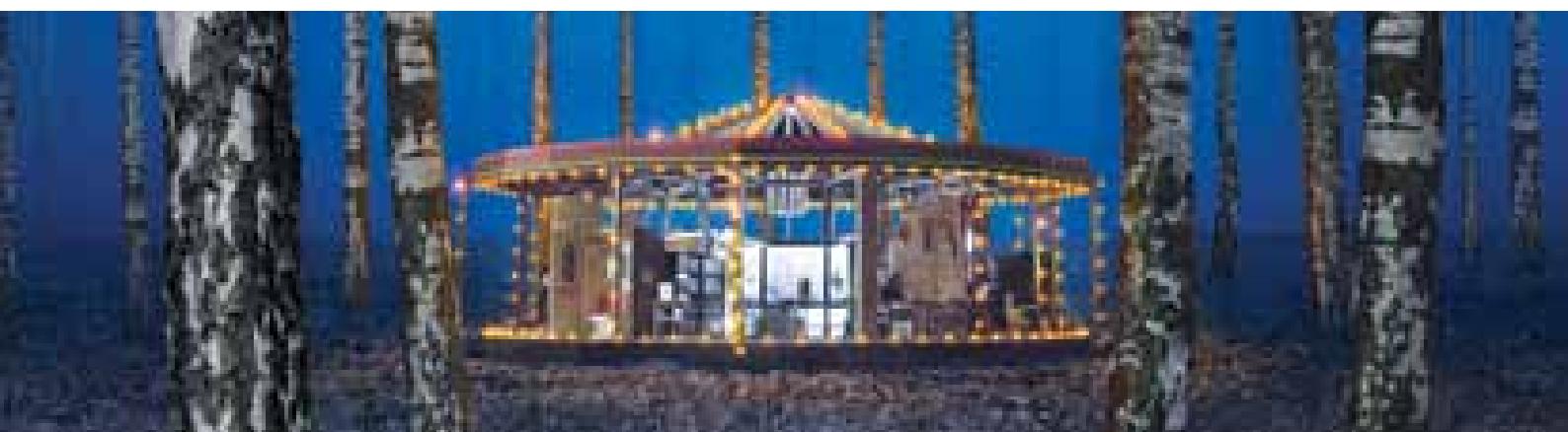


# Annual Report and Accounts 2012



On your side. When you need us

## On your side. When you need us

Our vision is to be the UK's leading retail financial services provider, offering a meaningful and unique alternative to the established banks.

We aim to achieve this through three core pillars: being true to our Mutual Values, acting as a challenger brand in the interests of consumers, and diversifying our business model.



**Heather Ogston**  
Member since 2004

**Jim MacAllan**  
Member since 2009

**Ramzie Vadakkayil**  
Member since 2010

**Adam Parnham**  
Member since 2006

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# Financial highlights

Underlying profit before tax:

**£304 million**

Statutory profit before tax:

**£203 million**

Strong capital ratios with Core Tier 1 ratio of:

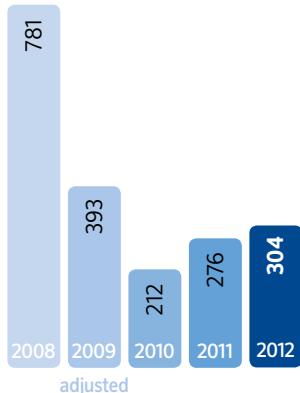
**12.5%**

Group Results 2008-2012		2008	2009 (adjusted)	2010	2011	2012
Profit before tax (underlying)	£m	781	393	212	276	<b>304</b>
Profit before tax (statutory)	£m	686	190	341	317	<b>203</b>
Total income (underlying)	£m	2,212	2,091	2,061	1,947	<b>2,143</b>
Total income (statutory)	£m	2,176	2,236	2,135	2,067	<b>2,178</b>
Cost income ratio (underlying)	%	55.7	59.5	60.6	63.9	<b>61.0</b>
Cost income ratio (statutory)	%	59.4	60.5	61.4	61.6	<b>63.6</b>
Total assets	£m	179,027	202,353	191,397	188,953	<b>196,129</b>
Loans and advances to customers	£m	142,804	155,469	152,429	149,417	<b>154,169</b>
Member savings balances	£m	113,816	128,292	120,943	122,552	<b>125,617</b>
Total regulatory capital	£m	9,474	9,690	9,722	9,233	<b>8,996</b>

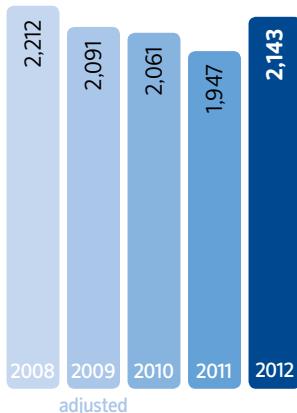
## Underlying results

These results have been prepared in line with International Financial Reporting Standards (IFRS). Where appropriate, certain aspects of the results are presented to reflect management's view of the Group's underlying performance with like for like comparisons of performance across years without the distortion of one off volatility and items which are not reflective of the Group's ongoing business activities.

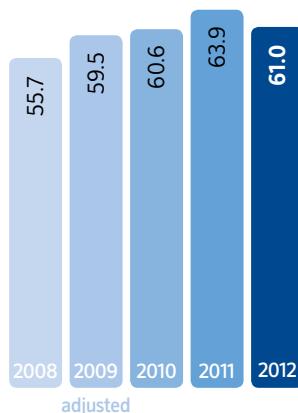
Underlying profit before tax equates to statutory profit before tax adjusted for the positive impact of movements in the value of derivatives and hedge accounting of £35 million, a charge of £59 million in respect of the Financial Services Compensation Scheme (FSCS), restructuring costs of £61 million and the bank levy of £16 million.



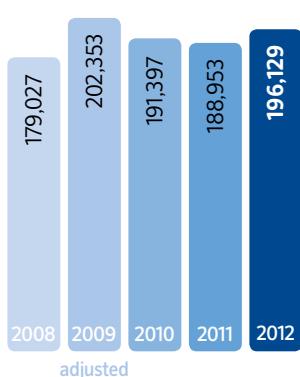
**Profit before tax (underlying) £m**



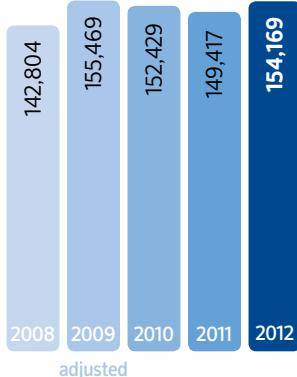
**Total income (underlying) £m**



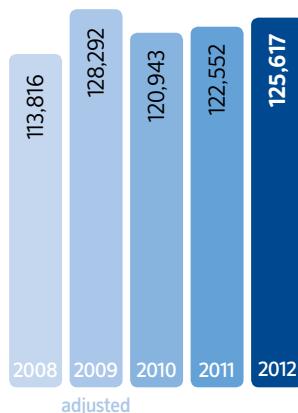
**Cost income ratio (underlying) %**



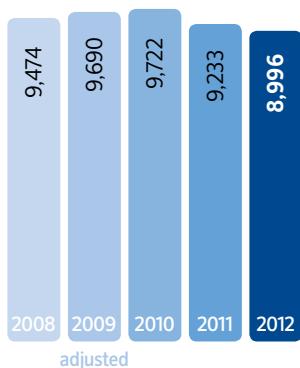
**Total assets £m**



**Loans and advances to customers £m**



**Member savings balances £m**



**Total regulatory capital £m**

# Chairman's Statement

**Our aim continues to be to deliver consistently good value products and services to our members.**



## **The core strengths of our mutual franchise**

The challenging market conditions that have faced the industry since 2008 have persisted over the past twelve months, with the UK economy failing to recover at the speed predicted by most commentators. The housing market has stabilised at a level of transactions well below pre-crisis norms, the Bank of England base rate has remained at 0.5% for the entire period and this, combined with stubbornly high inflation and slow wage growth, has contributed to another year of slow growth in the savings market.

Despite these challenges, we have delivered another good financial performance for our members. Our business continues to be underpinned by strong capital and liquidity ratios, and our underlying profit has risen to £304 million. Statutory profit was £203 million. Our core asset quality remains very strong, our underlying efficiency has improved and we have continued to deliver very significant levels of value to our members.

## **Great value for our members**

Regardless of external pressures, our aim continues to be to deliver consistently good value products and services to our members.

The protracted low interest rate environment has made it difficult to balance the requirements of our borrowing and savings customers with the

requirement to maintain sufficient profitability to support the long term strength of the business. Our mortgage customers have enjoyed significant benefits over the year, particularly those on our Base and Standard Mortgage Rates. In addition, we have made every effort to support the housing market with a range of initiatives, including a Save to Buy product, support for the Government's NewBuy scheme and a dedicated focus on helping first time buyers to enter the housing market.

The importance of our saving members has not been forgotten; alongside the delivery against our seven Savings Promises, we demonstrated our commitment to transparency by providing all savers with an annual statement to help them identify whether their current products were the most suitable for their needs. In addition, we have offered savers a range of excellent products, including a number reserved exclusively for those holding their main current account with Nationwide.

We have continued our drive to offer our members the opportunity to benefit from an ever broader range of our products. Over the past year we opened 828,000 new banking products, including current accounts, personal loans and credit cards. We are also proud to have entered the annuity market, as we believe we will be able to make a tangible difference to the income our members are able to secure for their retirement.

Our focus on offering the best possible service to all of our customers has continued, and every member of our staff is targeted on our strategic aim of being significantly ahead of our nearest competitor in terms of overall service satisfaction. However hard we try, we recognise that there will be instances where customers feel that our service has not been of the level required, and we aim to investigate and resolve every complaint as quickly as we can. The most notable issue of customer complaint over the past year has been that relating to the sale of Payment Protection Insurance. Whilst we have made an additional provision for customer redress during the year, our approach to delivering the right outcome is highlighted by the fact the Financial Services Ombudsman agreed with our decision in 93% of the cases referred, compared with an average of only 12% for the rest of the industry.

### **Developments in the financial services industry**

The past year has seen a number of developments that will shape the long term future of the financial services market in the UK.

As a building society operating a low risk business model, Nationwide adopted a cautious approach during the pre 2007 boom. As a result, we were well placed to withstand the pressures from 2008 onwards and did not require Government assistance to maintain our business. However, in the drive from the Government and regulators to ensure that the financial services sector is made more secure, they need to ensure that we are not impacted disproportionately by changes to capital requirements and the implementation of the recommendations from the Independent Commission on Banking.

We are very supportive of the ICB's aims of improving competition in UK banking and are well placed to offer a genuine alternative to the plc banks; indeed, Nationwide was recognised in the report as the only true challenger brand in UK personal financial services. At the time of writing we have yet to see the White Paper on implementation of the ICB report, but it is imperative that it creates a regime in which it is equally possible for both mutuals and plcs to flourish. Of particular note, we are very keen to ensure that the likely implementation of a minimum leverage ratio recognises our low risk business model and does not act as an undue constraint on our continued ability to provide finance to support home ownership.

On a positive note, both the FSA and European regulators have accepted the need for mutuals to be able to raise external capital that is consistent with mutual principles. Nationwide has been a prime mover in these discussions and is well advanced in the development of Core Capital Deferred Shares, a new instrument that the Board believes will provide the business with additional flexibility and security. In order to issue the Securities a rule change is required, and I would like to encourage all members to vote on the Special Resolution at the Annual General Meeting.

**'Our business continues to be underpinned by strong capital and liquidity ratios, and our underlying profit has risen to £304 million. Our core asset quality remains very strong, our underlying efficiency has improved and we have continued to deliver very significant levels of value to our members.'**

Over the past year we opened

**828,000**

new banking products.

### **Supporting communities across the UK**

As a business, we recognise and embrace our role in supporting communities and charities across the UK, and we are proud of our success to date. Over the past year we have reviewed our approach to corporate citizenship, to ensure that the areas in which we focus our efforts for the next few years will both support our business and make a meaningful difference to our members and the communities in which we operate.

### **Home ownership and housing**

As a building society, our core purpose is to provide finance for those wishing to buy a home of their own, and we have paid particular attention to helping first time buyers into the housing market. To support our aims our First Time Buyers' Guide, originally launched

in 2010, has been refreshed as a downloadable smartphone and tablet-friendly document, which is supported by a YouTube video created to demystify the mortgage and house buying process.

Whilst home ownership remains a goal for many people, we also recognise that for others simply having a place to live is a priority and, to help address this need, we have worked with Shelter for over a decade. Since November 2008 our funding has focused on Shelter's key community based services, complemented over the past year with support for the development of online teaching resources in Shelter's Teachers' Centre. To date over 3,000 families, adults and children have benefited from community based services supported by Nationwide.

#### **Financial education**

We have continued to focus on helping people to manage and make the most of their money, by investing in partnerships that build skills and capacity in the advice sector. Our three year, £3 million MoneyActive partnership with Citizens Advice has exceeded its original target and has now reached over 170,000 people, providing them with vital support and financial skills training to help them manage their finances. In addition, a new three year partnership with Money Advice Trust provides funding both to existing services, National Debtline and Business Debtline, and their new Innovation Grants Programme that focuses on supporting money advice and financial capability projects across the UK.

Our award winning website,

**NationwideEducation.co.uk**, continues to provide a comprehensive range of resources for schools and pupils to build a better understanding of money and financial products. To support the website, we have trained a number of our employees to deliver financial education sessions in schools, sharing their expertise and broadening the site's reach.

#### **Corporate charities**

The generosity of our employees and members has been demonstrated yet again, with over £1.1 million raised for charity during the year. We continue to support Macmillan Cancer Support and are now in the 19th year of our partnership which has raised over £6.2 million to improve the lives of people affected by cancer. In this Olympic year, I am pleased to say that our partnership with Disability Sport Events, which goes back a decade, has been supporting the identification of talented individuals and team selections ahead of the Paralympics.

## **Diversity**

We recognise the advantages that come from having people with a diverse range of backgrounds on our Board, and strongly support the recommendation of the Corporate Governance Code that all company boards should consider the benefits of diversity when making new appointments. When considering the composition of the Board, we aim to have a balance of skills, independence and knowledge to enable each director, and the Board as a whole, to discharge their duties and responsibilities effectively. The issue of gender is one aspect of the broader issue of diversity; we believe that establishing quotas or targets for the composition of the Board would not be appropriate, since the overriding issue is the selection of the best candidate, irrespective of background, thereby ensuring that you are represented by the highest quality Board possible.

The issue of diversity and inclusion across the business is part of a broad strategy pursued across the Group, and covered in more detail in the Employees section of the Directors' Report. It is about maximising our customer and employee experience, growing talent from a range of diverse backgrounds, driving diversity in decision making across the organisation and contributing to our communities. Our strategy aims to improve representation in our executive and non executive population, to be achieved through a more representative talent and recruitment pipeline, flexible working to meet career needs and mentoring by the Board of our diverse talent pool.

## **Engaging with our members**

Understanding the views of our customers is essential, and we appreciate the helpful comments and suggestions made by members over the past year. In order to get direct feedback, we have held Member TalkBack events in Exeter, Bristol, Leeds, Oxford, Southampton and Swansea. At each event members were able to meet face to face with Society directors and representatives of the executive management team, and were able to make suggestions or comment about policies and service.

In November we launched a new online area for members called 'Your Nationwide'. This forms part of the Society's main website and features latest news, graphs and data showing our levels of customer service satisfaction and videos, in which members can be seen putting their most topical questions to directors and receiving responses from them.

We run a members' suggestions scheme, providing a form that customers may complete in branches as well as offering a number of ways for ideas to be submitted online. Each month an external accredited research company calls 10,000 customers to gather feedback for the Society's Customer Service Tracker, which is used by management to monitor service performance, and it invites a further 5,000 customers to take part in an online satisfaction survey. All this contributes towards sound corporate governance and provides our members with the opportunity to make a real difference to how the Society is run.

## 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) or through the post. I would also encourage those members who are able to attend the Society's Annual General Meeting at The Bridgewater Hall in Manchester on 19 July.

## Board changes

Two long serving non executive directors, Robert Walther and Suzanna Taverne, will be retiring from the Board at the 2012 AGM. Robert has made a very significant contribution to Nationwide over a long period, having joined us in 2002 and serving as our Deputy Chairman and Senior Independent Director since July 2006 and as Chair of our Remuneration Committee since 2010. Suzanna joined us in 2005, helping the Board steer the Society through a turbulent period in financial services. Roger Perkin, an existing non executive director and Chair of our Audit Committee, will replace Robert as the Senior Independent Director.

In June 2011 we welcomed Lynne Peacock and Mitchel Lenson to our Board as non executive directors. Both bring significant experience in financial services to the Board; Lynne has worked at a senior level in the retail banking industry for over twenty five years, while Mitchel has spent nearly thirty years in senior IT roles at a number of banks. Lynne will take over from Robert Walther as Chair of our Remuneration Committee.

## The contribution of our employees

It is important to recognise once more the contribution that our employees have made to our achievements over the past year. I continue to be impressed by their commitment to providing high quality service to all of our members, helping your

Society to demonstrate that we are 'On your side'. All our market research shows us that our members believe that it is the positive, friendly and helpful attitude of our people that sets us apart from our competitors. As an employer we make every effort to ensure that our employees are both engaged in our aims and are provided with the support to enable them to perform their duties to the highest possible standard. The engagement and enablement of our people are monitored on an annual basis as one of our key strategic goals, and I am pleased to report that our scores for both are in excess of the benchmarks apparent in the financial services sector.

**'Each month an external accredited research company calls 10,000 customers to gather feedback for the Society's Customer Service Tracker, which is used by management to monitor service performance.'**

**Over 3,000**  
families, adults and children have benefited from community based services supported by Nationwide.

## Outlook

There are clearly a number of challenges facing the UK economy: interest rates are likely to remain low for a protracted period, both mortgage and savings markets are growing at only a fraction of their historic norms, and the potential impacts from developments in the Eurozone are still unclear. Despite the difficulties, our mutual business model has shown itself to be extremely resilient, and I am confident that Nationwide is well placed to pursue its policy of delivering excellent long term value to all of our members.



**Geoffrey Howe**  
Chairman  
22 May 2012

# Chief Executive's Review

We have maintained our impressive financial strength, with a balance sheet amongst the strongest of its kind in the industry. In a market which grew by only 5% over the past twelve months, Nationwide increased its gross lending by 44%.

## Financial performance

**Underlying profit** for the year is up 10% at £304 million (2011: £276 million). Total income is up 10% at £2.14 billion, including a £96 million gain on the acquisition of a prime mortgage portfolio and an additional £70 million reflecting a change to assumptions for recognition of residential mortgage fee income. Costs increased by 5%, driven by continuing strategic investment in our business, increasing regulatory costs, transactional volume growth and inflation. Credit impairments were broadly stable at £428 million, with the rise in commercial provisions being largely offset by an improvement in retail and treasury provisions. The PPI provision has been increased by a further charge of £103 million, reflecting the significant increase in complaints across the industry over the past six months, encouraged by the aggressive activities of Claims Management Companies (CMCs).

**Statutory profit** comprises underlying profit as stated above but adjusted for a fair value credit on financial instruments of £35 million, down £85 million on 2011, a charge of £75 million for the FSCS and the bank levy which is a 50% increase on 2011 and restructuring costs of £61 million representing the cost of changes to the Group's operations (2011: £29 million).

**Financial strength.** We have maintained our impressive financial strength, with a balance sheet amongst the strongest of its kind in the industry. Our asset quality is strong, with residential arrears significantly lower than industry levels; in addition, we maintain market leading capital ratios, high levels of liquidity and a diverse funding platform.

	4 April 2012	4 April 2011
	%	%
Core Tier 1 ratio	<b>12.5</b>	12.5
Tier 1 ratio	<b>15.9</b>	15.7
Solvency ratio (Basel II)	<b>18.9</b>	19.5
Core liquidity ratio	<b>13.7</b>	13.8
Wholesale funding ratio	<b>25.3</b>	25.9

## Support for the mortgage market

Our commitment to the mortgage market has remained strong: in a market which grew by only 5% over the past twelve months, Nationwide increased its gross lending by 44% to £18.4 billion (2011: £12.8 billion). Our net mortgage lending was £2.7 billion (2011: negative £3.5 billion) and, in addition, we acquired £1.2 billion of high quality prime residential loans.



We have been particularly supportive of first time buyers, providing mortgages that helped over 24,000 people to buy their first home, an increase of 9% year on year (2011: 22,200). This was underpinned by a number of product initiatives, and we were one of the founding lenders participating in the launch of the recent NewBuy scheme.

Nationwide is a leading provider of specialist mortgages in the UK through our subsidiary The Mortgage Works, supporting an expanding rental sector. We have increased our lending in high quality 'buy to let' to £4.4 billion (2011: £3.0 billion), taking our specialist lending book to over £23 billion (2011: £20 billion).

We have maintained our Base Mortgage Rate (BMR) pledge, ensuring the majority of our mortgage customers have access to a rate capped at 2% above Bank of England (BoE) base rate. We estimate the customer benefit of our BMR pledge has been in the region of £750 million over the past year, equating to an average of over £1,000 net benefit for each account per annum.

#### **Support for savers**

Nationwide is the second largest savings provider in the UK, and our net savings receipts for the year were up 67% at £1.0 billion (2011: £0.6 billion). Over the year we have taken a number of steps

to enhance our customer proposition, including a relaunch of our savings product range to provide greater clarity to members over product bonus rates and long term value. During the autumn we sent an annual statement to seven million savers, providing details of their savings accounts and full details of our product range, helping them to identify whether their products are the most suitable for their needs. We also became the first major savings provider to launch a junior cash ISA product, and we now have over 41,000 active accounts. We have continued our policy of delivering additional value to our existing members; over the year we delivered four loyalty savings products and an exclusive account for main current account holders, and in April we launched our Flexclusive ISA, offering an industry leading rate of interest to members using FlexAccount as their main current account.

**Nationwide is the second largest savings provider in the UK, and our net savings receipts for the year were up**

**67%**

## Diversifying our product franchise

We have made excellent progress in our strategy of diversifying our business through the expansion of our personal banking products. Over the past year we have opened 359,000 full facility current accounts (2011: 353,000). A total of 78,000 customers have taken advantage of our Account Transfer Promise by switching their main accounts to Nationwide, an increase of 90% on 2011. Our total current account base is just under five million, taking our market share of main standard accounts to around 7.0% (2011: 6.2%).

Throughout the year our main current account holders have benefited from free European travel insurance and a range of linked 'Flexclusive' product offers, which have been extended to include preferential savings, mortgage and credit card rates. 2011/12 also saw the launch of our 'Simply Rewards' scheme, providing account holders with discounts at a range of retailers when they use either their Visa debit or credit cards. FlexAccount continues to be a *Which?* 'recommended bank account' and has retained its Defaqto 5 star rating for the sixth consecutive year.

Our credit card business has grown strongly. In January 2012 we launched our new Select Credit Card exclusively to main FlexAccount customers, rewarding them with cashback on purchases and commission-free overseas usage. Unsurprisingly, the card has attracted significant positive media comment, and supported our total card sales of 357,000 for the year, an increase of 20% on last year (2011: 298,000), with a similar percentage rise in active card usage to over one million.

Our success in the personal loans market has continued, with total gross lending up 43% at £1 billion (2011: £0.7 billion). We have continued our policy of rewarding our most loyal customers by offering our best rate to customers holding a main FlexAccount.

Ahead of the implementation of the Retail Distribution Review, we have begun to break the mould of traditional financial advice by offering a more comprehensive financial solutions proposition, including an inheritance tax planning service and our new annuity service. We offer access to 90% of the best annuity rates through a panel of six major providers and initial reaction has been very positive, with *Which? Magazine* stating that 'Nationwide's new service is good news for consumer choice'.

Our investments business has performed well, with sales over the year up 33%, and we now have assets under advice of £6.7 billion (2011: £5.1 billion).

## Customer service

We pride ourselves not only on the quality of our products, but also on the provision of top quality service to all of our customers, and this is captured in our brand proposition of being 'On your side'. When compared with our peer group of high street competitors, we are ranked as one of the best performers for product service satisfaction<sup>1</sup> and our own customer service survey has reported high and growing satisfaction with our branch, telephone and internet services. In addition, in 2011 we again finished top of the PressWatch Financial Products analysis, receiving favourable UK press coverage over the full range of our products throughout the year.

Despite being the second largest savings provider, third largest mortgage lender and having an increasing market share across consumer banking products, we account for only 1.5% of total industry complaints. In the latest publication of FSA complaints data, Nationwide saw complaints in 2011 56% lower than in 2010, at a time when complaints against the majority of our high street peers rose rapidly. We are also pleased that the level of complaints against us which are upheld in the customer's favour by the FOS is only 12%, compared with an industry average of 72% (FOS H2 2011).

In line with other financial services institutions, we have experienced a significant increase in the number of complaints relating to the sale of PPI. These have quadrupled in the last six months, encouraged by the aggressive activities of CMCs, and have resulted in a significant charge of £103 million (2011: £16 million), 40% of which is to deal with the administration of the claims. One in three complaints we receive is false, in that no policy had actually been sold, and 75% of these false claims originate from CMCs. Such claims incur unnecessary costs and delay the processing of legitimate complaints. We are committed to dealing with customer complaints in a fair, transparent and constructive manner, as evidenced by the fact that of the PPI cases referred to FOS, only 7% of our original decisions were not upheld in our favour (compared with 88% for the industry). Along with others in the industry we advise and encourage customers to submit their legitimate claim directly rather than use a CMC, and we call for stricter regulation of the CMCs.

<sup>1</sup>Source: GfK NOP's Financial Research Survey (FRS), 12 months ending March 2012, proportion of extremely and very satisfied customers summed across current account, mortgage and savings, peer group is Barclays, Halifax, HSBC, Lloyds TSB, NatWest and Santander.

## Transforming our business

We have invested heavily in our transformation programme in recent years, making the business fit for the future and developing systems that will provide the best customer experience in the industry. We have had a number of important successes over the past year, including the delivery of a new internet bank with features that have greatly enhanced the experience for our customers. In addition, our new mortgage sales system has improved the service we are able to offer our intermediary customers, and the introduction of our faster payments service across all of our brands ensured both that we are fully compliant with European directives and improved the speed at which customers can transfer money and make electronic payments.

## Strategy

Our success is based on our long term strategy of delivering value to our members through consistently excellent products and services. Our vision is to be the UK's leading retail financial services provider, offering a meaningful and unique alternative to the established banks. We aim to achieve this through three core pillars: being true to our Mutual Values, acting as a challenger brand in the interests of consumers, and diversifying our business model. Our mutual status allows us to be different: we do not need to maximise our profits to pay shareholders; instead, we focus on supporting our members, generating sufficient profit to maintain our strong balance sheet and invest in the future development of the business.

We will maintain our position as one of the UK's largest providers of mortgage and savings products, using our mutual status to offer a range of long term good value products that are designed to meet the needs of our members in a fair and transparent way. We will continue to play the role of the primary challenger to the banks by expanding our capability and market presence in current accounts, personal loans, credit cards, insurance and financial planning markets. Over the coming years we will also develop and offer a full range of financial services to small and medium sized enterprises (SME), playing an increasing role in providing credit to an important part of the UK economy. By doing so we aim to support more needs for more customers and provide a diversified business mix that reduces our reliance on margin income. In support of our strategy, we will also continue to maximise revenues from our non-member businesses, using the profits to support our member proposition and our financial strength.

Our expectation is that both the housing and savings markets will be broadly flat until the economy recovers. However, we are already reaping the benefits of our strategy to diversify our business, with a growing share of the banking and financial planning markets, and the coming year will see us delivering a range of programmes that will strengthen our franchise and enhance customer service. Amongst the major deliverables will be a new and improved range of current accounts, a mobile banking app, and the roll out of our new mortgage systems throughout our branch network. We will also expand our financial solutions business in line with the Retail Distribution Review, providing access to financial advice for our customers.

**'We have begun to break the mould of traditional financial advice by offering a more comprehensive financial solutions proposition, including an inheritance tax planning service and our new annuity service.'**

We account for only  
**1.5%**  
of total industry complaints.

The strength of the Nationwide brand is increasingly compelling, and we believe that over the longer term we will be able to offer customers of our regional brands an improved proposition under a single Nationwide platform. As such, in the coming years we will migrate our regional brands to the Nationwide brand. We will continue to manage the size of the Group according to economic and market conditions, and emerging customer preferences.

We are well placed to broaden our franchise, deliver long term value to our members and achieve our vision of being the UK's leading retail financial services provider.



**Graham Beale**

Chief Executive

22 May 2012

# Our strategic goals

**Our vision is to be the UK's leading retail financial services provider, and to measure progress the Board has set a number of challenging strategic corporate goals which we aim to achieve over a five year period.**

The table below sets out these key goals and the progress made in the year.

Strategic Goal 2011/12	KPI	Performance to date		Five Year Strategic Goal
<b>Number 1 for service satisfaction</b>	Be the clear number 1 in service satisfaction, with a lead of at least 2% over the next best competitor	We are ranked as one of the best performers for product service satisfaction, with a year end lead of 1%		Be the clear number 1 in service satisfaction with a lead of at least 4% over the next best competitor
<b>Deepening our customer relationships</b>	Grow the proportion of our prime customers from 40% to 45%	Our prime customers now account for over 40% of the total, and the number is increasing in line with our target		Grow our base of valuable customer relationships to at least 7 million
<b>Core Tier 1 ratio</b>	Have a Core Tier 1 ratio that is top of our peer group comparison (Basel II)	Our Core Tier 1 ratio has remained at target levels throughout the year		Core Tier 1 ratio in the top quartile of our peer group comparison
<b>Other income</b>	Increase other income by 50% over the period 2009/10 to 2014/15	Other income has increased in line with target		Achieve £600 million of other income
<b>Underlying profitability</b>	Achieve £1 billion profit per annum to support growth plans and maintain capital self-sufficiency	Underlying profit of £304 million		Become self-sufficient in capital with a profit of £1 billion per annum
<b>Employee enablement and engagement</b>	Employee enablement and engagement scores in line with external high performance benchmarks	Employee engagement and enablement scores are in excess of the financial services benchmark and close to our strategic goal		Achieve the high performance external benchmark for employee enablement and engagement

We are pleased with our performance against these goals over the past year, and believe that they demonstrate the progress we are making towards our goal of becoming the UK's leading retail financial services provider.

The nature of the goals is such that their broad thrust will remain valid over many years, although some minor revisions will be made from time to time to reflect changes in the environment and our desire to set ourselves more challenging targets.

# Business review

## Income statement overview

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 £35 million, a charge of £59 million in respect of the Financial Services Compensation Scheme (FSCS), restructuring costs of £61 million and the bank levy of £16 million.

Year to 4 April 2012	Statutory profit	FSCS and bank levy	Restructuring costs	Movements on derivatives and hedge accounting	Underlying profit
	£m	£m	£m	£m	£m
Net interest income	1,623	-	-	-	1,623
Other income	520	-	-	-	520
Movement on derivatives and hedge accounting	35	-	-	(35)	-
<b>Total income</b>	<b>2,178</b>	-	-	(35)	<b>2,143</b>
Administrative expenses	(1,205)	16	61	-	(1,128)
Depreciation and amortisation	(180)	-	-	-	(180)
Impairment losses	(428)	-	-	-	(428)
Provisions for liabilities and charges	(162)	59	-	-	(103)
<b>Profit before tax</b>	<b>203</b>	<b>75</b>	<b>61</b>	<b>(35)</b>	<b>304</b>

Year to 4 April 2011	Statutory profit	FSCS and bank levy	Restructuring costs	Movements on derivatives and hedge accounting	Underlying profit
	£m	£m	£m	£m	£m
Net interest income	1,536	-	-	-	1,536
Other income	411	-	-	-	411
Movement on derivatives and hedge accounting	120	-	-	(120)	-
<b>Total income</b>	<b>2,067</b>	-	-	(120)	<b>1,947</b>
Administrative expenses	(1,123)	-	29	-	(1,094)
Depreciation and amortisation	(150)	-	-	-	(150)
Impairment losses	(425)	-	-	-	(425)
Provisions for liabilities and charges	(52)	50	-	-	(2)
<b>Profit before tax</b>	<b>317</b>	<b>50</b>	<b>29</b>	<b>(120)</b>	<b>276</b>

# Business review continued

## Performance by income statement category

### Net interest income

Net interest income, at £1,623 million was £87 million higher than the previous year.

	Year to 4 April 2012	Year to 4 April 2011
	£m	£m
Net interest income	<b>1,623</b>	1,536
Weighted average total assets	<b>195,612</b>	189,360
	%	%
<b>Net interest margin</b>	<b>0.83</b>	0.81

The Group's net interest margin has improved 2 basis points to 0.83% in the year to 4 April 2012 compared with the prior year. This includes £98 million of gains arising from the management of our liquidity portfolio (2011: £47 million), release of excess credit fair value adjustments of £5 million (2011: £36 million) and an additional £70 million from an update of our effective interest rate assumptions with respect to the recognition of mortgage fee income.

The margin was supported in the year by strong new business asset margins, including the significant positive impact of deal maturities that re-price as customers either revert to BMR or our Standard Mortgage Rate or opt to take a new mortgage product. This has been broadly offset by the increased cost of both liquidity, following full repayment of special liquidity scheme (SLS) balances, and funding

as a result of a competitive savings market that has been exacerbated by challenges within the wholesale funding market due principally to uncertainty relating to the ongoing Eurozone crisis.

Nationwide's BMR promise represents a significant distribution of value to our members in line with our mutual principles. However, this distribution of member value continues to be a significant factor contributing to margin compression, with balances in excess of £50 billion capped at 2 percentage points above base rate, which we estimate is having around a £750 million (0.38%) adverse impact on Group margin, by reference to SVRs available elsewhere in the market. We do not expect total BMR balances to grow significantly beyond their current level and forecasts indicate they will decline steadily from the middle of 2013 onwards.

### Underlying other income

	Year to 4 April 2012	Year to 4 April 2011
	£m	£m
Current account	<b>123</b>	106
Protection and investments	<b>106</b>	95
General insurance	<b>103</b>	88
Mortgage	<b>143</b>	57
Credit card	<b>33</b>	32
Commercial	<b>19</b>	20
Other	<b>(7)</b>	13
<b>Total underlying other income</b>	<b>520</b>	411
Movement on derivatives and hedge accounting	<b>35</b>	120
<b>Total statutory other income</b>	<b>555</b>	531

Underlying other income of £520 million is significantly higher than 2011 and includes a gain of £96 million in relation to the acquisition of a portfolio of UK based prime residential mortgages. Strong income growth in current accounts, protection and investments, and general insurance

continues to demonstrate the success of our strategic focus to grow the range and scale of our banking products and to diversify our income stream. The 'other' category includes personal loans, and other central fee income, offset by servicing fees in relation to the MySave savings product.

## Underlying expenses

	Year to 4 April 2012	Year to 4 April 2011
	£m	£m
Employee costs:		
• Wages and salaries	477	461
• Social security costs	45	40
• Pension costs	62	82
	584	583
Other administrative expenses	544	511
Administrative expenses (underlying)	1,128	1,094
Depreciation and amortisation	180	150
<b>Total underlying expenses</b>	<b>1,308</b>	<b>1,244</b>
Restructuring costs	61	29
Bank levy	16	-
<b>Total statutory expenses</b>	<b>1,385</b>	<b>1,273</b>

Underlying total expenses amounted to £1,308 million, representing an increase of 5% over the previous year. This is primarily driven by revenue expenditure and increased depreciation associated with the continuing strategic investment in our systems. In addition we continue to be impacted by external factors, including increases related to VAT, National Insurance and regulatory costs.

We are now in the final year of our three year cost optimisation programme and remain on track to deliver gross cost savings in excess of £200 million over the life of the project, with a number of new initiatives being identified. The programme has delivered cost reduction through business restructuring, revision of pension terms and increased efficiency. These reductions have enabled the business to absorb a significant proportion of the cost increases relating to growth in our sales and service volumes.

The underlying cost income ratio (CIR) for the year was 61.0% (2011: 63.9%). We remain committed to a medium term target for an underlying CIR of less than 50% in a normalised interest rate environment.

### Restructuring costs

These costs relate to the continuing restructuring of our business both to respond to challenging external market conditions and drive cost efficiency. The charge includes anticipated costs associated with completion of our three year cost optimisation programme, ongoing rationalisation of the branch network and progressive consolidation of our regional brands to focus on the core Nationwide brand reflecting its overwhelming strength within the market place.

### Bank levy

The bank levy charge of £16 million in the current year represents £3 million for the three month period 1 January 2011 to 4 April 2011 and £13 million for the year ending 4 April 2012. No charge was applied in the year to 4 April 2011 as the 2011 Finance Bill had not been enacted. Three different rates were applied during the accounting period. The averages of these rates were 0.082% for short term chargeable liabilities and 0.041% for long term chargeable liabilities. The Chancellor has announced a further increase in the rates from 1 January 2013 to 0.105% for short term chargeable liabilities and 0.0525% for long term chargeable liabilities. The Group expects this to increase the levy chargeable in 2012/13 by £1 million.

# Business review continued

## Impairment losses

Impairment losses for the year are £428 million (2011: £425 million) and comprise the following elements.

