Impaired                              | 369  | 173  |
| Possessions                           | 1    | -    |
|                                       | 398  | 178  |

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## Credit risk – Treasury financial instruments

### Treasury liquid assets

Treasury liquid assets include cash, loans and advances to banks and investment securities available for sale. These are held in two portfolios – the Treasury liquidity portfolio and the investment portfolio.

At 4 April 2011 the Treasury liquidity portfolio totalled £28.6 billion (2010: £25.7 billion) and the investment portfolio totalled £3.3 billion (2010: £3.7 billion). Analysis of each of these portfolios by credit rating and by location of issuer is given below.

| Treasury liquidity portfolio                             | April 2011  | AAA       | AA       | A         | Other    | UK        | US       | Europe    | Other    |
|--|-------------|-----------|----------|-----------|----------|-----------|----------|-----------|----------|
|  | £bn         | %         | %        | %         | %        | %         | %        | %         | %        |
| Cash   | 6.1         | 100       | -        | -         | -        | 100       | -        | -         | -        |
| Loans to financial institutions                          | 3.7         | -         | 44       | 56        | -        | 73        | -        | 15        | 12       |
| Other (including items in transit and clearing accounts) | 0.6         | -         | -        | -         | -        | 100       | -        | -         | -        |
| <b>Non-AFS assets</b>                                    | <b>10.4</b> |           |          |           |          |           |          |           |          |
| Gilts  | 8.6         | 100       | -        | -         | -        | 100       | -        | -         | -        |
| Non domestic Government bonds                            | 2.2         | 100       | -        | -         | -        | -         | 40       | 60        | -        |
| Supranational bonds                                      | 1.8         | 100       | -        | -         | -        | -         | -        | 100       | -        |
| Residential mortgage backed securities (RMBS)            | 2.3         | 85        | 11       | 2         | 2        | 43        | -        | 52        | 5        |
| Covered bonds  | 0.7         | 67        | 18       | 8         | 7        | -         | 4        | 88        | 8        |
| Floating rate notes                                      | 2.6         | 13        | 18       | 49        | 20       | 18        | 11       | 58        | 13       |
| <b>AFS assets</b>  | <b>18.2</b> |           |          |           |          |           |          |           |          |
| <b>Total Treasury liquidity portfolio</b>                | <b>28.6</b> | <b>77</b> | <b>9</b> | <b>13</b> | <b>1</b> | <b>71</b> | <b>4</b> | <b>22</b> | <b>3</b> |

## Credit risk – Treasury financial instruments (continued)

Ratings are obtained from Standard & Poors in the majority of cases, from Moody's if there is no Standard & Poors rating available, and internal ratings are used if neither is available.

We have continued to maintain the quality of the Treasury liquidity portfolio, with 65% (2010: 63%) of assets held in sovereign and supranational exposures and 99% (2010: 99%) of the portfolio rated A or better with 86% (2010: 85%) rated AA or above.

| Treasury liquidity portfolio                             | April 2010 | AAA | AA | A  | Other | UK  | US | Europe | Other |
|--|------------|-----|----|----|-------|-----|----|--------|-------|
|  | £bn        | %   | %  | %  | %     | %   | %  | %      | %     |
| Cash   | 4.0        | 100 | -  | -  | -     | 100 | -  | -      | -     |
| Loans to financial institutions                          | 1.7        | -   | 36 | 59 | 5     | 78  | 1  | 5      | 16    |
| Other (including items in transit and clearing accounts) | 0.3        | -   | -  | -  | -     | 100 | -  | -      | -     |
| Non-AFS assets   | 6.0        |     |    |    |       |     |    |        |       |
| Gilts  | 6.4        | 100 | -  | -  | -     | 100 | -  | -      | -     |
| Non domestic Government bonds                            | 3.9        | 100 | -  | -  | -     | -   | 43 | 57     | -     |
| Supranational bonds                                      | 2.0        | 100 | -  | -  | -     | -   | 2  | 98     | -     |
| Residential mortgage backed securities (RMBS)            | 2.7        | 96  | 4  | -  | -     | 43  | -  | 52     | 5     |
| Covered bonds  | 0.9        | 89  | 11 | -  | -     | -   | 3  | 90     | 7     |
| Floating rate notes                                      | 3.8        | 4   | 25 | 61 | 10    | 26  | 3  | 57     | 14    |
| AFS assets   | 19.7       |     |    |    |       |     |    |        |       |
| Total Treasury liquidity portfolio                       | 25.7       | 78  | 7  | 14 | 1     | 55  | 7  | 34     | 4     |

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## Credit risk – Treasury financial instruments (continued)

| Investment portfolio – all AFS assets              | April 2011 | AAA       | AA        | A         | Other     | UK        | US        | Europe    | Other    |
|--|------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|----------|
|  | £bn        | %         | %         | %         | %         | %         | %         | %         | %        |
| Collateralised debt obligations (CDO)              | 0.1        | -         | -         | -         | 100       | -         | 100       | -         | -        |
| Collateralised loan obligations (CLO)              | 0.6        | 6         | 82        | 12        | -         | 26        | 74        | -         | -        |
| Commercial mortgage backed securities              | 0.6        | 39        | 23        | 16        | 22        | 66        | 14        | 20        | -        |
| Corporate bond portfolio                           | 0.1        | -         | 40        | -         | 60        | 60        | 40        | -         | -        |
| Credit card backed securities                      | 0.2        | 100       | -         | -         | -         | 17        | 83        | -         | -        |
| Financial institutions including subordinated debt | 0.4        | -         | 21        | 61        | 18        | 32        | 15        | 42        | 11       |
| Other corporate bonds                              | -          | -         | 36        | -         | 64        | 100       | -         | -         | -        |
| Residential mortgage backed securities (RMBS)      | 0.5        | 31        | 30        | 19        | 20        | 76        | 22        | 1         | 1        |
| US student loan                                    | 0.7        | 68        | 6         | 17        | 9         | -         | 100       | -         | -        |
| Other investments                                  | 0.1        | 22        | 21        | 31        | 26        | 28        | 44        | 19        | 9        |
| <b>Total investment portfolio</b>                  | <b>3.3</b> | <b>35</b> | <b>28</b> | <b>21</b> | <b>16</b> | <b>37</b> | <b>51</b> | <b>10</b> | <b>2</b> |

Ratings are obtained from Standard & Poors in the majority of cases, from Moody's if there is no Standard & Poors rating available, and internal ratings are used if neither is available.

84% (2010: 87%) of the investment portfolio is rated A or better with 63% (2010: 69%) rated AA or better.

| Investment Portfolio – all AFS assets              | April 2010 | AAA       | AA        | A         | Other     | UK        | US        | Europe    | Other    |
|--|------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|----------|
|  | £bn        | %         | %         | %         | %         | %         | %         | %         | %        |
| Collateralised debt obligations (CDO)              | 0.1        | -         | -         | -         | 100       | -         | 100       | -         | -        |
| Collateralised loan obligations (CLO)              | 0.6        | 33        | 59        | 8         | -         | 25        | 75        | -         | -        |
| Commercial mortgage backed securities              | 0.6        | 60        | 19        | 11        | 10        | 47        | 14        | 39        | -        |
| Corporate bond portfolio                           | 0.1        | -         | 13        | 17        | 70        | 36        | 28        | 36        | -        |
| Credit card backed securities                      | 0.3        | 99        | -         | -         | 1         | 42        | 58        | -         | -        |
| Financial institutions including subordinated debt | 0.7        | -         | 22        | 64        | 14        | 21        | 33        | 39        | 7        |
| Other corporate bonds                              | -          | -         | 34        | 66        | -         | 100       | -         | -         | -        |
| Residential mortgage backed securities (RMBS)      | 0.3        | 24        | 23        | 23        | 30        | 61        | 36        | 3         | -        |
| US student loan                                    | 0.8        | 98        | 1         | 1         | -         | -         | 100       | -         | -        |
| Other investments                                  | 0.2        | 38        | 21        | 15        | 26        | 11        | 47        | 33        | 9        |
| <b>Total investment portfolio</b>                  | <b>3.7</b> | <b>49</b> | <b>20</b> | <b>18</b> | <b>13</b> | <b>27</b> | <b>55</b> | <b>16</b> | <b>2</b> |

Nationwide has £95 million of exposure to monoline insured transactions. Three holdings were impaired in 2010/11 (totalling £11 million) following coupon deferral (not covered by the terms of the insurance). We are reliant on the monoline insurance provider for one further holding (exposure £2 million) but in all other cases we anticipate full repayment without any assistance from the insurance provider. This is mainly as a result of the approach taken upon investment, where we placed no reliance on the monoline insurance, requiring the investment to stand up to credit analysis in its own right.

In assessing impairment, the Group evaluates among other factors, the normal volatility in valuation, evidence of deterioration in the financial health of the investee, industry and sector performance and operational and financing cash flows. An impairment loss of £66 million (2010: £29 million) has been recognised in the income statement in respect of the Treasury liquidity and investment portfolios. In addition, in 2010 impairments of £7 million were recognised on investments in equity shares (see note 19).

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## Credit risk – Treasury financial instruments (continued)

Collateral held as security for Treasury assets is determined by the nature of the instrument. Loans, debt securities, treasury and other eligible bills are generally unsecured with the exception of asset backed securities and similar instruments, which are secured by pools of financial assets. In addition, collateral is held under reverse sale and repurchase agreements as described in note 15.

**Derivative financial instruments**

The fair value of derivative assets at 4 April 2011 was £4.0 billion (2010: £4.9 billion). Additional information on these assets is set out in note 16. The International Swaps and Derivatives Association (ISDA) Master Agreement is Nationwide's preferred agreement for documenting derivative activity. It is common for a Credit Support Annex (CSA) to be executed in conjunction with the ISDA Master Agreement. Under a CSA, cash collateral is passed between parties

to mitigate the market contingent counterparty risk inherent in the outstanding positions. Where cash collateral is received, to mitigate the risk inherent in amounts due to us, it is included as a liability within deposits from banks. Where cash collateral is given to mitigate the risk inherent in amounts due from us, it is included as an asset in loans and advances to banks.

Netting arrangements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis. The Group's legal documentation for derivative transactions grants legal rights of set-off for those transactions. Accordingly, the credit risk associated with such contracts is reduced to the extent that negative mark to market values on derivatives will offset positive mark to market values on derivatives in the calculation of credit risk, subject to an absolute exposure of zero.

The following table shows the exposure to counterparty credit risk for derivative contracts after netting benefits and collateral:

|  | 2011  |       |       | 2010  |       |       |
|--|-------|-------|-------|-------|-------|-------|
|  | AA    | A     | Total | AA    | A     | Total |
|  | £bn   | £bn   | £bn   | £bn   | £bn   | £bn   |
| Gross positive fair value of contracts | 1.8   | 2.2   | 4.0   | 2.1   | 2.7   | 4.8   |
| Netting benefits                       | (0.8) | (0.5) | (1.3) | (0.9) | (0.8) | (1.7) |
| Net current credit exposure            | 1.0   | 1.7   | 2.7   | 1.2   | 1.9   | 3.1   |
| Collateral held                        | (0.1) | (0.9) | (1.0) | (0.1) | (1.0) | (1.1) |
| Net derivative credit exposure         | 0.9   | 0.8   | 1.7   | 1.1   | 0.9   | 2.0   |

Cash collateral on certain derivative assets with a fair value of £1.7 billion (2010: £2.0 billion) is only triggered when the counterparty rating falls to a specified rating level and the trigger event has not yet occurred. Our exposure to such counterparties is to AA or A rated banks.

As a consequence of the above no credit valuation adjustment is made on derivative assets nor has any debit valuation adjustment to reflect own credit risk been taken in our derivative liabilities.

The Group continues to use discount curves based on term Libor rates to fair value both collateralised and non-collateralised positions. There is an increasing trend in the market for collateral held to be based on Overnight Index Swap (OIS) rather than Libor and the Group is currently assessing the implications of this.

**Treasury portfolio credit mitigation**

The Group has no credit derivatives in place as at 4 April 2011 (2010: credit derivatives in place to cover credit risk of £88 million notional of assets).



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## Liquidity risk

For each material class of financial liability a maturity analysis is provided in notes 25 to 29.

The table below analyses the carrying value of financial assets and financial liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity

date. In practice, customer deposits will be repaid later than on the earliest date on which repayment can be required.

The carrying values of derivative financial instruments are included in the columns according to their contractual maturity.

| At 4 April 2011<br>Residual maturity                          | Repayable on<br>demand | Up to 3<br>months | 3 - 12<br>months | 1 - 5<br>years  | More than 5<br>years | Total          |
|---|------------------------|-------------------|------------------|-----------------|----------------------|----------------|
|   | £m                     | £m                | £m               | £m              | £m                   | £m             |
| <b>Assets</b>   |                        |                   |                  |                 |                      |                |
| Liquid assets   | 8,588                  | 2,015             | 1,808            | 8,217           | 11,223               | 31,851         |
| Loans and advances to customers                               | 695                    | 2,104             | 5,075            | 25,407          | 116,136              | 149,417        |
| Derivative financial instruments                              | -                      | 90                | 723              | 2,149           | 999                  | 3,961          |
| Other financial assets  | -                      | 25                | 131              | 1,035           | 475                  | 1,666          |
| <b>Total financial assets</b>                                 | <b>9,283</b>           | <b>4,234</b>      | <b>7,737</b>     | <b>36,808</b>   | <b>128,833</b>       | <b>186,895</b> |
| <b>Liabilities</b>  |                        |                   |                  |                 |                      |                |
| Shares  | 67,435                 | 7,284             | 20,091           | 27,361          | 381                  | 122,552        |
| Amounts owed to banks, customers and debt securities in issue | 6,093                  | 10,391            | 9,796            | 18,419          | 7,426                | 52,125         |
| Derivative financial instruments                              | -                      | 67                | 282              | 1,703           | 1,182                | 3,234          |
| Other financial liabilities                                   | -                      | (1)               | (4)              | (40)            | (23)                 | (68)           |
| Subordinated liabilities                                      | -                      | -                 | 381              | 763             | 829                  | 1,973          |
| Subscribed capital  | -                      | -                 | -                | 229             | 1,281                | 1,510          |
| <b>Total financial liabilities</b>                            | <b>73,528</b>          | <b>17,741</b>     | <b>30,546</b>    | <b>48,435</b>   | <b>11,076</b>        | <b>181,326</b> |
| <b>Net liquidity gap</b>                                      | <b>(64,245)</b>        | <b>(13,507)</b>   | <b>(22,809)</b>  | <b>(11,627)</b> | <b>117,757</b>       | <b>5,569</b>   |

## Liquidity risk (continued)

| At 4 April 2010<br>Residual maturity (Restated)                  | Repayable on<br>demand | Up to 3<br>months | 3 - 12<br>months | 1 - 5<br>years | More than 5<br>years | Total          |
|--|------------------------|-------------------|------------------|----------------|----------------------|----------------|
|  | £m                     | £m                | £m               | £m             | £m                   | £m             |
| <b>Assets</b>  |                        |                   |                  |                |                      |                |
| Liquid assets  | 5,773                  | 602               | 1,773            | 7,406          | 13,842               | 29,396         |
| Loans and advances to customers                                  | 547                    | 2,037             | 4,768            | 24,726         | 120,351              | 152,429        |
| Derivative financial instruments                                 | -                      | 214               | 337              | 2,867          | 1,434                | 4,852          |
| Other financial assets   | -                      | 18                | 220              | 2,165          | 481                  | 2,884          |
| <b>Total financial assets</b>                                    | <b>6,320</b>           | <b>2,871</b>      | <b>7,098</b>     | <b>37,164</b>  | <b>136,108</b>       | <b>189,561</b> |
| <b>Liabilities</b>   |                        |                   |                  |                |                      |                |
| Shares   | 66,862                 | 12,656            | 19,480           | 21,646         | 299                  | 120,943        |
| Amounts owed to banks, customers<br>and debt securities in issue | 5,295                  | 18,910            | 7,403            | 15,787         | 7,032                | 54,427         |
| Derivative financial instruments                                 | -                      | 68                | 463              | 2,901          | 1,510                | 4,942          |
| Other financial liabilities                                      | -                      | 10                | (14)             | 111            | (1)                  | 106            |
| Subordinated liabilities   | -                      | -                 | 800              | 773            | 593                  | 2,166          |
| Subscribed capital   | -                      | -                 | -                | 35             | 1,489                | 1,524          |
| <b>Total financial liabilities</b>                               | <b>72,157</b>          | <b>31,644</b>     | <b>28,132</b>    | <b>41,253</b>  | <b>10,922</b>        | <b>184,108</b> |
| <b>Net liquidity gap</b>   | <b>(65,837)</b>        | <b>(28,773)</b>   | <b>(21,034)</b>  | <b>(4,089)</b> | <b>125,186</b>       | <b>5,453</b>   |

Liquid assets include cash, loans and advances to banks and available for sale investment securities. Other financial assets and liabilities include the fair value adjustments for portfolio hedged risk and investments in equity shares.

Certain of the prior year comparatives have been amended to reflect changes to presentation for individual line items (see notes 17, 18 and 25).

The analysis above excludes other assets including property plant and equipment, intangible assets, investment property, other assets, deferred tax assets and accrued income and expenses prepaid, and other liabilities including provisions for liabilities and charges, accruals and deferred income, current tax liabilities, other liabilities and retirement benefit obligations.

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## Liquidity risk (continued)

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

| Gross contractual cash flows<br>2011                             | Repayable on<br>demand | Up to 3<br>months | 3 - 12<br>months | 1 - 5<br>years | More than 5<br>years | Total          |
|--|------------------------|-------------------|------------------|----------------|----------------------|----------------|
|  | £m                     | £m                | £m               | £m             | £m                   | £m             |
| Shares   | 67,435                 | 7,552             | 20,680           | 28,510         | 397                  | 124,574        |
| Amounts owed to banks, customers<br>and debt securities in issue | 6,093                  | 10,671            | 10,430           | 20,249         | 7,937                | 55,380         |
| Derivative financial instruments                                 | -                      | 536               | 1,048            | 1,766          | 334                  | 3,684          |
| Other financial liabilities                                      | -                      | (1)               | (5)              | (45)           | (25)                 | (76)           |
| Subordinated liabilities   | -                      | 6                 | 475              | 1,084          | 1,064                | 2,629          |
| Subscribed capital   | -                      | 6                 | 81               | 835            | 1,339                | 2,261          |
| <b>Total financial liabilities</b>                               | <b>73,528</b>          | <b>18,770</b>     | <b>32,709</b>    | <b>52,399</b>  | <b>11,046</b>        | <b>188,452</b> |
| <b>Off balance sheet commitments</b>                             | <b>3,476</b>           | <b>87</b>         | <b>341</b>       | <b>1,140</b>   | <b>792</b>           | <b>5,836</b>   |

| Gross contractual cash flows<br>2010 (Restated)                  | Repayable on<br>demand | Up to 3<br>months | 3 - 12<br>months | 1 - 5<br>years | More than 5<br>years | Total          |
|--|------------------------|-------------------|------------------|----------------|----------------------|----------------|
|  | £m                     | £m                | £m               | £m             | £m                   | £m             |
| Shares   | 66,862                 | 12,886            | 19,937           | 22,486         | 311                  | 122,482        |
| Amounts owed to banks, customers<br>and debt securities in issue | 5,295                  | 18,964            | 7,512            | 16,114         | 7,128                | 55,013         |
| Derivative financial instruments                                 | -                      | 702               | 1,907            | 2,463          | 56                   | 5,128          |
| Other financial liabilities                                      | -                      | 10                | (13)             | 112            | (1)                  | 108            |
| Subordinated liabilities   | -                      | 6                 | 851              | 933            | 619                  | 2,409          |
| Subscribed capital   | -                      | 10                | 81               | 872            | 1,393                | 2,356          |
| <b>Total financial liabilities</b>                               | <b>72,157</b>          | <b>32,578</b>     | <b>30,275</b>    | <b>42,980</b>  | <b>9,506</b>         | <b>187,496</b> |
| <b>Off balance sheet commitments</b>                             | <b>2,433</b>           | <b>61</b>         | <b>224</b>       | <b>1,499</b>   | <b>885</b>           | <b>5,102</b>   |

The analysis of gross contractual cash flows above 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 balance sheet date. The 2010 residual maturity and gross contractual cash flows have been restated; see notes 18 and 25 for further details.