	Year to 4 April 2012	Year to 4 April 2011
	£m	£m
Prime residential	13	32
Specialist residential	57	69
Residential lending	70	101
Consumer banking	69	83
Retail lending	139	184
Commercial lending	247	175
Other lending	4	-
Impairment losses on loans and advances to customers	390	359
Impairment losses on investment securities	38	66
<b>Total</b>	<b>428</b>	<b>425</b>

Retail impairments have fallen by 24% to £139 million (2011: £184 million). This reduction reflects strong performance across all of retail portfolios as a result of a combination of stable house prices, a low interest rate environment and relatively robust employment trends. These factors have contributed to stable or improving arrears trends on our residential portfolios and levels of delinquency in consumer banking which have improved year on year and remain ahead of industry norms. The HPI decline of only 0.9% (Nationwide Index) during 2011/12 together with consistently prudent LTV lending policies over many years has restricted negative equity within the residential portfolios and ensured that loss severity for those cases that are in arrears is not increasing.

Commercial loan impairments were £247 million (2011: £175 million) representing an increase of 41%, driven by a return to recessionary conditions in the UK and widespread Eurozone concerns, both undermining investor confidence and appetite for the sector. In consequence after some recovery during 2010/11 the market is now experiencing falls in commercial real estate valuations with an expectation that, whilst not severe, this trend will persist at least throughout 2012. Secondary office and retail sites and certain regional centres are particularly affected and an overall mood of uncertainty is affecting valuations and restricting even further the availability of both equity and debt finance to support restructurings.

The increased impairment in the year is largely attributable to new and additional provisions on existing watch list cases where valuations have been eroded or the commitment of equity providers to further investment has been withdrawn.

In addition we have reflected a more negative outlook for commercial property over the next 12 months with

an increase of approximately £23 million in our collective provision which accounts for around 32% of the year on year increase in the impairment charge.

The number of Nationwide originated commercial property cases more than three months in arrears decreased to 210 cases (2011: 235 cases). The total value of arrears on these cases was £59 million (2011: £48 million) reflecting the recessionary market conditions and more restricted ability to resolve certain longer term cases. The overall level of provision for commercial lending as a percentage of Nationwide originated assets is 2.65% (2011: 2.18%), and the provision coverage ratio against balances more than three months in arrears is 67% (2011: 69%).

In relation to other lending, a net increase in the provision held for restructured loans in the secured portfolio of £3.3 million, in addition to an increase in the collective provision of £0.4 million, resulted in a charge of £3.7 million in the year. Overall, with a £0.5 million charge for the student loan portfolio, there is a total impairment charge of £4.2 million reported in other lending. This lending is included within the Head office functions business segment, as the portfolios were acquired by our Treasury Division.

The impairment losses on investment securities of £38 million (2011: £66 million) relates to our treasury assets and equity shares impairment charge and includes £17 million for a collateralised debt obligation (CDO) of US residential mortgage backed securities (RMBS), £9 million on a UK commercial mortgage backed security (CMBS), £5 million on Portuguese bank subordinated debt and £7 million in respect of our private equity portfolio. The prior year charge of £66 million was driven by a £22 million impairment of a number of US RMBS exposures, £15 million on a CMBS, £18 million from restructuring of subordinated debt from Irish banks and £11 million on notes of a restructured Structured Investment Vehicle (SIV).

## Underlying provisions for liabilities and charges

	Year to 4 April 2012	Year to 4 April 2011
	£m	£m
Payment protection insurance (PPI)	103	16
Other provisions	-	(14)
Underlying provisions for liabilities and charges	103	2
FSCS	59	50
Statutory provisions for liabilities and charges	162	52

The increase in PPI provision follows significant developments since the initial PPI provision was estimated. 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 complaints. The costs of processing claims, including those that are vexatious, are substantial, and account for 40% of this year's charge.

The previous year's 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. 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. During the year the Group has implemented a valuation methodology change to use overnight indexed swap rates (OIS) for the discounting in the valuation of collateralised derivatives in

line with best market practice. The Group has also refined its estimation technique for fair valuing certain derivatives and associated assets or liabilities being hedged.

The £35 million credit (2011: £120 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, or because hedge accounting has not been adopted or is not achievable.

The overall impact of derivatives will remain volatile year to year 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, 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 £24 million (2011: £69 million). This represents an effective tax rate of 11.8% (2011: 21.8%), which is lower than the statutory rate in the UK of 26% (2011: 28%). The lower rate is due principally to adjustments with respect to prior periods and the effect of the change in the UK corporation tax rate from 26% to 24%, partially offset by the charge for the bank levy which is not an allowable deduction for corporation tax. The main items included within the adjustments with respect to prior periods are the release of £21 million of provisions held in respect of previously uncertain liabilities on historic transactions which are no longer required.

### Corporation tax rate change

The Chancellor announced on 21 March 2012 that the corporation tax rate would reduce from 26% to 24%. As a result the Group has written off £23 million of its deferred tax asset to reserves. This has resulted in credits to the income statement and revaluation reserve of £12 million and £1 million respectively, and debits to the available for sale reserve and general reserve of £12 million and £24 million respectively.

### Total tax contribution

During 2012 the Group incurred taxes of £250 million (2011: £200 million) including £133 million (2011: £103 million) of irrecoverable VAT, which represents a cost to the Group charged to profit before tax as part of administrative expenses and depreciation. The increase in the VAT rate from 17.5% to 20% resulted in an additional £11 million of costs to the Group. In addition, the Group collected and remitted on behalf of HM Revenue & Customs a further £436 million (2011: £409 million).

Corporate taxes paid were £37 million (2011: £33 million). The cash tax rate based on these payments was 18.2% (2011: 10.4%). The reason for the low cash tax rate in both periods was due to the availability of taxable trading losses to offset taxable profits and because significant contributions paid to the pension fund during the year have reduced taxable profit but not reported profit before tax. Once the tax losses carried forward are fully utilised the group expects the cash tax rate and the effective tax rate to be broadly the same.

Total taxes paid directly by the Group	Year to 4 April 2012	Year to 4 April 2011
	£m	£m
<b>Taxes paid</b>		
Corporate income taxes	<b>37</b>	33
Indirect taxes (irrecoverable VAT)	<b>133</b>	103
Employment taxes	<b>47</b>	42
Taxes on property	<b>22</b>	22
Bank levy	<b>11</b>	-
<b>Total</b>	<b>250</b>	200
 <b>Taxes collected and remitted</b>		
Tax withheld at source (on savings accounts)	<b>281</b>	266
Payroll taxes	<b>134</b>	127
Indirect taxes (Insurance Premium Tax and VAT)	<b>21</b>	16
<b>Total</b>	<b>436</b>	409
<b>Total</b>	<b>686</b>	609

## Balance Sheet

### Loans and advances to customers

Lending remains predominantly concentrated on high quality secured products, with residential mortgages accounting for 83.8% of our total loans and advances to customers. The composition of lending has remained broadly consistent with that reported at 4 April 2011.

Loans and advances to customers	4 April 2012		4 April 2011	
	£bn	%	£bn	%
Prime residential mortgages	<b>105.6</b>	<b>68.7</b>	104.3	69.7
Specialist residential mortgages	<b>23.2</b>	<b>15.1</b>	20.3	13.6
<b>Total residential mortgages</b>	<b>128.8</b>	<b>83.8</b>	124.6	83.3
Commercial lending	<b>21.5</b>	<b>14.0</b>	22.0	14.7
Other lending	<b>0.5</b>	<b>0.3</b>	0.5	0.3
Consumer banking	<b>3.0</b>	<b>1.9</b>	2.5	1.7
<b>Gross balances</b>	<b>153.8</b>	<b>100.0</b>	149.6	100.0
Impairment provisions	<b>(0.8)</b>		(0.8)	
Fair value adjustments for micro hedged risk	<b>1.2</b>		0.6	
<b>Total</b>	<b>154.2</b>		149.4	

#### Residential

Prime residential mortgages are primarily Nationwide branded advances made through our branch network and intermediary channels. In addition, our balance sheet includes prime mortgages totalling £3.4 billion that were brought onto our balance sheet in prior years following our acquisitions of the Derbyshire, Cheshire and Dunfermline portfolios and £1.2 billion in relation to the acquisition of the Bank of Ireland mortgage book in December 2011, in addition to a small element of prime residential lending originated through our specialist lending brand, The Mortgage Works (TMW).

Specialist residential mortgages are made up of £20.5 billion of advances made through our specialist lending brands, TMW and UCB Home Loans Corporation Limited (UCB), and £2.7 billion arising from the acquisitions of the Derbyshire, Cheshire and Dunfermline portfolios in

prior years. Loans were advanced primarily in the buy to let and self-certification markets. Buy to let mortgages make up 77% of total specialist lending, 16% relates to self-certification mortgages, 5% relates to near prime and just 2%, amounting to £0.4 billion, relates to sub prime. New specialist lending is restricted to buy to let with the Group having withdrawn from the self-certified lending market in 2009.

We have continued to focus on affordability and loan to value (LTV) ratios in underwriting loans during the year. The average LTV of residential mortgages completed has reduced to 63% (2011: 66%) as we have increased our proportion of lending to the remortgage market. The average indexed LTV of residential mortgages at 4 April 2012 has remained broadly stable at 50% (2011: 49%).

# Business review continued

Loan to value analysis: (Analysis calculated on a volume basis)	4 April 2012	4 April 2011
	%	%
<b>Total book:</b>		
<50%	<b>50</b>	52
50% - 60%	<b>10</b>	9
60% - 70%	<b>11</b>	11
70% - 80%	<b>13</b>	11
80% - 90%	<b>10</b>	10
90% - 100%	<b>4</b>	5
>100%	<b>2</b>	2
	<b>100</b>	100
Average LTV of stock (indexed)	<b>50</b>	49
Average LTV of new business*	<b>63</b>	66

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

The table below shows that arrears on the Group's prime lending remained stable at 0.54%, whilst there has been a reduction in specialist arrears as a result of reducing arrears volumes and strong book growth in TMW.

Our arrears performance remains very favourable relative to the CML industry average, and our specialist lending arrears are now below the overall industry measure that is inclusive of prime lending.

Cases more than 3 months in arrears as % of total book	4 April 2012	4 April 2011
	%	%
Prime	<b>0.54</b>	0.54
Specialist	<b>1.87</b>	2.47
<b>Group</b>	<b>0.73</b>	0.77
<b>CML Industry Average</b>	<b>1.96</b>	2.09

Total residential balance sheet provisions are £202 million, compared with £201 million at 4 April 2011, giving a coverage ratio against total originated balances of 0.16% (2011: 0.17%) and against originated balances more than three months in arrears of 18.6% (2011: 17.6%).

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, £71 million of losses have been written off and, as reported at 4 April 2012, £33 million of surplus fair value credit risk adjustment on mortgage books has been released to margin. It is believed that the remaining £95 million is sufficient to cover all expected future losses on these acquired residential portfolios.

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 monthly payment due. If the

customer can meet the interest portion of their repayment, we may grant a temporary interest only concession which would be non-arrears bearing so long as the customer continues to meet the terms of the new arrangement. Where this is not the case, arrears will continue to accrue and will be included in the arrears numbers reported above. Payment holidays are also non-arrears bearing, but a credit score assessment is included as part of the eligibility criteria to restrict the use of this concession.

If a customer demonstrates they are able to meet a payment schedule at a normal commercial rate for a period of six months or if they are able to overpay such that six months' full payments are made in a four month period, 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 properties in possession at 4 April 2012 was 1,129 properties representing 0.08% of our book, which compares well with the industry measure of 0.12%. The table below shows possessions as a percentage of book.

Possessions as % of total book (number of borrowers)		4 April 2012		4 April 2011
		Number of borrowers	%	%
Prime		291	0.02	0.03
Specialist		806	0.41	0.38
<b>Group</b>		<b>1,097</b>	<b>0.08</b>	0.07

Possessions as % of total book (number of properties)		4 April 2012		4 April 2011
		Number of properties	%	%
Prime		291	0.02	0.03
Specialist		838	0.40	0.38
<b>Group</b>		<b>1,129</b>	<b>0.08</b>	0.07
<b>Industry statistics</b>			<b>0.12</b>	0.12

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 the properties taken into possession has reduced to 1,885 representing 5.0% of properties taken in by the industry as a whole, against our par share of all cases of 12.4% (2011: 11.4%).

#### Commercial

Our commercial lending portfolio of £21.5 billion (2011: £22.0 billion) consists of £20.4 billion (2011: £20.8 billion) of self originated lending and £1.1 billion (2011: £1.2 billion) of assets acquired from the Derbyshire, Cheshire and Dunfermline building societies. Our originated portfolio comprises £11.2 billion secured on commercial property (Property Finance), £7.7 billion advanced to Registered Social Landlords and £1.5 billion advanced under Project Finance (principally via the Private Finance Initiative). Our Property Finance portfolio is diverse both in terms of sectors and geographic spread.

On self originated lending we have only modest exposure to development finance, with total balances of £142 million (2011: £172 million). The non-UK element of our commercial property portfolio, at £1.0 billion (2011: £1.1 billion) does not contain any exposure to Greece, Italy, Portugal or Spain and only a single exposure to Ireland.

The number of Nationwide originated commercial property cases more than three months in arrears decreased from 235 cases at 4 April 2011 to 210 cases at 4 April 2012. This equates to 2.33% of commercial originated accounts (2011: 2.41%). Total arrears balances on these cases at 4 April 2012 were £59 million (2011: £48 million) reflecting the recessionary market conditions. Robust arrears management continues to focus on close and proactive management of arrears and loan maturities and there are currently no arrears of three months or more on the Registered Social Landlord or PFI portfolios.

Economic uncertainty, ongoing funding pressures across the banking sector and a trend towards higher regulatory capital requirements for Commercial Real Estate (CRE) lending have significantly reduced the availability of credit for refinance within the sector. Furthermore, current depressed property values mean that foreclosure on loans which are operating outside the original terms of their advance is unlikely to provide the best economic outcome, except in those cases where ongoing serviceability is unachievable and/or the prospects of any recovery in cashflow performance or capital value is unlikely. Our strategy remains one of prudent loss mitigation over the medium term in a market which is both cyclical and currently experiencing extremely low investor demand. We make refinance available for existing exposures where we are satisfied that we continue to have a constructive relationship with the borrower which recognises our interests, and can achieve a level of expected return which reflects current funding costs or where there is a realistic likelihood that recovery over the medium term in the hands of the borrower represents a better prospect than short term disposal. To the extent this strategy leads to forbearance on loans which are renewed at 'off-market' interest rates or where the most likely outcome remains an ultimate financial loss, then impairment provisions are recognised in accordance with relevant accounting requirements.

Commercial mortgage assets totalling £1 billion acquired through mergers with Cheshire and Derbyshire have been fair valued in the same way as described for residential assets above including a credit risk adjustment of £179 million for expected losses over the remaining life of the loans. To date £19 million of additional provisions have been raised on individually assessed cases that have an impairment provision requirement in excess of the original fair value adjustment. In most cases however the credit risk adjustment exceeds the current impairment provision requirement. The acquisition of the Dunfermline's social housing portfolio was similarly fair valued and has seen no credit losses to date.

# Business review continued

## Other lending

Other lending includes £262 million (2011: £241 million) of secured lending relating to a European commercial loan portfolio and a loan secured by a senior ABS reference portfolio, and unsecured lending of £231 million (2011: £251 million) relating to a student loan portfolio. These investments were acquired by the Treasury Division and are therefore held within the head office functions business segment.

## Consumer banking

In consumer banking, the percentage of delinquent balances more than 30 days in arrears has shown an improvement across all products, and where available our performance compared with the industry remains favourable.

Percentage of delinquent balances more than 30 days in arrears	4 April 2012	4 April 2011
	%	%
FlexAccount	<b>9.18</b>	10.46
Personal loans	<b>3.14</b>	5.45
Credit cards	<b>2.72</b>	3.36

## Funding and Liquidity

### Overview

The Group 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 manage actively our balance sheet in response to conditions in both the retail and wholesale markets.

We have always maintained a high level of unencumbered liquid assets relative to our banking peers, and our core liquidity remains stable at 13.7% (2011: 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 represents a key area of risk management for financial institutions. In recent years there has been an increased focus on liquidity from the regulatory authorities. Having successfully met the timeframes for compliance with new regulatory requirements, the Group continues to enhance and strengthen its liquidity management systems and approach.

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 stable funding 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 2012 the LCR was estimated at 124% and the NSFR at 118% against proposed regulatory requirements of 100%. 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.

Liquidity stress testing is carried out against a number of scenarios including those prescribed by the regulator, considering a range of liquidity and economic factors and the consequent impact on the Group over multiple time horizons. Liquidity risk is managed against limits using a number of these scenarios. Included within the liquidity stresses is the deemed impact of potential rating agency downgrades. Nationwide also has in place a Contingency Funding Plan which details a range of actions the Group would be able to take in the event of a funding stress, including the utilisation of our large stock of self issued RMBS and covered bonds via repurchase agreements, allowing us to maintain adequate liquidity resources.

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 continued investment in 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.

As at 4 April 2012, the core liquidity portfolio as a percentage of adjusted share, deposit and loan liabilities was 13.7% (2011: 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.

#### **Other Eligible Central Bank Assets**

In addition to the core portfolio, as at 4 April 2012 the Group held a stock of unencumbered securities that are eligible for use in the funding operations of those central banks that we have access to. This figure does not include the value of self issue securities that could also be included in some central bank operations. 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 European Central Bank's operations but may be capable of financing through third party repo agreements.

#### **Self Issued RMBS and Covered Bonds**

The Group holds undrawn a total of £16.3 billion (2011: £18.3 billion) of AAA notes issued under the Group's asset backed funding programmes. These self issued notes represent eligible collateral for use in repurchase agreements with third parties or in central bank operations.

The table below sets out the fair value of each of the above liquidity types as at 4 April 2012. The table is not a representation of the accounting balance sheet position as it includes off balance sheet liquidity (including self issued RMBS and covered bonds) but excludes any encumbered assets.

	4 April 2012	4 April 2011
	£bn	£bn
Core liquidity	<b>24.5</b>	23.5
Other central bank eligible assets	<b>2.5</b>	5.6
Other securities	<b>4.0</b>	3.2
Self issued RMBS and covered bonds	<b>16.3</b>	18.3
<b>Total</b>	<b>47.3</b>	50.6

#### **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 2012		4 April 2011	
	£bn	%	£bn	%
Repo and other secured arrangements	<b>3.7</b>	<b>7.5</b>	2.7	5.8
Deposits, including PEB balances	<b>7.8</b>	<b>15.9</b>	7.2	15.5
Certificates of deposit	<b>4.3</b>	<b>8.7</b>	4.7	10.2
Commercial paper	<b>3.7</b>	<b>7.5</b>	6.2	13.3
Covered bonds	<b>13.0</b>	<b>26.5</b>	12.3	26.5
Medium term notes	<b>7.1</b>	<b>14.5</b>	8.4	18.1
Securitisations	<b>7.4</b>	<b>15.1</b>	3.7	8.0
Other	<b>2.1</b>	<b>4.3</b>	1.2	2.6
<b>Total</b>	<b>49.1</b>	<b>100.0</b>	46.4	100.0

We have received new investment premiums of £0.8 billion into protected equity bonds (PEBs) during the year, increasing total PEB balances to £2.9 billion as at 4 April 2012 (2011: £2.1 billion).

During the 2011/12 financial year we remained active in the long term markets utilising all our platforms to issue a total of £7.9 billion sterling equivalent which was significantly in excess of our maturities of £3.5 billion.

The following public transactions issued during the year demonstrated the strength of institutional support as well as the breadth of funding available for Nationwide:

- £1.5 billion of 5 year covered bond issued in October 2011
- RMBS issuances raising £3.8 billion sterling equivalent in US dollars and sterling via tranches of 3, 5 and 9

years; both the 5 year and 9 year helped to develop this market that has historically concentrated around shorter maturities

- €1 billion 5 year senior unsecured issuance, our first euro senior unsecured issuance for over two years
- £650 million 3 year floating rate covered bond, further developing the sterling covered bond market which had previously been dominated by longer dated, fixed rate issuance.

In addition to the public transactions a combined total of £1.3 billion private placements were issued to institutional investors during the year in both secured and unsecured formats. These issuances had durations ranging from 12 months to 21 years and had a weighted average life of over 13 years.

# Business review continued

During the year, SLS drawings were fully repaid well ahead of both our contractual commitments and our bilateral agreements with the BoE. In addition we have repaid £1.5 billion of Credit Guarantee Scheme (CGS) drawings during the year and have repaid a further US\$2 billion since the year end. Our remaining CGS drawings amount to a single issue of US\$2 billion which is due for repayment in August 2012.

The Group has reduced the amount of short term funding it holds to £12 billion (2011: £15 billion and 2010: £16 billion)

and we have been able to maintain a consistent presence in short term markets during the year. The average term at the point of issuance of outstanding short term balances as at 4 April 2012 was 131 days (2011: 156 days).

The Group has extended the residual maturity profile of its wholesale funding portfolio from 33 months to 37 months and the proportion of funding that is categorised as long term (>1 year to maturity) has increased to 62.7% (2011: 56.3%).

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

Wholesale funding residual maturity	4 April 2012		4 April 2011	
	£bn	%	£bn	%
Less than one year	<b>18.3</b>	<b>37.3</b>	20.3	43.7
One to two years	<b>3.9</b>	<b>7.9</b>	4.9	10.6
Two to five years	<b>17.6</b>	<b>35.8</b>	13.6	29.3
More than five years	<b>9.3</b>	<b>19.0</b>	7.6	16.4
<b>Total</b>	<b>49.1</b>	<b>100.0</b>	46.4	100.0

Our short and long term credit ratings from the major rating agencies as at 22 May 2012 are as follows:

	Long Term	Short Term	Subordinated	Date of last rating action/ confirmation*
Standard & Poor's	A+	A-1	BBB+	December 2011
Moody's	A2	P-1	Baa1	October 2011
Fitch	A+	F1	A	February 2012
DBRS	AA (low)	R-1 (middle)	A (high)	March 2012

\* The outlook for Standard & Poor's, Moody's and DBRS is Stable, outlook for Fitch is Negative.

## Treasury asset quality

Group treasury assets at 4 April 2012 were £34.3 billion (2011: £31.9 billion) and are held in two separate portfolios; the core liquidity portfolio and the non-core portfolio. At 4 April 2012, the core liquidity portfolio totalled £24.8 billion (2011: £18.7 billion) with the non-core portfolio totalling £9.5 billion (2011: £13.2 billion). The £6.1 billion increase in the core liquidity portfolio comprises high quality, predominantly sovereign or government backed assets. The reporting of asset quality within the treasury portfolio has been modified to reflect the management of the portfolios and to bring the analysis in line with FSA definitions as laid out in BIPRU 12.

We have continued to manage the treasury asset portfolio to increase the quality and liquidity of the assets with over 72% of the total portfolio held in core liquidity exposures (2011: 59%). 97% of the portfolio is rated A or better with 84% rated AA or above (2011: 97% rated A or better, 82% rated AA or better).

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 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 so called 'peripheral' Eurozone countries (Portugal, Ireland, Italy, Greece and Spain). Within the treasury assets we have £1.2 billion non-sovereign securities issued in these countries as detailed in the 'Country exposures' section. Of this 49% is rated AA or above and 70% is rated A or above. This exposure has reduced by 41% in the year and a further nominal £170 million, primarily senior debt, matures in the next year. Belgium is also being closely monitored as part of the Eurozone watch list although outstanding exposure is modest at £44 million.

An independent monthly review is undertaken 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 £75 million of exposure to monoline insured transactions. We are reliant on the monoline insurance provider for one holding (exposure £2 million) but in all other cases we anticipate full repayment without any assistance from the insurance provider.

Additional information on the treasury asset portfolio is disclosed in note 36.

#### Available for sale reserve

Out of a total of £34.3 billion of assets held in the core liquidity and non-core portfolios, £23.3 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 loans to banks or deposits with the Bank of England. Of the £23.3 billion of AFS assets only £76 million are classified as Level 3 (valuation not based on observable market data) for the purposes of IFRS 7.

The assets have been reviewed based upon latest performance data and an impairment charge of £31 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 or its regulatory capital.

As at 4 April 2012, the balance on the AFS reserve had improved to £356 million negative, net of tax (2011: £487 million negative). The improvement in the AFS reserve reflects the repayment of some of the non-core assets and a gradual pull towards par as the maturity profile of the remaining portfolio shortens. There has also been a strengthening of prices in some asset classes as market sentiment has improved.

	4 April 2012		4 April 2011	
	Fair value on balance sheet £bn	Cumulative AFS reserve £bn	Fair value on balance sheet £bn	Cumulative AFS reserve £bn
Cash	<b>8.1</b>	-	6.1	-
Gilts	<b>12.8</b>	<b>(1.0)</b>	8.6	0.1
Non-domestic government bonds	<b>2.4</b>	-	2.2	(0.1)
Supranational bonds	<b>1.5</b>	<b>(0.1)</b>	1.8	(0.1)
<b>Core liquidity portfolio total</b>	<b>24.8</b>	<b>(1.1)</b>	18.7	(0.1)
Loans and advances to banks	<b>2.9</b>	-	4.2	-
Residential mortgage backed securities (RMBS)	<b>2.1</b>	<b>0.4</b>	2.8	0.2
Commercial mortgage backed securities (CMBS)	<b>0.5</b>	<b>0.1</b>	0.6	0.1
Covered bonds	<b>0.9</b>	-	0.7	-
Collateralised loan obligations (CLO)	<b>0.6</b>	-	0.6	0.1
Financial institutions bonds	<b>1.4</b>	-	3.0	0.3
US student loans	<b>0.7</b>	<b>0.1</b>	0.7	0.1
Other investments	<b>0.4</b>	-	0.6	-
<b>Non-core portfolio total</b>	<b>9.5</b>	<b>0.6</b>	13.2	0.8
<b>(Positive)/Negative AFS reserve before hedge accounting and taxation</b>		<b>(0.5)</b>		0.7
Hedge accounting adjustment for interest rate risk		<b>1.0</b>		-
Taxation		<b>(0.1)</b>		(0.2)
<b>Total value of AFS assets/Negative AFS reserve (net)</b>	<b>34.3</b>	<b>0.4</b>	31.9	0.5

# Business review continued

## Country exposures

The following section summarises the Group's direct exposure to institutions, corporates and other issued securities domiciled in the peripheral Eurozone countries. The exposures are shown at their balance sheet carrying values.

4 April 2012	Greece	Ireland	Italy	Portugal	Spain	Total
	£m	£m	£m	£m	£m	£m
Mortgage backed securities	-	134	105	39	348	626
Covered bonds	-	71	-	17	334	422
Senior debt	-	31	36	-	96	163
Other assets	1	-	6	-	4	11
Other corporate	-	8	3	-	-	11
<b>Total</b>	<b>1</b>	<b>244</b>	<b>150</b>	<b>56</b>	<b>782</b>	<b>1,233</b>

4 April 2011	Greece	Ireland	Italy	Portugal	Spain	Total
	£m	£m	£m	£m	£m	£m
Mortgage backed securities	-	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
Other corporate	-	8	4	-	2	14
<b>Total</b>	<b>3</b>	<b>324</b>	<b>293</b>	<b>163</b>	<b>1,308</b>	<b>2,091</b>

Since 4 April 2012 the £163 million senior debt exposures above have further reduced by £31 million of Irish and £12 million of Italian senior debt which have been repaid. A further £82 million of Spanish senior debt is due for repayment before the end of August 2012.

Movements in our exposure to peripheral Eurozone countries since 4 April 2011 relate to disposals, maturities and fair value movements and there has been no new investment in the year.

Nationwide has further indirect exposure to peripheral Eurozone countries as a result of a €100 million loan to

a Luxembourg SPV, which has first loss exposure to a €2.1 billion portfolio of senior ranking European ABS assets. The sterling equivalent is £82.7 million (2011: £88.7 million). The geographical breakdown of this portfolio is as follows: UK 51%, Germany 16%, Spain 14%, Italy 8%, Netherlands 6%, Greece 3% and Portugal 2% (2011: UK 50%, Germany 15%, Spain 15%, Italy 9%, Netherlands 6%, Greece 3% and Portugal 2%).

In addition, the Group's exposure in respect of other non-UK countries is shown below at their balance sheet carrying value.

4 April 2012	Belgium	France	Germany	Netherlands	USA	Other	Total
	£m	£m	£m	£m	£m	£m	£m
Government bonds	-	-	169	1,049	1,104	75	2,397
Mortgage backed securities	41	34	114	239	110	147	685
Covered bonds	-	-	84	45	26	82	237
Senior debt	3	118	100	125	205	332	883
Loans and advances to banks	-	127	41	-	490	766	1,424
Other assets	-	-	35	-	1,335	1,441	2,811
Other corporate	-	46	984	25	28	21	1,104
<b>Total</b>	<b>44</b>	<b>325</b>	<b>1,527</b>	<b>1,483</b>	<b>3,298</b>	<b>2,864</b>	<b>9,541</b>

4 April 2011	Belgium	France	Germany	Netherlands	USA	Other	Total
	£m	£m	£m	£m	£m	£m	£m
Government bonds	-	-	568	686	867	47	2,168
Mortgage backed securities	42	44	149	258	117	144	754
Covered bonds	-	-	128	60	27	92	307
Senior debt	74	202	179	246	393	615	1,709
Loans and advances to banks	-	547	93	-	893	866	2,399
Other assets	-	9	11	76	1,495	1,767	3,358
Other corporate	2	58	1,053	47	26	27	1,213
<b>Total</b>	<b>118</b>	<b>860</b>	<b>2,181</b>	<b>1,373</b>	<b>3,818</b>	<b>3,558</b>	<b>11,908</b>

The 'Other' column represents exposures to the following countries: Australia £290 million (2011: £423 million), Austria £nil (2011: £7 million), Canada £532 million (2011: £383 million), Denmark £24 million (2011: £44 million), Finland £126 million (2011: £123 million), Iceland £6 million (2011: £6 million), Luxembourg £7 million (2011: £8 million), Norway £36 million (2011: £70 million), Sweden £4 million (2011: £38 million), Switzerland £410 million (2011: £701 million) and Supranationals £1,429 million (2011: £1,755 million).

# 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 the rules which implement the EU Capital Requirements Directive (Basel II). Since 4 April 2009 the Group has predominantly calculated its capital requirement on an Internal Ratings Based (IRB) approach.

As at 4 April 2012, regulatory capital stood at £9.0 billion (2011: £9.2 billion) with the Group's total solvency ratio remaining strong at 18.9% (2011: 19.5%). The Core Tier 1 solvency ratio remains at 12.5% (2011: 12.5%).

Nationwide called €300 million of Lower Tier 2 subordinated debt in December 2011 with no requirement from the FSA to refinance the redemption. In common with all European banks, we are constantly reviewing the appropriateness of our capital structure. Future decisions with respect to capital calls will be made in light of the then prevailing market, economic and regulatory conditions.

The pension fund net deficit add back increased to £383 million (2011: £33 million). More detail is provided in the Pension Fund section.

	4 April 2012	4 April 2011
	Basel II IRB	Basel II IRB
	£m	£m
General reserve	<b>6,450</b>	6,659
Regulatory adjustments:		
• Prudential valuation adjustment (Note 1)	(1)	-
• Defined benefit pension fund adjustment (Note 2)	<b>383</b>	33
Deductions (Note 3):		
• Intangible assets (Note 4)	(665)	(513)
• Goodwill (Note 4)	(16)	(16)
• Excess of expected losses over impairment (50%)	(57)	(52)
• Securitisation positions (50%)	(152)	(198)
• Other (50%)	(6)	(6)
	<b>(896)</b>	(785)
<b>Core Tier 1 capital</b>	<b>5,936</b>	5,907
Permanent interest bearing shares (Note 5)	<b>1,625</b>	1,510
<b>Total Tier 1 capital</b>	<b>7,561</b>	7,417
<b>Tier 2</b>		
Dated subordinated debt (Note 5)	<b>1,475</b>	1,884
Revaluation reserve	<b>65</b>	70
Collectively assessed impairment allowances	<b>110</b>	118
Deductions (Note 3):		
• Excess of expected losses over impairment (50%)	(57)	(52)
• Securitisation positions (50%)	(152)	(198)
• Other (50%)	(6)	(6)
	<b>(215)</b>	(256)
<b>Tier 2 capital</b>	<b>1,435</b>	1,816
<b>Total regulatory capital</b>	<b>8,996</b>	9,233

	4 April 2012	4 April 2011
	Basel II IRB	Basel II IRB
<b>Key capital ratios (Note 6):</b>	%	%
Core Tier 1	<b>12.5</b>	12.5
Tier 1	<b>15.9</b>	15.7
Total capital	<b>18.9</b>	19.5
<b>Risk weighted assets (Note 7):</b>	£m	£m
Credit risk:		
• Retail mortgages	<b>15,958</b>	15,081
• Commercial loans	<b>17,166</b>	17,610
• Treasury	<b>3,632</b>	4,088
• Other	<b>6,890</b>	6,388
Total credit risk	<b>43,646</b>	43,167
Operational risk	<b>3,760</b>	4,137
Market risk	<b>68</b>	72
<b>Total risk weighted assets</b>	<b>47,474</b>	47,376

#### Notes

- (1) A prudential valuation adjustment has been applied in respect of fair valued instruments as required under regulatory capital rules.
- (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) 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.
- (4) Intangible assets and goodwill do not qualify as capital for regulatory purposes.
- (5) 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.
- (6) Solvency ratios are calculated as relevant capital divided by risk weighted assets.
- (7) The Basel II Pillar 1 capital requirements (risk weights) are calculated using the Retail IRB approach for prime mortgages (other than those originated by the Derbyshire, Cheshire and Dunfermline 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.

In December 2010, the Basel Committee on Banking Supervision issued its final Basel III text. 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'. In July 2011, the European Commission released its proposal for implementing Basel III into Europe. The key elements of the Basel III rules that CRD IV is expected to incorporate are as follows:

- Capital requirements – higher minimum capital ratios and the introduction of conservation and countercyclical buffers, which are expected to come into force over the period 2016-19.
- Definition of capital – permanent interest bearing shares (PIBS) and subordinated debt will be phased out over ten years from 2013. The effect on the capital recognition of subordinated debt is minimal, with PIBS only materially impacted in the final years of the grandfathering period. Over the period 2014-18, there will be changes and additions to capital deductions. 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 anticipated to reduce by 2014.
- 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. The capital charge for financial transactions with large counterparties will also be increased.

- Securitisation exposures – the proposal calls for certain securitisation exposures to be risk-weighted at 1,250% from 2013 as opposed to being treated as capital deductions (50% Core Tier 1 and 50% Tier 2).

All the above regulatory changes are reflected in the firm's capital management plan. Nationwide has a strong track record of robust capital ratios and is confident that it is well positioned to maintain its overall capital strength. CRD IV is expected to be finalised in the coming months, after which a full capital impact assessment will be undertaken.

The release of the draft CRD IV text was followed by the final recommendations from the Independent Commission on Banking (ICB) in September 2011. Whilst we are broadly supportive of the ICB reforms, we feel that the imposition of a leverage ratio at a level well in excess of that proposed by Basel III/CRD IV is inappropriate for institutions with high value, low risk balance sheets including institutions like Nationwide with the majority of their loans in the form of prime residential mortgages. We will continue to lobby policymakers to ensure that leverage ratios are introduced into the regulatory framework in a balanced and proportionate way in order to avoid hampering our ability to supply credit to the wider economy and provide an effective challenge to the banks in the interests of consumers.

# Business review continued

## 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 all defined benefit arrangements measured under *IAS 19: Employee Benefits* is £517 million (2011: £300 million). The movement in the net liability over the year comprises:

	Year to 4 April 2012	Year to 4 April 2011
	£m	£m
Net retirement benefit liability at 4 April 2011	300	508
Service charge	50	76
Expected return on assets	(195)	(168)
Expected interest cost	166	166
Net actuarial loss/(gain)	494	(114)
Curtailment and past service	(2)	1
Employer contributions	(296)	(169)
<b>Net retirement benefit liability at 4 April 2012</b>	<b>517</b>	<b>300</b>

The Fund was closed to new entrants in 2007 and the final salary section closed to further accrual on 31 March 2011. From 1 April 2011 accrual in the CARE section continued for existing members, with a revised benefit structure in operation. The impact of these changes is a reduction in both the service charge and in the ongoing employer contributions to the Fund.

Following the results of the triennial valuation of the Fund at 31 March 2010, the Group paid additional contributions of £241 million (2011: £99 million) into the defined benefit

funds during the year which are included in the employer contributions above.

The increase in the net liability of the Fund at 4 April 2012 primarily arises because of a reduction in the discount rate used which has placed a higher value on the liabilities. Under IAS 19, the discount rate used to value Fund liabilities is based on the yield of AA-rated corporate bonds, which have decreased significantly in the year. This impact was partly offset by a reduction in the inflation and salary increase assumptions.

## 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
- Distribution channels supporting these product divisions.

### Commercial

- Commercial lending.

### Head Office Functions

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

During the year ending 4 April 2012, the Group revised the methodology for allocating the benefit of free capital between segments to align it more closely with regulatory capital requirements across business segments. Comparatives have been reclassified to be presented on a basis which is consistent with the current year's presentation.

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

	Year to 4 April 2012	Year to 4 April 2011
	£m	£m
Retail	<b>529</b>	464
Commercial	(196)	(129)
Head office functions	(29)	(59)
<b>Underlying profit before tax</b>	<b>304</b>	276
FSCS levies	(59)	(50)
Restructuring costs	(61)	(29)
Bank levy	(16)	-
Movements on derivatives and hedge accounting	35	120
<b>Statutory profit before tax</b>	<b>203</b>	317

## Retail business

	Year to 4 April 2012	Year to 4 April 2011
	£m	£m
Net interest income	<b>1,470</b>	1,378
Other income	<b>502</b>	381
Total income	<b>1,972</b>	1,759
Expenses	(1,201)	(1,109)
Impairment and other provisions	(242)	(186)
<b>Underlying profit before tax</b>	<b>529</b>	464

### Profitability

The Retail business made an underlying profit of £529 million, an increase of 14% compared with the previous year. Nationwide has a strong franchise, and our retail products have continued to perform well against a challenging backdrop.