## Classification and measurement

The following tables summarise the classification of carrying amounts of the Group's primary financial assets and liabilities.

| 2011 Group                                      | Available<br>for sale | Loans and<br>receivables | Fair value<br>through<br>income<br>statement | Liabilities at<br>amortised cost | Total          |
|---|-----------------------|--------------------------|--|----------------------------------|----------------|
|   | £m                    | £m                       | £m   | £m                               | £m             |
| <b>Financial assets</b>                         |                       |                          |  |                                  |                |
| Cash  | -                     | 6,130                    | -  | -                                | 6,130          |
| Loans and advances to banks                     | -                     | 4,181                    | -  | -                                | 4,181          |
| Investment securities                           | 21,540                | -                        | -  | -                                | 21,540         |
| Derivative financial instruments                | -                     | -                        | 3,961  | -                                | 3,961          |
| Loans and advances to customers                 | -                     | 149,417                  | -  | -                                | 149,417        |
| Fair value adjustment for portfolio hedged risk | -                     | 1,563                    | -  | -                                | 1,563          |
| Investments in equity shares                    | 103                   | -                        | -  | -                                | 103            |
| <b>Total financial assets</b>                   | <b>21,643</b>         | <b>161,291</b>           | <b>3,961</b>                                 | <b>-</b>                         | <b>186,895</b> |
| Other non financial assets                      |                       |                          |  |                                  | 1,983          |
| <b>Total assets</b>                             |                       |                          |  |                                  | <b>188,878</b> |
| <b>Financial liabilities</b>                    |                       |                          |  |                                  |                |
| Shares  | -                     | -                        | -  | 122,552                          | 122,552        |
| Deposits from banks                             | -                     | -                        | -  | 2,746                            | 2,746          |
| Other deposits                                  | -                     | -                        | 2,125  | 3,386                            | 5,511          |
| Due to customers                                | -                     | -                        | -  | 6,060                            | 6,060          |
| Debt securities in issue                        | -                     | -                        | -  | 37,808                           | 37,808         |
| Fair value adjustment for portfolio hedged risk | -                     | -                        | -  | (68)                             | (68)           |
| Derivative financial instruments                | -                     | -                        | 3,234  | -                                | 3,234          |
| Subordinated liabilities                        | -                     | -                        | -  | 1,973                            | 1,973          |
| Subscribed capital                              | -                     | -                        | -  | 1,510                            | 1,510          |
| <b>Total financial liabilities</b>              | <b>-</b>              | <b>-</b>                 | <b>5,359</b>                                 | <b>175,967</b>                   | <b>181,326</b> |
| Corporation tax                                 |                       |                          |  |                                  | 81             |
| Other non financial liabilities                 |                       |                          |  |                                  | 1,217          |
| <b>Total liabilities</b>                        |                       |                          |  |                                  | <b>182,624</b> |

During the year the Group ceased to elect to fair value mortgage commitments as doing so would have created an accounting mismatch. As a result at 4 April 2011 there are no items relating to mortgage commitments carried on the balance sheet as other

financial assets. Up to the time that the Group ceased to elect to fair value its mortgage commitments, an accounting mismatch did occur and this contributed to the gains from derivatives and hedge accounting shown on the face of the income statement.

# Notes to the Accounts

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## Classification and measurement (continued)

| 2010 Group                                      | Available<br>for sale | Loans and<br>receivables | Fair value<br>through<br>income<br>statement | Liabilities at<br>amortised cost | Total          |
|---|-----------------------|--------------------------|--|----------------------------------|----------------|
|   | £m                    | £m                       | £m   | £m                               | £m             |
| <b>Financial assets</b>                         |                       |                          |  |                                  |                |
| Cash  | -                     | 3,994                    | -  | -                                | 3,994          |
| Loans and advances to banks                     | -                     | 2,017                    | -  | -                                | 2,017          |
| Investment securities                           | 23,385                | -                        | -  | -                                | 23,385         |
| Derivative financial instruments                | -                     | -                        | 4,852  | -                                | 4,852          |
| Loans and advances to customers                 | -                     | 152,429                  | -  | -                                | 152,429        |
| Fair value adjustment for portfolio hedged risk | -                     | 2,798                    | -  | -                                | 2,798          |
| Investments in equity shares                    | 86                    | -                        | -  | -                                | 86             |
| Other financial assets*                         | -                     | -                        | 7  | -                                | 7              |
| <b>Total financial assets</b>                   | <b>23,471</b>         | <b>161,238</b>           | <b>4,859</b>                                 | <b>-</b>                         | <b>189,568</b> |
| Other non financial assets                      |                       |                          |  |                                  | 1,829          |
| <b>Total assets</b>                             |                       |                          |  |                                  | <b>191,397</b> |
| <b>Financial liabilities</b>                    |                       |                          |  |                                  |                |
| Shares  | -                     | -                        | -  | 120,943                          | 120,943        |
| Deposits from banks                             | -                     | -                        | -  | 8,031                            | 8,031          |
| Other deposits                                  | -                     | -                        | 1,128  | 3,381                            | 4,509          |
| Due to customers                                | -                     | -                        | -  | 5,085                            | 5,085          |
| Debt securities in issue                        | -                     | -                        | -  | 36,802                           | 36,802         |
| Fair value adjustment for portfolio hedged risk | -                     | -                        | -  | 106                              | 106            |
| Derivative financial instruments                | -                     | -                        | 4,942  | -                                | 4,942          |
| Subordinated liabilities                        | -                     | -                        | -  | 2,166                            | 2,166          |
| Subscribed capital                              | -                     | -                        | -  | 1,524                            | 1,524          |
| <b>Total financial liabilities</b>              | <b>-</b>              | <b>-</b>                 | <b>6,070</b>                                 | <b>178,038</b>                   | <b>184,108</b> |
| Corporation tax                                 |                       |                          |  |                                  | 42             |
| Other non financial liabilities                 |                       |                          |  |                                  | 1,531          |
| <b>Total liabilities</b>                        |                       |                          |  |                                  | <b>185,681</b> |

\* Other financial assets represents fair value movement in mortgage commitments entered into where a loan has not yet been made.

Certain of the prior year balance sheet comparatives have been reclassified to conform to the current year's presentation. This adjustment does not affect total assets.

## Classification and measurement (continued)

## Fair values of financial assets and liabilities

The following table summarises the carrying amounts and fair values of those financial assets and liabilities not presented on the Group balance sheets at fair value:

| 2011                             | Group          |            | Society        |            |
|----------------------------------|----------------|------------|----------------|------------|
|                                  | Carrying value | Fair value | Carrying value | Fair value |
|                                  | £m             | £m         | £m             | £m         |
| <b>Financial assets</b>          |                |            |                |            |
| Loans and advances to banks      | 4,181          | 4,181      | 4,104          | 4,104      |
| Loans and advances to customers: |                |            |                |            |
| Residential mortgages            | 124,453        | 119,472    | 104,960        | 99,971     |
| Consumer banking                 | 2,376          | 2,381      | 2,376          | 2,381      |
| Commercial lending               | 22,107         | 22,357     | 21,014         | 21,214     |
| Other lending                    | 481            | 481        | -              | -          |
| <b>Financial liabilities</b>     |                |            |                |            |
| Shares                           | 122,552        | 122,767    | 122,552        | 122,767    |
| Deposits from banks              | 2,746          | 2,766      | 1,842          | 1,862      |
| Other deposits                   | 5,511          | 5,513      | 13,113         | 13,115     |
| Due to customers                 | 6,060          | 6,060      | 1,315          | 1,315      |
| Debt securities in issue         | 37,808         | 37,661     | 32,080         | 32,165     |
| Subordinated liabilities         | 1,973          | 1,973      | 1,973          | 1,973      |
| Subscribed capital               | 1,510          | 1,219      | 1,510          | 1,219      |

| 2010                             | Group          |            | Society        |            |
|----------------------------------|----------------|------------|----------------|------------|
|                                  | Carrying value | Fair value | Carrying value | Fair value |
|                                  | £m             | £m         | £m             | £m         |
| <b>Financial assets</b>          |                |            |                |            |
| Loans and advances to banks      | 2,017          | 2,017      | 1,960          | 1,960      |
| Loans and advances to customers: |                |            |                |            |
| Residential mortgages            | 127,313        | 124,746    | 109,721        | 107,077    |
| Consumer banking                 | 2,143          | 2,164      | 2,143          | 2,164      |
| Commercial lending               | 22,417         | 22,724     | 21,269         | 21,522     |
| Other lending                    | 556            | 556        | -              | -          |
| <b>Financial liabilities</b>     |                |            |                |            |
| Shares                           | 120,943        | 121,423    | 120,943        | 121,423    |
| Deposits from banks              | 8,031          | 8,035      | 7,009          | 7,013      |
| Other deposits                   | 4,509          | 4,514      | 11,359         | 11,364     |
| Due to customers                 | 5,085          | 5,085      | 973            | 973        |
| Debt securities in issue         | 36,802         | 36,793     | 32,184         | 32,848     |
| Subordinated liabilities         | 2,166          | 2,025      | 2,166          | 2,025      |
| Subscribed capital               | 1,524          | 1,152      | 1,524          | 1,152      |

# Notes to the Accounts

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## Classification and measurement (continued)

### Loans and advances to customers

Loans and advances are net of provisions for impairment. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates to determine fair value.

### Deposits and borrowings

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits and other borrowings without quoted market price is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

### Debt securities in issue

The aggregate fair values are calculated based on quoted market prices. For those notes where quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity.

### Fair value measurement

The following table provides an analysis of financial assets and liabilities held on the Group balance sheet at fair value, grouped into levels 1 to 3 based on the degree to which the fair value is observable:

| 2011 Group                       | Level 1 | Level 2 | Level 3 | Total   |
|----------------------------------|---------|---------|---------|---------|
|                                  | £m      | £m      | £m      | £m      |
| <b>Financial assets</b>          |         |         |         |         |
| Investment securities – AFS      | 12,319  | 9,126   | 95      | 21,540  |
| Investments in equity shares     | 5       | -       | 98      | 103     |
| Derivative financial instruments | -       | 3,873   | 88      | 3,961   |
|                                  | 12,324  | 12,999  | 281     | 25,604  |
| <b>Financial liabilities</b>     |         |         |         |         |
| Derivative financial instruments | -       | (3,158) | (76)    | (3,234) |
| Other deposits – PEBs            | -       | -       | (2,125) | (2,125) |
|                                  | -       | (3,158) | (2,201) | (5,359) |

| 2010 Group                       | Level 1 | Level 2 | Level 3 | Total   |
|----------------------------------|---------|---------|---------|---------|
|                                  | £m      | £m      | £m      | £m      |
| <b>Financial assets</b>          |         |         |         |         |
| Investment securities – AFS      | 12,130  | 11,149  | 106     | 23,385  |
| Investments in equity shares     | -       | 7       | 79      | 86      |
| Derivative financial instruments | -       | 4,814   | 38      | 4,852   |
|                                  | 12,130  | 15,970  | 223     | 28,323  |
| <b>Financial liabilities</b>     |         |         |         |         |
| Derivative financial instruments | -       | (4,860) | (82)    | (4,942) |
| Other deposits – PEBs            | -       | -       | (1,128) | (1,128) |
|                                  | -       | (4,860) | (1,210) | (6,070) |

Level 1: Fair value derived from unadjusted quoted prices in active markets for identical assets or liabilities, e.g. G10 government securities.

Level 2: Fair value derived from inputs other than quoted prices that are observable for the asset or liability, either directly (i.e. a price) or indirectly (i.e. derived from prices), e.g. most investment grade and liquid bonds, asset backed securities, certain collateralised debt obligations (CDOs), collateralised loan obligations (CLOs) and OTC derivatives.

Level 3: Inputs for the asset or liability are not based on observable market data (unobservable inputs), e.g. private equity investments, derivatives including an equity element, deposits including an equity element, some CDOs and certain asset backed securities and bonds.



## Classification and measurement (continued)

Level 2 investment securities – AFS assets are sourced from consensus pricing or other observable market prices. None of these Level 2 assets are priced off models. Level 2 derivative assets and liabilities are priced from discounted cash flow models using yield curves based on observable market data.

There were no significant transfers between the Level 1 and 2 portfolios during the year. Composition of and movements in the Level 3 portfolio are described below.

The main constituents of the Level 3 portfolio are as follows:

### *Investment securities – AFS*

Of the £95 million Level 3 investment securities – AFS at this year end around £60 million are CDOs and £32 million are impaired UK CMBS assets, which are materially all priced from internal models based on observable and unobservable performance assumptions. The remaining £3 million is an illiquid security for which a single price was available.

Around half of the comparative Level 3 £106 million were CDOs with the balance made up of investments in impaired Icelandic financial institutions and some other bonds and asset backed securities.

### *Investments in equity shares*

Investments in unquoted equity instruments. Valuations are subjective in nature but have been consistently applied over time. Full valuations are performed bi-annually using details of the underlying funds combined with earnings estimates and applicable discount rates at the reporting date.

### *Derivative financial instruments*

Equity linked derivatives with external counterparties which economically match the investment return payable by the Group to customers invested in the PEB product. The derivatives are linked to the performance of specified stock market indices and have been valued by an independent third party.

### *Other deposits – PEBs*

Deposit accounts with the potential for stock market correlated growth linked to the performance of specified stock market indices. The PEBs liability is valued at a discount to reflect the time value of money, overlaid by a fair value adjustment representing the expected return payable to the customer. The fair value adjustment has been constructed from the valuation of the associated derivative as valued by an independent third party.

### Level 3 portfolio – movements analysis

The table below analyses movements in the Level 3 portfolio:

| 2011 Group                   | Investment securities – AFS | Investments in equity shares | Net derivative financial instruments | Other deposits – PEBs |
|------------------------------|-----------------------------|------------------------------|--------------------------------------|-----------------------|
|                              | £m                          | £m                           | £m                                   | £m                    |
| At 5 April 2010              | 106                         | 79                           | (44)                                 | (1,128)               |
| Total (loss)/gain:           |                             |                              |                                      |                       |
| • Income statement           | (18)                        | -                            | 56                                   | (56)                  |
| • Other comprehensive income | (5)                         | 5                            | -                                    | -                     |
| Issues                       | -                           | -                            | -                                    | (966)                 |
| Additions                    | -                           | 25                           | -                                    | -                     |
| Settlements                  | (11)                        | (11)                         | -                                    | 25                    |
| Transfers in to Level 3      | 46                          | -                            | -                                    | -                     |
| Transfers out of Level 3     | (23)                        | -                            | -                                    | -                     |
| At 4 April 2011              | 95                          | 98                           | 12                                   | (2,125)               |

# Notes to the Accounts

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## Classification and measurement (continued)

| 2010 Group                   | Investment securities – AFS | Investments in equity shares | Net derivative financial instruments | Other deposits – PEBs |
|------------------------------|-----------------------------|------------------------------|--------------------------------------|-----------------------|
|                              | £m                          | £m                           | £m                                   | £m                    |
| At 5 April 2009              | 182                         | 76                           | (38)                                 | (75)                  |
| Total (loss)/gain:           |                             |                              |                                      |                       |
| • Income statement           | (6)                         | (8)                          | (6)                                  | 14                    |
| • Other comprehensive income | 31                          | 4                            | -                                    | -                     |
| Purchases                    | -                           | 8                            | -                                    | -                     |
| Issues                       | -                           | -                            | -                                    | (1,068)               |
| Settlements                  | (83)                        | (1)                          | -                                    | 1                     |
| Transfers out of Level 3     | (18)                        | -                            | -                                    | -                     |
| At 4 April 2010              | 106                         | 79                           | (44)                                 | (1,128)               |

The significant movements in Level 3 positions during the year are explained below:

- An increase in other deposits – PEBs reflecting strong stock market growth in the year (with a corresponding movement in equity linked derivatives) and further investment into the product;
- A decrease in investment securities – AFS reflecting a small number of disposals and transfers out of Level 3 in respect of Icelandic financial institutions and other assets as improving market sentiment resulted in the availability of more observable prices, net of a transfer

in relating to an impaired UK CMBS asset now subject to model valuation using some unobservable inputs;

- An increase in investments in equity shares, reflecting improving market conditions and additional drawdowns of an existing investment portfolio.

Gains/losses recognised during the year on the Level 3 portfolio held at the year end (excluding settlements and transfers) have been recognised in the income statement or statement of comprehensive income as follows:

| 2011 Group                               | Investment securities – AFS | Investments in equity shares | Net derivative financial instruments | Other deposits – PEBs |
|--|-----------------------------|------------------------------|--------------------------------------|-----------------------|
|  | £m                          | £m                           | £m                                   | £m                    |
| Recognised in the income statement       |                             |                              |                                      |                       |
| • Net interest (expense)                 | (3)                         | -                            | (31)                                 | -                     |
| • Other income/(expense)                 | (15)                        | -                            | 87                                   | (56)                  |
| Recognised in other comprehensive income |                             |                              |                                      |                       |
| • Fair value movement taken to equity    | (5)                         | 5                            | -                                    | -                     |

| 2010 Group                               | Investment securities – AFS | Investments in equity shares | Net derivative financial instruments | Other deposits – PEBs |
|--|-----------------------------|------------------------------|--------------------------------------|-----------------------|
|  | £m                          | £m                           | £m                                   | £m                    |
| Recognised in the income statement       |                             |                              |                                      |                       |
| • Net interest (expense)/income          | (4)                         | (1)                          | 1                                    | -                     |
| • Other income/(expense)                 | 1                           | (7)                          | (7)                                  | 14                    |
| Recognised in other comprehensive income |                             |                              |                                      |                       |
| • Fair value movement taken to equity    | 24                          | 4                            | -                                    | -                     |

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## Classification and measurement (continued)

## Level 3 portfolio – sensitivity analysis

The table below provides sensitivity analysis of reasonably possible alternative valuation assumptions for the assets in the Level 3 portfolio.

| 2011 Group   | Carrying value | Increase in fair value | Decrease in fair value |
|--|----------------|------------------------|------------------------|
|  | £m             | £m                     | £m                     |
| <b>Investment securities – AFS:</b>  |                |                        |                        |
| • Collateralised debt obligations  | 60             | 25                     | (36)                   |
| • Commercial mortgage backed securities (CMBS)                             | 32             | 11                     | (21)                   |
| • Other investments  | 3              | -                      | -                      |
| <b>Investments in equity shares</b>  | <b>98</b>      | <b>2</b>               | <b>(9)</b>             |
|  | <b>193</b>     | <b>38</b>              | <b>(66)</b>            |
| Increases/(decreases) in fair value would be recognised in:                |                |                        |                        |
| • Income statement   |                | 11                     | (21)                   |
| • Statement of other comprehensive income (accumulated in the AFS reserve) |                | 27                     | (45)                   |
|  |                | <b>38</b>              | <b>(66)</b>            |

| 2010 Group   | Carrying value | Increase in fair value | Decrease in fair value |
|--|----------------|------------------------|------------------------|
|  | £m             | £m                     | £m                     |
| <b>Investment securities – AFS:</b>  |                |                        |                        |
| • Collateralised debt obligations  | 69             | 33                     | (67)                   |
| • Financial institutions   | 13             | 8                      | (4)                    |
| • Other investments  | 24             | 7                      | (3)                    |
| <b>Investments in equity shares</b>  | <b>79</b>      | <b>2</b>               | <b>(15)</b>            |
|  | <b>185</b>     | <b>50</b>              | <b>(89)</b>            |
| Increases/(decreases) in fair value would be recognised in:                |                |                        |                        |
| • Income statement   |                | 15                     | (6)                    |
| • Statement of other comprehensive income (accumulated in the AFS reserve) |                | 35                     | (83)                   |
|  |                | <b>50</b>              | <b>(89)</b>            |

The stresses take account of the nature of valuation techniques used, as well as the availability and reliability of observable proxy and historic data. The sensitivity methodologies are based on a reliable reference source or scenario based on alternative market views. The level of shift of scenarios applied is considered for each product and varied according to the quality of the data and variability of the underlying market.