Total income increased by 12% to £1,972 million, driven by £121 million growth in other income and £92 million from net interest income. Net interest income includes an additional £70 million from an update of our effective interest rate assumptions to reflect our latest mortgage profile expectations. Strong growth in other income from current accounts, investments and general insurance has been achieved during the year as a result of volume growth across the product range in line with our strategy of income diversification. Other income growth also includes a £96 million gain on acquisition of a high quality, prime residential mortgage portfolio.

The growth in net interest income for the year of £92 million is in part due to growth in new lending on prime

residential mortgages, buy to let mortgages and personal loans and includes the positive impact of asset repricing as mortgage customers revert to BMR or our Standard Mortgage Rate, or opt to take a new mortgage product as historically low fixed and tracker rate deals written in 2006-2007 mature. Margins on new mortgage lending have increased in the second half of the year as additional funding and liquidity costs across the industry continue to impact the cost of credit. This has been partially offset by higher funding costs as savers look for higher returns in a low base rate environment and funds transfer pricing reflects continued stress in wholesale markets which was particularly evident in the period up to the end of 2011 when action by the European Central Bank substantially eased conditions. Our strategy of income diversification has supported further growth in personal loan lending and has contributed an additional £38 million to net interest income in the year. Expenses increased by 8% reflecting higher volume related costs and refined overhead allocation.

# Business review continued

## Impairment

The impairment and other provisions charge of £242 million represents a residential impairment charge of £70 million (2011: £101 million), a charge in relation to consumer banking of £69 million (2011: £83 million), and a provision of £103 million (2011: £16 million) in connection with payment protection insurance (PPI) as outlined on pages 16 and 17. In addition, the prior year included a provision release of £14 million for customer bonus schemes which was no longer required. The high quality of our mortgage portfolio is a continuing strength in an environment of housing market uncertainty.

## Prime residential mortgage lending

Prime residential gross lending was £14.0 billion (2011: £9.8 billion) representing an increase of 42.9% which was delivered through a significant increase in competitiveness across the entire mortgage product range. In addition we acquired a £1.2 billion portfolio of high quality, prime residential loans during the year.

The majority of the increased lending was at lower loan to values, maintaining our prudent approach to lending, whilst ensuring we continued to support those customers with smaller deposits (largely first time buyers). The average loan to value (LTV) on our prime residential lending was 61.1% during the year (2011: 65.4%).

Existing mortgage customers have benefited from the low interest rate environment, with £3.1 billion of balances switching to another mortgage product and £11.7 billion reverting onto our BMR rate at the end of their mortgage deal. We continue to offer the 'Switch and Fix' option, allowing members to move from a tracker product to a fixed rate product during the deal term, without incurring exit fees.

Our BMR balances increased to £51.6 billion by the end of the year. Despite the low rate, which is capped at 2% above Bank of England (BoE) base rate, £4.1 billion of redemptions in the year have come from the BMR book. We do not expect total BMR balances to grow significantly beyond their current level and forecasts indicate they will decline steadily from the middle of 2013 onwards.

## Specialist mortgage lending

Gross lending on buy to let mortgages was £4.4 billion in the year (2011: £3.0 billion). As the demand for good quality rental property has risen, the buy to let sector has continued to perform strongly. Nationwide Group has played an active role in supporting this sector through its subsidiary, TMW, which continues to focus on originating high quality buy to let loans. The average LTV for new specialist business has been 68.0% in the year.

Strong retention within the specialist lending portfolio resulted in net lending of £2.8 billion (2011: £1.6 billion). Profitability of the specialist portfolio has improved during the year as a result of favourable margins on new business lending and higher maturities on to the subsequent variable rate. The overall specialist lending book has grown to £23.2 billion as at 4 April 2012 (2011: £20.3 billion), with arrears levels performing well in a low interest rate environment and a sector exhibiting strong demand.

## Other products

Nationwide is primarily a retail funded organisation. The low rate environment continues to make this a challenging time for savers, but we have responded positively through the year by continuing to refresh our product range. As a result the Group has continued to attract significant inflows, with net receipts of £1.0 billion (2011: £0.6 billion). Over the year to 4 April 2012 our savings balances grew by £3.1 billion, a market share of 7.7%.

Growth in our consumer banking portfolio remains central to our strategic ambitions of diversifying our income and maintaining our challenger brand status. During the year, we opened 359,000 new current accounts, 357,000 new credit cards and advanced 112,000 new personal loans. Our current account base now stands at 4.9 million accounts, whilst our credit card account base is 1.7 million with 2.2 million cards in issue.

Our protection and investment business and general insurance business have also performed ahead of both last year and expectations. During the year we sold around 63,000 protection plans and 178,000 investment products, and as at March 2012 we had £6.7 billion assets under advice (2011: £5.1 billion). Despite the ongoing challenges in the housing market we sold 455,000 new household insurance covers and our general insurance book now stands at just over 2 million covers. Other income from investments grew by 19% in the year and general insurance by 16%, reflecting the success of our ongoing diversification strategy.

## Commercial lending

	Year to 4 April 2012	Year to 4 April 2011
	£m	£m
Net interest income	71	58
Other income	18	20
Total income	89	78
Expenses	(38)	(32)
Impairment and other provisions	(247)	(175)
<b>Underlying loss before tax</b>	<b>(196)</b>	<b>(129)</b>

### Commercial portfolio

The commercial lending portfolio of £21.5 billion (2011: £22.0 billion) comprises £11.6 billion (2011: £12.3 billion) secured on commercial property (Property Finance), £8.4 billion (2011: £8.2 billion) advanced to Registered Social Landlords and £1.5 billion (2011: £1.5 billion) provided to Project Finance.

The Registered Social Landlord and Project Finance portfolios have not experienced any losses and there are no arrears as at 4 April 2012. 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 secure income streams to Government backed Project Finance (primarily PFI) projects.

### Profitability

The Commercial business made a £196 million loss in the year to 4 April 2012 (2011: £129 million loss) as improved income levels were more than offset by a higher than anticipated impairment charge in the second half of the year. Commercial lending income of £89 million improved in the year due to a continuing widening of customer margins as a result of the upward repricing of maturing loans and restructures agreed with existing borrowers.

The cautious stance which we outlined at the half year proved to be well founded, as UK commercial property market conditions remained extremely challenging in the second half with refinancing prospects diminishing further as banks withdrew from lending. Capital values on secondary properties also continued to drift downwards and the investment market saw a slowing in transaction levels as a result of weak demand.

### Impairment

Commercial loan impairments were £247 million (2011: £175 million) representing an increase of 41%, driven by a return to recessionary conditions in the UK and widespread Eurozone concerns, both undermining investor confidence and appetite for the sector. In consequence after some recovery during 2010/11 the market is now experiencing falls in commercial real estate valuations with an expectation that, whilst not severe, this trend will persist at least throughout 2012. The increased impairment in the year has therefore been largely attributable to new and additional provisions on existing watch list cases where valuations have been eroded further or the commitment of equity providers to further investment has been withdrawn. In addition we have reflected a more negative outlook for commercial property over the next 12 months with

an increase of approximately £23 million in our collective provision which accounts for around 32% of the year on year increase in the impairment charge.

We continue to adopt a cautious and proactive approach to commercial property exposures until there is clear evidence of market stability returning. In line with our views at the half year, while prime commercial property capital values increased 0.9% over the year, during the second half the market began to slow with prime capital values showing small falls from November 2011 onwards (IPD, March 2012). Investment transactions for 2011 were below the levels seen in 2010, and showed year on year reductions in the early months of 2012 (Property Data, April 2012). These developments mean that the outlook outside London and for secondary property is more challenging than ever and when added to ongoing concerns about the UK and Eurozone economies, suggests that the outlook for the UK commercial property market remains uncertain. Forecasts for 2012 envisage modest falls in capital values across the sectors with the exclusion of the prime London market, and secondary office and retail space is acknowledged as a particular concern.

The number of Nationwide originated cases three or more months in arrears is 210 (2011: 235) with total arrears balances on these cases of £59 million (2011: £48 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. Tenant failure is a key driver of arrears, and we have seen a number of high profile failures in the retail sector in the second half of the financial year. The impact of these has been assessed and while they weaken the cashflow on the loans affected our current assessment is that our exposure to these names is not expected to result in any material provisioning requirement.

### Non-core asset divestment

As a result of these challenges we continued to focus on helping existing customers and withdrew from new commercial property lending in September 2011. During 2011/12 gross commercial property lending was £719 million, with total gross lending on the whole book of £1.7 billion. Gross lending was more than offset by higher than expected capital repayments and redemptions resulting in the commercial property book decreasing in size by £737 million and the total book decreasing by £523 million. The Society's strategy for the commercial real estate portfolio is to continue to reduce our overall exposure over time.

# Business review continued

The Commercial business has been pursuing a policy of non-core asset divestment for some time. The subordinated debt book has further reduced this year following a number of sales, leaving a Nationwide originated and Cheshire Building Society legacy subordinated portfolio of £127 million. Also, as a result of a successful sale in December 2011, one of the Society's three development loans was repaid in full with the remaining Nationwide originated development book now limited to two exposures totalling £142 million, both performing.

The non-UK book, at £1.0 billion, has seen a reduction of £0.1 billion since 4 April 2011 and consists predominantly of lending to Germany (95%) with no exposure to Greece, Spain, Portugal or Italy and only a single exposure to Ireland.

To support asset divestment our recoveries team have successfully sold 160 properties in the last twelve months with a value of £81 million and their focus on asset realisation continues.

As our Nationwide originated Property Finance book has 37% of its loans scheduled to mature by the end of 2013 our loan maturity process is focused on early dialogue and/or intervention to ensure effective loss mitigation and income generation. Our strategy to help existing borrowers

includes restructuring and/or refinancing those cases which are capable of maintaining serviceability, and during the year £0.4 billion of loans have been restructured and/or refinanced in this way underpinning the significant improvements seen in income.

## Diversification

Having entered the business savings market during the second half of 2010/11, with a relatively limited product range available only to our existing customers, in March 2012 we launched a national marketing campaign to the wider business savings market. Our improved business savings product range now includes a number of new products aimed at different segments of the market all with market leading rates.

To further diversify our commercial business we also began developing plans to enter the SME business banking market. This market sector has been identified as an area which offers a good strategic fit given our strong Group franchise, broad distribution network and current exposure to both the retail personal financial services market and existing commercial lending activities. Launch will not take place for some time and will be subject to prevailing market conditions.

## Head office functions

	Year to 4 April 2012	Year to 4 April 2011
	£m	£m
Net interest income	82	100
Other income	-	10
Total income	82	110
Expenses	(69)	(103)
Impairment and other provisions	(42)	(66)
<b>Underlying loss before tax</b>	<b>(29)</b>	<b>(59)</b>

Head office functions reported an underlying loss before tax of £29 million (2011: £59 million loss). Total income was 25% lower than the prior year, reflecting the higher cost of wholesale funding, partly offset by higher gains from the management of the liquidity portfolio. Administrative expenses have fallen reflecting lower corporate costs.

Impairment and other provisions of £42 million relates to impairment losses on treasury investments of £38 million (2011: £66 million) and a £4 million charge (2011: £nil) for other lending in connection with investments acquired by the Treasury Division.

# Risk management and control

## Overview

Nationwide seeks to manage appropriately all the risks that arise from its activities. The risks inherent within the business are lending risks (retail, commercial, treasury), financial risks (liquidity and funding, capital, market, pension risks), business risk (transformation, operational risks), legal and regulatory risk, and strategic risk.

There is a formal structure for monitoring and managing risks across the Group comprising a risk appetite approved by the Board, detailed risk management frameworks (including policies and supporting documentation), and independent governance and oversight of risk.

The statements of risk appetite set out, in descriptive and quantitative form, the parameters within which the Group will operate. These influence:

- Capital, liquidity and funding strategies
- Lending strategies
- Operational and change management
- Legal and regulatory controls and procedures
- Corporate strategy.

Nationwide has continued to strengthen its risk management frameworks and controls. In July 2011, Nationwide appointed a Chief Risk Officer (CRO), with responsibility to oversee all risks for the Group, who reports to the Chief Executive Officer. Nationwide has also undertaken a substantial refresh of its Enterprise Risk Management Framework, which is described below.

Further detail of risk exposures will be available in the Pillar 3 Disclosures by August 2012 on the website: [nationwide.co.uk/about\\_nationwide/results\\_and\\_accounts/](http://nationwide.co.uk/about_nationwide/results_and_accounts/)

## Enterprise Risk Management Framework

The Enterprise Risk Management Framework (ERM), which applies to the entire Nationwide Group including all trading

divisions and subsidiaries, is structured around five headings:

**Risk culture** is the system of values and behaviours present throughout the organisation that shape risk decisions. It encompasses the general awareness, attitude and behaviour of employees to risk and the management of risk within the organisation.

**Risk governance and control** sets out the Three Lines of Defence and how these are deployed, the committee governance structure, how risks are categorised, and standards for documentation and policy.

**Risk strategy** sets out the Board risk appetite and the strategy for risk management, connecting the Board's corporate plan and risk appetite with practical and detailed strategies, controls and limits to deliver this strategy without compromising risk appetite.

**Risk measurement** encompasses the use of data, models, reporting, and risk-based performance measurement, setting out standards across the Group.

**Stress testing and planning** sets out the approach to Group-wide stress testing, scenario analysis, and contingency plans and the interaction with other corporate processes.

The elements of the framework that have already been introduced during financial year 2011/12 are:

- A revised risk categorisation model that strengthens the coverage of risk management
- Enhanced distinction between risk control and risk oversight under the Three Lines of Defence model
- Revised Board risk appetite to reflect the new framework
- Revised risk committee governance to align to the above
- Enhanced risk reporting aligned to the new risk categories.

The next sections describe these elements, followed by more detailed information about the principal risks and other risks under the new framework.

## Risk categorisation

The risk categories in the new framework are as follows:

Risk category	Definition	Sub-components
<b>Lending</b>	The risk that a borrower or counterparty fails to pay the interest or to repay the principal on a loan or other financial instrument (e.g. a bond) on time. Lending risk also encompasses other risks associated with credit risk (e.g. concentrations and extensions to terms).	<ul style="list-style-type: none"><li>• prime mortgages</li><li>• specialist mortgages</li><li>• unsecured lending</li><li>• commercial lending</li><li>• treasury.</li></ul>
<b>Financial</b>	The risk of Nationwide having inadequate earnings, cash flow or capital to meet current or future requirements and expectations. It includes loss or damage to the earnings capacity, market value or liquidity of the Group, arising from mismatches between the Group's assets, funding and other commitments, and which may be exposed by changes in market rates, market conditions or Nationwide's credit profile.	<ul style="list-style-type: none"><li>• capital management</li><li>• liquidity and funding</li><li>• market risks</li><li>• pension risk.</li></ul>
<b>Business</b>	The risk of damage to the Nationwide Group as a result of loss or failure arising from inadequate or failed internal processes, projects, people and systems, or from external events.	<ul style="list-style-type: none"><li>• operational risk</li><li>• transformation risk.</li></ul>
<b>Legal and regulatory</b>	The risk of regulatory censure or adverse regulatory intervention or legal compromise to the Group's chosen business strategy.	<ul style="list-style-type: none"><li>• conduct of business</li><li>• prudential compliance</li><li>• legal.</li></ul>
<b>Strategic</b>	The risk of loss or damage to the Group through risks that are large and long term, span several risk categories, or fit no other risk category.	<ul style="list-style-type: none"><li>• business model risk</li><li>• planning risk</li><li>• group risk.</li></ul>

# Business review continued

In addition, model risk, an inherent part of other risk categories, has been introduced as a separate risk framework. Model risk will therefore be managed under this separate framework that cuts across all risk categories to cover where models are used.

The frameworks for the above risks (including associated risk appetite, limits, supporting policies and other documents) are reviewed annually or more frequently as appropriate. They are also subject to continuous monitoring by the relevant committees. The Chief Risk Officer is responsible for monitoring all risks for the Group.

## Three Lines of Defence

Nationwide continues to adopt the Three Lines of Defence model with the objectives of:

- Making the Group resilient, compliant and efficient
- Making risk appetite and risk exposure simple, transparent and controlled
- Maintaining a strong risk culture.

In organisational terms, this brings distinct separation between the elements of risk control (first line), independent oversight (second line) and audit assurance (third line).

First line risk control is provided by all relevant business units. These are supported either by specialist risk teams (lending and financial risks) or, where risks apply across the Group, through an embedded network of risk representatives within the organisational areas under the control of executive and group directors.

Second line independent oversight functions, reporting into the Group Risk Director (who reports to the Chief Risk Officer), are aligned to the risk categories and model risk.

The oversight teams maintain and review risk management policies, set standards, establish limits that are consistent with risk appetite, monitor and report on compliance with those limits, and oversee the first line management of risk, including concentrations where appropriate. Oversight of strategic risk is provided by the Group Risk Director.

Third line assurance is provided by Group Internal Audit, which ultimately reports to the Audit Committee. Group Internal Audit provides independent assurance regarding the activities of both first line risk control and second line risk oversight. Information about the role and activities of the Audit Committee can be found in the Corporate Governance section of this report.

## Board risk appetite

The Board sets risk appetite statements to enable Nationwide to:

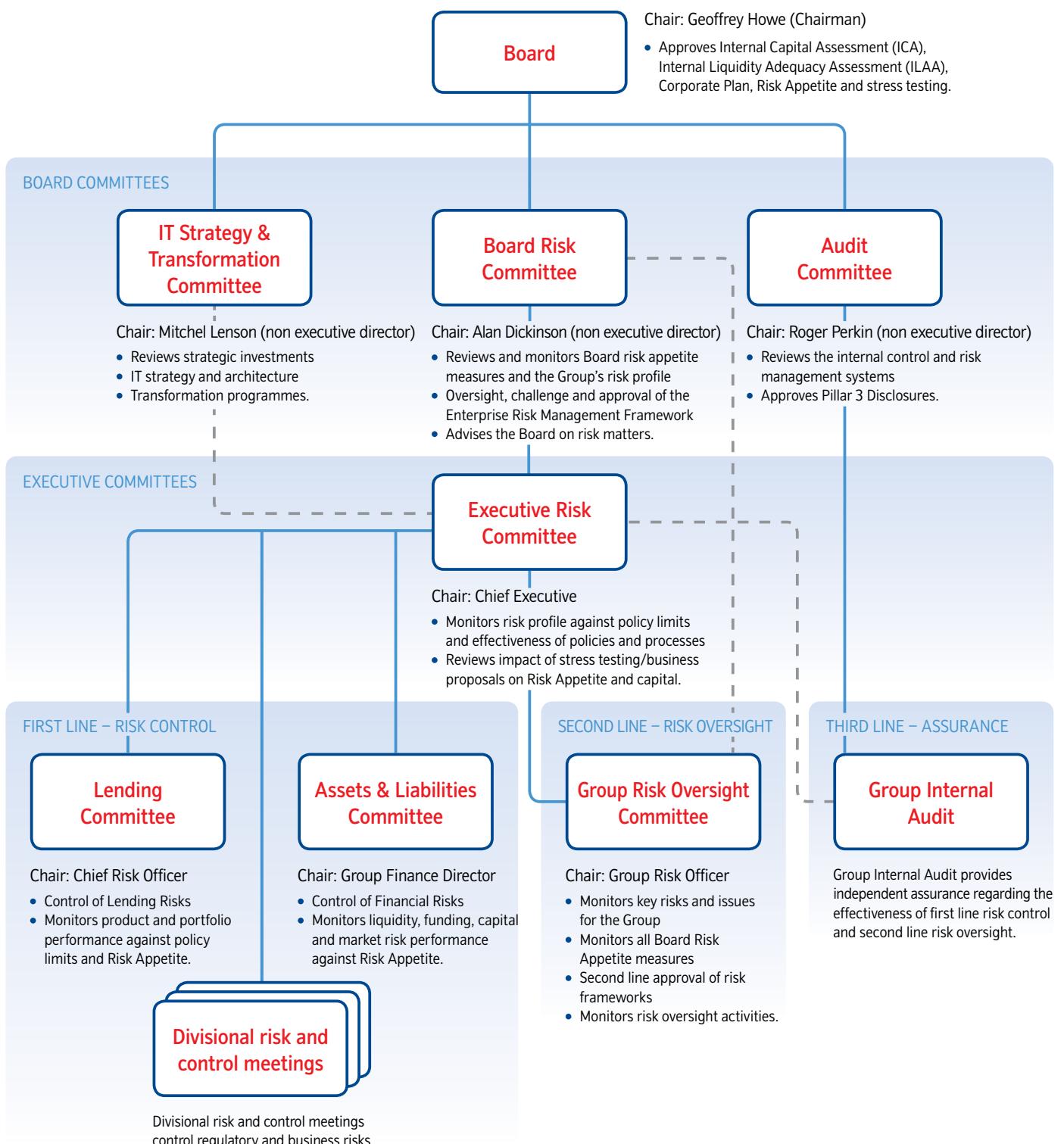
- Identify and define the type and levels of risks it is willing to accept in both qualitative and quantitative terms
- Describe the risks Nationwide is willing to take, and those it will not take, in pursuit of its strategic goals
- Establish a framework for business decision-making.

The Board risk appetite is structured around 23 qualitative statements. These are supported by a focused suite of Board risk metrics, limits and triggers, designed to aggregate the Group's risks, and to look forward, rather than backward, where possible.

The Board risk appetite is in turn supported by a strategy, reporting, limit and controls hierarchy that links the Board's tolerance for risk with on the ground risk-taking actions and behaviour throughout the Group.

## Risk Governance

The introduction of the Enterprise Risk Management Framework has required revisions to the risk governance structure. The principal committees that form the Group's risk governance structure are set out below:



# Business review continued

## Risk governance structure at Group level

The Board Risk Committee and Audit Committee continue to provide support and insight to the Board. The Executive Risk Committee continues to ensure a co-ordinated management approach across all risks in operational terms. The remit and scope of risk reporting for each of these committees has been reviewed and revised to align to the new framework.

Beneath the Executive Risk Committee, two key changes have been made:

- Formation of a Lending Committee in the first line (replacing two credit committees) responsible for all retail, commercial and treasury lending
- Creation of a new Group Risk Oversight Committee to provide second line oversight support to the Executive Risk Committee and Board Risk Committee.

The Chief Risk Officer is Chair of Group Risk Oversight Committee and, as an attendee of the Board Risk Committee, has direct access to the Chair of the Board Risk Committee to escalate risk issues as appropriate.

Specialist risk forums beneath Lending Committee and ALCO in the first line consider technical detail and reports, making recommendations to their parent committee as appropriate. In addition, all executive divisions hold Risk and Control meetings so that there is the opportunity to report and escalate risks across the entire organisation.

Three specialist risk oversight committees have been created beneath the second line Group Risk Oversight Committee:

- Business Risk Oversight Committee (incorporating the previous Operational Risk Committee)
- Legal & Regulatory Risk Oversight Committee (incorporating the previous Compliance Committee)
- Model Risk Oversight Committee.

The Group operates with clear independence of responsibilities for risk control, oversight and governance in accordance with best practice within the industry. Primary responsibility for managing risk and ensuring controls are put in place lies in the first line business functions, with dedicated second line risk oversight teams aligned to the committee structure described above.

## Principal risks

### Lending risk

Lending risk arises from credit risk, concentration risk, and extension risk. Credit risk is the risk that a borrower or counterparty fails to pay the interest or to repay the principal on a loan or other financial instrument (e.g. a bond). Credit risk for Nationwide arises from residential mortgages, unsecured retail lending, commercial lending, liquidity and other investments, and derivatives used for hedging purposes by the Treasury Division.

Concentration risk is the risk of extreme credit loss as a

result of insufficient diversification within lending portfolios. Extension risk is the risk that repayment of a loan or other financial instrument occurs later than that originally anticipated (not necessarily beyond the contracted maturity date).

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 conservative approach to risk as shown by the quality of its balance sheet as documented in the balance sheet section of the Business Review. Lending risk portfolios are managed within concentration limits and are subjected to stress testing and scenario analysis to simulate outcomes and calculate their associated impact.

#### a) Retail credit risks

##### Significant events/environment

Year to date impairments in retail portfolios have been within planned levels and are expected to remain stable until base rates increase, which is now not anticipated until late 2013.

Nationwide has maintained a strong presence in the buy to let market with 24% of Group new lending and circa 30% UK market share during 2011/12. Although it is generally recognised that buy to let lending is a higher risk segment than prime mortgages, average new lending margins and arrears performance remain very strong. The portfolio is managed proportionately to the higher potential risk, with specific lending and portfolio limits, tight credit policy, and bespoke collection and recovery strategies.

Regulatory initiatives during 2011/12 have prompted significant market responses across areas such as interest only mortgages and forbearance. Nationwide continues to fully engage in this process.

##### Outlook/response

New lending volumes and profile have been carefully managed since the onset of the credit crunch. During 2011/12, the Nationwide prime portfolio returned to positive net lending. However, lending policy remains cautious relative to that prior to the credit crunch, and will remain so while there remains considerable market and house price uncertainty.

The performance of the unsecured portfolios remains very strong. Significant retrenchment at the start of the downturn has resulted in the unsecured bad debt charge falling for the past three years in a row. Despite continued prudent underwriting and strong asset quality, increased lending flows during 2011/12 are expected to result in a proportionate increase in unsecured credit losses in future years.

Policies for retail portfolios continue to be reviewed to ensure that they are appropriate and reflect industry practice, and in light of regulatory initiatives are fully aligned to FSA-defined good practice.

## b) Commercial credit risks

### Significant events/environment

The commercial property market in 2011/12 has seen a shift in market sentiment. The forecast for 2012, which was previously for stable collateral values, is now for decreases in value across commercial property sectors with particular shifts for secondary office and retail space.

There is a continued lack of finance for property investors, driven partly by property outlook, but also by uncertainties around the capital treatment of commercial real estate lending.

There have been several high profile tenant failures and a continuation of the trend for shorter lease life and of tenants exercising breaks. This reduces the certainty around cash flows and further exacerbates shifts in collateral values and difficulties in refinancing.

Banks across Europe have been reducing their exposures to higher risk assets through portfolio sales and individual asset disposals, further depressing prices for secondary assets in a market with limited demand for this asset.

### Outlook/response

Over the last year we have strengthened our watch list process and widened the scope of its criteria, which has resulted in an increase in the number of loans included for more rigorous analysis.

New controls have been implemented to ensure greater focus on assessing loans as they mature in order to highlight potential difficult situations and manage them appropriately in advance of maturity dates. Collective provisioning assumptions have been revised to better reflect current market conditions, and a more segmented, granular view of the commercial property portfolio. In managing the portfolio we seek to reduce higher risk exposures whilst avoiding excessive losses which would be caused by making asset disposals into a depressed market. Portfolio analysis ensures that we recognise the inherent risks and exposures within the portfolio transparently.

## c) Treasury credit risks

### Significant events/environment

The Eurozone debt crisis and the threat of sovereign defaults in peripheral countries remains.

Nationwide's peripheral European exposure is mainly secured by assets and in many cases is via senior positions with structural protection. This means that our risk, in most instances, is partly mitigated in the event of any further widespread weakness.

There is still a risk that fractures appear in the structure of the Eurozone. The full impact on the markets in which Nationwide is active, if a country were to leave the euro, is difficult to predict. In the event that a country in which Nationwide holds assets leaves the euro and introduces a new currency, then Nationwide may be exposed to risks associated with re-denomination.

The condition of the US economy is also relevant given Nationwide's exposure to US treasury bonds, banks and asset backed securities (ABS). Whilst the US economy continues to show signs of recovery, there are limited measures in place to address the rising debt burden, which could negatively impact future economic performance.

The US residential mortgage backed securities (RMBS) portfolio has been severely impacted by the decline of US house prices, resulting in a number of impairments in recent years. Other US ABS exposures include Student Loan ABS and collateralised loan obligations (CLOs).

Year to date impairments in our core liquidity portfolio and non-core portfolio have been within forecasts, despite the continuing difficult economic conditions. The available for sale reserve is broadly unchanged over the year, with changes to the investment portfolio offsetting those seen in the liquidity portfolio.

### Outlook/response

The debt crisis in Europe continues and is being followed closely. There are still concerns over European economic growth, which may result in the need for further bail-outs or debt restructurings. Developments in Europe are the subject of close monitoring and impact assessments. Further impairments or losses could result from weaknesses in the financial system.

Current US trends are more positive, with stabilising house prices and falling delinquency and foreclosure rates. The progress of the US economy will continue to be closely monitored although current performance suggests that significant additional impairment is unlikely.

### Financial risks

This represents the risk of Nationwide having inadequate earnings, cash flow or capital to meet current or future requirements and expectations. It includes loss or damage to the earnings capacity, market value or liquidity of the Group, arising from mismatches between the Group's assets, funding and other commitments, and which may be exposed by changes in market rates, market conditions or Nationwide's credit profile.

Financial risk is managed within a framework of approved assets, currencies and capital instruments supported by detailed limits set by either the Board or ALCO under its delegated mandate. The Nationwide Board retains responsibility for approval of derivative classes that may be used for market risk management purposes, restrictions over the use of such derivative classes (within the limitations imposed under the Building Societies Act, Section 9a) and for asset classes that may be classified as liquidity.

Group-wide stress testing is an integral part of the annual corporate planning process, the adequacy processes for liquidity and capital, and the annual review of Group risk appetite. This is to ensure that the financial position and risk profile of the Nationwide Group provide sufficient resilience to withstand the impact of stress. The stress testing programme is overseen by the Board Risk Committee, with the process led by a centralised team within Group Finance. Macroeconomic scenarios are designed to be both severe and plausible and include additional specific 'shocks'. Scenarios are tested against the FSA's scenario framework and were shown to be appropriately conservative. At the Group level, stress test scenarios capture a wide range of macroeconomic variables that are relevant to Nationwide's business model; for example, GDP, unemployment, asset prices including house prices, and interest rates.

The stress testing process is detailed and comprehensive using bottom-up analysis performed by relevant forecasting functions and includes all aspects of the Group's balance sheet across all risk types and is forward-looking over a five year period. Having been approved by the relevant business areas and a specialist stress testing forum, stress test results are subject to detailed review, challenge and approval through a hierarchy of committees including ALCO, Executive Risk Committee and the Board Risk Committee, before being shared with the FSA. Should the Board Risk Committee conclude that the impact falls outside of its expectations, the business plans will be appropriately amended.

# Business review continued

In addition, reverse stress testing is also carried out to identify the increased severity that would be needed over and above the stressed scenarios to result in the business model being no longer viable. This is used to help support ongoing risk management and is fully integrated into the risk appetite framework. Stress testing techniques are also applied at portfolio and product level to support risk management.

Financial risk is split into four sub-categories: liquidity and funding, capital, market risks, and pension risk.

## **a) Liquidity and funding risk**

The Group has developed comprehensive liquidity and funding policies to ensure that the Group continues to meet its funding obligations and to maintain or grow its business. 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.

On a regular basis, the Group prepares an Individual Liquidity Adequacy Assessment in order to reassess the adequacy of the Group's liquidity risk management procedures.

### **Significant events/environment**

The introduction in 2010 of new liquidity regulations has led to increased reliance upon longer term funding and highly liquid Government-issued debt, and a corresponding reduced reliance on shorter term wholesale funding and less readily realisable forms of liquidity.

More recently, the continuing Eurozone debt crisis has led to volatility in wholesale markets and increased competition for retail deposits as institutions look for alternative funding sources.

Nationwide's long term rating has been cut to A2 (from Aa3) by Moody's and to A+ (from AA-) by Fitch. This follows sector wide reviews by both agencies and leaves Nationwide a strongly rated institution, both in absolute terms and relative to its peers. Nationwide's short term rating remains unaffected and the impact on the Society is therefore expected to be modest.

### **Outlook/response**

Competition within the retail savings market is expected to remain high while there is continued uncertainty in Europe.

Nationwide remains well funded through retail and term wholesale funding. Due to a strong franchise, the wholesale market was accessed for both unsecured and secured funding, thereby maintaining an appropriate maturity profile. Together with a strong market share of retail funding, Nationwide has flexibility to access stable funding from the most cost-effective sources.

In addition to core liquidity holdings of £24.5 billion, Nationwide holds £2.5 billion of other central bank eligible assets and £16.3 billion of undrawn AAA self issued notes that could be used in repurchase agreements with third parties or in central bank operations, for contingency funding purposes.

## **b) Capital risk**

In order to ensure that the Group continues to meet its capital requirements, whilst supporting growth within risk appetite (defined in part by the maintenance of capital self-sufficiency through the cycle), capital is managed above both regulatory minima and expectations of other key external stakeholders and to be amongst the best in market compared to peers. Nationwide's strategy is therefore to optimise capital requirements and support this through stable earnings.

In terms of capital requirements, the Group started moving towards the Internal Ratings Based (IRB) modelling approach in May 2008. The Group will continue to develop its IRB models in accordance with the roll out plan included within its IRB Waiver approval from the FSA. On an annual basis, the Group conducts an Internal Capital Adequacy Assessment Process to assess the Group's capital adequacy and determine the levels of capital required going forward to support the current and future risks of the business.

### **Significant events/environment**

The draft Capital Requirements Directive IV (CRD IV) text was published in July 2011 and outlines proposals to strengthen the regulation and supervision of liquidity and capital management across the banking sector. The final version of the text is expected to be published in the latter half of 2012. The Government published a response to the Independent Commission on Banking report in December 2011, with the proposals going beyond the CRD IV requirements. Based on current understanding of the reforms, the Group is confident it is well positioned to maintain its overall capital strength.

### **Outlook/response**

Nationwide has been working with the regulator and investors to create a mutual Core Tier 1 instrument. This will allow Nationwide to access external capital to support its capital position and the achievement of strategic objectives.

## **c) 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 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 markets to fund lending, create exposures to interest rate risk.

Foreign exchange risk arises from movements in the foreign exchange market adversely affecting the value of the Group's foreign currency assets, funding and future cash flows.

### **Significant events/environment**

Low and flat interest rates have continued to dominate, driven by reduced expectations for economic growth. Base rates remain unchanged, but underlying rates in longer term debt securities markets, principally gilts, have fallen.

A significant proportion of the Society's mortgages earn Base Mortgage Rate (BMR), which the Society has guaranteed will never be more than 2% above the Bank of England base rate. This rate is significantly lower than the equivalent Standard Variable Rate (SVR) charged by peers, or the Standard Mortgage Rate (SMR) that more recent Society mortgage advances mature onto. This has the effect of compressing the Society's mortgage margins and reducing the flexibility with which these margins can be managed. However, the BMR portfolio is well seasoned, has low loan to value, low arrears rates and low possession rates. The low risk nature of the portfolio partly compensates the low margin it yields.

The Eurozone debt crisis has had the additional effect of restricting inter-bank lending, widening the net margin between base rate and Libor, and widening foreign exchange basis spreads. This is as a result of the concerns over the exposure of European financial institutions and governments' creditworthiness.

Competition for retail funding may increase the margins that have to be paid to attract and retain retail deposits.

#### **Outlook/response**

Flat interest rates are expected to dominate the market outlook.

The Eurozone debt crisis is expected to continue to impact liquid asset pricing and basis pricing between assets, currencies, and associated derivatives. This impacts the market value of such instruments prior to maturity.

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.

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.

Foreign currency exposure is hedged through natural offset on the balance sheet or by using derivatives to reduce currency exposures to acceptable levels. The Assets and Liabilities Committee sets and monitors limits on net currency exposure.

#### **d) Pension obligation risk**

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 returns from 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, and discount factors; the actual outturn of which may differ from the estimates.

The Fund is also exposed to possible changes in pension legislation.

#### **Significant events/environment**

The reduction in gilt yields has reduced the discount rates

applied in valuation of pension liabilities, resulting in an increase in the present value of fund liabilities and ongoing volatility in the valuation of these liabilities as gilt yields vary.

#### **Outlook/response**

To mitigate pension risks, management, together with the Trustees of the Fund, review regular reports prepared by the Fund's independent actuaries and investment consultants to assess these risks and take appropriate actions which may, for example, include adjusting the investment strategy, adjusting contribution levels, hedging inflation risks and/or hedging interest rate risks.

Investment returns continue to be managed against long term return targets.

#### **Business risk**

Nationwide defines business risk as the risk of damage to the Nationwide Group as a result of loss or failure arising from inadequate or failed internal processes, projects, people and systems, or from external events. Business risk encompasses transformation risk and operational risk.

##### **a) Transformation risk**

Transformation risk is the risk of damage to the Nationwide Group as a result of loss or failure arising from formally managed project activities that seek to deliver change in Nationwide's capabilities.

#### **Significant events/environment**

The Nationwide Group is engaged in a significant transformation program that aims to update and enhance the Group's core systems. The most significant projects within this program are well controlled, are at a mature stage of development and are close to delivery.

As these projects enter delivery phases the Society will need to manage:

- The risk of cost overruns or delivery delays
- The risk of business disruption and adverse customer impact on delivery
- The realisation of expected benefits
- The architectural fit of the systems developed with future plans and needs.

#### **Outlook/response**

An improved framework for transformation risk has been developed to strengthen risk control and oversight given the degree of transformational change underway at present and through the coming years. This recognises that it is not possible to achieve large-scale transformation of the business without impacting day to day operations in some way, but seeks to manage that impact.