The sensitivities used to derive the results in the above table have not been offset by the impact of hedge accounting. Increases in fair values of the PEB derivative financial instruments would be offset by decreases in the fair values of the associated PEB deposit and vice versa. These items have therefore been excluded from the table above.

**Investment securities – AFS***Collateralised debt obligations*

Sensitivities on these assets, which are not subject to impairment, have

been calculated by assessing movements in the preceding 12 months on an applicable market index.

*Commercial mortgage backed securities*

Sensitivities on this asset, which is subject to impairment, have been derived from a modelled approach using estimated expected losses at legal maturity and risk adjusted discount rates.

*Other investments*

This relates to a government guaranteed security where the preceding 12 months on an applicable market index, were used to calculate the sensitivities.

*Investments in equity shares*

Sensitivities in these holdings have been based on the variance in underlying valuation seen in these holdings over the past 12 months.

# Notes to the Accounts

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## Related party transactions

### Subsidiary, parent and ultimate controlling party

The Group is controlled by the Nationwide Building Society registered in England and Wales which is also considered to be the ultimate parent. Details of principal subsidiary undertakings can be found in note 20 to these accounts.

### Key management compensation

The directors of the Society are considered to be the key management personnel as defined by IAS 24 ('Related Party Disclosures').

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

|  | 2011  | 2010  |
|--|-------|-------|
|  | £'000 | £'000 |
| Short term employee benefits                             | 4,961 | 5,558 |
| Post employment benefits                                 | 30    | 35    |
| Other long term benefits                                 | 1,782 | 1,591 |
| Contractual / other settlements                          | 700   | 1,772 |
| Total key management personnel compensation for the year | 7,473 | 8,956 |

## Related party transactions (continued)

### Transactions with related parties

A number of transactions are entered into with related parties in the normal course of business. These include loans, deposits and the

payment and recharge of administrative expenses. The volumes of related party transactions, outstanding balances at the year end, and the related income and expenses for the year are as follows:

|  | Society<br>Subsidiaries |            | Group and Society<br>Key management personnel |            |
|--|-------------------------|------------|---|------------|
|  | 2011<br>£m              | 2010<br>£m | 2011<br>£m                                    | 2010<br>£m |
| <b>Loans payable to the Society</b>      |                         |            |   |            |
| Loans outstanding at 5 April             | 18,460                  | 20,340     | 0.9   | 0.4        |
| Loans issued during the year             | 8,979                   | 1,341      | 0.9   | 0.6        |
| Loans impaired                           | (1)                     | (61)       | -   | -          |
| Loan repayments during the year          | (7,428)                 | (3,160)    | (1.2)   | (0.1)      |
| Loans outstanding at 4 April             | 20,010                  | 18,460     | 0.6   | 0.9        |
| <b>Deposits payable by the Society</b>   |                         |            |   |            |
| Deposits outstanding at 5 April          | 6,850                   | 5,216      | 5.0   | 4.9        |
| Deposits issued during the year          | 1,928                   | 2,833      | 10.6  | 27.4       |
| Deposit repayments during the year       | (1,176)                 | (1,199)    | (13.5)  | (27.3)     |
| Deposits outstanding at 4 April          | 7,602                   | 6,850      | 2.1   | 5.0        |
| <b>Net interest income</b>               |                         |            |   |            |
| Interest receivable                      | 965                     | 960        | -   | -          |
| Interest expense                         | 250                     | 167        | 0.1   | 0.1        |
| <b>Other income and expenses</b>         |                         |            |   |            |
| Dividends payable to the Society         | 61                      | 352        | -   | -          |
| Fees and expenses paid to the Society    | -                       | 1          | -   | -          |
| <b>Other balance sheet items</b>         |                         |            |   |            |
| Amounts owed to the Society              | 2,227                   | 2,728      | -   | -          |
| Other liabilities payable by the Society | 3,476                   | 2,232      | -   | -          |

### Transactions with key management personnel

Transactions with key management personnel are on the same terms and conditions applicable to other employees within the Group.

A register is maintained by the Society containing details of loans, transactions and arrangements made between the Society or its subsidiary undertakings and directors of the Society or persons connected with directors of the Society.

The register will be available for inspection by members at the Annual General Meeting on 21 July 2011 and during normal office hours at the Society's principal office (Nationwide House, Pipers Way, Swindon) during the period of 15 days prior to the meeting.

### Transactions with Group companies

Transactions with Group companies arise in the normal course of business. Interest on outstanding loans and deposits accrues at a transfer price rate agreed between the Society and its subsidiaries.

# Notes to the Accounts

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## Notes to the cash flow statements

|   | Group |      | Society |      |
|---|-------|------|---------|------|
|   | 2011  | 2010 | 2011    | 2010 |
|   | £m    | £m   | £m      | £m   |
| <b>Non-cash items included in profit before tax</b> |       |      |         |      |
| Net increase in impairment provisions               | 15    | 280  | 6       | 282  |
| Impairment losses on investment securities          | 66    | 36   | 66      | 36   |
| Depreciation and amortisation                       | 150   | 151  | 149     | 150  |
| Profit on sale of fixed assets                      | -     | (1)  | -       | (1)  |
| Interest on subordinated liabilities                | 110   | 92   | 110     | 92   |
| Interest on subscribed capital                      | 96    | 91   | 96      | 91   |
| Loss on the revaluation of land and buildings       | 1     | 5    | -       | 3    |
| Gain on the revaluation of investment properties    | (1)   | -    | (1)     | -    |
| Gains from derivatives and hedge accounting         | (120) | (34) | (117)   | (31) |
| Gain on portfolio acquisition                       | -     | (40) | -       | (40) |
|   | 317   | 580  | 309     | 582  |

### Changes in operating assets

|  |       |         |         |         |
|--|-------|---------|---------|---------|
| Loans and advances to banks  | 13    | 578     | 13      | 573     |
| Investment securities  | 472   | (1,434) | 486     | (1,394) |
| Derivative financial instruments and fair value adjustment for portfolio hedged risk | 2,246 | 1,863   | 1,743   | 1,741   |
| Deferred tax assets  | 143   | 509     | 140     | 471     |
| Loans and advances to customers  | 2,997 | 3,177   | 4,777   | 2,434   |
| Other operating assets   | (101) | 684     | (1,107) | 1,141   |
|  | 5,770 | 5,377   | 6,052   | 4,966   |

### Changes in operating liabilities

|  |         |          |         |          |
|--|---------|----------|---------|----------|
| Shares   | 1,609   | (7,349)  | 1,609   | (7,349)  |
| Deposits from banks, customers and others  | (3,308) | (5,702)  | (3,071) | (4,807)  |
| Derivative financial instruments and fair value adjustment for portfolio hedged risk | (1,882) | (1,177)  | (2,355) | (1,659)  |
| Debt securities in issue   | 1,006   | 2,008    | (104)   | (268)    |
| Retirement benefit obligations   | (208)   | 177      | (208)   | 176      |
| Other operating liabilities  | (37)    | 738      | 1,227   | 2,808    |
|  | (2,820) | (11,305) | (2,902) | (11,099) |

### Cash and cash equivalents

|   |        |       |        |       |
|---|--------|-------|--------|-------|
| Cash  | 6,130  | 3,994 | 6,130  | 3,994 |
| Loans and advances to other banks repayable in 3 months or less | 3,994  | 1,817 | 3,917  | 1,760 |
|   | 10,124 | 5,811 | 10,047 | 5,754 |

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## Notes to the cash flow statements (continued)

Changes in operating liabilities include movements in the Group's wholesale funding balances of deposits from banks, other deposits and debt securities in issue. These are considered operating activities as they relate to the Group's lending activity and liquidity management and so form part of the normal course of business. Movements in subordinated liabilities and subscribed capital are considered financing activities because these form part of our capital management for solvency purposes.

The Group is required to maintain balances with the Bank of England which, at 4 April 2011, amounted to for the Group and Society £187 million (2010: £200 million). These balances are included within loans and advances to banks on the balance sheet and are not included in the cash and cash equivalents in the cash flow statement as they are not liquid in nature.

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Notes to the Accounts

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## Capital management

The Group is subject to the capital requirements imposed by its regulator the Financial Services Authority (FSA). Regulatory capital comprises the Group's general reserve, revaluation reserve, permanent interest bearing shares (PIBS) and subordinated debt, subject to various adjustments required by the capital rules.

During the year the Group complied with the capital requirements set by the FSA. Further unaudited details about the Group's capital position can be found in the Business Review.

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## Registered office

Nationwide is a building society, incorporated and domiciled in the United Kingdom. The address of its registered office is:

Nationwide Building Society  
Nationwide House  
Pipers Way, Swindon  
SN38 1NW



# Annual Business Statement

## Statutory Percentages

For the year ended 4 April 2011

|               | 2011 | Statutory limit |
|---------------|------|-----------------|
|               | %    | %               |
| Lending limit | 14.4 | 25.0            |
| Funding limit | 25.9 | 50.0            |

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986 as amended by the Building Societies Act 1997.

The lending limit measures the proportion of business assets not in the form of loans fully secured on residential property and is calculated as  $(X-Y)/X$  where:

X = business assets, being the total assets of the Group plus impairment provisions on loans and advances to customers less liquid assets, property, plant and equipment, intangible fixed assets and investment properties as shown in the Group balance sheet.

Y = the principal of, and interest accrued on, loans owed to the Group which are fully secured on residential property.

The funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals and is calculated as  $(X-Y)/X$  where:

X = shares and borrowings, being the aggregate of:

- i) the principal value of, and interest accrued on, shares in the Society;
- ii) the principal of, and interest accrued on, sums deposited with the Society or any subsidiary undertaking of the Society excluding offshore deposits; and
- iii) the principal value of, and interest accrued under, bills of exchange, instruments or agreements creating or acknowledging indebtedness and accepted, made, issued or entered into by the Society or any such undertaking, less any amounts qualifying as own funds.

Y = the principal value of, and interest accrued on, shares in the Society held by individuals otherwise than as bare trustees (or, in Scotland, simple trustees) for bodies corporate or for persons who include bodies corporate.

The statutory limits are as laid down under the Building Societies Act 1986 as amended by the Building Societies Act 1997 and ensure that the principal purpose of a building society is that of making loans which are secured on residential property and are funded substantially by its members.

## Other Percentages

For the year ended 4 April 2011

|  | 2011 | 2010 |
|--|------|------|
|  | %    | %    |
| As a percentage of shares and borrowings:                          |      |      |
| • Gross capital  | 5.6  | 5.4  |
| • Free capital   | 4.9  | 4.8  |
| • Liquid assets  | 18.2 | 16.8 |
| Profit for the financial year as a percentage of mean total assets | 0.13 | 0.13 |
| Management expenses as a percentage of mean total assets           | 0.69 | 0.68 |

The above percentages have been prepared from the Society's consolidated accounts and in particular:

- 'Shares and borrowings' represent the total of shares, deposits from banks, other deposits, amounts due to customers and debt securities in issue.
- 'Gross capital' represents the aggregate of general reserve, revaluation reserve, available for sale reserve, subscribed capital and subordinated liabilities.
- 'Free capital' represents the aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment and intangible fixed assets.
- 'Liquid assets' represent the total of cash, loans and advances to banks and investment securities.
- 'Mean total assets' represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
- 'Management expenses' represent the aggregate of administrative expenses, depreciation and amortisation.

# Annual Business Statement

continued

Information relating to directors and other officers (unaudited)

At 4 April 2011

## Directors

| Name and date of birth  | Occupation                            | Date of appointment | Other directorships   |
|---|---------------------------------------|---------------------|---|
| G M T Howe<br>MA (Cantab)<br>Chairman<br>3 September 1949                   | Company Director                      | 1 January 2005      | Gateway Electronics Components Limited<br>Jardine Lloyd Thompson Group plc, Chairman<br>Close Brothers Group plc<br>The Cavendish School Charitable Trust Limited   |
| G J Beale<br>BSc, ACA<br>19 October 1958                                    | Chief Executive Officer               | 5 April 2003        |   |
| R P Walther<br>MA, FIA<br>Joint Deputy Chairman<br>31 July 1943             | Company Director                      | 1 July 2002         |   |
| W Tudor John<br>MA (Cantab), D.L.<br>Joint Deputy Chairman<br>26 April 1944 | Company Director                      | 28 August 2007      | NFTS Foundation<br>Wales in London Limited  |
| T P Prestedge<br>12 February 1970   | Group Development<br>Director         | 28 August 2007      | Nationwide Anglia Property Services Limited   |
| M M Rennison<br>BA, FCA<br>9 August 1960                                    | Group Finance Director                | 1 February 2007     | Confederation Mortgage Services Limited<br>Exeter Trust Limited<br>First Nationwide<br>LBS Mortgages Limited<br>Nationwide Anglia Property Services Limited<br>Nationwide Housing Trust Limited<br>Nationwide Investments (No.1) Limited<br>Nationwide Lease Finance Limited<br>Nationwide Mortgage Corporation Limited<br>Nationwide Syndications Limited<br>NBS Fleet Services Limited<br>Staffordshire Financial Services Limited<br>Staffordshire Leasing Limited |
| C S Rhodes<br>ACA<br>17 March 1963  | Group Product &<br>Marketing Director | 20 April 2009       | The Nationwide Foundation<br>at.home nationwide Limited<br>Derbyshire Home Loans Limited<br>E-Mex Home Funding Limited<br>Jubilee Mortgages Limited<br>The Mortgage Works (UK) plc<br>UCB Home Loans Corporation Limited  |
| M P V Wyles<br>ACII<br>25 August 1958                                       | Group Distribution<br>Director        | 28 August 2007      | Confederation Mortgage Services Limited<br>Exeter Trust Limited<br>Jubilee Mortgages Limited<br>LBS Mortgages Limited<br>Staffordshire Financial Services Limited<br>The Mortgage Works (UK) plc<br>UCB Home Loans Corporation Limited  |

## Information relating to directors and other officers (unaudited) (continued)

### At 4 April 2011

#### Directors

| Name and date of birth  | Occupation            | Date of appointment | Other directorships   |
|---|-----------------------|---------------------|---|
| A P Dickinson<br>MBA, BSc (Hons), FSS,<br>FCIB, FCIBS<br>12 June 1950 | Company Director      | 15 June 2010        | Kennington Oval Limited<br>Frogmore Property Company Limited<br>Motability (Governor)<br>Carpetright plc  |
| M K Jary<br>MA (Oxon), MBA<br>15 June 1963                            | Management Consultant | 1 January 2009      | Duchy Originals Limited<br>Duchy Originals Foods Limited<br>OC&C Peleus Advisors LLP<br>OC&C Strategy Consultants Limited Partnership (Guernsey)<br>OC&C Resources Limited<br>OC&C Strategy Consultants LLP<br>OC&C Strategy Consultants International (Netherlands)<br>The Prince's Social Enterprises Limited |
| R K Perkin<br>MA (Cantab), FCA<br>30 April 1948                       | Company Director      | 20 April 2010       | Electra Private Equity plc<br>Electra Private Equity Investments plc<br>The Evolution Group plc<br>Crime Reduction Initiative (Trustee)<br>Chiddingstone Castle (The Denys Eyre<br>Bower Bequest) (Trustee)   |
| Ms S Taverne<br>3 February 1960                                       | Company Director      | 16 November 2005    | FCE Bank plc<br>The Design Museum<br>Vlessing & Taverne Limited<br>Good Governance Network<br>Foundation for Credit Counselling   |

Documents may be served on any of the directors at  
Burgess Salmon LLP, Narrow Quay House, Narrow Quay, Bristol  
BS1 4AH.

#### Directors' service contracts

The standard terms for new executive director appointments include a contractual notice period of 12 months. Five executive directors have contracts on this basis; they are (with the date of their contract), G J Beale (3 March 2003), M M Rennison (1 February 2007), T P Prestedge (28 August 2007), M P V Wyles (28 August 2007) and C S Rhodes (20 April 2009).

#### Directors' share options

No director or other officer, including connected persons, has any rights to subscribe for shares in, or debentures of, any connected undertaking of the Society.

# Annual Business Statement

continued

Information relating to directors and other officers (unaudited) (continued)

At 4 April 2011

## Officers

| Name          | Occupation   | Directorships  |
|---------------|--|--|
| G P Hughes    | Group Director<br>(HR & Corporate Affairs)             | Nationwide Pension Fund Nominee Limited<br>Nationwide Pension Fund Trustee Limited<br>The Nationwide Foundation  |
| Miss A J Robb | Group Director<br>(Group Strategy & Planning)          | NBS Fleet Services Limited<br>Dunfermline BS Nominees Limited  |
| A J Alexander | Divisional Director<br>(Financial Performance)         | Confederation Mortgage Services Limited<br>Ethos Independent Financial Services Limited<br>Exeter Trust Limited<br>Jubilee Mortgages Limited<br>Monument (Sutton) Limited<br>Nationwide Healthcare Trustee Limited<br>Nationwide Pension Fund Nominee Limited<br>Nationwide Pension Fund Trustee Limited<br>NBS Fleet Services Limited<br>Staffordshire Financial Services Limited<br>Staffordshire Leasing Limited<br>The Derbyshire (Premises) Limited |
| R T Bailey    | Divisional Director<br>(Savings & Investments)         | at.home nationwide Limited<br>Nationwide International Limited, Isle of Man<br>Nationwide Independent Financial Services Limited<br>The New Swindon Company Limited  |
| A J B Boulton | Divisional Director<br>(Customer Strategy & Marketing) |  |
| J Crane       | Divisional Director<br>(Group Transformation)          | John Crane Associates Limited<br>The Avenues Trust Support Services (Trustee)  |
| B P Glover    | Divisional Director<br>(Commercial)                    | at.home nationwide Limited<br>Derbyshire Home Loans Limited<br>E-Mex Home Funding Limited<br>Longwide Limited<br>Nationwide Housing Trust Limited<br>Nationwide Lease Finance Limited<br>Nationwide Mortgage Corporation Limited<br>Nationwide Syndications Limited  |
| M Goldman     | Divisional Director<br>(Central Retail)                |  |
| T K Kaye      | Divisional Director<br>(Customer Operations)           |  |
| Mrs E J Kelly | Group General Counsel                                  |  |
| P J McCabe    | Divisional Director<br>(Core Platforms Programme)      |  |