This approach to managing transformation risks has been designed to achieve a balance of prudent and controlled management of the change portfolio with achieving progressive transformation of the business within a competitive market place. Revised risk appetite statements and measures, coupled with a new common approach to delivering change in Nationwide, are now guiding and influencing the delivery of the transformation portfolio within levels of acceptable risk set by the Board.

##### **b) Operational risk**

The risk of loss arising from inadequate or failed internal processes, people and systems or from external events.

# Business review continued

This definition is further refined into 10 key risk and control policy areas:

- Third party
- Business continuity
- Financial crime
- Financial reporting, accounting, management and taxation
- Information management
- Information security
- Information technology
- People
- Premises and physical assets
- Service delivery.

## Significant events/environment

The Nationwide Group continues to invest in new products and services for a growing customer base. Whilst Nationwide's operations are well-controlled, resulting in a market leading level of customer service delivery, customer and regulator expectations of consistent, stable, and responsive service are steadily increasing. Continued improvement is necessary.

Financial criminals and fraudsters continue to innovate and develop new strategies to exploit weaknesses in financial firms' processes and consumer behaviour. This is especially prevalent in the context of cyber crime. The Society needs to continually improve its controls to remain ahead of these threats.

## Outlook/response

The operational risk framework has been reviewed and enhanced to maintain a robust risk management capability. Risk appetite is focused on minimising any impacts on our customer service and is considered as part of decision making across the business.

A programme of continuous control improvements has been adopted to respond to emerging threats.

Key areas include:

- Nationwide has prioritised investment to ensure we remain industry leaders in information security and cyber crime controls
- The Society's Strategic Fraud Initiative (SFI) responds to new financial crime opportunities created by globalisation, open borders to travel and global payments solutions, whilst maintaining the focus on traditional forms of fraud such as theft of card data
- Nationwide's transformation programme is investing in the latest information technology systems to provide stable, reliable, resilient and recoverable services to our members.

This approach has been designed to ensure control investment is directed towards areas of maximum risk, whilst reducing the cost and impact of controls when delivering to our customers.

## Legal and regulatory risk

The risk of regulatory censure or adverse regulatory intervention or legal compromise to the Group's chosen business strategy. This category of risk includes conduct of business, prudential compliance and legal risks.

A new framework has been developed for the management of legal and regulatory risks. The new framework comprises the following categories:

- Conduct of business risk – regulation relating to the manner in which Nationwide Group does business with its retail customers, wholesale customers and counterparties
- Prudential risk – regulation of financial risk; including financial stability, credit risk, capital funding and liquidity management
- Legal risk – legal requirements with which the Group must comply.

Legal and regulatory risks are managed and controlled in the first line by business management. The legal and regulatory risk framework complements the business risk framework to ensure the identification, management and control of legal and regulatory risks are undertaken consistently with the other operational risk categories.

Group Legal & Compliance provides the business areas with support, advice and guidance to enable Nationwide to identify all relevant legal and regulatory requirements, extending to related voluntary codes and standards affecting the Group, and to work with business management to determine how the laws, legislation or regulations apply and how best to implement the respective requirements. The second line Regulatory Risk Oversight function within Risk Management Division carries out a risk-based monitoring plan approved by Audit Committee to ensure the risks are being appropriately managed, as well as providing more proactive challenge to first line business areas to ensure risks, issues and incidents are identified and controlled effectively in line with appetite.

## Significant events/environment

The regulatory framework and general financial services environment continues to move through a period of significant change with major influences from within the UK, but extending to Europe and the US.

Key areas of regulatory change include:

- Regulation of capital, including the implementation of Basel III, Capital Requirements Directive (CRD) IV and the Independent Commission on Banking's (ICB) recommendations
- Regulation of Conduct of Business, including the establishment of the Financial Conduct Authority
- Regulation of products and distribution, in particular the implementation of the Retail Distribution Review and Mortgage Market Review.

## Outlook/response

The Group continues to engage actively in consultation on

forthcoming regulation, and dedicates significant resources to executing the changes required to comply with, for example, the Retail Distribution Review. We anticipate that regulatory change will continue to drive a large element of the Society's transformation agenda.

The Nationwide Group always aims to comply with applicable laws, regulations and voluntary codes/standards responsibly, focusing on achieving the best outcome for the Nationwide Group's membership.

## Other risks

### Strategic risk

The risk of loss or damage to the Group through risks that are large and long term, span several risk categories, or fit no other risk category.

Strategic risk focuses on large, longer term risks that could become a material problem for the Nationwide Group. Whilst all business areas are responsible for managing their own risks, management of strategic risk is primarily the responsibility of senior management and committees whose remit encompasses all the risk categories on a group-wide combined basis. A new risk framework has been developed that formally brings existing practices together for risks associated with the business model, planning and group 'contagion' risk. The new framework therefore includes that defined as 'business risk' in last year's annual report.

The management of strategic risk is intrinsically linked to the corporate planning and stress testing processes, and is further supported by the regular provision of consolidated business performance and risk reporting data to the Board and senior risk committees.

Reputation risk is inherent in all risk categories where actions and incidents can affect whether people trust, and wish to do business with, Nationwide. Reputation is monitored via incident reporting, media monitoring, business performance, complaints monitoring and both internal and external benchmarking.

There are several issues that have the potential to affect other risk categories, which could have significant impact on the business model if these were to crystallise in the same timeframe. In addition, regulatory changes affecting several risk categories have the potential to threaten the viability of the mutual model.

To manage strategic risk, the Nationwide Group therefore focuses on serving both current and future members while maximising member benefit. Activities are centred on mainstream UK retail personal financial services, with participation in other non-member businesses only where these activities fit with core capabilities, diversify risks, and earn a premium return for members. The Nationwide Group also operates as a single business unit, with organisational and legal structures aligned to this, which ensures no material exposure to group 'contagion' risk.

### Model risk

Model risk is the risk that an adverse outcome (incorrect/unintended decision or financial loss) occurs as a direct result of weaknesses or failures in the design or use of a model.

Models are mathematical representations of business systems designed to help describe, predict or forecast, experiment with, or optimise decisions or scenarios. Models are used throughout Nationwide, for instance, to make or support lending, investment and payment

decisions (e.g. credit scorecards and rating models), to calculate provisioning, capital and liquidity requirements, and to value or price products and assets.

Nationwide has established Group Modelling, Measurement and Methodology, a new department within Risk Management Division, to oversee model risk within the Group. It has defined the model risk framework to ensure effective governance and oversight of models, and that standards are consistently applied. The department has the responsibility to review and challenge the development, use and management of models in first line risk management, to oversee the Group's model risk profile, and to promote modelling best practice. It has specific responsibilities to undertake independent validations of models, and to maintain a registry of models.

First line management remains responsible for ensuring that models and rating systems are fit for purpose, and meet applicable standards and regulatory requirements, subject to support and challenge from Group Modelling, Measurement and Methodology. Models are subject to approval and oversight at the Model Risk Oversight Committee, through reviewing the outcome of independent model validation reviews.

### Tax risk

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. Nationwide has adopted the Government sponsored 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 HM Revenue & Customs and to undertake tax planning only to support business operations and not to achieve unintended tax advantages. Nationwide takes 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.

### Recovery and resolution plans

The strong regulatory focus on recovery and resolution planning has continued in 2011/12. Nationwide has been engaged with the authorities and external consultants to develop such plans for the Group. This work has entailed identifying a broad range of credible options that could be used in response to an episode of extreme stress. The plan includes triggers, governance arrangements and a communication plan to be deployed in the event the recovery plan is invoked. These plans are documented together with information designed to aid resolution. The Group will be required to prepare its initial recovery plans and resolution packs for the UK regulators in the early part of the next financial year.

# Corporate responsibility report

As the UK's largest building society dedicated to serving our members and supporting the communities in which we operate, 'citizenship' is far from a new concept to Nationwide.

## Fit for purpose

For the first time this year, we built citizenship objectives into our Corporate Plan, both to reinforce the strength of our commitment and to reflect the contribution it will make to our future success.

In fact, this year, alongside delivering activity under the current corporate responsibility themes of housing, money, environment and communities, we have been reviewing our overall approach to citizenship. We want to ensure that over the next five years our efforts support our main business activity and make a meaningful difference to our members and their communities.

To inform our thinking, specialist agencies New Philanthropy Capital and FreshMinds were engaged last year to advise us. Then in November, we invited a group of charities, non-governmental organisations, think tanks and opinion formers to review the plans being developed and further challenge us on the ideas presented. Their feedback along with that gathered by the research agencies has been critical in shaping our new citizenship strategy, which will be reported on later this year.

## Governance and recognition

On a day to day basis, citizenship is owned by all our employees. It is brought to life in the way we work with each other and our suppliers, and through the products and services we deliver to our members. Overall accountability for citizenship rests with our Board of Directors as the table below shows.

This year we have received a number of awards validating the approach we take.

- We retained the Investors in People Gold status for our commitment and practices in developing and supporting our employees. We are still the only retail financial services provider to hold Gold status.
- We achieved the CommunityMark – the UK's only national standard for excellence in community investment. We are one of only 38 companies in the UK to hold the standard awarded by Business in the Community.
- The success of our MoneyActive partnership with Citizens Advice was recognised by Best Business Awards and Global Business Excellence Awards.



## Workplace diversity

This aspect of our business is overseen by our Diversity and Inclusion Steering Committee, chaired by group director Graeme Hughes and consisting of senior managers from around the business. For the third year running, we were awarded silver in the Opportunity Now Benchmarking Survey, the UK's most extensive survey of gender equality, diversity and inclusion in the workplace.

## The people who take overall accountability for citizenship in Nationwide

Issue	Responsibility	Position
Occupational health and safety	Graham Beale	Chief Executive
Employee engagement	Graeme Hughes	Group Director Human Resources, Customer Experience & Corporate Affairs
Corporate responsibility	Graeme Hughes	Group Director Human Resources, Customer Experience & Corporate Affairs
Members/customers	Chris Rhodes	Executive Director Group Product & Marketing
Supply chain	Mark Rennison	Group Finance Director
Environment	Tony Prestedge	Chief Operating Officer

# Housing

From our earliest days, helping people to save and buy their first home through to fifty years of providing funding for social housing, we know how important a place called home is.

## Supporting first time buyers

As the third largest lender in the UK we are committed to helping first time buyers, and last year, one in six of all the mortgages we agreed were for those taking that first step. In October, we re-launched our interactive and independent online First Time Buyers' Guide as a smartphone and tablet-friendly PDF, which you can download at [nationwide.co.uk](http://nationwide.co.uk). A new YouTube video has also been created to help demystify the mortgage process for first time buyers.

## Our mortgage lending

We have continued to take a responsible, prudent approach to our mortgage lending, based on our strong mutual values. We want people to be able to stay in the homes they buy, so we continue to only agree borrowing that we believe will not overstretch their finances and that allows for some natural increase in expenditure. As a result we continue to experience a low level of arrears, around one third of the industry average.

## Affordable and sustainable housing

Over the last year we have provided £87 million of additional loan finance to housing association customers. This funding will support the development and provision of new affordable homes in North West and South East England, Scotland and North Wales. Our total funding in support of the affordable housing sector now stands at £9.8 billion.

Together with the Royal Institute of British Architects, we ran the third Nationwide Sustainable Housing Awards, which looked for ideas to address the urgent issue of upgrading the UK's existing built environment.

## Shelter

### Helping those in housing need

Our partnership with the housing and homelessness charity Shelter has focused on two key areas this year.

We help to fund their Skills Support Service in Bristol which works with volunteers to address the training, skills and employment needs of homeless families in Bristol. In one year, the project can work with up to 70 volunteers delivering 90 volunteer sessions, attended by 50 adults and young people who are facing homelessness.



Originally launched in 2010, our online First Time Buyers' Guide has been updated after gathering feedback from first time buyers and engaging with consumer groups like *Which?* It certainly made a good impression on the Mortgage Finance Gazette. It won their 2011 'Innovator Award' for using technology in an innovative way to support consumers with one of the most critical decisions they will make. This year we have followed it up with independent and interactive guides on remortgaging and buying and selling a home.

All our guides are available for viewing or download at [NationwideEducation.co.uk](http://NationwideEducation.co.uk)

Through our sponsorship of Shelter's Teachers' Centre, we also helped develop an online classroom kit that offers a free, interactive programme of themed work looking at the issues young people face with homelessness and money management. Packed with exciting and stimulating resources, including video, games and information slides, the kit hosted on [shelter.org.uk/teachers](http://shelter.org.uk/teachers) is designed to inspire students while meeting key curriculum objectives.

# Money management

**The ability to manage and make the most of your money is a learned skill. As a provider of financial services, we focus on making our products simple and on investing in partnerships that build skills and capacity in the advice sector.**

## Responsible money practices

With over 160 years' experience of helping our customers manage their money, we understand that people's circumstances can change especially in difficult economic times.

That is why our triage team continues to support customers approaching financial difficulties, working together with them to explore options and alleviate worries. The phone support service has been running successfully since March 2010 and our money worries section on [nationwide.co.uk](http://nationwide.co.uk) provides information and handy advice for customers.

## Building financial capability

In partnership with Citizens Advice, MoneyActive is our volunteer-led initiative offering free, community based, financial skills training sessions to help people manage their finances. To widen the reach of MoneyActive, the money management pages of [adviceguide.org.uk](http://adviceguide.org.uk) were developed to provide online advice and information.

Importantly, MoneyActive trains and supports volunteers to deliver local financial capability sessions boosting the ability of Citizens Advice's network to undertake preventative as well as advice work.

At the beginning of the partnership, we wanted to increase the number of financial capability volunteers from 100 to 1,400 and reach 100,000 people. Three years later the results have surpassed our expectations.

## MoneyActive

- More than 1,700 volunteers recruited
- Over 11,000 training sessions attended by 63,571 people
- Another 141,293 estimated to have benefited from training given to frontline workers in 1,231 partner organisations who in turn helped their clients
- Over 4.4 million visits to the money management pages of [adviceguide.org.uk](http://adviceguide.org.uk)

Given that over 80% of MoneyActive funded bureaux plan to continue to be involved in financial capability even though the funding has now finished, it is clear that the initiative has made a lasting difference.

## Working with the Money Advice Trust

Our new three year partnership with the Money Advice Trust (MAT) is focused on increasing the provision and quality of debt advice. In addition to MAT's core work, including National Debtline and Business Debtline which provide free telephone advice, we are the main supporter of their Innovation Grants Programme.



Aimed at supporting original money advice and financial capability projects across the UK, the first ten grants were announced in January.

## Championing numeracy

Our latest partnership has seen us working with The Rayne Foundation to establish National Numeracy, a new charity focused on promoting and championing numeracy for all.

Numeracy is such a fundamental life skill, yet around 17 million people in the UK are believed to be 'functionally innumerate', with many failing to manage their money or at risk of making poor financial choices. National Numeracy aims to tackle this issue.



## Educating for the future

[NationwideEducation.co.uk](http://nationwideeducation.co.uk) provides a comprehensive range of age-specific resources for schools and pupils to build a better understanding of money and financial products. In addition to providing resources for teachers to use, we have been training our employees to deliver financial education sessions in schools, sharing their expertise and broadening the site's reach.

The new animated Finance Ready films on [NationwideEducation.co.uk](http://nationwideeducation.co.uk) explain the basics of finance in a fun, engaging way. We consulted with our charity partners to identify what subjects we should cover and the result was five films – Start Banking, Start Saving, Paying with Plastic, Get Online and ATMs.

# Environment

Our main environmental impact stems from the energy and other resources we use in delivering services to our members, the waste we generate and the travel required for our employees. Across all three areas we are working hard to reduce our impact.

## Understanding and managing the impact of doing business

By investing in new technological solutions, we have been able to reduce and manage more efficiently the energy used by our buildings and equipment. This has included improvements to our metering and monitoring, helping to identify and target energy and water waste.

We have also been keen to see how far we can go to 'green' our branch refurbishment programme. In piloting a new environment impact assessment tool for retail fit-outs, called 'Ska' which was developed by the Royal Institute of Chartered Surveyors, we adopted a wide range of good practice measures that have been worked through with our supply chain. These will be used to shape future refurbishments. The pilot branch in Oxford city centre achieved the highest possible Gold Ska rating.

To enable our employees to attend business meetings without travelling we provide telephone conferencing facilities. An awareness raising campaign highlighting the benefits of telephone conferencing has resulted in a 55% increase in registered telephone conferencing users.

Over the last three years Nationwide's average fleet vehicle emissions have been reduced from 190 to 137 grams CO<sub>2</sub> per kilometre. Much of this is due to carbon-efficient cars being highlighted as cost effective options for our employee users.

We have raised awareness of environmental issues among our employees by 10% through campaigns to support Climate Week, Energy Week and World Environment Day.

Over the year our carbon dioxide emissions have reduced by

**7,900 tonnes**

and overall energy use by 14%. Water usage has fallen by 6%.

## Committing to a sustainable future

Over the last 12 months we have been working with the Carbon Trust to assess our main environmental impacts. While we have achieved much already, we know we can do more and have set out a bold vision to be one of the leading performers for environmental sustainability in the UK financial services sector.



To deliver this vision we have made a range of commitments across our business to reduce the impacts of our own activities, develop solutions with our suppliers and help our members save energy at home.

Our biggest environmental impact is the energy we use to provide financial services to our members. Energy is used to power our IT infrastructure, our branches, online banking and our administrative centres. In 2010/2011 the carbon footprint from our energy consumption was 62,000 tonnes of CO<sub>2</sub>. We have committed to ensuring our carbon footprint is no greater than that by 2020/2021.

We are also committed to reducing our water consumption by 10% and diverting all our waste from landfill by 2015.



With the refurbishment of our branch in Oxford city centre, we piloted a wide range of measures to reduce our environmental impact, measures that we will now use to shape future refurbishments.

# Supporting local communities

From supporting national charity days like Comic Relief to working with local partners, last year saw our employees and members make a real difference to the communities in which we all live and work.

## Building skills and investing in people

The continuing rise in long term youth unemployment in the UK is an issue that concerns us greatly as both an employer and a financial services provider.

Along with a number of Britain's biggest companies we have signed up to the Business Compact. The scheme aims to get businesses involved in raising aspirations in communities and schools, advertising work experience places as widely as possible and making access to internships open and transparent.

Designed for 4-16 year olds, our Employability Skills programme on [NationwideEducation.co.uk](http://NationwideEducation.co.uk) focuses on what is involved in working in a financial corporate environment like Nationwide and seeks to bridge the gap between education and employment.

Nearly two years ago it emerged that Swindon, where our head office is located, had one of the fastest growing levels of 16-24 year olds claiming Job Seekers Allowance in the country. With representatives from the public and private sector we came together to address this worrying trend and the result was Plan 500, which successfully created over 500 new opportunities for young people.

Our Resourcing team has been supporting work clubs in Northamptonshire offering expertise and coaching on job application skills. This led to us founding the Work Inspiration Network (WIN) Northants, bringing together other like-minded employers and organisations. Following the success of Plan 500 in the Swindon area, we are planning a similar approach in Northampton.

## Getting involved

We have always been supportive of our employees' involvement in their local communities, and in October 2010 we launched our employee volunteering programme offering them up to two days paid leave each year. In the last year the percentage of employees volunteering has more than tripled to 5.9%.

The benefit of actively engaging with our employees in community activities was highlighted in our annual employee opinion survey. There was a 25% increase in employees feeling proud of the positive contribution we are making in our local communities.

We are now in the 19th year of our partnership with Macmillan Cancer Support during which time we have raised over £6.2 million with support from our employees and members.



Carly is just one of our employees who have gone into their local schools to deliver financial education sessions using the resources of [NationwideEducation.co.uk](http://NationwideEducation.co.uk)

## Donations by vote

Members' votes in the 2011 AGM added up to a charity donation of £203,237. Members could choose from a list of three charities or allow their donation to be split equally between all three.

- Macmillan Cancer Support received £96,789, which funded welfare benefits advice services.
- Alzheimer's Society received £75,919, which they used to research and raise the profile of issues that people with dementia and carers face when managing their money.
- Shelter received £30,529, which funded the Skills Support Service in Bristol to help young people and adults in Bristol gain employment and housing.

## Supporting local partners

Our Community Champions programme, launched mid 2011, is a network of over 100 employees promoting citizenship and driving local community activity across Nationwide.

Since 2003, the Derbyshire Building Society has sponsored the annual Derby 10k run. The 2011 race had 3,500 entrants. As well as bringing together the local community, it is an essential fundraising activity for the charity organiser, Sporting Futures. They seek to reduce the risk of crime and antisocial behaviour in Derbyshire's communities by encouraging targeted young people to join in physical recreation.

The Prospect Hospice in Swindon's annual Starlight Walk has been supported by Nationwide since 2008. This year 629 women took part and raised almost £87,000 for the hospice. Our catering supplier, Aramark, donated refreshments and provided volunteers to serve them.

Through our principal sponsorship of Bournemouth Symphony Orchestra (BSO), we now sponsor their Community Musician, Andy Baker, and work with the orchestra on a number of key community projects including BSO Resonate and its Rusty Musicians Project.

Working together,  
Nationwide's employees  
and members raised over

# £1.1 million

for good causes during 2011/12.



## Supporting sporting opportunities for disabled people

Disability Sport Events (DSE) is part of the English Federation of Disability Sport – the strategic lead for disabled people in sport throughout England. The events programme is world renowned, organising Championships in a variety of sports.

Swimming and athletics are the highest participation sports for disabled people in the UK and our sponsorship allows DSE to provide opportunities from regional through to international level. The Nationwide programme helps DSE to engage over 500 swimmers at a national level and 1,000 swimmers in regional competition. In athletics, 400 athletes compete at national level, 2,000 take part at regional level.

With London 2012 just around the corner, the events programme has made a vital contribution to what we hope will be a successful Paralympics for UK athletes, helping to identify talent and make team selections. And we are confident that there will be a lasting legacy too, as disabled people continue to have more opportunities to participate in sport at every level.

# The Nationwide Foundation

Since it was established in 1997, The Nationwide Foundation has given over £28 million to over 3,000 UK charities supporting vulnerable people in need.

The Nationwide Foundation is a registered charity (number 1065552) which makes grants to other charities across the UK. It has over 14 years' experience of supporting causes which help people in need and has won awards in recognition of its work. Since its launch, The Nationwide Foundation has made grants of over £28 million to more than 3,000 charities.

The Nationwide Foundation is funded by Nationwide Building Society and under the current strategy, grants are given to work which tackles financial exclusion, financial abuse, housing problems and debt. The current strategy commenced in 2009 and is called 'Money Matters, Homes Matter and Families Matter'.

## Investor Programme grants

The core, flexible and long-term funding of The Nationwide Foundation's Investor Programme has continued to make a significant difference to the charities funded during 2011/12. Crucial to the Foundation's approach is the commitment it has to helping its Investor Programme grantees build organisational resilience, through additional hands on support, training and consultancy. This is provided in partnership with The Cranfield Trust. As the charities enter their third and final year of funding, The Cranfield Trust works with them to ensure they are prepared for the end of The Nationwide Foundation's grant and have planned how to continue their good work.

## Key achievements of the Investor Programme

- Over 9,000 vulnerable people have been helped with their housing and finance issues
- The incomes of beneficiaries have been increased by over £600,000
- 500 people suffering from dementia have been provided with advocacy to help them address a finance or housing issue
- Almost 6,000 older people living in rural areas have received advice and support to address fuel poverty.



### Age Concern Camden

The Nationwide Foundation is supporting Age Concern Camden to provide a bilingual advisory service to help older people from Camden's large Somali community gain access to support services, benefits and grants. Older people who do not speak English can find themselves particularly vulnerable to financial exclusion, poverty and severe housing issues. This service is able to make a very real difference to the people it reaches. 310 people have received support through this project.



**The Nationwide Foundation**

*Supporting communities nationwide*

## Small Grants Programme

The Small Grants Programme offered up to £5,000 to smaller charities and £250,000 was given to over 50 charities in 2011/12. The simple application process meant that charities could quickly put the money to good use.

- **The Advicepoint** provides guidance to people in Swindon on matters relating to debt, welfare benefits and housing. The Nationwide Foundation made a grant towards the salary costs for a worker giving specialist advice and support to older people.
- **Pendower Good Neighbour Project** supports residents living on a housing estate in Newcastle Upon Tyne make improvements to their local housing, environment, amenities and services. The Foundation made a grant towards salary costs for the garden maintenance service available to older people. Providing support to maintain properties enables older people to remain in their own homes.

### Key achievements of the Small Grants Programme during 2011/12

Funding provided by the programme has resulted in:

- Over 4,000 survivors of domestic abuse being assisted with housing and finance matters
- 6,000 older people being helped with a variety of housing and finance issues.



**'We are very grateful for the funding from The Nationwide Foundation, which enabled us to establish a new outreach advice project, specifically aimed at older people.'**

Tonbridge & Malling Citizens Advice Bureau

### Next steps

The Nationwide Foundation's current strategy will draw to a close in 2012/13. Its Board of Trustees has commenced a strategic review to develop a new three year grant making strategy for implementation in 2012/13. The Financial Inclusion Centre has been engaged to independently review the UK's housing and finance sectors on behalf of the Board, to help identify key areas where The Nationwide Foundation's future grants could achieve maximum impact in the areas of housing and financial inclusion.

For more information about The Nationwide Foundation's activities, visit

[nationwidefoundation.org.uk](http://nationwidefoundation.org.uk) or email [enquiries@nationwidefoundation.org.uk](mailto:enquiries@nationwidefoundation.org.uk)

The Foundation's current strategy has given over

**£4.3 million**

to more than 200 charities and supported over 40,000 people in need.

# Board of Directors

As at 4 April 2012



## 1 Graham Beale (53) BSc, ACA

### Term of Office:

Executive Director of Nationwide Building Society since April 2003, Chief Executive since April 2007.

### Independent:

No

### Skills and experience

#### (including directorships):

Graham 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. 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. As Chief Executive, Graham leads the strategic direction of the Group and oversees its operation through chairing the Executive Committee which comprises the Executive and Group Directors. Graham is a member of the Financial Services Practitioner Panel.

## 2 Chris Rhodes (49) BSc (Hons), ACA

### Term of Office:

Executive Director of Nationwide Building Society since April 2009.

### Independent:

No

### Skills and experience

#### (including directorships):

Chris joined Nationwide in April 2009 from Abbey Santander, where he was Director of Retail Distribution for Alliance and Leicester (A&L). Chris is the Group Product & Marketing Director and his responsibilities include Nationwide's product range, its commercial activities, consumer finance and customer strategy and marketing. Chris has spent 20 years working in the financial services sector and his previous positions include Deputy Managing Director of Girobank and Retail Operations Director of A&L. In 2003 he was appointed as Managing Director Retail Banking for the entire A&L Group. In 2007 Chris moved to become Group Finance Director, a role he held until the merger with Santander in 2008.

## 3 Suzanna Taverne (52)

### Term of Office:

Non Executive Director of Nationwide Building Society since November 2005.

### Independent:

Yes

### Skills and experience

#### (including directorships):

Suzanna brings expertise in strategy, finance and management. She is currently a director of FCE Bank plc and a Trustee of the BBC, the Foundation for Credit Counselling and the Shakespeare Schools Festival. Suzanna was formerly Chair of Gingerbread, Trustee of the Design Museum, 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.

## 4 Geoffrey Howe (62) MA (Cantab)

### Term of Office:

Non Executive Director of Nationwide Building Society since January 2005, Chairman since July 2007.

### Independent:

Yes  
(upon appointment)

### Skills and experience

#### (including directorships):

Geoffrey has considerable regulatory, management and legal experience in financial services, insurance and investment markets. Geoffrey is currently the Chairman of Nationwide Building Society and of Jardine Lloyd Thompson Group plc. He is also a director of Close Brothers Group plc. He 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.



**5 Alan Dickinson (61)**  
**MBA, BSc (Hons), FSS,**  
**FCIB, FCIBS**

**Term of Office:**  
Non Executive Director of  
Nationwide Building Society  
since June 2010.

**Independent:** Yes

**Skills and experience**  
**(including directorships):**  
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 RBS  
UK. Alan is also a non executive  
director of Carpetright plc and  
Frogmore Property Company  
Limited, a governor of the charity  
Motability and Honorary Treasurer  
of Surrey County Cricket Club.

**6 Robert Walther (68)**  
**MA, FIA**

**Term of Office:**  
Non Executive Director of  
Nationwide Building Society since  
July 2002 and Deputy Chairman  
and Senior Independent Director  
since July 2006.

**Independent:** Yes

**Skills and experience**  
**(including directorships):**  
Robert's 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.

**7 Mitchel Lenson (57)**  
**MBA, BA (Hons), ACIB, FSI**

**Term of Office:**  
Non Executive Director of  
Nationwide Building Society  
since July 2011.

**Independent:** Yes

**Skills and experience**  
**(including directorships):**  
Mitchel has spent nearly 30 years  
in the financial services industry  
and is a former Group Chief  
Information Officer at Deutsche  
Bank with responsibility for IT  
and Operations for all operating  
divisions of the bank, including  
its retail banking operations.  
Mitchel was a member of the  
executive committees for both the  
Corporate and Investment Bank  
and the Private Client and Asset  
Management Division. He has also  
served as Managing Director, Global  
Head of Operations & Operations  
IT at UBS Warburg and as Director,  
Group Operations at Credit Suisse  
First Boston. More recently Mitchel  
was a partner of Olivant & Co, an  
investment company providing  
strategic and operational expertise  
alongside investment capital to  
financial services businesses in  
Europe, the Middle East and  
Asia-Pacific and was a non  
executive director of NYFIX,  
a NASDAQ listed company.

# Board of Directors

As at 4 April 2012



## 8 Matthew Wyles (53)

### Term of Office:

Executive Director of Nationwide Building Society since August 2007.

### Independent:

No

### Skills and experience

#### (including directorships):

Matthew is the Group Distribution Director 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 intermediary sales across all of the Group's brands. Matthew is a board member of Race for Opportunity and was Chairman of the Council of Mortgage Lenders during 2009 and 2010.

## 9 Tony Prestedge (42)

### Term of Office:

Executive Director of Nationwide Building Society since August 2007.

### Independent:

No

### Skills and experience

#### (including directorships):

Tony is the Chief Operating Officer 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 strategy, performance and transformation and his divisional reports include Customer and Product Operations, Technology, Transformation Delivery and Group Services. Tony is a board member of Opportunity Now.

## 10 Lynne Peacock (58)

### BA (Hons)

### Term of Office:

Non Executive Director of Nationwide Building Society since July 2011.

### Independent:

Yes

### Skills and experience

#### (including directorships):

Lynne, a former Chief Executive of National Australia Bank's (NAB) UK business and Chief Executive of Woolwich plc, has over 25 years' senior management experience in a range of roles comprising brand development, mergers & acquisitions, change management and business transformation, including 15 years at board level. During her time at NAB, Lynne was responsible for its businesses in the UK consisting of the Clydesdale and Yorkshire Bank. She became Chief Executive of Woolwich plc in October 2000 following its takeover by the Barclays Bank Group, having previously held a number of senior management and board positions at the Woolwich Building Society, both before and after its conversion to a public listed company in 1997. Lynne is a non executive director of Scottish Water and Standard Life plc.



### 11 Mark Rennison (51) BA, FCA

#### Term of Office:

Executive Director of Nationwide Building Society since February 2007.

#### Independent:

No

#### Skills and experience (including directorships):

Mark, a chartered accountant, is the Group Finance Director with responsibility for Finance, Treasury, Strategy & Planning, Group Legal and Compliance 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.

### 12 Roger Perkin (63) MA (Cantab), FCA

#### Term of Office:

Non Executive Director of Nationwide Building Society since April 2010.

#### Independent:

Yes

#### Skills and experience

#### (including directorships):

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, chairing its Audit Committee and a former non executive director of The Evolution Group plc. Additionally, he is a trustee of two charities, Chiddingstone Castle and Crime Reduction Initiatives.

### 13 Michael Jary (48) MA (Oxon), MBA, FRAS

#### Term of Office:

Non Executive Director of Nationwide Building Society since January 2009.

#### Independent:

Yes

#### Skills and experience

#### (including directorships):

Michael 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 advisor 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.

Principal Committees	Membership
Audit Committee	Roger Perkin (Chairman), Alan Dickinson, Lynne Peacock and Suzanna Taverne.
Board Risk Committee	Alan Dickinson (Chairman), Mitchel Lenson, Roger Perkin and Robert Walther.
Remuneration Committee	Robert Walther (Chairman), Michael Jary, Lynne Peacock and Suzanna Taverne.
Nomination Committee	Geoffrey Howe (Chairman), Alan Dickinson, Roger Perkin and Robert Walther.
Board IT Strategy and Transformation Committee	Mitchel Lenson (Chairman), Alan Dickinson, Geoffrey Howe, Michael Jary and Roger Perkin.
Results Approval Committee	Geoffrey Howe (Chairman), Graham Beale, Roger Perkin and Mark Rennison.

# Directors' report

## For the year ended 4 April 2012

The directors have pleasure in presenting their Annual Report and Accounts for the year ended 4 April 2012.

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) as adopted by the EU. 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 2012 and 2011 are given in the Business Review.

The information that fulfils the requirements of the Accounting Standards Board's Reporting Standard Operating and Financial Review (OFR) can be found in the following sections of the Annual Report and Accounts, which are incorporated into this report by reference:-

- Chairman's Statement
- Chief Executive's Review
- Business Review.

### 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, future developments and Key Performance Indicators

The Group's business and future plans are reviewed in the Chairman's Statement, the Chief Executive's Review and the Business Review. The Group's principal Key Performance Indicators are reviewed in the Business Review.

### Profits and capital

Profit before tax for the year ending 4 April 2012 was £203 million (2011: £317 million). The profit after tax transferred to the general reserve was £179 million (2011: £248 million).

Total Group reserves at 4 April 2012 were £6,159 million (2011: £6,242 million). Further details on the movements of reserves are given in the Group statement of movements in members' interests.

Gross capital at 4 April 2012 was £9,428 million (2011: £9,725 million) including £1,644 million (2011: £1,973 million) of subordinated debt and £1,625 million (2011: £1,510 million) of subscribed capital. The ratio of gross capital as a percentage of shares and borrowings at 4 April 2012 was 5.2% (2011: 5.6%) and the free capital ratio was 4.5% (2011: 4.9%). The Annual business statement gives an explanation of these ratios.

### Mortgage arrears

The Group mortgage portfolios at 4 April 2012 included 2,793 mortgage accounts (2011: 2,799), including those in possession, where payments were more than 12 months in arrears. The total amount of principal loans outstanding in these cases was £420 million (2011: £429 million). The total amount of arrears in these cases was £34 million (2011: £32 million) or 0.03% (2011: 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.

### Charitable and political donations

Results for the year include charitable donations of £1,511,579 (2011: £2,679,555) including £700,000 (2011: £1,015,000) to the Nationwide Foundation, a report on which is given above. 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 participated in the Government-backed unclaimed assets scheme, whereby savings accounts that have been inactive for 15 years 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. The Society transferred £32,323,110 on 5 April 2011 to the Reclaim Fund Limited, the administrators of the unclaimed assets scheme. Subsequent to the year end the Society transferred an additional £4,273,364 to the scheme on 5 April 2012 so that total contributions at that date are £36,596,474.

### 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 19 days at 4 April 2012 (2011: 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 of risk.

The financial risk management objectives and policies of the Group are shown in the Business Review and in notes 34 to 37.

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

- Lending risk
- Financial risk
- Business risk
- Legal and regulatory risk
- Strategic 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 and in the Report of the Directors on Corporate Governance.

In addition to these 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 Business Review.

## Employees

The values of the Society remain the core of our employment proposition and we have built our people strategy around maintaining and enhancing them to the benefit of our employees and our customers. Our aim is to reach levels of employee engagement and enablement that match those of high performing organisations from across the world, creating a culture that is unique to Nationwide as the leading mutual financial services organisation.

This has been captured in the statement that Nationwide is an employer of integrity, in practice this means making Nationwide a great place to work balanced with, not at the expense of, our ongoing need to deliver customer value.

A key component running through our strategy is the development of an inclusive culture in which employees can thrive and succeed and we have committed ourselves to a comprehensive plan to support diversity and foster inclusiveness. It is important to us that everyone at Nationwide feels able to be themselves and perform to their full potential and that the Society is able to reflect and represent its communities and members in all their walks of life; through our Corporate Citizenship strategy we enable employees to support those communities through our volunteering programme.

One of the key drivers of culture and employee engagement is the quality of leadership. We have continued to invest in the development of leaders at every level, with a particular focus on identifying and developing key talent to ensure we have the capabilities and succession required to deliver our forward strategy. In addition, we aim to attract and select

new talent that will support the delivery of our business objectives, in a fair and consistent manner, supporting our Treating Customers Fairly policies and our PRIDE values (the behaviours we seek from employees to treat our customers fairly).

Our continued achievement of Investors in People Gold standard provides an external benchmark for excellence which enables us to measure our continuous improvement in communication, people management, recruitment and training.

The Society continues to consult actively with the Nationwide Group Staff Union. The Employee Involvement Committee, chaired by the Chief Operating Officer, acts as a forum where representatives from the business and the Union consult and share information on a range of business and employment issues to the benefit of our employees and our business.

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

This statement, which should be read in conjunction with the Independent Auditors' Report, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Report and 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, an Annual Report and 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 the Annual Report and 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 financial statements
- Prepare the financial statements 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 Report and 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.

# Directors' report continued

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
- Clearly differentiate in their annual reports between information that is audited and information that is unaudited.

The Group and other major UK banks have continued to adopt the BBA code in their 2011/12 financial statements. The Group's financial statements have therefore been prepared in compliance with the code's principles.

The Group aims to continually enhance its disclosures and their usefulness to the readers of the financial statements in the light of developing market practice and areas of focus. This year we have continued to streamline and enhance disclosure to focus on significant information to assist readers, with specific focus on:

- Loans subject to forbearance and the effects of collateral
- Disclosure of bonus costs and deferred employee remuneration
- Provisions relating to PPI redress including key assumptions and qualitative sensitivity
- Exposures to selected countries
- Presentation format of regulatory capital disclosures
- Analysis between assets pledged for external or internal debt issuances
- Deferred tax asset recoverability
- Further development of the glossary.

A copy of the Annual Report and Accounts can be found 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
- 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 Report and Accounts comply with the Act
- 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 in accordance with the Financial Reporting Council's guidance 'Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009' and IAS 1 Presentation of Financial Statements.

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. 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 risk are described in the Business Review. In addition, note 34 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 financial statements.

## Directors

The directors of the Society who were in office during the year and up to the date of signing the financial statements were:

**Geoffrey Howe** (Chairman)

**Robert Walther**

(Deputy Chairman and Senior Independent Director)

**Graham Beale** (Chief Executive)

**Tony Prestedge** (Chief Operating Officer)

**Mark Rennison** (Group Finance Director)

**Chris Rhodes**

(Executive Director Group Product & Marketing)

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

**Alan Dickinson**

**Michael Jary**

**Mitchel Lenson** (Appointed to the Board 18 July 2011)

**Lynne Peacock** (Appointed to the Board 18 July 2011)

**Roger Perkin**

**Suzanna Taverne**

Former Directors:

**Bill Tudor John** (Joint Deputy Chairman – until retired)

(Retired from the Board 21 July 2011)

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 Mitchel Lenson and Lynne Peacock will stand for election at the 2012 AGM and the remainder of the directors will stand for re-election except for Robert Walther and Suzanna Taverne who will retire from the Board on 19 July 2012.

None of the directors has any beneficial interest in equity 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

22 May 2012

# Report of the Directors on Corporate Governance

For the year ended 4 April 2012

## Dear Member

During the last year we have continued to evaluate and develop our governance arrangements, whilst understanding the changes that are necessary for a large mutual retail financial services business operating in an increasingly complex and regulated market place.

In my Chairman's Statement I have highlighted the main areas of focus for the Board during the last financial year. In this report I will set out the work and operation of the Board and the governance framework that has been implemented to ensure that the Board continues to provide strong and effective leadership.

There have been a number of changes to the corporate governance landscape in which we operate, including publication of Lord Davies' report 'Women on Boards', a further revision to the UK Corporate Governance Code (the Code), the Sharman Inquiry (going concern and liquidity) and the FRC's revised best practice guidance on Audit Committees.

The revised Code was issued in May 2010 and this is the first reporting year for which compliance will be reported. Although the new Code is specifically addressed to public quoted companies, building societies are encouraged by the FSA to have regard to it. An updated version of the Code to reflect progress on boardroom diversity will apply for financial years commencing on or after 1 October 2012 and reference is made in this report and my Chairman's Statement to our diversity and inclusion policy.

We will continue to strive to implement best practice in corporate governance and to ensure that the Board provides transparent reporting with a continued focus on improving the business for the benefit of all our members.

### Geoffrey Howe

Chairman

## What is the role of the Board?

The Board's primary role is to focus on the formulation of strategy and review of business performance, and it is also responsible for ensuring that risks are appropriately identified and managed, and that a sound system of internal controls is in place. Management's performance is monitored against the delivery of the Corporate Plan, which sets the Society's strategy for the next five years. The Corporate Plan is thoroughly reviewed annually and assessed on the basis of current and prospective market conditions. The Board is responsible for establishing the guidelines within which the business is managed and for ensuring the long term success of the Society. Finally, the Board must be aware of the Society's obligations to its members and other stakeholders and to ensure it is responsive to their changing demands.

## Does the Society comply with the UK Corporate Governance Code?

The Board considers that the Society complied with the BSA Guidance for Building Societies on the Code during 2011/12. The new Code requires disclosures on our business model and strategies for delivering our objectives and these are addressed in the Business Review. This report sets out how the Society has applied the main principles and complied with the provisions of the Code.

## What matters are reserved for the Board?

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. Outlined below is an overview of the principal matters:

### Strategy and management

- Responsibility for the overall management of the Group
- Approval of the Group's long term objectives and commercial strategy
- Approval of the Group's annual operating and expenditure budgets
- Review of performance in the light of the Group's strategy, objectives, business plans and budgets
- Any material extension of the Group's activities.

### Structure, capital and funding

- Changes relating to the Group's capital structure including capital raising activity
- Major changes to the Group's corporate structure
- Changes to the Group's management and control structure
- Any change to the Society's mutual status
- The principles of any new forms of wholesale funding and capital instruments.

### Financial reporting and controls

Approval of:

- Preliminary announcements of interim and year end results
- The Annual Report and Accounts
- Any significant changes in accounting policies or practices
- Corporate expenditure over £10 million which either does not fall within the budget approved by the Board or falls within the application for financial investment appraisal process.

### Internal controls and risk management

- Ensuring maintenance of a sound system of internal control and risk management
- Approval of the Group's risk appetite, risk management framework, key regulatory documents and Contingency Funding Plan
- The Board Risk Committee will advise the Board on risk matters and highlight significant risks.

### Lending

Approval of:

- Recommendations from the Executive Risk Committee
- Treasury counterparty exposures in excess of the Executive Risk Committee's mandate.

### Board membership

- Changes to the structure, size and composition of the Board, following recommendations from the Nomination Committee

- Ensuring adequate succession planning for the Board and senior management
- Appointments to the Board
- Appointment, reappointment or removal of the external auditor to be put to members for approval, following the recommendation of the Audit Committee.

### Remuneration

- Determining the remuneration policy for the directors
- The introduction of new incentive plans for executive, group or divisional directors or major changes to existing plans.

### Corporate governance matters

- Undertaking a formal and rigorous review annually of its own performance, that of its committees and individual directors
- Review of the Group's overall corporate governance arrangements.

### How are the Board Committees structured?

The Board has the following principal committees:

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 in a separate section of this report below.

The **Remuneration Committee** determines and agrees on behalf of 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.

The **Board Risk Committee** reviews the Group'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 below in a separate section of this report.

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 below in a separate section of this report.

The **Board IT Strategy and Transformation Committee** is responsible for oversight on behalf of the Board of:

- The Strategic Investment portfolio and delivery of the Transformation business case
- The IT strategy, architecture, delivery roadmap and architectural governance controls
- All individual programmes with an investment spend of over £50 million.

The **Results Approval Committee** reviews and executes the decisions made by the Board in relation to the interim and year end financial statements of the Society.

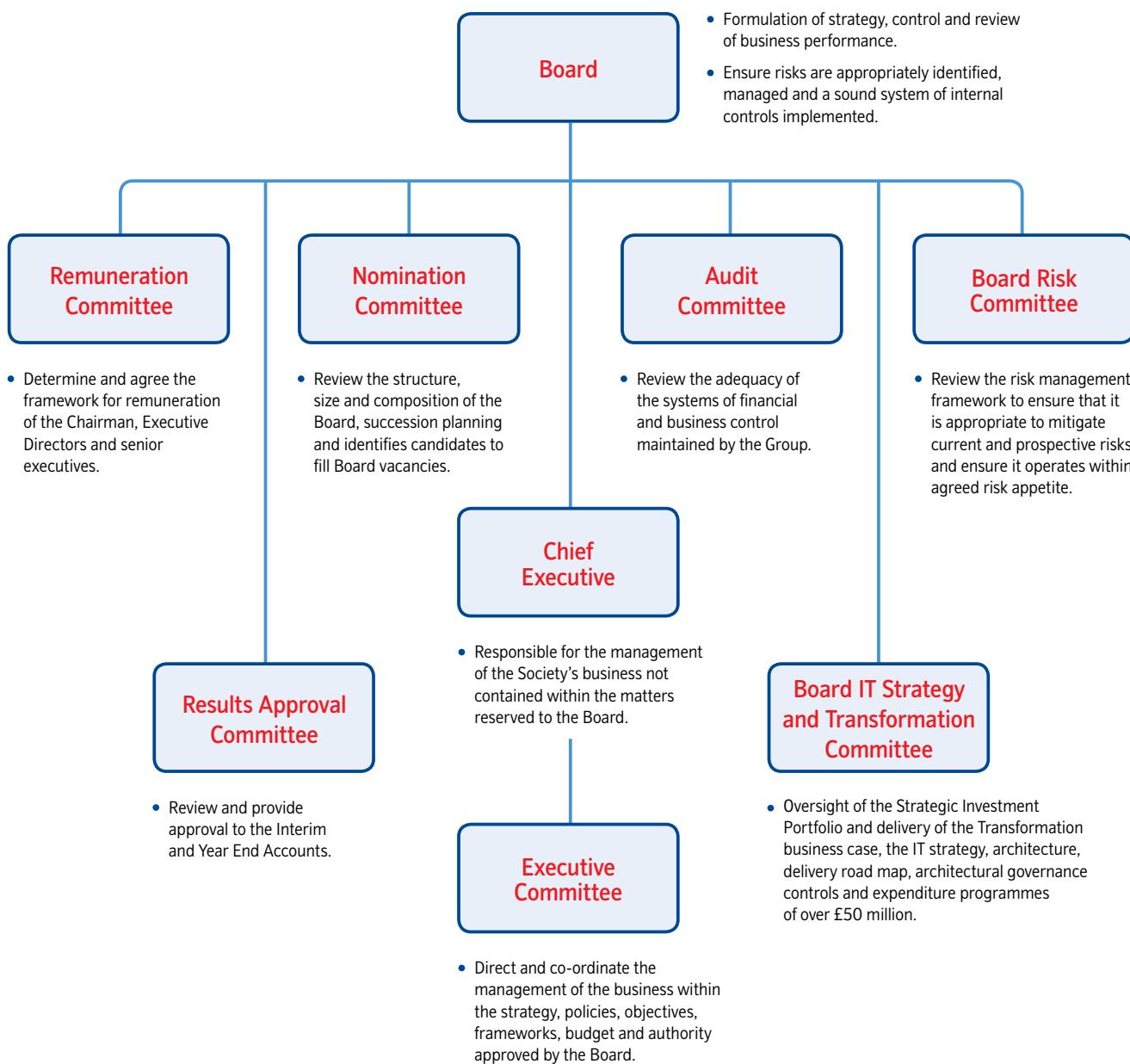
The terms of reference of the above committees are available at [nationwide.co.uk](http://nationwide.co.uk) or on request from the Society's Secretary.

# Report of the Directors on Corporate Governance

continued

## Board and Committee structure

The structure of the Board and its committees is set out below.



## What are the roles of the Chairman and the Chief Executive?

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 Chairman is responsible for ensuring a high quality of decision making at Board level which is facilitated by focused and concise Board reporting, the provision of an open and inclusive forum which provides the opportunity for all directors to contribute to Board discussions, with a clear process for agreeing actions, timescales and responsibilities.

Summaries of the Chairman's and Chief Executive's roles are set out below:

### Chairman

- Providing leadership to the Board of directors and management of Board meetings
- Ensuring the effectiveness of the Board of directors and the development and evaluation of directors
- Fostering a culture of open dialogue and mutual respect between executive and non executive directors
- Leading open and honest debate at Board meetings and constructive challenge to the executive decisions
- Together with the other Board members, setting and challenging the strategic direction and risk appetite of the Society
- Together with the other Board members, promoting the long term success of the Society and ensuring the accountability of the Society.

### Chief Executive

- With the support of the Executive Committee, directing and co-ordinating the management of the Group's business generally
- With the support of the Executive Committee leading the Executive Risk Committee, to monitor the Group's risk profile and performance and oversight of the Group's risk management committees
- Implementing and monitoring systems for apportionment and oversight of responsibilities, controls and best practices, policies and processes within the Group
- Establishing and maintaining effective working relationships with the Chairman, the Board and all directors and officers of the Group and being available to the Chief Internal Auditor, the Compliance Officer and the Chief Risk Officer
- Establishing and maintaining effective working relationships with regulators, the Government, industry sector analysts, trade organisations and the media and strategically influencing and lobbying these bodies as and when appropriate in the best interests of the Group
- Promoting the Group, its good corporate image and social standing in the UK financial services industry.

## Who is on the Board of Directors and what are their responsibilities?

As at 4 April 2012 the Board comprised the Chairman, five executive directors and seven non executive directors.

All of the non executive directors, including the Chairman at the time of his appointment, are considered to be independent based on the guidance in the Code. Biographical details of each of the directors, together with their Board Committee memberships are set out within this report and the Board of Directors section of the Annual Report and Accounts.

In April 2011 an Executive Committee was formed to replace the Executive Directors Committee and its remit is to direct and co-ordinate the management of the business within the strategy, policies, objectives, frameworks, budget and authority approved by the Board. This Committee acts as a decision making forum, comprised of the five executive and three group directors who meet to assist the Chief Executive with his responsibilities.

The non executive directors' role is to bring an external and independent view to support, and as necessary, challenge the work and recommendations of the senior management team. The roles and responsibilities of the non executive directors are set out in their appointment letters and additional job information summaries. 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 effective challenge.

Robert Walther, Deputy Chairman, was the Senior Independent Director (SID) during the year; however he will stand down from the Board in July 2012 and will be replaced by Roger Perkin. The role of the SID is to provide support to the Chairman in his role of leading and managing the Board, ensuring the views of all other directors are conveyed to, and given due consideration by the Chairman, ensuring the views of members and other stakeholders are conveyed and in conjunction with the other non executive directors, evaluating the performance of the Chairman and leading succession planning for the Chairman.

The Group'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 the Group'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 other directorships, which remain unchanged during the year, are in the Board of Directors section of this report. The Board believes that the Chairman remains wholly committed to his role and allocates sufficient time to meet its demands. As part of the director's performance review, as explained below, consideration is given to ensuring that each director is able to allocate sufficient time to discharge their responsibilities effectively.

The Chairman and the non executive directors meet at least once a year without the executive directors.

# Report of the Directors on Corporate Governance

continued

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	Audit Committee	Nomination Committee	Remuneration Committee	Board Risk Committee	Board IT Strategy & Transformation Committee	Results Approval Committee
Graham Beale*, Chief Executive	<b>11 (11)</b>	-	-	-	-	-	<b>2 (2)</b>
Alan Dickinson, Chairman of the Board Risk Committee	<b>11 (11)</b>	<b>6 (6)</b>	<b>4 (4)</b>	-	<b>6 (6)</b>	<b>2 (2)</b>	-
Geoffrey Howe, Chairman of the Board and the Nomination Committee	<b>11 (11)</b>	-	<b>6 (6)</b>	-	-	<b>2 (2)</b>	<b>2 (2)</b>
Michael Jary	<b>11 (11)</b>	-	-	<b>5 (6)</b>	-	<b>2 (2)</b>	-
Mitchel Lenson, Chairman of Board IT Strategy and Transformation Committee (Appointed on 18 July 2011)	<b>8 (8)</b>	-	-	-	<b>4 (4)</b>	<b>2 (2)</b>	-
Lynne Peacock (Appointed on 18 July 2011)	<b>8 (8)</b>	<b>5 (5)</b>	-	<b>4 (4)</b>	-	-	-
Roger Perkin, Chairman of the Audit Committee	<b>11 (11)</b>	<b>6 (6)</b>	<b>4 (4)</b>	-	<b>6 (6)</b>	<b>1 (2)</b>	<b>2 (2)</b>
Tony Prestedge*	<b>11 (11)</b>	-	-	-	-	-	-
Mark Rennison*	<b>11 (11)</b>	-	-	-	-	-	<b>2 (2)</b>
Chris Rhodes*	<b>11 (11)</b>	-	-	-	-	-	-
Suzanna Taverne	<b>11 (11)</b>	<b>6 (6)</b>	-	<b>6 (6)</b>	-	-	-
Robert Walther, Deputy Chairman, Senior Independent Director and Chairman of the Remuneration Committee	<b>11 (11)</b>	-	<b>6 (6)</b>	<b>6 (6)</b>	<b>6 (6)</b>	-	-
Matthew Wyles*	<b>11 (11)</b>	-	-	-	-	-	-

Former Directors	Board	Audit Committee	Nomination Committee	Remuneration Committee	Board Risk Committee	Board IT Strategy & Transformation Committee	Results Approval Committee
Bill Tudor John, Joint Deputy Chairman (Retired 21 July 2011)	<b>4 (4)</b>	-	<b>2 (2)</b>	<b>2 (2)</b>	<b>2 (2)</b>	-	-

\*Executive directors

The Board IT Strategy and Transformation Committee was established on 1 January 2012.

#### **What were the key issues addressed during the year?**

During the year the Board held eleven meetings, including a strategy conference.

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
- Review of the interim and annual results
- 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
- Member engagement
- Regulatory reports and updates on market developments
- Minutes and reports from the chairmen of the board committees and governance updates.

#### **What changes have been made to the Board's composition?**

During the year changes were made to the composition of the Board in order to further enhance its skills, knowledge and experience base to meet the needs of the business in the longer term. This process was the main focus of the Nomination Committee. In recommending appointments to the Board, the Nomination Committee considers the mix of relevant skills, knowledge and experience of the current directors and identifies where there are potential gaps and a role specification is produced for use by an external search consultant. Although the Board was considered to be well balanced with considerable collective depth in finance, risk management, legal and general management experience, in order to fill a vacancy following the retirement of a director in 2011 and to strengthen the Board further it was determined that two new non executive directors should be recruited with financial services backgrounds, one of whom would have a strong operational and IT background.

The Nomination Committee, in conjunction with the independent executive search consultant, Spencer Stuart, was responsible for identifying and recommending the appointment of Mitchel Lenson. Mr Lenson is a member of the Board Risk Committee and chairs the Board IT Strategy and Transformation Committee. Additionally, the Committee was also responsible for recommending the appointment of Lynne Peacock, following her retirement as the chief executive of National Australia Bank's UK business and a former chief executive of Woolwich plc. Mrs Peacock has over 25 years senior management experience in a range of roles comprising brand development, mergers, acquisitions, change management and business transformation, including 15 years at Board level. As a former director of the Woolwich Building Society she also has a strong affinity with the mutual sector in which the Society operates.

It was subsequently agreed that an additional non executive director should be recruited in anticipation of the retirements of Robert Walther and Suzanna Taverne in July

2012, if possible with a strong market research/consumer background. It is expected that an appointment will be made to fill this role by the middle of 2012.

In addition to fulfilling the requirements of the role specification 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.

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 2012, which was the deadline for the AGM in 2012.

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, Lynne Peacock and Mitchel Lenson will stand for election at the AGM in 2012. The remainder of the directors will stand for re-election except for Robert Walther and Suzanna Taverne who will both retire from the Board in July 2012.

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

Bill Tudor John, a Joint Deputy Chairman and non executive director, retired from the Board at the AGM on 21 July 2011.

#### **What is the Board's opinion on diversity and inclusion?**

During the year the Board and the Nomination Committee have both considered the issue of diversity and inclusion from a Board and Society wide perspective. Diversity and inclusion is part of a much broader strategy referenced in the Employees section of the Directors' Report. There has been much debate this year on the subject of board diversity, notably on the subject of gender and the representation of women on the boards of companies.

Nationwide supports the recommendation in the new Code that boards should consider the benefits of diversity, including gender, when making Board appointments. The Society has an established policy of including female representation on all short lists for senior management roles.

Our aim as regards the composition of the Board is that we should have a balance of skills, experience, independence and knowledge to enable each director and the Board as a whole to discharge their duties and responsibilities effectively. For us, the issue of gender is one aspect of this broader issue of diversity. It is not believed that establishing quotas or targets for the composition of the Board of the Society is appropriate as the overriding issue is the selection of the best candidate, irrespective of background. The aim should be to seek to create as diverse a Board as possible.

#### **What has the Board done during the year to improve its effectiveness?**

Over the past few years the Board has strengthened its induction and development programmes for new and existing directors. A comprehensive and structured induction programme is now in place to enable new directors to make an early and effective contribution. A formal development and training framework for non executive directors has been implemented during the year to ensure that so far as possible they are provided collectively and/or individually with the inputs and

# Report of the Directors on Corporate Governance continued

information necessary for them to understand the business and raise effective challenge. The directors attend regular training/learning sessions which are designed to address a range of both Society specific and market related issues. Non executive directors are encouraged to spend time with executives and with relevant departments to acquire information about the Society.

The Chairman meets with each non executive director twice a year and obtains feedback from each director about their perception of the performance of the Board and the individual over the preceding period and the Chairman provides feedback on his or her contribution. As part of the process the Chairman identifies where there are opportunities to fill in any gaps in knowledge and/or expertise with appropriate training either from within the Society or externally and to also identify areas of the business on which that director might focus by way of visits or conversations with relevant executives during the next period. This process provides a regular dialogue between the Chairman and each of the non executive directors to ensure that feedback is provided about the way the Board is working and how the director is contributing and can continue to contribute in the future.

An evaluation of the Chairman's performance was carried out by the SID, 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.

Each year the Board conducts a review of its performance as a Board both collectively and as individuals and identifies areas where it can improve its effectiveness. 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. The outcome of this process resulted in recommended actions in five key areas, namely, the Board paper production process, strategic discussions, Board composition, Board committee reporting and performance and management information. An alternative approach, which combined elements of external and internal evaluation, was adopted for 2011/12 whereby Dr Tracy Long, from Boardroom Review, facilitated a Board effectiveness workshop. The themes arising from the workshop will be

reported in next year's report. Boardroom Review has no other connections with the Society.

The principal Board committees each carried out separate evaluations of their own performance, led by the committee chairmen, with input provided by each committee member and regular attendees. Recommendations from these evaluations were implemented during the year. In order to ensure that all the directors are fully aware of the issues being considered by each of the Board committees regular written updates are now provided by the committee chairmen and form a part of the formal Board reporting process.

All directors have access to the services and advice of the Group Secretary and are able to obtain independent, professional advice on matters relating to their responsibilities. Under the Society's Articles of Association and to the extent permitted by law, directors have been granted an indemnity by the Society in respect of any third party liabilities which they incur as a result of holding office. This policy was in force during the financial year and at the date of approval of this report.

In April 2011 the Board formalised its conflicts of interest policy and implemented revised procedures for reviewing and as appropriate authorising situations where conflict arises. Directors have an ongoing obligation to declare the nature and extent of any interest before an appointment is taken up or proposed contract, transaction or arrangement is entered into. The Chairman or Senior Independent Director has been delegated with the authority to authorise interests and directors confirm such interests on an annual basis with the Nomination Committee reviewing the Register of Interests in April each year.

## What is the role of the Nomination Committee?

The Nomination Committee comprises Geoffrey Howe (Chairman), Robert Walther, Alan Dickinson and Roger Perkin.

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 external advisers, as appropriate, to facilitate the search. A role specification is drawn up for all Board appointments. See the section above headed 'What changes have been made to the Board's composition?' for more information on specific activity in the year.

During the year the Committee agreed a schedule of items for consideration which includes annual reviews of director development, the Register of Directors' Interests, Board composition and senior executive talent and succession, as

well as papers on the time commitment of non executive directors and the annual Board effectiveness review process.

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.

#### **What is the role of the Audit Committee?**

As at the date of this report the Audit Committee comprises four non executive directors: Roger Perkin (Chairman), Alan Dickinson, Lynne Peacock and Suzanna Taverne. 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, and holds a relevant qualification.

By invitation, Audit Committee meetings are also attended by the Chairman of the Board, the Chief Executive, Group Finance Director, Group Director Financial Reporting, Strategy and Planning, Chief Risk Officer, 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 including regulatory compliance, responsibility for making recommendations to the Board on the appointment, reappointment, remuneration 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 Society's control framework is operating effectively, the Committee members received a range of reports and other information.

#### **What issues were considered by the Audit Committee during the year?**

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, and also on accounting for derivative financial instruments. The Committee also discussed the accounting treatment and presentation of any individually significant transactions in the year, including the acquisition of a portfolio of residential mortgage loans and provisions for restructuring costs and claims in respect of previous sales of payment protection insurance, as set out in note 27. These matters were discussed with management and with the external auditors.
- 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 the Society's whistle blowing arrangements and results of investigation of whistle blowing cases.
- Approval of the annual plans for Group Internal Audit and for the Regulatory Risk Review function.
- Review of regular reports from the Chief Internal Auditor and the Head of Regulatory Risk Oversight, setting

out the results of work carried out, conclusions on the effectiveness of the control environment and compliance with regulation, 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.
- Periodic updates on a wide range of issues including tax, hedge accounting, the framework for financial control, risk disclosures required by regulation, fraud and anti-money laundering controls.

Immediately following each Audit Committee meeting, the Chairman of the Audit Committee provided a verbal update to the Society's Board of Directors on matters discussed by the Audit Committee. An annual reporting schedule has been introduced for presentation of formal papers from the Chairman of the Audit Committee to the Board. Papers setting out matters considered by the Committee, and conclusions reached, were presented twice during the year.

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 and attendees including the Chairman of the Board, the Chief Executive, the Group Finance Director and the external auditors.

#### **What is the relationship between the Audit Committee and the external auditors?**

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. PricewaterhouseCoopers LLP has been auditor to the Society since 1991, and the last audit re-tender was in 2003. There is regular rotation of the audit partner responsible for the audit engagement. In considering re-appointment of the external audit firm, the Committee discussed the length of tenure of PricewaterhouseCoopers LLP and the circumstances under which a re-tender would be appropriate. Taking into account all of these factors, the Audit Committee has recommended to the Board that PricewaterhouseCoopers LLP should be re-appointed as the Society's external auditors.

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. The policy sets out permitted and prohibited services, and also specifies types of non-audit work which present a low risk to independence and are pre-approved as a matter of policy, and those which require specific Audit Committee pre-approval for each engagement. Before approving proposals to appoint the external audit firm for non-audit work, the Committee considers whether the firm is demonstrably

# Report of the Directors on Corporate Governance continued

the most appropriate firm for the work, and evaluates threats to independence including the risk of self-review or involvement in management decisions. The Committee also considers the significance of the fees involved in the assignment and the cumulative value of non-audit fees paid to the firm. A schedule of fees for non-audit work was reviewed at each Committee meeting. The fees paid to the external audit firm for non-audit services are set out in note 9 to the accounts.

The external auditors presented their plan for the audit of the Group, setting out areas of audit risk, and this was discussed with and approved by the Committee. Reports were provided by the external auditors at the conclusion of the review of the interim financial statements and the Annual Report and Accounts, which were considered by the Committee prior to recommending approval of the financial statements. These reports set 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
- A summary of any misstatements identified during the course of testing.

The principal matters discussed with the external auditors were those areas of accounting judgement and estimate noted above. There have been no disagreements with the external auditors.

The Committee also held private discussions with the external auditors, the Chief Risk Officer and the Chief Internal Auditor.

As part of the ongoing training and development of Board members, the Committee members receive periodic updates on relevant technical subjects outside Committee meetings. This included a presentation from the external audit firm on the future direction of IFRS 9, the accounting standard designed to replace IAS 39 Financial Instruments.

The Society has complied with the recommendations included in the Financial Reporting Council's Guidance on Audit Committees.

## What risk management and internal control procedures are employed by the Group?

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, together with an explanation of the structure adopted within the Group for managing risk. This section sets out the context of the Board Risk Committee and the Executive Risk Committee, and how they are supported by the Group Risk Oversight Committee and Risk Management Division; independent assurance is provided to the Board by the Audit Committee.

The Board has ultimate responsibility for risk management and control, which is reviewed by the Board during the year, and has approved a risk appetite statement. In the context of the risk appetite statement, the Board Risk Committee has approved the supporting risk frameworks 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.

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, lending, financial, business, legal and regulatory and strategic 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, macroeconomic indicators 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 to 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 Executive Risk Committee (ERC) is supported by Group Risk Oversight Committee (GROC) to provide oversight across all risks faced by the Group. In turn, GROC is supported by specialist oversight committees for business risk, legal and regulatory risk, and model risk. The Chief Risk Officer, as chair of GROC and a member of ERC, escalates oversight issues to the Board Risk Committee where appropriate.

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 and Board Risk Committee, the Board is satisfied that the Society's systems for identifying, evaluating and managing risks are appropriate. This process has been in place throughout the financial year and as at the date of approval of this report and accords with the provisions of the Turnbull Report.

#### **What is the role of the Board Risk Committee?**

The Board Risk Committee comprises four non executive directors: Alan Dickinson (Chairman), Robert Walther, Roger Perkin and Mitchel Lenson. 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 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 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 six times during the year and is scheduled to meet six times in 2012/13. 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 frameworks and considered the results of a number of stress testing scenarios, including the FSA Anchor Stress Test and the Group's inaugural reverse stress test. The Committee also approved the adoption of an Enterprise Risk Management Framework (ERMF). The establishment of the ERMF is as a result of a comprehensive review of the Group's risk management framework instigated by the Chief Risk Officer during 2011/12. The ERMF has resulted in a restructure of risk governance, including materially strengthening the distinctions between the three lines of defence in terms of risk control and risk oversight. The framework will be implemented and embedded during 2012/13.

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 the Capital Requirements Directive IV, 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 business continuity, operational risk and transformation 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.

#### **What does the Society do to support member engagement?**

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 and the Board regularly reviews its member engagement activity.

During the year the Society launched the Your Nationwide members' website. The site provides members with access to a wide range of information, including our customer service and complaints handling data, while inviting them to regularly interact with the Society. A number of online initiatives have been launched including Talking Points which provides opportunities for discussions on product innovation, You Asked, We Acted, which gives feedback to members to highlight the action taken to address issues raised by members, and an online service improvements suggestions facility. A monthly members' e-newsletter was also launched in November 2011.

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 financial year TalkBack sessions were held in Exeter, Bristol, Leeds, Oxford, Southampton and Swansea, 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 us in the shaping of products and services to meet members' needs.

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 there has been contact with around 15,000 customers each month.

The Society will once again send out AGM packs to over 7.5 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, online at [nationwide.co.uk](http://nationwide.co.uk) or at the AGM. All votes and all proxy votes are counted under independent scrutiny. Results of the voting at the AGM are published on the Society's website.

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**

On behalf of the Board  
Chairman  
22 May 2012

# Report of the Directors on Remuneration

For the year ended 4 April 2012

## Introduction

Dear Member

I am pleased to present the Remuneration Committee's (the Committee's) Report on directors' remuneration for the year to 4 April 2012.

This has been a successful year for Nationwide with excellent progress against most of our strategic goals as shown on page 74. Our experienced leadership team has performed well enabling the Society to deliver a strong trading performance in a challenging market environment.

I would like to share with you our remuneration policies and practices for our executive team including:

- (a) How the Society pays the executive team
- (b) How our pay policy and principles support our business strategy and enhance member value
- (c) What we have paid to our executive directors in respect of 2011/12, and why.

The key highlights of our activities during the year are:

- As communicated last year, we have introduced a new reward scheme for executive directors whereby base salary has been set at around the market median and total compensation for 'on target performance' has been positioned slightly below the market median. For 'maximum performance' total compensation levels have been set to be substantially below market median.
- The Committee approved payments at or below the target levels under our annual and medium term bonus schemes for 2011/12.
- There will be no increase in base salaries for 2012/13.

Nationwide is committed to best practice in corporate governance and therefore 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 considering the performance of the directors we have taken into account the overall financial results and our broader strategic goals against most of which we have made excellent progress. In this context we believe that the Society continues to deliver long term good value to our members.

On behalf of the Remuneration Committee, I recommend that you endorse our report.

**Robert Walther**

Chairman of the Remuneration Committee

## Executive summary

### Key features

- In line with the new reward scheme communicated last year, bonus opportunity was reduced and base salaries were brought in line with the market
- Annual and medium term bonuses are lower this year than previous year
- Chief Executive's fixed and variable pay up by 4.1%. (Employees' pay settlement was circa 4.4%)
- All directors have ceased membership of defined benefit pension plans and now receive a cash allowance which has reduced future costs and liabilities for the Society
- No increase in base salaries for executive directors awarded for 2012/13.

In last year's Directors' Remuneration Report we communicated to members the changes we were making to the structure of the remuneration package for our executive team. To recap:

- Base salary was set at around the market median.
- Total compensation for 'on target performance' was positioned slightly below the market median, but would not fall below lower quartile. For 'maximum performance' total compensation levels were set to be substantially below market median. This has been achieved by reducing the proportion of total compensation that is achievable through bonuses.
- Our incentive programmes have been 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.

In order to ensure that the relationship between risk and reward is appropriate, we decided to change the balance between fixed and variable pay for our executive directors:

- Base salaries were increased with effect from 1 April 2011 to recognise that the executive directors' base salary had fallen behind the market.
- At the same time, the award opportunity under our bonus schemes was reduced for the second year in succession.

The performance of executive directors is assessed against a balanced scorecard of financial and non-financial measures. This approach ensures that executive directors cannot make inappropriate decisions to generate significant additional reward by delivering high levels of performance in a single area at the expense of other corporate priorities.

In addition to the above, we also made a number of changes to the way in which payments are delivered to executives under our bonus schemes in order to bring these into line with developing best practices in the

financial services sector and FSA regulations on pay. In particular:

- We introduced an element of deferral to our bonus schemes and gave the Remuneration Committee the power to reduce or cancel the deferred element if it emerges that the original assessment of performance was misleading or if performance declines substantially over the deferral period.
- We also introduced a condition to our medium term bonus scheme, the achievement of which ensures that the Society maintains a strong capital base that is consistent with our risk appetite and regulatory requirements for the business and helps to ensure a safe and secure business for our members. Failure to meet this condition would result in no payment under the medium term bonus scheme irrespective of performance in other areas.

All of these changes were communicated to members in last year's Annual Report. There have been no further changes to the structure of remuneration during the year.

Taking into account our results in the year and our sustained performance over the three year period 2009-2012, the Committee approved payments under our annual and medium term bonus schemes. These awards were at or below the target levels under the plans and were down on prior years.

Looking forward, there are no planned changes to our remuneration policy for 2012/13 and no increase in base salaries as at 1 April 2012. We may be required to change the way in which we deliver reward to executives in order to meet the FSA regulatory requirements and will communicate any changes to our members in next year's report.

### Executive remuneration policy and principles

As a mutual, we seek to make sufficient profits for our members rather than maximise profits and concentrate on giving our members great value products and excellent service. This principle underpins our remuneration policy, which is designed to support our business strategy and low risk appetite.

Our pay policy and framework helps us to motivate, reward and retain our leadership team to deliver value for members.

We believe in pay for performance and operate bonus schemes which reward our executive directors for the achievement of our key performance indicators over the short and medium term. The way we assess performance is based on our Corporate Plan and includes:

- Financial measures such as underlying profit and non-margin income
- Non-financial measures such as customer satisfaction and the development of new systems and products which adds value for our members
- Each individual's personal and leadership performance against objectives set at the start of each year.

# Report of the Directors on Remuneration

continued

The targets we agree are stretching; e.g. for the customer satisfaction measure we must be ahead of all our key competitors, and the bonus potential for the executive directors is at the lower end when compared with our main competitors. The pay and conditions of the broader

employee population are taken into account when determining executive pay. The Chief Executive is the Society's most highly paid employee and no employee earns more than the executive directors.

## Executive remuneration

The main elements of remuneration for executive directors are:

Total pay package		
Fixed Pay	Performance Pay (bonus schemes)	
Base salary and benefits (car allowance and pension)	Annual Bonus Scheme	Medium Term Bonus Scheme
Fixed pay reflects the size of the role and what other similar organisations offer.	Rewards the achievement of challenging individual and corporate targets for a single financial year.	Rewards sustained strong performance over a three year performance cycle. A new three year performance cycle starts each year.

### (a) Base salary

The Committee reviews base salary on an annual basis taking into account market data for similar roles in the financial services sector. Other factors considered in setting base salaries include the individual's skills, experience and performance and the approach being taken on salaries in the wider organisation. Any changes to base salary are normally effective from 1 April each year.

Last year base salaries were increased with effect from 1 April 2011 to recognise that the executive directors' base

salary had fallen behind the market and this position was not sustainable from a competitive perspective. These changes were considered in the context of wider changes to the remuneration framework which included a significant decrease in the variable pay opportunity.

The table below sets out the base salary levels for executive directors which were in effect during the year compared with the previous year. There will be no increase in base salaries as at 1 April 2012.

Base salary	2012/13	2011/12	2010/11
G J Beale	<b>£825,000</b>	<b>£825,000</b>	£650,000
T P Prestedge	<b>£470,000</b>	<b>£470,000</b>	£350,000
M M Rennison	<b>£560,000</b>	<b>£560,000</b>	£440,000
C S Rhodes	<b>£470,000</b>	<b>£470,000</b>	£350,000
M P V Wyles	<b>£470,000</b>	<b>£470,000</b>	£350,000

### (b) Variable pay

The Society operates two variable pay plans for executive directors:

- The annual bonus scheme (the Annual Performance Pay Plan or APPP) which rewards performance against challenging targets over the financial year
- The medium term bonus scheme (the Medium Term Performance Pay Plan or MTPPP) which is the deferred element of pay and rewards performance over the medium term.