## Information relating to directors and other officers (unaudited) (continued)

At 4 April 2011

## Officers

| Name            | Occupation   | Directorships   |
|-----------------|--|---|
| A McQueen       | Divisional Director<br>(Mortgages & General Insurance) | Confederation Mortgage Services Limited<br>Derbyshire Home Loans Limited<br>E-Mex Home Funding Limited<br>Exeter Trust Limited<br>Jubilee Mortgages Limited<br>LBS Mortgages Limited<br>Staffordshire Financial Services Limited<br>The Mortgage Works (UK) plc<br>UCB Home Loans Corporation Limited |
| S G Nowell      | Divisional Director<br>(Business Protection)           |   |
| Mrs A Obey      | Chief Internal Auditor                                 |   |
| G Pilkington    | Divisional Director<br>(Banking)                       | Nationwide Trust Limited<br>Visa UK Limited   |
| P Stafford      | Divisional Director<br>(Technology Services)           | Nationwide International Limited, Isle of Man<br>Mid Devon Citizen's Advice Bureau (Trustee)  |
| P A Townsend    | Divisional Director<br>(Treasury)                      | First Nationwide<br>Nationwide Lease Finance Limited<br>Nationwide Investments (No.1) Limited<br>Moulton Finance Overseas BV  |
| J D Wrighthouse | Divisional Director<br>(Human Resources)               | Nationwide Healthcare Trustee Limited<br>Nationwide Pension Fund Nominee Limited<br>Nationwide Pension Fund Trustee Limited   |

# Glossary

The following glossary defines terminology used within the Annual Report and Accounts to assist the reader and to facilitate comparison with publications by other financial institutions:

|  |   |
|--|---|
| Alt A  | A US description for loans regarded as lower risk than sub prime, but with higher risk characteristics than lending under normal criteria.  |
| Arrears                                      | A customer is in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan payment is overdue. Such a customer can also be said to be in a state of delinquency.  |
| Asset backed securities (ABS)                | Securities that represent an interest in an underlying pool of referenced assets. The referenced pool can comprise any assets which attract a set of associated cash flows, including credit card assets, but are commonly pools of residential or commercial mortgages. Investors in these securities have the right to cash received from future payments (interest and/or principal) on the underlying asset pool. |
| Bank levy                                    | A levy that applies to certain UK financial institutions (including Nationwide) and the UK operations of foreign banks from 1 January 2011. The levy is based on a percentage of the chargeable equity and liabilities of the institution at the balance sheet date.  |
| Basel II                                     | The Basel Committee on Banking Supervision's statement of best practice that defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive and was implemented in the UK via the FSA Handbook.   |
| Basel III                                    | In December 2010, the Basel Committee on Banking Supervision issued the Basel III rules text, which presents the details of strengthened global regulatory standards on bank capital adequacy and liquidity. The standards will be phased in gradually from 2013.   |
| BIPRU  | The prudential sourcebook for banks, building societies and investment firms which sets out the FSA's capital requirements.   |
| Career average revalued earnings (CARE)      | A defined benefit pension arrangement where the pension benefit accrued by the employee is based on pensionable salary earned each year, revalued by the Retail Price Index (RPI) to retirement (or, if earlier, the date the employee leaves the scheme).  |
| Collateralised debt obligations (CDO)        | Securities issued by a third party which reference ABS and/or certain other related assets purchased by the issuer. Nationwide has not established any programmes creating CDOs but has invested in instruments issued by other banking groups.   |
| Collateralised loan obligations (CLO)        | A cash collateralised debt obligation (CDO) backed by leveraged loans provided by banks. Nationwide has not established any programmes creating CLOs but has invested in instruments issued by other banking groups.  |
| Commercial lending                           | Loans secured on commercial property, loans to Registered Social Landlords and loans undertaken under Private Finance Initiatives.  |
| Commercial mortgage backed securities (CMBS) | Securities that represent interests in a pool of commercial mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal).   |
| Commercial paper (CP)                        | An unsecured promissory note issued to finance short term credit needs. It specifies the face amount paid to investors on the maturity date.  |
| Commercial real estate                       | Includes office buildings, industrial property, medical centres, hotels, retail stores, shopping centres, multifamily housing buildings, warehouses, garages and industrial properties.   |
| Consumer banking                             | Comprises credit card, unsecured personal lending and our FlexAccount (current account) product.  |
| Contractual maturity                         | The final payment date of a loan or other financial instrument, at which point the entire remaining outstanding principal and interest is due to be repaid.   |
| Core Tier 1 capital                          | Total Tier 1 capital (see definition below) less permanent interest bearing shares (PIBS).  |
| Cost income ratio                            | A ratio that represents the proportion of management expenses (i.e. administrative expenses, depreciation and amortisation) to total income. The Group calculates the cost income ratio on an underlying basis.   |
| Coverage ratio                               | Impairment allowances (provisions) as a percentage of the loans and advances to which they relate.  |
| Covered bonds                                | Debt securities backed by a portfolio of mortgages that is segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds. The Group issues covered bonds as part of its funding activities.  |



|   |   |
|---|---|
| Credit default swap                           | An arrangement where the credit risk of an asset (the reference asset) is transferred from the buyer to the seller of the protection. A credit default swap is a contract where the protection seller receives premium or interest-related payments in return for contracting to make payments to the protection buyer upon a defined credit event. Credit events normally include bankruptcy, payment default on a reference asset or assets, or downgrades by a rating agency.    |
| Credit risk                                   | The risk that a borrower or counterparty fails to pay the interest or to repay the capital on a loan. Credit risk is the largest risk category to which the Group is exposed and sub-divided as follows: retail products, commercial lending, and Treasury credit risks.  |
| Credit valuation adjustment (CVA)             | An adjustment that represents an estimate of the change to fair value that a market participant would make to incorporate the credit risk inherent in counterparty derivative exposures.  |
| Current account                               | A non-fee paying debit card and cheque book account.  |
| Debt restructuring                            | The changing of the terms and provisions of outstanding debt agreements. Restructuring may be done in order to improve cash flow and the ability of the borrower to repay the debt. It can involve altering the repayment schedule as well as debt or interest charge alteration.   |
| Debt securities                               | See investment securities.  |
| Debt securities in issue                      | Transferable certificates of indebtedness of the Group to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit.   |
| Delinquency                                   | See Arrears.  |
| Economic capital                              | An internal assessment of the amount of capital required to protect against potential unexpected future losses arising from business activities, across a defined time horizon and confidence interval.   |
| Effective interest rate method (EIR)          | The method used to measure the carrying value of a financial asset or a liability. EIR allocates associated interest income or expense to produce a level yield, either to maturity or to the next re-pricing date.   |
| Expected loss (EL)                            | A Basel II calculation under the IRB approach to estimate the potential losses on current exposures due to potential defaults over a one-year time horizon. It is the product of PD, LGD and EAD.   |
| Exposure                                      | The maximum loss that a financial institution might suffer if a borrower, counterparty or group fails to meet their obligations or if assets and off-balance sheet positions have to be realised.   |
| Exposure at default (EAD)                     | A Basel II parameter used in IRB approaches to estimate the amount outstanding at the time of default.  |
| Final salary pension arrangements             | A defined benefit pension arrangement where the pension payable to the employee is based on final pensionable salary prior to retirement.   |
| Financial services compensation scheme (FSCS) | The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every firm authorised by the FSA is obliged to pay an annual levy, which goes towards its running costs and compensation payments. |
| FlexAccount                                   | The Group's current account product.  |
| Forbearance strategies                        | Strategies to assist borrowers in financial difficulty, such as extending loan terms, temporarily converting loans to an interest-only basis and agreeing a temporary reduction in payments. Forbearance strategies aim, if possible, to avoid foreclosure or repossession.   |
| Foundation IRB approach                       | A method of calculating credit risk capital requirements using internal PD models but with FSA supervisory estimates of LGD and conversion factors for the calculation of EAD.  |
| 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.   |
| Gross capital                                 | The aggregate of general reserve, revaluation reserve, available for sale reserve, subscribed capital and subordinated liabilities.   |
| Impaired loans                                | A loan is impaired if there is objective evidence that an impairment event has occurred, and that the event has an impact on the estimated future cash flows of the loan which can be reliably estimated. Impairment may be caused by a single event, or a combination of events. Impairment events include redundancy or marital breakdown.  |
| Impairment allowances                         | Provisions held against assets on the balance sheet. The provisions represent management's best estimate of losses incurred in the loan portfolio at the balance sheet date.  |
| Indexed LTV (Loan to value)                   | A ratio which expresses the amount of a mortgage as a percentage of the value of the property. The Group calculates residential mortgage LTV on an indexed basis (the value of the property is updated on a regular basis to reflect changes in the house price index (HPI)).   |