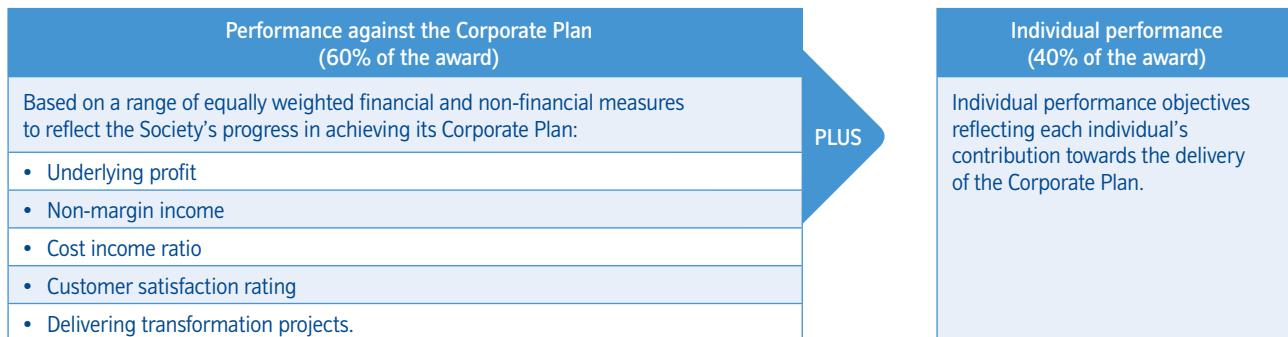
These plans measure the Society's performance against a range of financial and non-financial measures and are completely discretionary. The Remuneration Committee may reduce or cancel payments if it believes that the plan outcomes are not representative of the overall performance of Nationwide.

The maximum award levels under the annual bonus scheme (APPP) and medium term bonus scheme (MTPPP) are shown below. For two years in succession, the Committee decided to reduce the level of awards under the performance pay plans. This was in line with the principle of offering lower than market incentive opportunities to reflect the Society's low risk appetite.

	Maximum award levels (% of salary)							
	Annual Bonus Scheme (APPP)				Medium Term Bonus Scheme (MTPPP)			
	2012/13	2011/12	2010/11	2009/10	2012-2015	2011-2014	2010-2013	2009-2012
CEO	<b>80%</b>	<b>80%</b>	90%	105%	<b>120%</b>	<b>120%</b>	180%	200%
Other directors	<b>54%</b>	<b>54%</b>	67.5%	80%	<b>81%</b>	<b>81%</b>	135%	160%

### Annual Bonus Scheme

The annual bonus scheme (APPP) has two performance elements:



Assessing performance based on a broad range of financial and non-financial measures means that participants are not incentivised to focus on performance in a single area at the expense of other corporate priorities.

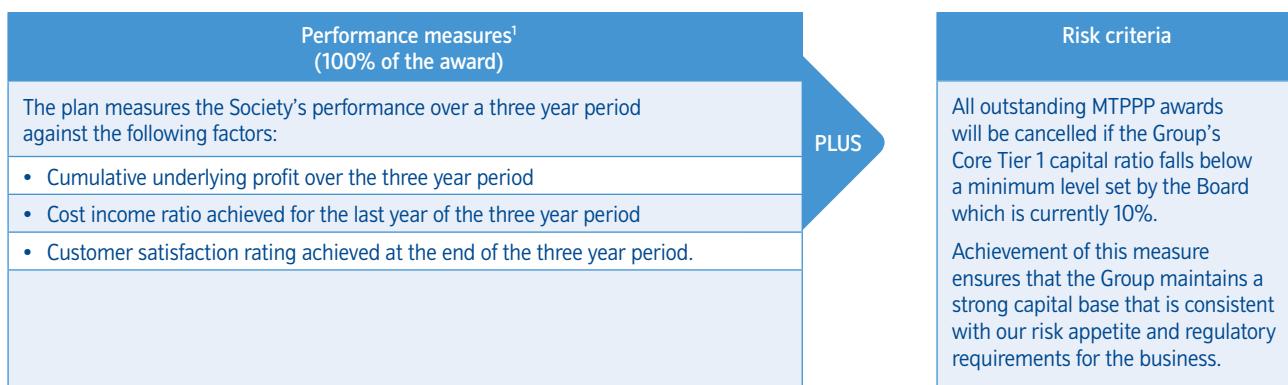
Half of the annual award is paid in June following the year

end and half is retained for six months. The retained element may be reduced or cancelled at the Committee's discretion if it emerges that the original assessment of performance was misleading or if performance against the annual measures declines substantially over the retained period.

### Medium Term Bonus Scheme

The medium term bonus scheme (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. For the 2009-2012 award cycle the measures were:



<sup>1</sup> The performance measures for the 2010-2013 and 2011-2014 cycles also include cumulative non-margin income.

Two thirds of the award earned is paid in the final year of the three year cycle and the remaining one third is deferred for an additional year. The deferred element may be reduced or cancelled at the Committee's discretion if it

emerges that the original assessment of performance was misleading or if performance against the medium term scheme measures declines substantially over the following year.

# Report of the Directors on Remuneration

continued

## (c) Committee's assessment of performance in 2011/12

The key performance indicators used to determine awards under our variable pay plans reflect the areas which deliver value for our members. Equal weighting is given to profit, non-margin income, cost income ratio, customer satisfaction, and the delivery of transformation projects. These measures are directly linked to member benefits such as delivering the best rates on loans and 'best ever' credit card as well as a wide range of products and services more efficiently.

In reviewing the Society's performance against our annual key performance indicators and over the three year MTPPP cycle, the Committee determined that the executive team had delivered a good performance in a challenging economic environment.

The key achievements of the Group during 2011/12, with reference to the objectives set under the APPP and MTPPP are as follows:

Key performance indicator	Performance outcome	
	2011/12 Annual Bonus Scheme (APPP)	2009-2012 Medium Term Bonus Scheme (MTPPP)
Underlying profit	*x	✓✓
Non-margin income	✓✓	n/a
Cost income ratio	✓✓	✓✓
Customer satisfaction rating	✓✓✓✓✓	✓✓✓✓✓
Delivering transformation projects	✓✓✓	n/a

\* Below threshold ✓ Threshold ✓✓ Below target ✓✓✓ Target ✓✓✓✓ Above target ✓✓✓✓✓ Maximum

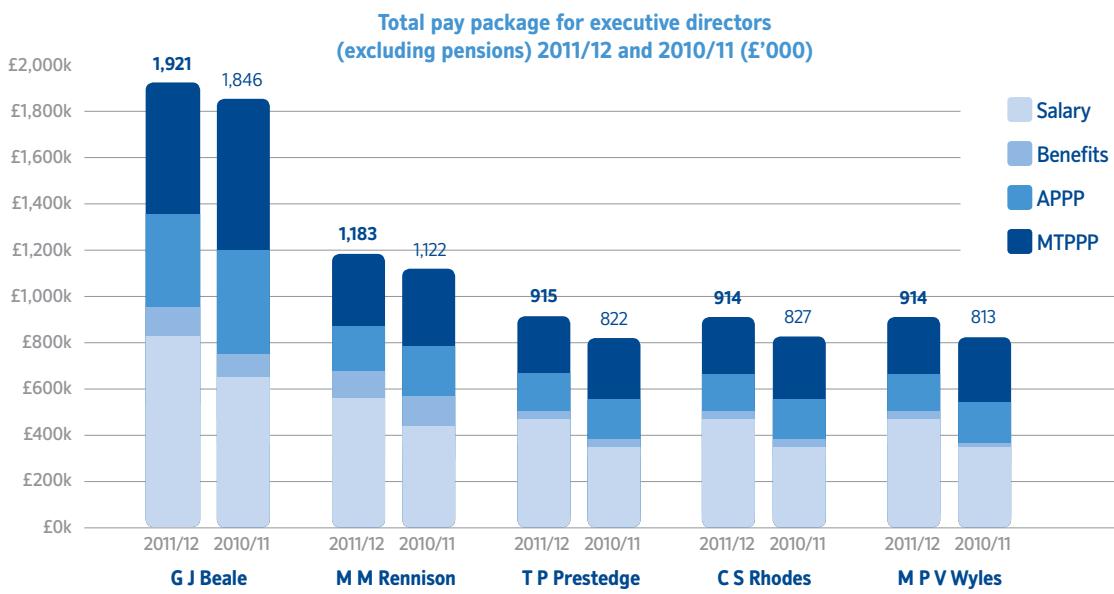
\* The underlying profit measure for the annual bonus scheme has been adjusted by the Remuneration Committee to exclude the acquisition of a mortgage portfolio.

The Committee confirmed that the risk criteria for the MTPPP had been met.

Executive directors' individual performance was assessed on a discretionary basis against objectives which were set at the start of the year. These objectives related to targets

specific to their roles as well as leadership, people engagement and strategic contribution factors.

Taking into account benefits but excluding pensions, the total pay package received by executive directors for 2011/12 is illustrated below compared with the previous year.



**(d) Pensions and benefits**

During 2011/12 three executive directors (G J Beale, M M Rennison and M P V Wyles) ceased ongoing participation in the Group's defined benefit pension arrangements. They have moved from pension provision, partly funded by the Group through scheme contributions, to pensions solely funded through cash allowances in accordance with their pre-existing terms of employment.

For these directors the pension benefit included as part of the audited information below is reported on a non-comparable basis. The pension allowance in 2011/12 is shown as a cash benefit and represents the true total cost to the Society. Previously the pension benefit was shown as the annual increase in the pension that the director would

receive when they retire. This did not represent the full cost to the Society of providing the benefit. For example in the case of G J Beale the increase in accrued pension in 2010/11 was £14,000 but the cost to the Society of the equivalent annuity has been estimated at £186,000.

We report this way because it is a requirement of the Building Societies (Accounts and Related Provisions) Regulations 1998.

In the table below we have set out the estimated cost to the Society of pension arrangements in both years. This includes the cash allowance together with the cost of the equivalent annuity.

**Estimated cost to Society of pension arrangements**

	2011/12	2010/11
G J Beale	<b>£330,000</b>	£287,000
M M Rennison	<b>£176,000</b>	£242,000
M P V Wyles	<b>£146,000</b>	£147,000
<b>Total</b>	<b>£652,000</b>	£676,000

**(e) Executive directors' remuneration (Audited information)**

PricewaterhouseCoopers LLP have audited the information contained in the tables below that are headed Audited information.

The tables below show the remuneration received for the years ended 4 April 2012 and 4 April 2011 as required to be reported under the Building Societies (Accounts and Related Provisions) Regulations 1998.

**Audited information: Executive directors' pay**

Executive directors	Salary	Benefits	Annual Performance Pay	Medium Term Performance Pay	Total Pay Package	Pension allowance (Note 1, 2)	Increase in accrued pension (Note 3)	Total including pension benefits
2012	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
G J Beale	825	120	400	576	1,921	330	-	2,251
T P Prestedge	470	30	161	254	915	155	-	1,070
M M Rennison	560	119	192	312	1,183	161	2	1,346
C S Rhodes	470	29	161	254	914	155	-	1,069
M P V Wyles	470	29	161	254	914	124	2	1,040
	2,795	327	1,075	1,650	5,847	925	4	6,776

Executive directors	Salary (Note 4)	Benefits	Annual Performance Pay	Medium Term Performance Pay	Total Pay Package	Pension allowance (Note 2)	Increase in accrued pension (Note 3)	Total including pension benefits (restated) (Note 5)
2011	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
G J Beale	650	105	441	650	1,846	101	14	1,961
T P Prestedge	350	28	178	266	822	105	-	927
M M Rennison	440	124	224	334	1,122	99	11	1,232
C S Rhodes	350	29	182	266	827	116	-	943
D J Rigney	807	9	-	-	816	43	-	859
M P V Wyles	350	12	185	266	813	65	5	883
	2,947	307	1,210	1,782	6,246	529	30	6,805

**Notes:**

- Following changes to Group pension arrangements, executive directors ceased to be members of defined benefit schemes and in return receive a cash allowance. A full explanation of the changes to the pensions arrangements are outlined in the pensions and benefits section above.
- G J Beale opted out of the CARE arrangement completely from 1 April 2011.
- This is the increase in accrued pension excluding CPI and not the cost to the Society.
- D J Rigney stepped down from the Board on 21 July 2010. His salary costs include £700,000 in relation to contractual settlement payments, which are made up of salary and performance pay for the balance of his notice period, earned Medium Term Performance Pay Plan payments (based on the Society's performance and reduced to take into account that he left the Society before the end of the normal plan cycles) and other payments that he was entitled to.
- The 2011 comparative benefit figures have been restated to include costs of drivers and the tax charge thereon of £77,000 for G J Beale and £96,000 for M M Rennison which has been paid by the Society. In addition, for periods prior to 2010/11 similar benefits of £197,000 for G J Beale and £170,000 for M M Rennison have been paid; these amounts are not included in the table above and have not been previously disclosed.

# Report of the Directors on Remuneration

continued

## Audited information: Executive directors' pensions

Executive directors	Accrued pension at 4.4.12	Accrued pension at 4.4.11	Transfer value at 4.4.12	Transfer value at 4.4.11	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	268	256	5,001	4,624	377	–	–	–
M M Rennison	55	53	947	896	51	–	–	6
M P V Wyles	58	56	1,146	1,079	67	–	–	8

### Explanations:

(a) and (b) show deferred pension entitlements at 4 April 2012 and 2011 respectively.  
 (c) is the transfer value of the deferred pension in (a) calculated at 4 April 2012. As a deferred member of the Fund throughout 2011/12, the increase in G J Beale's transfer value takes into account that he is one year closer to normal retirement age, which gives an increase of 6.6% within the actuarial transfer assumptions; plus, includes that his deferred pension during the year increased by 1.6% more than estimated on 4 April 2011 due to a higher than expected rate of CPI.  
 (d) is the equivalent transfer value at 4 April 2011 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. A zero figure means that, after allowing for inflation, no additional pension was built up.  
 (f) is the capital value of the pension in (e).  
 (g) contributions are inclusive of salary sacrifice contributions.

### (f) Service Contracts

Executive directors' terms and conditions of employment are detailed in their individual contracts which include a notice period of twelve months. Each contract includes a provision for a termination payment in lieu of notice of up

to a maximum of twelve months' salary and benefits. In addition, a payment may be made in respect of the APPP and existing MTPPP awards depending on the circumstances and according to the rules of the plans.

Executive director	Service contract date	Date first appointed to the Board
G J Beale	3 March 2003	5 April 2003
M M Rennison	1 February 2007	1 February 2007
T P Prestedge	28 August 2007	28 August 2007
M P V Wyles	28 August 2007	28 August 2007
C S Rhodes	20 April 2009	20 April 2009

### (g) Other directorships

None of the executive directors currently hold any paid external directorships.

### Chairman and non executive directors

The Chairman's fee is reviewed and approved by the Remuneration Committee. The fees paid to non executive directors are reviewed and approved by the executive directors and the Chairman. Fees are reviewed annually taking into account practice at other organisations as well as the time commitment for the role at Nationwide.

Non executive directors are paid a basic fee, with an additional supplement paid for serving on or chairing a Board Committee. Non executive directors do not take part in any performance pay plans or in any pension arrangement. The fee policy was reviewed last year and changes were made to the level of basic fees, and specific 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 were last reviewed in April 2012 at which point no changes were made.

Fee policy	Fees for 2012/13	Fees for 2011/12	Fees for 2010/11
Chairman	£300,000	£300,000	£250,000
Basic fee	£60,000	£60,000	£47,250
Joint Deputy Chairman fee	£30,000	£30,000	£30,000
Chairman of the Audit Committee or Board Risk Committee	£35,000	£35,000	£35,000
Member of the Audit Committee or Board Risk Committee	£10,000	£10,000	£10,000
Remuneration Committee Chairman	£25,000	£25,000	£20,000
Remuneration Committee member	£10,000	£10,000	£4,000
Nomination Committee member	£2,500	£2,500	£2,500

Additional fees may be paid for other committee responsibilities during the year.

#### Audited information: Non executive directors' fees

The total fees paid to each non executive director are shown below.

Non executive directors	2012	2011
	Society & Group Fees (Note 1, 2) £'000	Society & Group Fees (Note 1, 2) £'000
G M T Howe (Chairman)	300	250
Mrs S J David	-	23
A P Dickinson	111	75
M K Jary	74	58
M A Lenson	55	-
K Loosemore	-	11
Mrs L M Peacock	57	-
R K Perkin	111	84
D A Ross	-	38
Ms S Taverne	80	61
W Tudor John (Joint Deputy Chairman)	27	102
R P Walther (Joint Deputy Chairman)	131	138
<b>Total</b>	<b>946</b>	<b>840</b>
Pension payments to past directors in respect of services as directors (Note 3)	396	381

#### Notes:

1. W Tudor John retired from the Board on 21 July 2011. Mrs L M Peacock and M A Lenson were appointed to the Board on 18 July 2011. 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.

# Report of the Directors on Remuneration

continued

## Future remuneration policy and potential impacts of regulation

There are no changes to our remuneration policy for 2012/13:

- There will be no change to the target or maximum award levels under our bonus schemes (APPP and MTPPP)
- There will be no change to the performance measures for our variable pay plans.

We may be required to change the way in which our performance pay is delivered to executives in order to meet the FSA Remuneration Code requirement to award a proportion of performance pay in shares or share linked instruments. This requirement presents challenges for the Society as a mutual organisation given that we do not have equity shares and no obvious alternative instrument exists. We are engaged in an ongoing discussion with the FSA as to what an appropriate instrument could be and are actively considering how best to meet this requirement in 2012/13.

## Remuneration of eight highest paid senior executive officers – excluding main board

On 6 December 2011, HM Treasury published a consultation document which set out draft additional remuneration disclosure regulations for banks. The proposals set out that all large banks operating in the UK should publish the pay details of their eight highest paid senior executive officers who are not main board directors.

Whilst it is not mandatory for Nationwide to comply with this requirement, the Committee has decided to include the disclosure as part of our ongoing commitment to transparency and meeting sector best practice on remuneration disclosure.

2012	Senior Executive Officers							
	1	2	3	4	5	6	7	8
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
<b>Fixed (Note 1)</b>	<b>284</b>	<b>284</b>	<b>256</b>	<b>241</b>	<b>239</b>	<b>226</b>	<b>238</b>	<b>218</b>
<b>Variable</b>								
Cash bonus	155	155	147	127	129	126	124	127
Deferred cash bonus	33	33	26	23	23	23	12	22
<b>Total variable</b>	<b>188</b>	<b>188</b>	<b>173</b>	<b>150</b>	<b>152</b>	<b>149</b>	<b>136</b>	<b>149</b>
<b>Total Pay Package</b>	<b>472</b>	<b>472</b>	<b>429</b>	<b>391</b>	<b>391</b>	<b>375</b>	<b>374</b>	<b>367</b>

Notes:

1. Fixed remuneration includes salary and car allowance.

## **The Remuneration Committee**

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 Remuneration Code ('Code Staff') and, within the terms of the agreed policy, the specific remuneration packages for these roles. This includes 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.

The Committee also oversees 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 2012. 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 a member of the Board Risk Committee. During the year the Committee members were: Robert Walther (Chairman of Remuneration Committee), Suzanna Taverne, Bill Tudor John (retired from the Board on 21 July 2011), Michael Jary and Lynne Peacock.

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

- Agreeing the performance targets for awards to be made under the APPP and MTPPP, taking into account the Corporate Plan
- Reviewing the outcome of the APPP and MTPPP awards which were paid in respect of the year
- Ongoing work in relation to the FSA Remuneration Code and how it applies to Nationwide as a mutual, with a particular focus on how to deliver a portion of the senior team's reward in the form of a non-cash instrument.

The Committee is supported by Geoffrey Howe (Chairman of the Board), the Group Director of Human Resources, Customer Experience and Corporate Affairs and where appropriate the Chief Executive, who is invited to attend Committee meetings to provide further background information and 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.

### **Robert Walther**

Chairman of the Remuneration Committee  
22 May 2012

# 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 2012 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 57 to 59, 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 financial statements. 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 2012

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  
22 May 2012

# Income statements

For the year ended 4 April 2012

	Notes	Group		Society	
		2012 £m	2011 £m	2012 £m	2011 £m
Interest receivable and similar income	3	<b>5,353</b>	4,643	<b>5,390</b>	4,672
Interest expense and similar charges	4	(3,730)	(3,107)	(4,145)	(3,516)
<b>Net interest income</b>		<b>1,623</b>	1,536	<b>1,245</b>	1,156
Fee and commission income	5	<b>515</b>	492	<b>505</b>	481
Fee and commission expense	6	(96)	(92)	(96)	(89)
Income from investments		<b>10</b>	4	<b>496</b>	66
Other operating income/(loss)	7	<b>91</b>	7	(3)	8
Gains/(losses) from derivatives and hedge accounting	8	<b>35</b>	120	(56)	117
<b>Total income</b>		<b>2,178</b>	2,067	<b>2,091</b>	1,739
Administrative expenses	9	(1,205)	(1,123)	(1,158)	(1,093)
Depreciation and amortisation		(180)	(150)	(180)	(149)
Impairment loss on loans and advances to customers	11	(390)	(359)	(327)	(287)
Impairment losses on investment securities	15	(38)	(66)	(35)	(66)
Provisions for liabilities and charges	27	(162)	(52)	(162)	(54)
<b>Profit before tax</b>		<b>203</b>	317	<b>229</b>	90
Taxation	12	(24)	(69)	<b>49</b>	(3)
<b>Profit after tax</b>		<b>179</b>	248	<b>278</b>	87

The notes on pages 87 to 163 form part of these Accounts.

# Statements of comprehensive income

For the year ended 4 April 2012

	Group		Society	
	2012	2011	2012	2011
Notes	£m	£m	£m	£m
<b>Profit after tax</b>	<b>179</b>	248	<b>278</b>	87
<b>Other comprehensive income:</b>				
Available for sale investments:				
• Fair value movements taken to equity	<b>272</b>	308	<b>281</b>	294
• Amount transferred to income statement	(78)	12	(78)	18
• Taxation	12	(63)	(100)	(65)
		<b>131</b>	220	<b>138</b>
Revaluation of property:				
• Revaluation before tax	(8)	3	(8)	3
• Taxation	12	4	1	4
		<b>(4)</b>	4	<b>(4)</b>
Effect of tax rate change on other items through the general reserve	12	<b>(4)</b>	(6)	<b>(3)</b>
Adjustment to deferred tax transferred from acquisitions	12	-	5	-
Actuarial (loss)/gain on retirement benefit obligations:				
• Actuarial (loss)/gain before tax	31	<b>(494)</b>	114	<b>(493)</b>
• Taxation credit/(charge)	12	<b>109</b>	(47)	<b>109</b>
		<b>(385)</b>	67	<b>(384)</b>
<b>Total comprehensive (expense)/income</b>	<b>(83)</b>	538	<b>25</b>	369

The notes on pages 87 to 163 form part of these Accounts.

# Balance sheets

At 4 April 2012

	Notes	Group		Society	
		2012 £m	2011 £m	2012 £m	2011 £m
<b>Assets</b>					
Cash		<b>8,126</b>	6,130	<b>8,126</b>	6,130
Loans and advances to banks	14	<b>2,914</b>	4,181	<b>2,850</b>	4,104
Investment securities – available for sale	15	<b>23,325</b>	21,540	<b>23,246</b>	21,449
Derivative financial instruments	16	<b>4,176</b>	3,961	<b>2,433</b>	1,541
Fair value adjustment for portfolio hedged risk		<b>1,330</b>	1,634	<b>1,330</b>	1,634
Loans and advances to customers	17	<b>154,169</b>	149,417	<b>128,768</b>	128,350
Investments in equity shares	18	<b>29</b>	103	<b>29</b>	32
Investments in Group undertakings	19	-	-	<b>24,957</b>	20,397
Intangible assets	20	<b>681</b>	529	<b>669</b>	517
Property, plant and equipment	21	<b>945</b>	948	<b>938</b>	940
Investment properties		<b>9</b>	9	<b>9</b>	9
Accrued income and expenses prepaid		<b>129</b>	215	<b>1,317</b>	2,441
Deferred tax assets	22	<b>229</b>	218	<b>192</b>	163
Current tax assets		-	-	<b>13</b>	12
Other assets		<b>67</b>	68	<b>111</b>	52
<b>Total assets</b>		<b>196,129</b>	188,953	<b>194,988</b>	187,771
<b>Liabilities</b>					
Shares	37	<b>125,617</b>	122,552	<b>125,617</b>	122,552
Deposits from banks	23	<b>3,370</b>	2,746	<b>2,730</b>	1,842
Other deposits	24	<b>6,899</b>	5,809	<b>13,333</b>	13,113
Due to customers	25	<b>5,833</b>	5,762	<b>1,301</b>	1,315
Fair value adjustment for portfolio hedged risk		<b>278</b>	19	<b>278</b>	19
Debt securities in issue	26	<b>38,854</b>	37,808	<b>28,735</b>	32,080
Derivative financial instruments	16	<b>4,287</b>	3,234	<b>4,763</b>	3,373
Other liabilities		<b>349</b>	376	<b>8,427</b>	3,819
Provisions for liabilities and charges	27	<b>295</b>	165	<b>295</b>	165
Accruals and deferred income	28	<b>369</b>	376	<b>365</b>	370
Subordinated liabilities	29	<b>1,644</b>	1,973	<b>1,644</b>	1,973
Subscribed capital	30	<b>1,625</b>	1,510	<b>1,625</b>	1,510
Deferred tax liabilities	22	<b>28</b>	36	<b>14</b>	21
Current tax liabilities		<b>5</b>	45	-	-
Retirement benefit obligations	31	<b>517</b>	300	<b>516</b>	299
<b>Total liabilities</b>		<b>189,970</b>	182,711	<b>189,643</b>	182,451
General reserve		<b>6,450</b>	6,659	<b>5,648</b>	5,756
Revaluation reserve		<b>65</b>	70	<b>65</b>	70
Available for sale reserve		<b>(356)</b>	(487)	<b>(368)</b>	(506)
<b>Total reserves and liabilities</b>		<b>196,129</b>	188,953	<b>194,988</b>	187,771

The notes on pages 87 to 163 form part of these Accounts.

Approved by the Board of Directors on 22 May 2012.

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 2012

	General reserve	Revaluation reserve	AFS reserve	Total
	£m	£m	£m	£m
At 5 April 2011	6,659	70	(487)	6,242
Profit for the year	179	-	-	179
Net movement in available for sale reserve	-	-	131	131
Revaluation of property	-	(4)	-	(4)
Reserve transfer	1	(1)	-	-
Effect of tax rate change on other items through the general reserve	(4)	-	-	(4)
Net actuarial loss on retirement benefit obligations	(385)	-	-	(385)
<b>Total comprehensive (expense)/income</b>	<b>(209)</b>	<b>(5)</b>	<b>131</b>	<b>(83)</b>
<b>At 4 April 2012</b>	<b>6,450</b>	<b>65</b>	<b>(356)</b>	<b>6,159</b>

For the year ended 4 April 2011

	General reserve (adjusted)	Revaluation reserve	AFS reserve (adjusted)	Total
	£m	£m	£m	£m
At 5 April 2010	6,343	68	(707)	5,704
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>
<b>At 4 April 2011</b>	<b>6,659</b>	<b>70</b>	<b>(487)</b>	<b>6,242</b>

The notes on pages 87 to 163 form part of these Accounts.

# Society statement of movements in members' interests

For the year ended 4 April 2012

	General reserve	Revaluation reserve	AFS reserve	Total
	£m	£m	£m	£m
At 5 April 2011	5,756	70	(506)	5,320
Profit for the year	<b>278</b>	-	-	<b>278</b>
Net movement in available for sale reserve	-	-	<b>138</b>	<b>138</b>
Revaluation of property	-	<b>(4)</b>	-	<b>(4)</b>
Reserve transfer	<b>1</b>	<b>(1)</b>	-	-
Effect of tax rate change on other items through the general reserve	<b>(3)</b>	-	-	<b>(3)</b>
Net actuarial loss on retirement benefit obligations	<b>(384)</b>	-	-	<b>(384)</b>
<b>Total comprehensive (expense)/income</b>	<b>(108)</b>	<b>(5)</b>	<b>138</b>	<b>25</b>
<b>At 4 April 2012</b>	<b>5,648</b>	<b>65</b>	<b>(368)</b>	<b>5,345</b>

For the year ended 4 April 2011

	General reserve (adjusted)	Revaluation reserve	AFS reserve (adjusted)	Total
	£m	£m	£m	£m
At 5 April 2010	5,604	68	(721)	4,951
Profit for the year	<b>87</b>	-	-	<b>87</b>
Net movement in available for sale reserve	-	-	<b>215</b>	<b>215</b>
Revaluation of property	-	<b>4</b>	-	<b>4</b>
Reserve transfer	<b>2</b>	<b>(2)</b>	-	-
Effect of tax rate change on other items through the general reserve	<b>(4)</b>	-	-	<b>(4)</b>
Net actuarial gain on retirement benefit obligations	<b>67</b>	-	-	<b>67</b>
<b>Total comprehensive income</b>	<b>152</b>	<b>2</b>	<b>215</b>	<b>369</b>
<b>At 4 April 2011</b>	<b>5,756</b>	<b>70</b>	<b>(506)</b>	<b>5,320</b>

The notes on pages 87 to 163 form part of these Accounts.

# Cash flow statements

For the year ended 4 April 2012

Notes	Group		Society	
	2012	2011	2012	2011
	£m	£m	£m	£m
<b>Cash flows generated from operating activities</b>				
Profit before tax	<b>203</b>	317	<b>229</b>	90
Adjustments for:				
• Non-cash items included in profit before tax	40	<b>378</b>	317	<b>561</b>
• Changes in operating assets	40	<b>(4,648)</b>	5,770	<b>(5,890)</b>
• Changes in operating liabilities	40	<b>7,392</b>	(2,820)	<b>7,373</b>
• Interest paid on subordinated liabilities		<b>(114)</b>	(90)	<b>(114)</b>
• Interest paid on subscribed capital		<b>(91)</b>	(91)	<b>(91)</b>
• Dividend income from non-Group entities		<b>(5)</b>	(4)	<b>(5)</b>
Purchase of retail mortgages portfolio		<b>(1,104)</b>	-	-
Taxation		<b>(37)</b>	(33)	<b>(1)</b>
<b>Net cash flows generated from operating activities</b>	<b>1,974</b>	3,366	<b>2,062</b>	3,359
<b>Cash flows generated from investing activities</b>				
Purchase of investment securities	<b>(13,140)</b>	(13,525)	<b>(13,140)</b>	(13,525)
Sale and maturity of investment securities	<b>12,570</b>	14,898	<b>12,565</b>	14,884
Purchase of property, plant and equipment	<b>(192)</b>	(138)	<b>(192)</b>	(137)
Sale of property, plant and equipment	<b>8</b>	13	<b>8</b>	13
Purchase of intangible assets	<b>(213)</b>	(219)	<b>(213)</b>	(219)
Sale of investment properties	-	1	-	1
Sale of investment	<b>72</b>	2	<b>2</b>	2
Dividends received from non-Group entities	<b>5</b>	4	<b>5</b>	4
<b>Net cash flows generated from investing activities</b>	<b>(890)</b>	1,036	<b>(965)</b>	1,023
<b>Cash flows used in financing activities</b>				
Maturity of subordinated liabilities	<b>(360)</b>	(719)	<b>(360)</b>	(719)
Issue of subordinated liabilities	-	630	-	630
<b>Net cash flows used in financing activities</b>	<b>(360)</b>	(89)	<b>(360)</b>	(89)
<b>Net increase in cash</b>	<b>724</b>	4,313	<b>737</b>	4,293
Cash and cash equivalents at start of year	<b>10,124</b>	5,811	<b>10,047</b>	5,754
<b>Cash and cash equivalents at end of year</b>	40	<b>10,848</b>	10,124	<b>10,784</b>

The notes on pages 87 to 163 form part of these Accounts.

# Notes to the Accounts

## 1 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. As stated in the Directors' Report, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the accounts. 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.

### Adjustments to comparative information

Certain comparatives have been reclassified to be presented on a basis which is consistent with the current year. The reclassifications, which have not impacted net assets or profit before tax of the Group or Society, have been detailed for the Group below. The impacts for the Society have been similar in nature and value except for the reclassification between other deposits and due to customers on the balance sheet which relates to a subsidiary entity.

Balance sheet of the Group at 4 April 2011	Previously published	Reclassified	
	£m	£m	
Deferred tax liabilities	-	36	Tax balances have been reclassified to reflect appropriate offsetting.
Current tax liabilities	81	45	
Other deposits	5,511	5,809	Corporate deposits received through the Group's offshore deposit taker have been reclassified from due to customers to other deposits.
Due to customers	6,060	5,762	
Provisions for liabilities and charges	113	165	Severance costs and a number of property related provisions have been reclassified from accruals to provisions for liabilities and charges.
Accruals and deferred income	428	376	

Income statement of the Group for the year ended 4 April 2011	Previously published	Reclassified	
	£m	£m	
Net interest income	1,537	1,536	Reclassification of certain product related income and costs to allow a more meaningful presentation.
Fee and commission income	440	492	
Fee and commission expense	(4)	(92)	
Other operating income	5	7	
Administrative expenses	(1,158)	(1,123)	

# Notes to the Accounts continued

## 1 Statement of accounting policies (continued)

In addition, the opening reserves at 5 April 2010 have been adjusted to reflect a correction of an error in relation to hedge accounting. The impact of the correction as at 5 April 2010 for both the Group and Society was to decrease the general reserve by £20 million and increase the available for sale

reserve by £8 million. The adjusted lines of the balance sheet of the Group at 4 April 2011 have been detailed below. The adjustments of the Society have been identical in nature and value. The adjustment did not impact the income statement of the Group or Society for the year ended 4 April 2011.

Balance sheet of the Group at 4 April 2011	Previously published	Adjusted
	£m	£m
Fair value adjustment for portfolio hedged risk – asset	1,563	1,634
Deferred tax assets	214	218
Fair value adjustment for portfolio hedged risk – liability	(68)	19
General reserve	6,679	6,659
Available for sale reserve	(495)	(487)

### Changes in accounting policy

The following IFRS and IFRIC pronouncements, relevant to the Group, were adopted with effect from 5 April 2011:

- 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 has had no impact on the accounts for the year ended 4 April 2012.

- Improvements to IFRSs (May 2010): Several small amendments, the most significant of which requires disclosure of the financial effect of collateral held. Collateral disclosures are provided in note 35.

### Future accounting developments

The following pronouncement, relevant to the Group, has been adopted by the European Union (EU) but was not effective at 4 April 2012 and has not therefore been applied in preparing these financial statements.

Pronouncement	Nature of change	Effective date
IFRS 7 Disclosures – Transfers of Financial Assets	Requires additional 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.	Accounting periods (AP) beginning on or after 1 July 2011

# 1 Statement of accounting policies (continued)

The following pronouncements, relevant to the Group, are neither adopted by the EU nor effective at 4 April 2012 and have not therefore been applied in preparing these financial statements.

Pronouncement	Nature of change	Effective date
IFRS 9 Financial Instruments and subsequent amendments	<p>The new standard addresses Phase 1 of the IASB's project to replace IAS 39 Financial Instruments: Recognition and Measurement 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 unless this results in an accounting mismatch. The Group has only opted to fair value its liabilities on protected equity bonds.</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 2015
IFRS 7 Transitional Disclosures for IFRS 9	Requires additional disclosures on adoption of IFRS 9 to enable users to understand the effect of transition from IAS 39.	AP beginning on or after 1 January 2015
Amendment to IAS 12 Deferred Tax: Recovery of Underlying Assets	Provides a practical approach for measuring deferred tax liabilities and assets when investment property is measured using the fair value model in IAS 40 Investment Property. The amendment is not expected to have a significant impact for the Group.	AP beginning on or after 1 January 2012
IAS 1 Presentation of Items of Other Comprehensive Income	<p>Requires entities to group items presented in the statements of other comprehensive income on the basis of whether they are potentially reclassifiable to profit or loss in subsequent periods.</p> <p>The amendment will only have a presentational impact on the Group's statements of comprehensive income.</p>	AP beginning on or after 1 July 2012
IFRS 10 – 12 and amendments to IAS 27 and 28	<p>A package of five new and revised standards addressing the accounting for consolidation, involvements in joint arrangements and disclosure of involvements with other entities.</p> <p>With the exception of additional disclosure requirements, the new and revised standards are not expected to have a significant impact for the Group.</p>	AP beginning on or after 1 January 2013
IFRS 13 Fair Value Measurement	<p>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.</p> <p>With the exception of enhanced disclosures, the new standard is not expected to have a significant impact for the Group.</p>	AP beginning on or after 1 January 2013
IAS 19 Employee Benefits	<p>Updates the recognition, presentation and disclosures of retirement benefit plans. The most significant impact for the Group is the replacement of the expected return on plan assets and interest cost with a single measure of net interest income (or expense) based on the net retirement benefit asset (or obligation).</p> <p>If the new revised standard had applied in the year ended 4 April 2012 net interest income would have been approximately £37 million lower with an equivalent increase in other comprehensive income. There would have been no impact on the Group's net assets or reserves.</p>	AP beginning on or after 1 January 2013
IFRS 7 Offsetting Disclosures	Requires additional disclosures to enable users to evaluate the effect of netting arrangements, including rights of set off, of financial assets and liabilities.	AP beginning on or after 1 January 2013
IAS 32 Offsetting Financial Assets and Financial Liabilities	Clarifies existing offsetting criteria. The amendment is not expected to have an impact for the Group.	AP beginning on or after 1 January 2014

# Notes to the Accounts continued

## 1 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 and consistent accounting policies are used throughout the Group for the purposes of the consolidation.

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 intra-Group 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 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 17, 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 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, with a small level of operations in the Isle of Man and the Republic of Ireland.

# 1 Statement of accounting policies (continued)

## 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 five 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 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).

Where applicable, directly attributable borrowing costs incurred in the construction of qualifying assets are capitalised.

### (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.

Other intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Where the carrying amount is not recoverable the asset is written down immediately to the estimated recoverable amount, based on value in use calculations.

## 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. Operating lease payments and receipts are charged or 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 profits 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.

Deferred income tax assets and liabilities are offset where there is a legally enforceable right to offset current tax assets against current tax liabilities and where the deferred income tax assets and liabilities related to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle on a net basis.

## 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, as at 4 April, by independent surveyors.

# Notes to the Accounts continued

## 1 Statement of accounting policies (continued)

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	the period of the lease
Plant and machinery	5 to 15 years
Equipment, fixtures, fittings and vehicles	3 to 10 years

Estimated useful lives are reviewed annually and adjusted, if appropriate, in the light of technological developments, usage and other relevant factors.

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Where the carrying amount is not recoverable the asset is written down immediately to the estimated recoverable amount.

Gains and losses on disposals are included in other operating income in the income statement.

### Investment properties

Investment properties, which comprise properties held for rental, are stated at fair value. The properties are revalued annually, as at 4 April, 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. 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 actuaries 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 12 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 and when there is an obligation to pay a bonus under the terms of the scheme.

#### (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.

# 1 Statement of accounting policies (continued)

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

## 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.

Assets in this category 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.

**(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.

Loans and receivables acquired through a business combination or portfolio acquisition are recognised at fair value at the acquisition date. The fair value at acquisition becomes the new amortised cost for acquired loans and receivables. Fair value adjustments are made to reflect both credit and interest rate risk associated with the acquired loan assets.

For a portfolio acquisition the fair value is normally assumed to be the transaction price (i.e. the consideration paid). However, the fair value may differ from the transaction price in certain circumstances. In these circumstances the fair value is based on a valuation technique whose variables only include data from observable markets (for example, interest rates prevailing for similar instruments). Where such circumstances exist, an immediate gain or loss is recognised on acquisition, being the difference between the consideration paid and the fair value. The gain or loss on the acquisition is included in other operating income.

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 using, in the majority of cases, market prices or, where markets have 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 models are used. Further information is provided in note 38.

Interest on available for sale assets is recognised using the effective interest rate method.

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 are recognised in the income statement, including any cumulative gains or losses previously recognised in other comprehensive income, which 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 and has not reclassified any financial assets between categories.

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.

# Notes to the Accounts continued

## 1 Statement of accounting policies (continued)

### Impairment of financial assets

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:

#### (a) Assets carried at amortised cost

- 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 of future cash flows 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. The provision methodology recognises previous arrears as a driver of future possible default and therefore accounts which have either capitalised arrears or have been in arrears in the last 12 months typically attract a higher provision level.

In the case of commercial loans, where there is objective evidence of impairment, 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' claims 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
- ix) when available, the secondary market price of the debt.

In the case of other loans, 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
- 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 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. 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.

# 1 Statement of accounting policies (continued)

## (b) Available for sale (AFS) assets

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. If any such evidence exists for AFS 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 AFS asset 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 AFS asset 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 premiums, discounts and transaction costs. 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.

The financial liabilities of dormant shares and deposit accounts have been extinguished when balances have been transferred to the Government-backed unclaimed asset scheme under the terms of the Dormant Accounts and Building Society Accounts Act 2008 with no impact on the income statement.

## 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. 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 collateralised positions the Group uses discount curves based on overnight indexed swap rates, which is a change from last year, as detailed in note 8, and for non-collateralised positions the Group uses discount curves based on term Libor rates.

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 and short positions and the grouping 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. The derivatives hedging PEBs are not traded in an active market and are therefore valued at mid price.

In measuring fair value, separate adjustments are made for counterparty or own credit risk to the extent not already included in the valuation.

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 the Group, it is included as a liability within deposits from banks. Where cash collateral is given, to mitigate the risk inherent in amounts due from the Group, it is included as an asset in loans and advances to banks.

# Notes to the Accounts continued

## 1 Statement of accounting policies (continued)

### **(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.

### **(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 the hedge relationship must be clearly documented at inception and the derivative must be expected to be highly effective in offsetting the hedged risk. 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 recognised 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 portfolio 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) and collateralised total return swaps**

Investment and other securities may be lent or sold subject to a commitment to repurchase them (a repo) or a right to continue to receive all future cash flows and changes in capital value on collateral pledged (a total return swap). 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) or settle all future cash flows and changes in capital value to a third party on collateral held (a reverse total return swap) 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 rate 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 as disclosed in notes 3 and 4.

### **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.

### **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 disclose the contingent liabilities associated with such claims where they cannot reasonably be estimated or where such disclosure could be seriously prejudicial to the conduct of the claims.

## 2 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 2012 loans and advances to customers totalled £153,816 million (2011: £149,635 million) against which impairment provisions of £843 million (2011: £765 million) have been made.

In accordance with the accounting policy described in note 1, the impairment 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 impairment include 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 and the Group's strategy for the book. The accuracy of the impairment provision would therefore be affected by unexpected changes in these 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 £154 million. On our residential mortgage books our estimate of future house price index (HPI) movements is also a key assumption in estimating the eventual loss. To the extent that future HPI movements were to differ from expectations by 5%, the impact on the impairment provision would be £16 million.

### Fair value adjustments in relation to acquired assets

Fair value adjustments held to reflect the credit risk associated with acquired loan assets are released to the income statement to the extent that they are no longer required to cover future expected losses. The amount of any release of fair value adjustment is based on management's estimate of future expected losses. In estimating future expected losses assumptions are made based upon observed historical data and updated where appropriate to reflect current conditions. The calculation of any surplus fair value adjustment to release would therefore be affected by unexpected changes in these assumptions.

At 4 April 2012, the Group's balance sheet includes a £95 million (2011: £132 million) credit risk fair value adjustment in relation to the Group's residential assets acquired through the acquisition of the Derbyshire, Cheshire and core parts of the Dunfermline building societies. During the year ended 4 April 2012 the Group made no release of surplus credit fair value adjustment (2011: £33 million release). In estimating expected losses, management considers 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. A key assumption in estimating the eventual loss 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 £14 million.

For the Group's acquired commercial loans, a £108 million fair value adjustment is included in the balance sheet at 4 April 2012 (2011: £147 million). A number of loans are reviewed on an individual basis. On these loans, surplus fair value is released where actual write offs are lower than the fair value adjustments relating to the individual loans. No surplus fair value adjustment has been released to date on the remainder of the acquired commercial portfolio which is assessed on a collective basis.

### Effective interest rates (EIR)

The Group uses the EIR method to recognise income from certain financial assets (including residential and commercial mortgages) held at amortised cost. To calculate the appropriate EIR recognition the Group makes assumptions of the expected lives of financial instruments and the level of income to be recognised, including the anticipated level of early redemption charges for residential mortgages. Certain fees in relation to residential mortgages are recognised over a deal period to which they relate and the Group makes assumptions in relation to the average deal period for the portfolio.

The impact of a one year change in the expected lives assumption would be a £4 million change to the value of the loans. A one year change to the average deal period would result in a £52 million change to the value of the loans. 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 of £7 million.

### Impairment of available for sale assets

At 4 April 2012 the fair value of investment securities – available for sale totalled £23,325 million (2011: £21,540 million). In the year ended 4 April 2012 impairment losses of £31 million (2011: £66 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 overseen by Risk Management 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 million to £60 million would be possible for these assets.

### Fair value of financial instruments

Derivative financial instruments, available for sale assets and the liability in relation to the protected equity bond products are stated at fair value. Details of the Group's valuation methods have been detailed in note 1.

# Notes to the Accounts continued

## 2 Judgements in applying accounting policies and critical accounting estimates (continued)

Where valuation models have been used, changes in assumptions could affect the reported fair values. In addition, prices obtained from market participants in an illiquid market are inherently less reliable and therefore careful judgement is required in applying them. The calculation of the PEB liability includes an estimate of the expected investment return payable on maturity of the product.

For financial assets and liabilities with valuations inputs which are not based on observable market data (a Level 3 classification) a sensitivity analysis is provided in note 38.

### Provisions for payment protection insurance (PPI) claims

At 4 April 2012, the Group holds a provision of £105 million (2011: £19 million) based on management's best estimate of the cost 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, the level of redress paid on each complaint and the subsequent level of refuted complaints referred to the Financial Ombudsman Service (FOS). The main sensitivity to the provision estimate is a change in volumes of complaints, with each 1% increase in the expected level of complaints increasing the value of the required provision by £5 million. A 1% change in uphold rates would change the provision by £1 million and a 1% change in either the average redress paid or referral rates to FOS would change the provision by £0.6 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
- The Group's share of industry protected deposits as at 31 December 2011.

The impact of a 1% increase in the interest rate assumption would be to increase the carrying value of the FSCS provision by approximately £20 million. The impact of the Group's share of industry protected deposits at 31 December 2011 increasing by 1% would be to increase the carrying value of the FSCS provision by approximately £5 million.

Further detail of the FSCS and the provision are included in note 27.

### Retirement benefit obligations (Pensions)

At 4 April 2012 net retirement obligations totalled £517 million (2011: £300 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.

The impact of a 0.1% increase in the inflation assumption would be to increase the carrying value of the pension obligations by approximately £66 million. The impact of a 0.1% increase in the discount rate would be to reduce the value of the pension obligations by approximately £76 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 £89 million. Further details on the assumptions used in valuing the retirement benefit obligations are included in note 31.

## 3 Interest receivable and similar income

	Group		Society	
	2012	2011	2012	2011
	£m	£m	£m	£m
On residential mortgages	<b>4,924</b>	5,004	<b>3,871</b>	4,149
On other loans:				
• Connected undertakings	-	-	<b>1,147</b>	965
• Other	<b>1,158</b>	1,148	<b>1,095</b>	1,061
On investment securities	<b>1,071</b>	1,029	<b>1,075</b>	1,028
On other liquid assets	<b>56</b>	32	<b>54</b>	29
Foreign exchange differences	-	-	<b>4</b>	10
Net expense on financial instruments hedging assets	<b>(2,051)</b>	(2,738)	<b>(2,051)</b>	(2,738)
Expected return on pension assets (note 31)	<b>195</b>	168	<b>195</b>	168
	<b>5,353</b>	4,643	<b>5,390</b>	4,672

Included within interest receivable and similar income is interest accrued on loans three or more months in arrears: Group £54 million, Society £23 million (2011: Group £58 million, Society £25 million) and the unwind of the discount on the impairment provisions: Group £23 million, Society £25 million (2011: Group £38 million, Society £35 million). Further detail is included in note 11.

Interest receivable on residential mortgages is net of amortisation of fair value adjustments relating to the acquisitions of the Derbyshire and Cheshire building societies and core parts of the Dunfermline Building Society and in the year ended 4 April 2011 included a £33 million release of excess credit risk fair value adjustments. This category also includes £70 million in the year ended 4 April 2012 which has resulted from an update of the

Group's effective interest rate assumptions with respect to the recognition of mortgage fee income.

Interest receivable on other loans, which are primarily commercial loans and loans to registered social landlords, is net of amortisation of fair value adjustments relating to the acquisitions of the Derbyshire and Cheshire building societies 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 £5 million (2011: £3 million).

Interest receivable on investment securities includes a net gain of £98 million (2011: £47 million) relating to the sale of investment securities. This includes a £112 million gain relating to the sale of gilts (2011: £40 million).

# Notes to the Accounts continued

## 4 Interest expense and similar charges

	Group		Society	
	2012	2011	2012	2011
	£m	£m	£m	£m
On shares held by individuals	<b>2,826</b>	2,511	<b>2,826</b>	2,511
On subscribed capital	<b>96</b>	96	<b>96</b>	96
On deposits and other borrowings:				
• Subordinated liabilities	<b>108</b>	110	<b>108</b>	110
• Connected undertakings	-	-	<b>318</b>	250
• Other	<b>252</b>	258	<b>151</b>	165
On debt securities in issue	<b>1,093</b>	915	<b>914</b>	794
Foreign exchange differences	<b>12</b>	3	-	-
Net income on financial instruments hedging liabilities	<b>(823)</b>	(952)	<b>(434)</b>	(576)
Pension interest cost (note 31)	<b>166</b>	166	<b>166</b>	166
	<b>3,730</b>	3,107	<b>4,145</b>	3,516

Comparatives have been reclassified as described in note 1.

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.

At 4 April 2012, other liabilities on the Group balance sheet of £349 million (2011: £376 million) included third party income tax withheld on interest paid to customers and payable to the tax authorities of £110 million (2011: £117 million).

## 5 Fee and commission income

	Group		Society	
	2012	2011	2012	2011
	£m	£m	£m	£m
Mortgage related fees	<b>37</b>	36	<b>29</b>	28
Banking and savings fees	<b>235</b>	218	<b>235</b>	218
General insurance fees	<b>140</b>	142	<b>138</b>	141
Other insurance fees	<b>32</b>	32	<b>32</b>	32
Other fees and commissions	<b>71</b>	64	<b>71</b>	62
	<b>515</b>	492	<b>505</b>	481

Comparatives have been reclassified as described in note 1.

## 6 Fee and commission expense

	Group		Society	
	2012	2011	2012	2011
	£m	£m	£m	£m
Banking and savings fees	88	86	88	86
Other fees and commissions	8	6	8	3
	96	92	96	89

Comparatives have been reclassified as described in note 1.

## 7 Other operating income/(loss)

	Group		Society	
	2012	2011	2012	2011
	£m	£m	£m	£m
Gain on portfolio acquisition	96	-	-	-
(Loss)/gain on revaluation of property, plant and equipment	(6)	-	(6)	1
Rental income	5	6	5	5
Loss from sale of property, plant and equipment	(3)	-	(3)	-
Other	(1)	1	1	2
	91	7	(3)	8

Comparatives have been reclassified as described in note 1.

The gain on portfolio acquisition relates to the acquisition of a portfolio of UK based prime residential mortgages from the Bank of Ireland in December 2011 for consideration of £1,104 million. The gain on acquisition reflects the extent

to which the price paid for the portfolio was lower than a comparative market valuation, derived from interest rates prevailing for similar quality mortgages at the transaction date.

# Notes to the Accounts continued

## 8 Gains/(losses) from derivatives and hedge accounting

	Group		Society	
	2012 £m	2011 £m	2012 £m	2011 £m
Derivatives designated as fair value hedges	(108)	1,141	(886)	1,633
Fair value movement attributable to hedged risk	47	(1,028)	808	(1,519)
(Losses)/gains from fair value hedges (note i)	(61)	113	(78)	114
Fair value movement attributable to mortgage commitments (note ii)	-	10	-	10
	(61)	123	(78)	124
Fair value gains/(losses) from other derivatives (note iii)	96	(3)	22	(7)
	35	120	(56)	117

## Notes

- (i) Gains or losses from fair value hedges can arise where there is an IFRS hedge accounting relationship in place and either:
  - the relationship passed all the monthly effectiveness tests but the fair value of the derivative was not exactly offset by the change in fair value of the asset or liability being hedged (sometimes referred to as hedge ineffectiveness) or
  - the relationship failed a monthly effectiveness test which, for that month, disallows recognition of the change in fair value of the underlying asset or liability being hedged.
- (ii) As a result of structural balance sheet changes, the Group ceased electing to fair value its mortgage commitments during the year ended 4 April 2011 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, effectiveness test failures or because hedge accounting has not been adopted or is not achievable.

A loss of £61 million (2011: gain of £113 million) has been recognised on assets and liabilities held in hedge accounting relationships. Included within this result were the impacts of the following:

- To align with evolving market convention, the Group implemented the use of overnight indexed swap (OIS) rates for the discounting of collateralised derivatives, decreasing the fair value of derivative assets at 4 April 2012 by £11 million.
- To reflect the increasing basis spreads between interest rate curves, the Group has refined its estimation technique for fair valuing derivatives and associated assets and liabilities being hedged. At 4 April 2012 the refinement resulted in a net gain of £25 million.

A gain of £96 million (2011: loss of £3 million) has been recognised in respect of derivatives entered into by the Group for hedging purposes where hedge accounting has not been adopted or is not achievable. Included within this result was a £63 million gain arising from increasing volatility seen in currency markets, which has led to a change in the estimation technique used to value cross-currency interest rate swaps hedging non-sterling wholesale funding. This gain incorporates the impact of implementing OIS rates for the discounting of these swaps which resulted in a £16 million decrease in fair value at 4 April 2012.

In the previous year the net gain from derivatives and hedge accounting was primarily driven by £86 million of hedge ineffectiveness on large gilt asset and covered bond liability positions and £28 million on derivatives hedging savings before these savings were brought into a hedge accounting relationship.

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 and other risks are continually managed. Management are comfortable that this volatility arises from the application of the accounting rules which do not reflect the economic reality.

## 9 Administrative expenses

	Group		Society	
	2012	2011	2012	2011
	£m	£m	£m	£m
Employee costs:				
• Wages and salaries	415	398	402	385
• Bonuses	62	63	61	62
• Social security costs	45	40	44	38
• Pension costs (note 31)	62	82	60	81
	584	583	567	566
Other administrative expenses	605	540	575	527
Bank levy (note 27)	16	-	16	-
	1,205	1,123	1,158	1,093
Other administrative expenses include:				
• Property operating lease rental	43	38	43	37
• Other property costs	76	81	75	80
• Postage and communications	68	66	68	66
• Computer costs	99	81	99	81
• Marketing and advertising	32	23	32	23
• Money transmission and other bank costs	47	45	46	44
• Legal, professional and consultancy	48	39	44	36
• Training, education and other staff related costs	106	81	104	79
• Other	86	86	64	81
	605	540	575	527

Comparatives have been reclassified as described in note 1.

Administrative expenses include £61 million (2011: £29 million) of restructuring costs, including £20 million relating to severance provisions (2011: £1 million) and £8 million (2011: £3 million) relating to onerous lease and other property

related provisions. The remaining restructuring costs relate primarily to changes to parts of the business as part of the Group's ongoing cost optimisation programme and other initiatives.

An analysis of the bonuses included within employee costs is set out below:

	Group		Society	
	2012	2011	2012	2011
	£m	£m	£m	£m
Income statement charge for bonuses				
• Deferred bonuses	1	-	1	-
• Other bonuses	61	63	60	62
	62	63	61	62

Deferred bonuses are bonuses that are retained for a defined period and subject to a further assessment of performance up until the point of payment.

A portion of the bonuses paid to directors and senior executives are deferred. The Medium Term Bonus Scheme (MTPPP) is based upon a three year performance period and includes the deferred element of bonuses awarded by

the Group. A separate MTPPP cycle starts each year and bonuses awarded to individuals under the MTPPP are paid following the final year of each cycle. The bonus for each plan cycle is charged to the income statement at the end of the three year period. Awards under the plan are subject to approval by the Remuneration Committee following a review of corporate performance against targets. In accordance

# Notes to the Accounts continued

## 9 Administrative expenses (continued)

with FSA requirements, one third of the MTPPP award is subject to a deferral for a period of one year. This deferred element may be reduced at the Remuneration Committee's discretion if it emerges that the original assessment of

performance was misleading or if performance against MTPPP measures declines substantially over the one year deferral period. Deferred bonuses are awarded in cash.

The deferred bonuses are expected to be charged to the income statement in the following years:

	Group and Society			
	Actual	Actual	Expected	Expected
	2010/11	2011/12	2012/13	2013/14
	£m	£m	£m	£m
<b>Bonus plan cycle:</b>				
• 2009-2012	-	1	-	-
• 2010-2013	-	-	1	-
• 2011-2014	-	-	-	2
<b>Income statement charge for deferred bonuses</b>	-	1	1	2

The deferred element of the MTPPP was introduced for the first time in relation to the 2009-2012 plan cycle.

Directors' emoluments are shown as part of the Report of the Directors on Remuneration in accordance with Schedule 10A, paragraphs 1 to 9 of the Building Societies Act 1986.

The remuneration of the external auditors, PricewaterhouseCoopers LLP, is set out below:

	Group		Society	
	2012	2011	2012	2011
	£m	£m	£m	£m
<b>Audit fees for the Group and Society statutory audit</b>	<b>1.6</b>	1.7	<b>1.5</b>	1.7
<b>Fees payable for other services:</b>				
• Audit of subsidiaries pursuant to legislation	0.5	0.6	-	-
• Other services pursuant to legislation	0.5	0.6	0.5	0.6
	2.6	2.9	2.0	2.3
• All other services	1.0	0.5	1.0	0.5
	3.6	3.4	3.0	2.8

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.

The 2012 fees payable for all other services of £1.0 million (2011: £0.5 million) includes £0.4 million (2011: £nil) in relation to a review of reporting and £0.4 million (2011: £nil) for services in connection with the Group's implementation of the FSA's Retail Distribution Review requirements.

## 10 Employees

	Group		Society	
	2012	2011	2012	2011
The average number of persons employed during the year was:				
• Full time	<b>13,156</b>	12,879	<b>12,928</b>	12,324
• Part time	<b>4,550</b>	4,813	<b>4,523</b>	4,741
	<b>17,706</b>	17,692	<b>17,451</b>	17,065
Society				
• Central administration	<b>8,812</b>	8,257	<b>8,812</b>	8,257
• Branches	<b>8,639</b>	8,808	<b>8,639</b>	8,808
Subsidiaries	<b>255</b>	627	-	-
	<b>17,706</b>	17,692	<b>17,451</b>	17,065

During the year ended 4 April 2012, employees working in the administrative functions of a subsidiary company were transferred to and now work directly for the Society within central administration.

Central administration employee numbers include employees engaged in direct customer facing operations in administrative centres.

## 11 Impairment provisions on loans and advances to customers

The following provisions have been deducted from the appropriate asset values in the balance sheet:

2012 Group	Prime residential	Specialist residential	Consumer banking	Commercial lending	Other lending	Total
	£m	£m	£m	£m	£m	£m
At 5 April 2011	40	161	90	463	11	765
Charge for the year	<b>13</b>	<b>57</b>	<b>69</b>	<b>247</b>	<b>4</b>	<b>390</b>
Amounts written off during the year	(13)	(60)	(111)	(135)	(3)	(322)
Amounts recovered during the year	1	2	27	1	2	33
Unwind of discount	(1)	2	5	(29)	-	(23)
<b>At 4 April 2012</b>	<b>40</b>	<b>162</b>	<b>80</b>	<b>547</b>	<b>14</b>	<b>843</b>

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>

The Group impairment provision of £843 million at 4 April 2012 (2011: £765 million) comprises individual provisions of £574 million (2011: £478 million) and collective provisions of £269 million (2011: £287 million).

# Notes to the Accounts continued

## 11 Impairment provisions on loans and advances to customers (continued)

2012 Society	Prime residential	Consumer banking	Commercial lending	Total
	£m	£m	£m	£m
At 5 April 2011	40	90	454	584
Charge for the year	13	69	241	323
Amounts written off during the year	(13)	(111)	(126)	(250)
Amounts recovered during the year	1	27	1	29
Unwind of discount	(1)	5	(29)	(25)
<b>At 4 April 2012</b>	<b>40</b>	<b>80</b>	<b>541</b>	<b>661</b>

2011 Society	Prime residential	Consumer banking	Commercial lending	Total
	£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>90</b>	<b>454</b>	<b>584</b>

The Society impairment provision of £661 million at 4 April 2012 (2011: £584 million) comprises individual provisions of £482 million (2011: £411 million) and collective provisions of £179 million (2011: £173 million).

The Society's impairment loss on loans and advances to customers in the income statement of £327 million includes a £4 million provision relating to the Society's loan to a subsidiary undertaking, driven by the impairment of corporate loans held within the subsidiary. The Group figures above include the impairment of the underlying corporate loans within other lending.

## 12 Taxation

	Group		Society	
	2012	2011	2012	2011
	£m	£m	£m	£m
Current Tax:				
• UK corporation tax	25	65	(57)	9
• Corporation tax – adjustment in respect of prior years	(25)	1	(1)	-
	-	66	(58)	9
Overseas income tax	-	2	-	-
Total current tax	-	68	(58)	9
Deferred tax (note 22):				
• Current year	38	14	25	6
• Adjustment in respect of prior years	(2)	(4)	(5)	(2)
• Effect of corporation tax rate change	(12)	(9)	(11)	(10)
Total deferred taxation	24	1	9	(6)
Tax charge/(credit)	24	69	(49)	3

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	
	2012	2011	2012	2011
	£m	£m	£m	£m
Profit before tax	203	317	229	90
Tax calculated at a tax rate of 26% (2011: 28%)	53	89	59	25
Effect of different tax rates in other countries	(5)	(6)	-	-
Expenses/(income) not taxable/deductible for tax purposes:				
• Building depreciation	1	1	1	1
• Non-taxable dividend received	-	-	(128)	(14)
• Bank levy	4	-	4	-
• Other	10	7	32	3
Adjustments in respect of prior years	(27)	(3)	(6)	(2)
Previously unrecognised losses	-	(10)	-	-
Effect of corporation tax rate change	(12)	(9)	(11)	(10)
	24	69	(49)	3

# Notes to the Accounts continued

## 12 Taxation (continued)

The tax on items through other comprehensive income is as follows:

	Group		Society	
	2012 £m	2011 £m	2012 £m	2011 £m
Available for sale investments	<b>63</b>	100	<b>65</b>	97
Revaluation of property	(4)	(1)	(4)	(1)
Actuarial (loss)/gain on retirement benefit obligations	(109)	47	(109)	47
Effect of corporation tax rate change on other items through the general reserve	4	6	3	4
Adjustment to deferred tax transferred from acquisitions	-	(5)	-	-
	<b>(46)</b>	147	<b>(45)</b>	147

The Group tax charge through the available for sale reserve of £63 million is made up of a charge of £67 million through deferred tax and a credit of £4 million through current tax.

## 13 Operating segments

For management reporting purposes, the Group is organised into the following business groupings:

- Retail
- Commercial
- 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.

### Retail

Retail functions include prime residential lending, specialist residential lending, consumer banking, retail funding (savings products), commercial deposits which are managed by the retail business, insurance and investments. The distribution channels supporting these products are also included in this segment.

### Commercial

This segment comprises the commercial lending business.

### Head office functions

Head office functions include treasury operational and income generation activities, head office and central support functions, commercial deposits received and managed by the Treasury Division and the result arising from the funds 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.

### Funds transfer pricing methodology

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. Under the Group's 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 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 and is 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 retail and commercial business segments are charged for the benefit of free capital as part of the funds transfer pricing mechanism. Previously this was based upon economic capital models. However, in April 2011 these were replaced with regulatory capital metrics. The comparative segment results have been amended to a basis that is consistent with the current year's methodology.

## 13 Operating segments (continued)

Segmental results are as follows:

2012	Notes	Retail	Commercial	Head office functions	Total
		£m	£m	£m	£m
Net income/(expense) from external customers		2,198	866	(1,441)	1,623
(Charge)/revenue from other segments		(728)	(795)	1,523	-
<b>Net interest income</b>		<b>1,470</b>	<b>71</b>	<b>82</b>	<b>1,623</b>
Gain on acquisition of mortgage portfolio		96	-	-	96
Other income	i	406	18	-	424
<b>Total revenue</b>		<b>1,972</b>	<b>89</b>	<b>82</b>	<b>2,143</b>
Expenses	ii	(1,201)	(38)	(69)	(1,308)
Impairment and other provisions	iii	(242)	(247)	(42)	(531)
<b>Underlying profit/(loss) before tax</b>		<b>529</b>	<b>(196)</b>	<b>(29)</b>	<b>304</b>
FSCS levies		(59)	-	-	(59)
Restructuring costs		(1)	-	(60)	(61)
Bank levy		-	-	(16)	(16)
Gains from derivatives and hedge accounting		-	-	35	35
<b>Profit/(loss) before tax</b>		<b>469</b>	<b>(196)</b>	<b>(70)</b>	<b>203</b>
Taxation					(24)
<b>Profit after tax</b>					<b>179</b>
<b>Total assets</b>	iv	<b>131,533</b>	<b>22,157</b>	<b>42,439</b>	<b>196,129</b>
<b>Total liabilities</b>		<b>131,436</b>		<b>58,534</b>	<b>189,970</b>

# Notes to the Accounts continued

## 13 Operating segments (continued)

2011		Retail	Commercial	Head office functions	Total
	Notes	£m	£m	£m	£m
Net income/(expense) from external customers		2,649	995	(2,108)	1,536
(Charge)/revenue from other segments		(1,271)	(937)	2,208	-
Net interest income		1,378	58	100	1,536
Other income	i	381	20	10	411
Total revenue		1,759	78	110	1,947
Expenses	ii	(1,109)	(32)	(103)	(1,244)
Impairment and other provisions	iii	(186)	(175)	(66)	(427)
Underlying profit/(loss) before tax		464	(129)	(59)	276
FSCS levies		(50)	-	-	(50)
Restructuring costs		(4)	-	(25)	(29)
Gains from derivatives and hedge accounting		-	-	120	120
Profit/(loss) before tax		410	(129)	36	317
Taxation					(69)
Profit after tax					248
Total assets	iv	126,829	22,107	40,017	188,953
Total liabilities		128,647	-	54,064	182,711

### Notes

- (i) Other income excludes gains from derivatives and hedge accounting which are shown separately.
- (ii) Expenses exclude restructuring costs and bank levy which are shown separately.
- (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) Retail assets include goodwill arising on the acquisitions of The Mortgage Works (UK) plc and the Derbyshire Building Society.

The prior year comparatives of total assets and total liabilities have been amended as described in note 1.

## 14 Loans and advances to banks

Loans and advances to banks for the Group and Society at 4 April 2012 include £192 million (2011: £187 million) of mandatory reserve deposits with the Bank of England.

## 15 Investment securities – available for sale

	Group		Society	
	2012	2011	2012	2011
	£m	£m	£m	£m
Government and supranational investment securities	<b>16,546</b>	12,563	<b>16,546</b>	12,563
Listed private sector investment securities	<b>6,779</b>	8,977	<b>6,700</b>	8,886
	<b>23,325</b>	21,540	<b>23,246</b>	21,449

Listed private sector investment securities includes items with a carrying value of £1,325 million (2011: £227 million) which have been sold under sale and repurchase agreements. These assets have not been derecognised as the Group has retained substantially all the risks and rewards of ownership. Notes issued by Silverstone Master Issuer plc to the Society have also been sold under sale and repurchase agreements. In accordance with accounting standards these notes are not recognised by the Group. The proceeds of all repurchase agreements of £2,145 million (2011: £1,249 million) are included within deposits from banks (note 23).

The Group holds no collateral under reverse sale and repurchase agreements at 4 April 2012 (2011: £1,500 million).

At 4 April 2012 the Group holds collateral under total return swaps of £149 million (2011: £nil). In line with current accounting standards, the collateral is not recognised in the accounts and therefore not reflected in the table above.

The impairment loss on investment securities of £38 million in the year ended 4 April 2012 (2011: £66 million) includes £31 million in relation to available for sale assets (2011: £66 million) and £7 million in respect of investments in a private equity portfolio managed by the Treasury Division (2011: £nil). The 2012 impairment charge on investment securities available for sale of £31 million comprises £17 million for a collateralised debt obligation (CDO) of US residential mortgage backed securities (RMBS) exposures, £9 million on a UK commercial mortgage backed security (CMBS) and £5 million on Portuguese bank subordinated debt which has subsequently been sold. The prior year charge of £66 million was driven by a £22 million impairment of a number of US RMBS exposures, £15 million on a CMBS, £18 million from restructuring of subordinated debt from Irish banks and £11 million on notes of a restructured Structured Investment Vehicle (SIV). Further information on treasury credit risk is included in note 36.

# Notes to the Accounts

continued

## 16 Derivative financial instruments

All derivative financial instruments are held for risk mitigation purposes, although not all derivatives are designated as hedging under the terms of IAS 39. 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:

	2012			2011		
	Contract/ notional amount	Fair value		Contract/ notional amount	Fair value	
		Assets £m	Liabilities £m		Assets £m	Liabilities £m
	£m			£m		
<b>a) Society</b>						
Derivatives designated as fair value hedging instruments:						
• Interest rate swaps	<b>86,538</b>	<b>1,194</b>	<b>3,996</b>	99,989	990	2,964
Other derivatives not designated in hedge accounting relationships:						
• Cross currency interest rate swaps	<b>19,765</b>	<b>531</b>	<b>142</b>	10,088	344	154
• Caps, collars and floors	<b>666</b>	<b>2</b>	<b>3</b>	732	2	3
• Forward foreign exchange	<b>6,443</b>	-	<b>60</b>	3,692	53	19
• Forward rate agreements	<b>5,190</b>	<b>1</b>	-	150	-	-
• Swaptions	<b>349</b>	<b>3</b>	<b>28</b>	464	2	41
• Interest rate futures	<b>4,424</b>	-	-	2,299	-	-
• Interest rate and equity index swaps	<b>73,516</b>	<b>702</b>	<b>534</b>	48,600	150	192
	<b>196,891</b>	<b>2,433</b>	<b>4,763</b>	166,014	1,541	3,373
<b>b) Subsidiaries</b>						
Derivatives designated as fair value hedging instruments:						
• Interest rate swaps	<b>13,182</b>	<b>1,126</b>	-	14,895	427	69
Other derivatives not designated in hedge accounting relationships:						
• Cross currency interest rate swaps	<b>17,414</b>	<b>1,389</b>	<b>296</b>	14,991	2,214	13
Intra Group derivative elimination	<b>(35,622)</b>	<b>(772)</b>	<b>(772)</b>	(19,571)	(221)	(221)
<b>Group</b>	<b>191,865</b>	<b>4,176</b>	<b>4,287</b>	176,329	3,961	3,234

Contract/notional amount indicates the amount on which payment flows are derived at the balance sheet date and does not represent amounts at risk. The notional of contracted derivatives has increased as a result of the Group's hedging of new funding issuances to the market and short term derivative contracts to hedge the Group's exposure to differences between Libor and the Bank of England base rates.

For valuing collateralised derivatives the Group introduced the use of discount curves based on overnight indexed swap (OIS) rates in the year ended 4 April 2012, whilst for non-collateralised derivatives the Group continues to use discount curves based on term Libor rates. Further information on derivatives credit risk is included in note 36.

## 16 Derivative financial instruments (continued)

Group	2012				2011		
	Contract/ notional amount	Fair value		Contract/ notional amount	Fair value		
		Assets £m	Liabilities £m		Assets £m	Liabilities £m	
Derivatives have remaining maturities as follows:							
• In not more than one year	<b>105,073</b>	<b>814</b>	<b>404</b>	79,719	813	349	
• In more than one year	<b>86,792</b>	<b>3,362</b>	<b>3,883</b>	96,610	3,148	2,885	
	<b>191,865</b>	<b>4,176</b>	<b>4,287</b>	176,329	3,961	3,234	

Society	2012				2011		
	Contract/ notional amount	Fair value		Contract/ notional amount	Fair value		
		Assets £m	Liabilities £m		Assets £m	Liabilities £m	
Derivatives have remaining maturities as follows:							
• In not more than one year	<b>101,317</b>	<b>330</b>	<b>404</b>	76,193	350	349	
• In more than one year	<b>95,574</b>	<b>2,103</b>	<b>4,359</b>	89,821	1,191	3,024	
	<b>196,891</b>	<b>2,433</b>	<b>4,763</b>	166,014	1,541	3,373	

## 17 Loans and advances to customers

	Group		Society	
	2012	2011	2012	2011
	£m	£m	£m	£m
Prime residential mortgages	<b>105,549</b>	104,229	<b>103,544</b>	103,846
Specialist residential mortgages	<b>23,096</b>	20,224	<b>1,055</b>	1,114
Consumer banking	<b>2,888</b>	2,376	<b>2,888</b>	2,376
Commercial lending	<b>20,961</b>	21,560	<b>20,005</b>	20,467
Other lending	<b>479</b>	481	<b>80</b>	-
	<b>152,973</b>	148,870	<b>127,572</b>	127,803
Fair value adjustment for micro hedged risk	<b>1,196</b>	547	<b>1,196</b>	547
	<b>154,169</b>	149,417	<b>128,768</b>	128,350

# Notes to the Accounts continued

## 17 Loans and advances to customers (continued)

### Maturity analysis

Loans and advances to customers have remaining contractual maturities as follows:

	Group		Society	
	2012 £m	2011 £m	2012 £m	2011 £m
Repayable on demand	<b>1,678</b>	1,460	<b>1,655</b>	1,400
Other loans and advances by residual maturity repayable:				
• In not more than three months	<b>1,773</b>	2,104	<b>1,648</b>	2,067
• In more than three months but not more than one year	<b>4,737</b>	5,070	<b>4,647</b>	4,972
• In more than one year but not more than five years	<b>26,783</b>	25,295	<b>25,684</b>	24,372
• In more than five years	<b>118,845</b>	115,706	<b>94,599</b>	95,576
	<b>153,816</b>	149,635	<b>128,233</b>	128,387
Impairment provision on loans and advances (note 11)	<b>(843)</b>	(765)	<b>(661)</b>	(584)
Fair value adjustment for micro hedged risk	<b>1,196</b>	547	<b>1,196</b>	547
	<b>154,169</b>	149,417	<b>128,768</b>	128,350

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. The analysis is based on contractual maturity rather than actual redemption levels experienced by the Group or Society, which are likely to be materially different. Arrears are spread across the remaining term of the loan.