# Glossary

continued

|   |  |
|---|--|
| Individually/collectively assessed impairment allowances                | Impairment is measured individually for assets that are individually significant to the Group, and collectively where a portfolio comprises homogenous assets and where appropriate statistical techniques are available. Collective assessment also covers losses that have occurred but are not yet individually identified on loans subject to individual assessment. |
| Individual liquidity guidance (ILG)                                     | Guidance from the FSA on the quantity of a firm's liquidity resources and the firm's funding profile.  |
| Internal capital adequacy assessment process (ICAAP)                    | The Group's own assessment, as part of Basel II requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements (for credit, market and operational risks) and for other risks including stress events.   |
| Internal ratings-based approach (IRB)                                   | A Basel II approach for measuring exposure to credit risks. IRB approaches are more sophisticated and risk-sensitive than the Standardised Approach and may be Foundation or Advanced. IRB approaches may only be used with FSA permission.  |
| International Swaps and Derivatives Association (ISDA) master agreement | A standardised contract developed by ISDA and used to enter into bilateral derivatives transactions. The contracts grant legal rights of set-off for derivative transactions with the same counterparty. This reduces the credit risk of the derivatives to the extent that negative values offset positive values.  |
| Investment securities   | Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings excluding those issued by central banks. Sometimes referred to as debt securities.  |
| IPD index   | Measures the returns on property investments in the UK.  |
| Level 1 fair values   | Fair value derived from unadjusted quoted prices in active markets for identical assets or liabilities, e.g. G10 government securities.  |
| Level 2 fair values   | Fair value derived from inputs other than quoted prices that are observable for the asset or liability, either directly (i.e. a price) or indirectly (i.e. derived from prices), e.g. most investment grade and liquid bonds, asset backed securities, certain collateralised debt obligations (CDOs), collateralised loan obligations (CLOs) and OTC derivatives.       |
| Level 3 fair values   | Fair value derived from inputs for the asset or liability that are not based on observable market data (unobservable inputs), e.g. private equity investments, derivatives including an equity element, deposits including an equity element, some CDOs and certain asset backed securities and bonds.   |
| Leverage ratio  | As currently proposed under Basel III rules, it is a supplementary measure of risk-adjusted capital requirements, defined as the ratio of Tier 1 capital to total exposures. Total exposures include on and off balance sheet items (after netting derivatives).   |
| Leveraged loans   | Loans or other financing agreements provided to companies whose overall level of debt is high in relation to their cash flow (net debt: EBITDA (earnings before interest, tax, depreciation and amortisation)) typically arising from private equity sponsor led acquisitions of the businesses concerned.   |
| Liquidity coverage ratio (LCR)  | As currently proposed under Basel III rules, this is a liquidity metric which aims to ensure that a firm maintains an adequate level of liquidity to meet its needs for a 30-calendar day time horizon under a severe stress scenario.   |
| Liquidity and funding risk  | The risk that the Group is not able to meet its financial obligations as they fall due or can secure them only at excessive cost.  |
| Loan to deposit ratio   | Represents loans and advances to customers divided by the aggregate of shares, other deposits and amounts due to customers.  |
| Loan to value ratio (LTV)   | A ratio which expresses the amount of a mortgage as a percentage of the value of the property. The Group calculates residential mortgage LTV on an indexed basis (the value of the property is updated on a regular basis to reflect changes in the house price index (HPI)).  |
| Loans past due/past due loans   | Loans are past due when a counterparty has failed to make a payment when contractually due.  |
| Loss given default (LGD)  | A Basel II parameter used in IRB approaches to estimate the difference between exposure at default (EAD) and the net amount of the expected recovery expressed as a percentage of EAD.   |
| Main current account  | The primary or sole current account used by the holder.  |
| Management expenses   | The aggregate of administrative expenses, depreciation and amortisation.   |
| Market risk   | The potential losses or decrease in value of the Group balance sheet as a result of adverse market movements. Specific types of market risk include interest rate risk (banking book), swap spread risk and currency risk.   |
| Medium term notes (MTN)   | Notes issued by corporates across a range of maturities. MTNs are frequently issued by corporates under MTN programmes whereby notes are offered on a regular and continuous basis to investors.   |
| Member  | A person who has a share investment or a mortgage loan with the Society.   |

|   |  |
|---|--|
| Monoline Insurer  | An entity which specialises in providing credit protection to the holders of debt instruments in the event of default by the debt security counterparty. This protection is typically held in the form of derivatives such as credit default swaps referencing the underlying exposures held.  |
| Mortgage backed securities (MBS)  | A category of asset backed security that represents interests in a group of mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal).  |
| Negative equity mortgages   | Negative equity occurs when the value of the property purchased using the mortgage is less than the balance outstanding on the loan. Negative equity is the difference between the current value of the property and the outstanding balance on the loan.  |
| Net interest income   | The difference between interest receivable on assets and similar income and interest paid on liabilities and similar charges, including the effect of certain derivatives.   |
| Net stable funding ratio (NSFR)   | A liquidity ratio, currently proposed under Basel III, to calculate the proportion of long term assets that are funded by stable, long term funding sources (customer deposits and long term wholesale funding).   |
| OECD  | Used to refer to member countries of the OECD (Organisation for Economic Co-operation and Development). The OECD has 34 member countries, including (but not limited to) key European countries, the United States, Canada and Japan.  |
| Operational risk  | The risk of loss arising from inadequate or failed internal processes, people and systems, or from external events.  |
| Overnight indexed swap rate (OIS)   | A rate reflecting the overnight interest typically earned or paid in respect of collateral exchanged. OIS can be used in valuing collateralised interest rate derivatives, though this approach has not been adopted by the Group to date.   |
| Over-the-counter (OTC)  | A bilateral transaction (e.g. derivatives) that is not exchange traded and valued using valuation models.  |
| Own credit adjustment   | Adjustment for the effect of the Group's credit standing on the fair value of its financial liabilities. This is sometimes referred to as a debit valuation adjustment.  |
| Permanent interest bearing shares (PIBS)                                  | Unsecured, deferred shares of the Society that are a form of Tier 1 capital. PIBS rank behind the claims of all subordinated debt holders, depositors, creditors and investing members of the Group. Also known as subscribed capital.   |
| Prime residential mortgages   | Prime mortgages are mainstream residential loans, which typically have a higher credit quality and fit standard underwriting processes. As such, they are likely to have a good credit history, and pass a standard affordability assessment at the point of origination.  |
| Private equity investments/holdings                                       | Equity holdings in operating companies not quoted on a public exchange.  |
| Probability of default (PD)   | A Basel II parameter used in IRB approaches to estimate the probability that a borrower will default on their credit obligations in the next 12 months.  |
| Protected equity bond (PEB)   | A deposit account with the potential for stock market correlated growth linked to the performance of specified stock market indices. The PEB protects an investor's original investment amount against reductions in the linked stock market indices, whilst providing potential for upside from movements in the stock markets over a fixed term.   |
| Regulatory capital  | The capital held by the Group, determined in accordance with rules established by the FSA. The regulatory capital base comprises Tier 1 and Tier 2 capital (see below).  |
| Renegotiated loans  | Loans and advances may be renegotiated either as part of an ongoing customer relationship with a creditworthy customer or in response to a borrower's financial difficulties. In the latter case, the renegotiated loan may no longer be treated as past due or impaired if there is no change to the estimated future flows. Individually significant loans whose terms have been renegotiated are subject to ongoing review to determine if they remain past due or impaired.                                      |
| Repurchase agreement (repo) / Reverse repurchase agreement (reverse repo) | A repurchase agreement that allows a borrower to use a financial security as collateral for a cash loan. In a repo, the borrower agrees to sell a security to the lender subject to a commitment to repurchase the asset at a specified price on a given date. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the counterparty to the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or reverse repo. |
| Residential mortgage backed securities (RMBS)                             | A category of asset backed security that represents interests in a group of residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal).  |
| Retail IRB approach   | A Basel II approach for measuring exposure to retail credit risks. The method of calculating credit risk capital requirements uses internal PD, LGD and EAD models. IRB approaches may only be used with FSA permission.   |

# Glossary

continued

|                                |  |
|--------------------------------|--|
| Retail loans                   | Loans to individuals rather than institutions, including residential mortgage lending and consumer banking.  |
| Risk appetite                  | The articulation of the level of risk that the Group is willing to take (or not take) in order to safeguard the interests of the Society's members whilst achieving business objectives.   |
| Risk-weighted assets (RWA)     | The value of assets, after adjustment, under the Basel II capital rules to reflect the degree of risk they represent.  |
| Return on Capital (ROC)        | Profit after tax as a percentage of average gross capital (general reserve, revaluation reserve, available for sale reserve, PIBS and subordinated liabilities). Profit after tax excludes the interest cost of PIBS and subordinated liabilities.   |
| Securitisation                 | A process by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities. A company transfers assets to a special purpose entity (SPE) which then issues securities backed by the assets. The Group has established securitisation structures as part of its funding activities. These securitisation structures use retail mortgages as the asset pool. In addition, the Group invests in various securitisation structures in its Treasury portfolio. |
| Shares                         | Funds deposited by a person in a retail savings or current account with the Society. Such funds are recorded as liabilities for the Society.   |
| Shares and borrowings          | The total of shares, deposits from banks, other deposits, amounts due to customers and debt securities in issue.   |
| Specialist residential lending | Consists of Buy to Let, self-certified and other non standard mortgages.   |
| Special purpose entities (SPE) | Entities that are created to accomplish a narrow and well defined objective. There are often specific restrictions or limits around their ongoing activities. The Group uses a number of SPEs, including those set up under securitisation programmes. Where the Group has control of these entities or retains the risks and rewards relating to them they are consolidated within the Group's results. This term is used interchangeably with SPV (special purpose vehicle).                                       |
| Standardised approach          | The basic method used to calculate credit risk capital requirements under Basel II. In this approach the risk weights used in the capital calculation are determined by FSA supervisory parameters. The Standardised approach is less risk-sensitive than IRB.   |
| Subscribed capital             | See permanent interest bearing shares (PIBS).  |
| Subordinated debt /liabilities | A form of Tier 2 capital that is unsecured and ranks behind the claims of all depositors, creditors and investing members but before the claims of holders of permanent interest bearing shares (PIBS).  |
| Sub prime                      | Loans to borrowers that typically have weakened credit histories that include payment delinquencies and potentially more severe problems such as court judgements and discharged bankruptcies. They may also display higher risk characteristics as measured by credit scores, or other criteria indicating heightened risk of default.  |
| Tier 1 capital                 | A component of regulatory capital comprising general reserves from retained profits, permanent interest bearing shares (PIBS), less goodwill, intangible assets and other regulatory adjustments.  |
| Tier 2 capital                 | A further component of regulatory capital comprising the property revaluation reserve, qualifying subordinated debt and the collective impairment allowance (for exposures treated on a Basel II standardised basis), less certain regulatory deductions.  |
| Transformation costs           | Costs, included within administrative expenses, which are directly related to business combinations or the restructuring of parts of our business. The main costs included within this category are employee severance costs, external advisor fees, lease cancellation fees, property impairment and onerous lease costs.   |
| Value at risk (VaR)            | A technique that estimates the potential loss that could occur on risk positions as a result of future movements in market rates and prices over a specified time horizon and to a given level of statistical confidence. In its day-to-day monitoring, Nationwide uses a 10 day horizon and a 99% confidence level.   |

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**FSC Guide**



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