### Asset backed funding

Certain prime residential mortgages have been pledged to the Group's asset backed funding programmes. The programmes have enabled the Group to obtain secured funding or to create additional collateral which could be used to source additional funding. Mortgages pledged and the values of the notes in issue are as follows:

	2012				
	Mortgages pledged	Notes in issue			Total
		Held by third parties	Held by the Group		
	£m	£m	£m	£m	£m
Covered bond programme	<b>32,109</b>	<b>13,024</b>	-	<b>6,764</b>	<b>19,788</b>
Securitisation programme	<b>26,172</b>	<b>7,404</b>	<b>1,250</b>	<b>12,291</b>	<b>20,945</b>
Other secured lending programmes	<b>2,225</b>	<b>1,500</b>	-	-	<b>1,500</b>
	<b>60,506</b>	<b>21,928</b>	<b>1,250</b>	<b>19,055</b>	<b>42,233</b>

	2011				
	Mortgages pledged	Notes in issue			Total
		Held by third parties	Held by the Group		
	£m	£m	£m	£m	£m
Covered bond programme	33,051	12,264	4,611	5,602	22,477
Securitisation programme	32,679	3,746	2,500	14,686	20,932
Other secured lending programmes	2,212	1,500	-	-	1,500
	67,942	17,510	7,111	20,288	44,909

## 17 Loans and advances to customers (continued)

Mortgages pledged include £4.5 billion (2011: £6.8 billion) in the covered bond and securitisation programmes that are in excess of the amount contractually required to support notes in issue and provide capacity for further potential issuances.

Mortgages pledged are not derecognised from the Group or Society balance sheets as the Group has retained substantially all the risks and rewards of ownership. No gain or loss has been recognised on pledging the mortgages to the programmes.

Notes in issue and held by third parties are included within debt securities in issue (note 26).

Notes in issue, held by the Group and drawn are debt securities issued by the programmes to the Society which have been used as collateral in sale and repurchase agreements with third parties. Further details have been provided in note 15.

Notes in issue, held by the Group and undrawn are debt securities issued by the programmes to the Society, the majority of which are held to provide collateral for potential future use in repurchase agreements or central bank operations.

In accordance with accounting standards, notes in issue and held by the Group are not recognised by the Group or Society in their balance sheets.

The Society established the Nationwide Covered Bond programme in November 2005. Mortgages pledged provide security for issues of covered bonds made by the Society. During the year, the programme issued notes in euro and sterling to third parties raising £3.2 billion sterling equivalent with

maturities ranging between three and five years. In addition, €2.0 billion (£1.6 billion sterling equivalent) of notes matured.

The Society established the Silverstone Master Trust securitisation programme in July 2008. Mortgages pledged are held by Silverstone Finance Trustee Limited. The proceeds of notes issued by this programme of £20.9 billion (2011: £20.9 billion) have been used to purchase a share of the beneficial interest in the mortgages pledged for the beneficial interest of the note holders. The remaining beneficial interest in the pledged mortgages of £5.2 billion (2011: £11.7 billion) stays with the Society and incorporates its required minimum seller share in accordance with the rule of the programme. The Group is under no obligation to support losses incurred by the programme or holders of the notes and does not intend to provide such further support. The entitlement of note holders is restricted to payment of principal and interest to the extent that the resources of the programme are sufficient to support such payment and the holders of the notes have agreed not to seek recourse in any other form. During the year ended 4 April 2012, the programme issued notes in US dollars and sterling to third parties raising £3.7 billion sterling equivalent with maturities ranging between three and nine years.

The Society holds cash deposited by the covered bond programme of £1.4 billion (2011: £2.2 billion) and by the Silverstone programme of £1.2 billion (2011: £2.1 billion).

## 18 Investments in equity shares

	Group		Society	
	2012	2011	2012	2011
	£m	£m	£m	£m
At 5 April	103	86	32	26
Additions	2	25	-	-
Disposals	(67)	(11)	-	-
(Decrease)/increase in fair value	(2)	3	(3)	6
Impairment	(7)	-	-	-
<b>At 4 April</b>	<b>29</b>	<b>103</b>	<b>29</b>	<b>32</b>

Investments in equity shares include investments of £28 million (2011: £102 million) carried at fair value. £16 million (2011: £15 million) of the Group's investments in equity shares relate to participation in industry wide banking and credit card service operations.

Investments in equity shares with a carrying value of £65 million were sold at a fair value of £68 million to the Nationwide Pension Fund during the year ended 4 April 2012. Further details are provided in note 39.

During the year ended 4 April 2012 an impairment charge of £7 million (2011: £nil) was made in respect of an investment in a private equity portfolio.

# Notes to the Accounts continued

## 19 Investments in Group undertakings

	Shares	Loans	Total
	£m	£m	£m
At 5 April 2011	387	20,010	20,397
Additions	1	8,024	8,025
Impairment	-	(8)	(8)
Disposals, redemptions and repayments	-	(3,457)	(3,457)
<b>At 4 April 2012</b>	<b>388</b>	<b>24,569</b>	<b>24,957</b>

	Shares	Loans	Total
	£m	£m	£m
At 5 April 2010	393	18,460	18,853
Additions	2	8,778	8,780
Impairment	-	(1)	(1)
Disposals, redemptions and repayments	(8)	(7,227)	(7,235)
<b>At 4 April 2011</b>	<b>387</b>	<b>20,010</b>	<b>20,397</b>

The impairment charge for the year ended 4 April 2012 includes £4 million relating to a subsidiary that holds a corporate loan portfolio and is included in impairment loss on loans and advances to customers in the income statement. A further £4 million relates to a subsidiary which holds a portfolio of investment securities and is included in impairment losses on investment securities in the income statement.

## 19 Investments in Group undertakings (continued)

The interests of the Society in its principal subsidiary undertakings, as at 4 April 2012 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.

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 owned by the Group. As a consequence, these entities are consolidated in the Group accounts.

The principal interests of the Society in these entities as at 4 April 2012 are set out below:

Other 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	Funding vehicle	England and Wales	UK
Pride No. 1 LLP	Funding vehicle	England and Wales	UK

During the year ended 4 April 2012 the Society received dividend payments of £489 million (2011: £64 million) from subsidiary undertakings.

# Notes to the Accounts

continued

## 20 Intangible assets

2012 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 2011	583	74	657	42	16	715
Additions	150	63	213	-	-	213
Disposals	(26)	(9)	(35)	-	-	(35)
<b>At 4 April 2012</b>	<b>707</b>	<b>128</b>	<b>835</b>	<b>42</b>	<b>16</b>	<b>893</b>
<b>Accumulated amortisation and impairment</b>						
At 5 April 2011	142	33	175	11	-	186
Amortisation charge	23	25	48	4	-	52
Impairment in the year	-	-	-	9	-	9
Disposals	(26)	(9)	(35)	-	-	(35)
<b>At 4 April 2012</b>	<b>139</b>	<b>49</b>	<b>188</b>	<b>24</b>	<b>-</b>	<b>212</b>
<b>Net book value</b>						
<b>At 4 April 2012</b>	<b>568</b>	<b>79</b>	<b>647</b>	<b>18</b>	<b>16</b>	<b>681</b>

Intangible assets at 4 April 2012 include £340 million (2011: £307 million) of assets in the course of construction. These assets relate mainly to the Group's investment 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 amortisation has been charged against these assets.

In the year ended 4 April 2012 £14 million (2011: £11 million) of borrowing costs have been capitalised using a capitalisation rate of 2.73 % (2011: 2.31%).

An impairment loss of £9 million (2011: £nil) has been recognised in respect of core deposit intangible assets which were recognised on the acquisition of the Derbyshire, Cheshire and Dunfermline building societies.

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>Accumulated amortisation and impairment</b>						
At 5 April 2010	141	22	163	6	-	169
Amortisation charge	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>

The Society's intangible assets are as shown above for the Group, except that they exclude £12 million of goodwill relating to the acquisition of The Mortgage Works (UK) plc, which is only recognised at Group level.

## 21 Property, plant and equipment

2012 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 2011	248	185	47	480	104	936	1,520
Additions	2	1	1	4	22	115	141
Revaluation	(14)	-	-	(14)	-	-	(14)
Disposals	(4)	-	-	(4)	(6)	(83)	(93)
<b>At 4 April 2012</b>	<b>232</b>	<b>186</b>	<b>48</b>	<b>466</b>	<b>120</b>	<b>968</b>	<b>1,554</b>
<b>Accumulated depreciation and impairment</b>							
At 5 April 2011	-	67	32	99	59	414	572
Depreciation charge	-	4	1	5	15	99	119
Disposals	-	-	-	-	(6)	(76)	(82)
<b>At 4 April 2012</b>	<b>-</b>	<b>71</b>	<b>33</b>	<b>104</b>	<b>68</b>	<b>437</b>	<b>609</b>
<b>Net book value</b>							
<b>At 4 April 2012</b>	<b>232</b>	<b>115</b>	<b>15</b>	<b>362</b>	<b>52</b>	<b>531</b>	<b>945</b>

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>Accumulated depreciation and impairment</b>							
At 5 April 2010	-	60	30	90	57	391	538
Depreciation charge	-	3	2	5	12	90	107
Impairment in the year	-	4	-	4	-	-	4
Disposals	-	-	-	-	(10)	(67)	(77)
<b>At 4 April 2011</b>	<b>-</b>	<b>67</b>	<b>32</b>	<b>99</b>	<b>59</b>	<b>414</b>	<b>572</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>

Group property, plant and equipment includes £7 million (2011: £8 million) of land and buildings held by subsidiary undertakings.

Property, plant and equipment includes £184 million (2011: £162 million) of assets in the course of construction.

In the year ended 4 April 2011 an impairment charge of £4 million was made in respect of the former head office buildings of the Derbyshire and Cheshire building societies.

# Notes to the Accounts continued

## 22 Deferred tax

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 2012 UK Budget Statement. Legislation to reduce the main rate of corporation tax from 24% to 23%

from 1 April 2013 is expected to be included in the Finance Act 2012. Further reductions to the main rate are proposed to reduce the rate by 1% to 22% 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 movements on the deferred tax account are as follows:

	Group		Society	
	2012	2011	2012	2011
	£m	£m	£m	£m
At 5 April	182	361	142	318
Income statement charge	(36)	(10)	(20)	(4)
Income statement effect of corporation tax rate change	12	9	11	10
Adjustment to amounts transferred from acquisitions	-	5	-	-
Reclassification from current tax	-	(36)	-	(36)
Available for sale investments	-	1	-	-
Property revaluation	2	-	2	-
Retirement benefit obligations	129	(32)	128	(32)
Tax losses utilised	(53)	(88)	(53)	(87)
Effect of corporation tax rate change in other comprehensive income	(35)	(28)	(32)	(27)
Taxation on items through other comprehensive income	43	(147)	45	(146)
<b>At 4 April</b>	<b>201</b>	<b>182</b>	<b>178</b>	<b>142</b>

Deferred tax assets and liabilities are attributable to the following items:

	Group		Society	
	2012	2011	2012	2011
	£m	£m	£m	£m
<b>Deferred tax assets</b>				
Accelerated depreciation	(54)	(15)	(54)	(15)
Property revaluation	2	2	-	-
Tax losses carried forward	84	58	83	58
Retirement benefit obligations	123	77	123	77
Provisions for loan impairment	17	21	7	9
Other provisions	57	75	33	34
	229	218	192	163
<b>Deferred tax liabilities</b>				
Accelerated tax depreciation	(1)	(1)	-	-
Property revaluation	(13)	(18)	(13)	(19)
Other provisions	(14)	(17)	(1)	(2)
	(28)	(36)	(14)	(21)
<b>Net deferred tax asset</b>	<b>201</b>	<b>182</b>	<b>178</b>	<b>142</b>

## 22 Deferred tax (continued)

The prior year comparatives have been amended as described in note 1.

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. The tax losses carried forward have been assessed for recoverability against the Group's five year corporate plan forecast. The losses are expected to be

fully utilised within three to five years. There is no time limit for utilising tax losses brought forward in the UK.

As at 4 April 2012 the Group and Society held £5 million of unused capital losses (2011: Group and Society £5 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/(credit) in the income statement comprises the following temporary differences (note 12):

	Group		Society	
	2012	2011	2012	2011
	£m	£m	£m	£m
Accelerated tax depreciation	43	8	43	8
Retirement benefit obligations	72	26	72	26
Provisions for loan impairment	2	2	2	2
Other	13	5	(4)	3
Tax losses carried forward	(94)	(31)	(93)	(35)
Effect of corporation tax rate change	(12)	(9)	(11)	(10)
	24	1	9	(6)

## 23 Deposits from banks

	Group		Society	
	2012	2011	2012	2011
	£m	£m	£m	£m
Deposits from banks are repayable from the balance sheet date in the ordinary course of business as follows:				
Accrued interest	10	7	10	7
Repayable on demand	836	1,048	196	144
Other amounts owed to banks with residual maturity repayable:				
• In not more than three months	306	403	306	403
• In more than three months but not more than one year	53	84	53	84
• In more than one year but not more than five years	2,145	1,204	2,145	1,204
• In more than five years	20	-	20	-
	3,370	2,746	2,730	1,842

For the Group and Society, deposits from banks include £2,145 million (2011: £1,249 million) in respect of sale and repurchase agreements. The carrying value of assets of £1,325 million (2011: £227 million) sold under sale and repurchase agreements is included within investment securities – available for sale (see note 15).

# Notes to the Accounts continued

## 24 Other deposits

	Group		Society	
	2012	2011	2012	2011
	£m	£m	£m	£m
Amounts owed to subsidiary undertakings	-	-	<b>6,790</b>	7,602
Other	<b>6,899</b>	5,809	<b>6,543</b>	5,511
	<b>6,899</b>	5,809	<b>13,333</b>	13,113

The prior year comparatives have been amended as described in note 1.

Other deposits comprise wholesale deposits placed with Treasury Division 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 £2,890 million (2011: £2,125 million) based on management's best estimate of the amounts that will be paid at contractual maturity.

Changes in fair value of the PEB liability are recognised in the income statement. A loss of £179 million was recognised by the Group and Society during the year ended 4 April 2012 (2011: £56 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 has been attributable to changes in credit risk.

The minimum amount on an undiscounted basis that the Group and Society are contractually required to pay at maturity for the PEBs is £2,863 million (2011: £2,232 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 £77 million (2011: £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 £1,169 million (2011: £748 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 investment returns on the PEBs.

The amounts owed to subsidiary undertakings by the Society are repayable on demand.

## 25 Due to customers

	Group		Society	
	2012	2011	2012	2011
	£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	<b>40</b>	29	<b>5</b>	2
Repayable on demand	<b>3,779</b>	4,744	<b>985</b>	1,308
Other amounts owed to customers with residual maturity repayable:				
• In not more than three months	<b>457</b>	362	<b>67</b>	3
• In more than three months but not more than one year	<b>1,201</b>	459	<b>221</b>	2
• In more than one year but not more than five years	<b>356</b>	168	<b>23</b>	-
	<b>5,833</b>	5,762	<b>1,301</b>	1,315

Comparatives have been reclassified as described in note 1.

Amounts due to customers in the Group include savings deposit balances held in the Group's offshore subsidiary Nationwide International Limited.

Amounts classified as due to customers do not confer membership rights.

## 26 Debt securities in issue

	Group		Society	
	2012	2011	2012	2011
	£m	£m	£m	£m
Certificates of deposit and commercial paper	<b>7,952</b>	10,883	<b>7,952</b>	10,883
Fixed and floating rate notes	<b>21,977</b>	22,571	<b>20,270</b>	20,850
Other debt securities	<b>7,677</b>	3,989	<b>260</b>	249
	<b>37,606</b>	37,443	<b>28,482</b>	31,982
Fair value adjustment for micro hedged risk	<b>1,248</b>	365	<b>253</b>	98
	<b>38,854</b>	37,808	<b>28,735</b>	32,080
Debt securities in issue are repayable from the balance sheet date in the ordinary course of business as follows:				
Accrued interest	<b>195</b>	261	<b>192</b>	229
Residual maturity repayable:				
• In not more than one year	<b>13,616</b>	14,881	<b>12,776</b>	14,881
• In more than one year	<b>23,795</b>	22,301	<b>15,514</b>	16,872
	<b>37,606</b>	37,443	<b>28,482</b>	31,982
Fair value adjustment for micro hedged risk	<b>1,248</b>	365	<b>253</b>	98
	<b>38,854</b>	37,808	<b>28,735</b>	32,080

Debt securities in issue in the Group and Society include £21,928 million (2011: £17,510 million) secured on certain loans and advances to customers. Further information is given in note 17.

# Notes to the Accounts continued

## 27 Provisions for liabilities and charges

Group	Bank levy	FSCS	PPI provision	Other provisions	Total
	£m	£m	£m	£m	£m
At 5 April 2011	-	94	19	52	165
Provisions utilised	(11)	(42)	(17)	(15)	(85)
Charge for the year	16	59	103	59	237
Release for the year	-	-	-	(22)	(22)
Net income statement charge	16	59	103	37	215
<b>At 4 April 2012</b>	<b>5</b>	<b>111</b>	<b>105</b>	<b>74</b>	<b>295</b>
At 5 April 2010	-	93	9	88	190
Provisions utilised	-	(49)	(6)	(31)	(86)
Charge for the year	-	50	16	26	92
Release for the year	-	-	-	(31)	(31)
Net income statement charge/(release)	-	50	16	(5)	61
At 4 April 2011	-	94	19	52	165

The prior year comparatives have been amended as described in note 1.

At 5 April 2010 other provisions included a £3 million provision held by a subsidiary company, £1 million of which was utilised and £2 million of which was released to the income statement during the year ended 4 April 2011.

### Bank levy

The bank levy came into force on 1 January 2011 for certain UK banks, building societies and the UK operations of foreign banks. No charge was applied in the accounts to 4 April 2011 as the 2011 Finance Bill had not been enacted. The £16 million charge in the accounts, which is included within administrative expenses, represents £3 million for the three month period 1 January 2011 to 4 April 2011 and £13 million for the year ended 4 April 2012.

### Financial services compensation scheme (FSCS)

The FSCS, the UK's independent statutory compensation fund for customers of authorised financial services firms, pays compensation if a firm is unable to pay claims against it. The FSCS is funded by levies on the industry.

Following the default of a number of deposit takers, the FSCS borrowed funds from HM Treasury, which total approximately £18 billion, to meet the compensation costs for customers of those firms. 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 the borrowings will be repaid wholly from recoveries from the institutions concerned, the FSCS has advised of an expected

shortfall. At current rates and based on latest information which is subject to change, the Group's share of the expected shortfall would total approximately £100 million which, in line with the intentions of the FSCS on timing of resultant levies, the Group would expect to be recognised over three years beginning in the year ending 4 April 2013.

The Group also has a potential exposure to future levies resulting from the failure of the Dunfermline Building Society. The quantification and timing of such losses have yet to be determined and hence, although the Group's share could be significant, no provision has been recognised.

The amount provided by the Group of £111 million is in respect of the 2011/12 and 2012/13 scheme years (2011: £94 million in respect of the 2010/11 and 2011/12 scheme years).

### PPI provision

The increase in PPI provision follows significant developments since the initial PPI provision was estimated. The FSA released their policy statement PS10/12: *The assessment and redress of Payment Protection Insurance complaints* on 10 August 2010 and the Group has been monitoring the subsequent level of complaints. In line with the wider industry, Nationwide has experienced a significant increase in complaints during the second half of the year ended 4 April 2012, driven by media focus and claims management company activity. This has resulted in a re-assessment of the volume of complaints that the Group ultimately expects to receive, including significant levels of complaints where a customer has not been sold a product by Nationwide.

## 27 Provisions for liabilities and charges (continued)

The overall PPI provision is calculated based upon management's estimate of complaint volumes, the proportion of cases relating to no product sold, referral rates to the Financial Ombudsman Service (FOS), uphold rates internally and with the FOS, response rates from customer contact activity relating to our previous sales of PPI, average redress payments and complaint handling costs. In addition to higher expected volumes, the expected cost of processing the complaints has increased as a result of the decision by FOS to increase its cost of reviewing escalated cases from £500 to £850. This cost is incurred by Nationwide on every referred complaint, regardless of the outcome. Management's estimate of the level of redress that Nationwide expects to pay has also increased, reflecting the FSA and FOS stances on PPI.

Of the Group's charge for the year ended 4 April 2012 of £103 million (2011: £16 million) 40% relates to the cost of processing claims, rather than the cost of customer redress.

### Other provisions

Other provisions include provisions for severance costs and a number of property related provisions. Provisions are made for the expected severance costs in relation to the Group's restructuring activities where there is present obligation and it is probable that the expenditure will be made. Within the net charge for the year ended 4 April 2011 there is a release of £14 million which is included in provisions for liabilities and charges in the income statement, all other components of the net charge for other provisions in the years ended 4 April 2011 and 4 April 2012 are included within administrative expenses.

## 28 Accruals and deferred income

The prior year comparatives have been amended as described in note 1.

Accruals and deferred income for the Group and Society include £37 million (2011: £44 million) of interest accrued on subordinated liabilities, £17 million (2011: £17 million) of interest accrued on subscribed capital and £89 million (2011: £94 million) of deferred income on PEBs.

Income received on PEBs is deferred and recognised in the income statement on an effective interest basis over the term of the product. Movements in the PEBs balance are as follows:

	Group and Society	
	2012	2011
	£m	£m
At 5 April	94	65
Additions	16	49
Releases	(21)	(20)
<b>At 4 April</b>	<b>89</b>	<b>94</b>

# Notes to the Accounts continued

## 29 Subordinated liabilities

	Group and Society	
	2012	2011
	£m	£m
5 1/4% Subordinated notes due 2014 (\$225m)	<b>142</b>	139
5% Subordinated notes due 2015 (\$400m)	<b>252</b>	248
Subordinated floating rate notes due 2016 (€300m)	-	265
7.125% Subordinated notes due 2016 (£)	-	75
5 3/4% Callable reset subordinated notes 2016 (£)	-	35
5 1/4% Subordinated notes due 2018 (£)	<b>200</b>	200
8 5/8% Subordinated notes due 2018 (£)	<b>125</b>	125
6.73% Subordinated loan due 2019 (£)	<b>15</b>	15
6.75% Subordinated loan due 2020 (€750m)	<b>620</b>	661
5.25% Subordinated loan due 2020 (£)	<b>150</b>	150
6.5% Callable reset subordinated notes 2022 (£)	<b>30</b>	30
	<b>1,534</b>	1,943
Fair value adjustment for micro hedged risk	<b>119</b>	40
Unamortised premiums and issue costs	<b>(9)</b>	(10)
	<b>1,644</b>	1,973

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 5 1/4% 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 five year benchmark gilt rate.
- All or some of the 8 5/8% notes due 2018 at the higher of par (100%) or the benchmark 8 3/4% 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 be redeemed on 7 April 2014, five years before the final maturity date, by giving no less than two 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 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%.

- All or some of the 6.5% notes due 2022 on 1 March 2017 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.

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.

In October 2011 the Group, with the consent of the FSA, redeemed early all of £75 million 7.125% subordinated notes due 2016 at par. In December 2011 the Group, with the consent of the FSA, redeemed early all of the £35 million 5 3/4% subordinated notes due 2016 at par and all of the €300 million subordinated floating rate notes due 2016 at par at a sterling equivalent cost of £250 million.

## 30 Subscribed capital

	Group and Society	
	2012	2011
	£m	£m
6.024% Permanent interest bearing shares	<b>350</b>	350
6.875% Permanent interest bearing shares	<b>30</b>	30
7.971% Permanent interest bearing shares	<b>200</b>	200
7.25% Permanent interest bearing shares	<b>60</b>	60
6.25% Permanent interest bearing shares	<b>125</b>	125
5.769% Permanent interest bearing shares	<b>400</b>	400
7.859% Permanent interest bearing shares	<b>100</b>	100
Floating rate permanent interest bearing shares	<b>10</b>	10
6% Permanent interest bearing shares	<b>140</b>	140
	<b>1,415</b>	1,415
Fair value adjustment for micro hedged risk	<b>248</b>	137
Unamortised premiums and issue costs	<b>(38)</b>	(42)
	<b>1,625</b>	1,510

All permanent interest bearing shares (PIBS) are unsecured and denominated in sterling. The PIBS are only repayable with the prior consent of the FSA as follows:

- 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 five year gilt benchmark. These PIBS were acquired on the acquisition of the Cheshire Building Society.
- The floating rate PIBS are only repayable in the event of winding up the Society. Interest is payable on the PIBS at 2.4% above 6 month Libor. 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.

# Notes to the Accounts

continued

## 31 Retirement benefit obligations

	Group	
	2012	2011
	£m	£m
Present value of funded obligations	<b>3,594</b>	2,982
Fair value of fund assets	<b>(3,089)</b>	(2,695)
	<b>505</b>	287
Present value of unfunded obligations	<b>12</b>	13
	<b>517</b>	300

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. The Group retirement benefit obligation of

£517 million (2011: £300 million) includes £1 million (2011: £1 million) relating to a separate pension fund operated for a 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 applicable for the year ended 4 April 2012, including employees' contributions payable under salary sacrifice arrangements, varied between 8.0% and 23.3%.

The amounts recognised in the income statement are as follows:

	Group	
	2012	2011
	£m	£m
Defined benefit current service cost	<b>50</b>	76
Defined contribution cost	<b>16</b>	11
Curtailment	<b>(4)</b>	(5)
Included in employee costs (note 9)	<b>62</b>	82
Expected return on pension assets (note 3)	<b>(195)</b>	(168)
Pension interest cost (note 4)	<b>166</b>	166
	<b>33</b>	80

## 31 Retirement benefit obligations (continued)

Changes in the present value of defined benefit obligations (including unfunded obligations) are as follows:

	Group	
	2012	2011
	£m	£m
At 5 April	2,995	2,976
Current service cost	50	76
Past service cost	2	6
Curtailment	(4)	(5)
Pension interest cost	166	166
Employee contributions	1	1
Actuarial losses/(gains)	467	(152)
Benefits paid	(71)	(73)
<b>At 4 April</b>	<b>3,606</b>	2,995

The actuarial losses of £467 million for the year ended 4 April 2012 arose primarily due to a reduction in the discount rate used which increases the measurement of the defined benefit obligation. This has resulted in an increase in the deficit, despite additional contributions of £241 million being paid in the year. Further details are included in the Business Review.

Following changes in Government legislation, the actuarial gains of £152 million in the year ended 4 April 2011 included £60 million arising from using CPI, rather than RPI, to index deferred pensions before retirement.

The past service cost of £2 million (2011: £6 million) includes amounts that were provided for in previous years as part of the Group's restructuring costs.

Changes in the fair value of plan assets for the pension funds are as follows:

	Group	
	2012	2011
	£m	£m
At 5 April	2,695	2,468
Expected return on assets	195	168
Actuarial losses	(27)	(38)
Contributions by employer	296	169
Employee contributions	1	1
Benefits paid	(71)	(73)
<b>At 4 April</b>	<b>3,089</b>	2,695

The actual return on assets was 6.3% (2011: 5.0%). Contributions paid by the Group in the year included additional deficit contributions of £241 million (2011: £99 million).

# Notes to the Accounts continued

## 31 Retirement benefit obligations (continued)

The major categories of plan assets for the pension funds, stated at fair value, are as follows:

	Group	
	2012	2011
	£m	£m
Listed equities	1,245	1,293
Government bonds	903	576
Corporate bonds	308	235
Infrastructure	188	149
Property	198	195
Private equity investments	133	57
Cash	46	127
Other	68	63
	3,089	2,695

None of the funds' assets are invested in the Nationwide Group (2011: £nil).

£421 million of the plan assets (2011: £307 million) have been valued using inputs which are not based on observable market data and represent Level 3 assets as defined in IFRS 7. These assets include private equity investments, infrastructure and certain property investments.

The amounts recognised in respect of pension obligations in the statements of comprehensive income are as follows:

	Group	
	2012	2011
	£m	£m
Cumulative actuarial losses at 5 April	(217)	(331)
Actuarial (losses)/gains in the year	(494)	114
<b>Cumulative actuarial losses at 4 April</b>	<b>(711)</b>	<b>(217)</b>

Experience gains and losses in respect of pension obligations for the current and the previous years are as follows:

	Group				
	2012	2011	2010	2009	2008
	£m	£m	£m	£m	£m
Experience (losses)/gains on plan liabilities	(31)	68	55	12	(41)
Changes in actuarial assumptions	(436)	84	(617)	186	245
Actuarial (losses)/gains on plan liabilities	(467)	152	(562)	198	204
Experience (losses)/gains on plan assets	(27)	(38)	393	(519)	(143)
	(494)	114	(169)	(321)	61

## 31 Retirement benefit obligations (continued)

The present value of the defined benefit obligation and the fair value of plan assets for the current and previous years are:

	Group				
	2012	2011	2010	2009	2008
	£m	£m	£m	£m	£m
Present value of defined benefit obligation	<b>3,606</b>	2,995	2,976	2,267	2,172
Fair value of plan assets	<b>3,089</b>	2,695	2,468	1,936	2,132
Total deficit	<b>517</b>	300	508	331	40

The principal actuarial assumptions used were as follows:

	Group	
	2012	2011
	%	%
Discount rate	<b>4.8</b>	5.6
Expected return on plan assets	<b>6.2</b>	6.9
Future salary increases	<b>4.3</b>	4.5
Future pension increases	<b>2.0 - 3.7</b>	2.1 - 3.8
Retail price index (RPI) inflation	<b>3.3</b>	3.5
Consumer price index (CPI) inflation	<b>2.3</b>	2.8

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 2012. This resulted in the selection of the 6.2% assumption as at 4 April 2012 (2011: 6.9%). A deduction is made for the expenses of the Fund.

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:

	2012	2011
Retire at 4 April 2012		
• Males	<b>28.4</b>	28.4
• Females	<b>30.8</b>	30.7
Retire at 4 April 2032		
• Males	<b>30.4</b>	30.3
• Females	<b>31.5</b>	31.4

The Group estimates that its contributions to the defined benefit pension funds during the year ended 4 April 2013 will be £49 million.

# Notes to the Accounts continued

## 32 Capital and leasing commitments

Capital commitments	Group and Society	
	2012	2011
	£m	£m
Capital expenditure contracted for but not provided for in the Accounts	102	122

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 at 4 April	Group	
	2012	2011
	£m	£m
Future minimum payments under operating leases relating to land and buildings were as follows:		
Amounts falling due:		
• Within one year	31	31
• Between one and five years	90	93
• After five years	126	123
	247	247

£2 million of the leasing commitments arise in a subsidiary of the Group (2011: £6 million).

Leasing payments receivable as lessor at 4 April	Group and Society	
	2012	2011
	£m	£m
Subleasing payments receivable under non-cancellable subleases	10	8
Future minimum lease payments receivable under non-cancellable operating leases were as follows:		
Amounts falling due:		
• Within one year	5	5
• Between one and five years	12	13
• After five years	13	12
	30	30

## 33 Contingent liabilities

The Society does not expect the ultimate resolution of any threatened or actual legal proceedings to have a significant adverse effect on the financial position of the Society.

# 34 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 35 to 37 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 Group uses derivative instruments to manage various aspects of risk which arise from this core activity. However, in doing so it complies with the Building Societies Act 1986 which limits the 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. The Group has not used derivatives to mitigate credit risks during the year. 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 note 1. 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 Group's Lending Committee for Retail, Commercial and Treasury 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 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 the Group's 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. In addition the Group's Treasury Division has a mandate to run a small interest rate risk to prevent the requirement to enter into hedges where the Group expects the risk to be offset naturally by customers' future transactions.

# Notes to the Accounts continued

## 34 Financial instruments (continued)

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 ten 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:

	2012			2011		
	Average	High	Low	Average	High	Low
	£m	£m	£m	£m	£m	£m
VaR	59	67	46	74	81	66
Sensitivity analysis (PV01)	2	2	2	2	2	2
Stress testing (PV200: all currencies)	396	441	303	409	438	373

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 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.

## 34 Financial instruments (continued)

### 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 Lending Committee for Retail, Commercial and Treasury is responsible for approving and monitoring the Group's credit exposures which it does 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 Lending Committee together with key risk monitoring metrics are reviewed by the Executive Risk Committee. Oversight of these activities is provided by an independent second line Group Lending Risk Oversight team, which is accountable to the Group Risk Oversight 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 the Treasury Division arises primarily from the instruments held by Treasury for liquidity and investment purposes. This aspect of credit risk is managed by the Treasury Credit function which underwrites all new facilities and monitors existing exposures. It also sets and monitors compliance with policy and limits, reporting to the Lending Committee. In addition, counterparty credit risk arises from the Group's derivatives where the market values are positive. Derivatives are only traded with highly rated organisations and the vast majority include collateral agreements which are either active or have contingent rating triggers.

The Treasury Credit function also monitors exposure concentrations against a variety of criteria including industry sector, asset class and country of risk. The treasury exposure is well spread across both industry sectors and jurisdictions. Nationwide has no exposure to emerging markets, hedge funds or credit default swaps and only modest exposure to non investment grade debt. The Group's exposure to investments from selected Eurozone countries has been detailed in the Business Review.

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.

	2012			2011		
	Carrying value	Commitments	Maximum credit risk exposure	Carrying value	Commitments	Maximum credit risk exposure
	£m	£m	£m	£m	£m	£m
Cash	8,126	-	8,126	6,130	-	6,130
Loans and advances to banks	2,914	437	3,351	4,181	199	4,380
Investment securities – AFS	23,325	-	23,325	21,540	-	21,540
Derivative financial instruments	4,176	-	4,176	3,961	-	3,961
FV adjustment for portfolio hedged risk	1,330	-	1,330	1,634	-	1,634
Loans and advances to customers	154,169	4,853	159,022	149,417	5,637	155,054
Investment in equity shares	29	-	29	103	-	103
	194,069	5,290	199,359	186,966	5,836	192,802

The prior year comparatives have been amended as described in note 1.

In addition to the figures shown above, the Group has, as part of its retail operations, commitments of £6,721 million (2011: £6,857 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.

# Notes to the Accounts continued

## 34 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:

	2012			2011		
	Average	High	Low	Average	High	Low
	£m	£m	£m	£m	£m	£m
VaR	0.3	0.7	-	0.1	0.5	-

### 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.

The Group liquidity policy is to maintain sufficient liquid resources to cover cash flow mismatches 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 risk management policy is approved by the Board.

Liquid assets are categorised according to their liquidity characteristics. The most liquid category of assets 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 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.

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. 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). The total swap spread is governed by an ALCO limit.

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 every six months and various components are tested on a scheduled basis.

Additional quantitative information on liquidity risk is contained in note 37.

## 35 Credit risk – loans and advances to customers

The Group's loans and advances to customers continue to have a low risk profile when compared to industry benchmarks. The mix of lending has remained broadly consistent over the year.

Loans and advances to customers	Notes	2012		2011	
		£m	%	£m	%
Prime residential mortgages		<b>105,589</b>	<b>69</b>	104,269	70
Specialist residential mortgages		<b>23,258</b>	<b>15</b>	20,385	13
<b>Total residential mortgages</b>		<b>128,847</b>	<b>84</b>	124,654	83
Consumer banking		<b>2,968</b>	<b>2</b>	2,466	2
<b>Retail loan portfolio</b>	(a)	<b>131,815</b>	<b>86</b>	127,120	85
Commercial lending	(b)	<b>21,508</b>	<b>14</b>	22,023	15
Other lending operations	(b)	<b>493</b>	-	492	-
<b>Total gross balance</b>		<b>153,816</b>	<b>100</b>	149,635	100

The figures above are before impairment provisions and fair value adjustments for micro hedged risks.

### a) Retail loan portfolio

By their nature, the Group's 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

Residential mortgages are only secured against UK properties. The geographical split has not changed over the year ended 4 April 2012 and is shown below:

	2012	2011
	%	%
Greater London	<b>22</b>	22
Central England	<b>22</b>	22
Northern England	<b>19</b>	19
South East England (excluding London)	<b>12</b>	12
South West England	<b>9</b>	9
Scotland	<b>9</b>	9
Wales and Northern Ireland	<b>7</b>	7
<b>Total</b>	<b>100</b>	100

The Group's residential mortgages include both prime and specialist loans. The make up of specialist lending is as follows:

	2012		2011	
	£m	%	£m	%
Self-certified	<b>3,609</b>	<b>16</b>	4,058	20
Buy to let	<b>18,041</b>	<b>77</b>	14,633	72
Near prime	<b>1,201</b>	<b>5</b>	1,250	6
Sub prime	<b>407</b>	<b>2</b>	444	2
<b>Specialist lending</b>	<b>23,258</b>	<b>100</b>	20,385	100

All new specialist lending is originated through The Mortgage Works (UK) plc (TMW), primarily in the buy to let market. The Group has not written any new self-certification, near prime or sub prime business during the year ended 4 April 2012. The majority of near prime and sub prime balances were acquired from the Derbyshire and Cheshire building societies and were subject to a fair value adjustment at the point of acquisition.

In December 2011 TMW acquired £1.2 billion of prime mortgage assets from the Bank of Ireland. These mortgages are all secured on property in England, Scotland and Wales, with an average loan to value (LTV) of approximately 50% and at the time of purchase none of the accounts were in arrears.

# Notes to the Accounts continued

## 35 Credit risk – loans and advances to customers (continued)

The quality of all new residential mortgage lending remains strong as focus remains on affordability and LTV ratios. The value of residential property is updated on a monthly basis to reflect changes in the Nationwide house price index (HPI). The percentage of cases per LTV band and an analysis of gross residential mortgage lending during the year by borrower type are set out below on a value and volume basis:

Analysis calculated on a volume basis:	2012	2011
	%	%
<b>Loan to value analysis:</b>		
<50%	50	52
50% - 60%	10	9
60% - 70%	11	11
70% - 80%	13	11
80% - 90%	10	10
90% - 100%	4	5
>100%	2	2
	100	100
Average loan to value of stock (indexed)	50	49
Average loan to value of new business	63	66
<b>New business profile:</b>		
First time buyers	17	23
Home movers	25	34
Remortgagers	27	12
Buy to let	31	31
	100	100

Analysis calculated on a value basis:	2012	2011
	%	%
<b>Loan to value analysis:</b>		
<50%	30	31
50% - 60%	12	12
60% - 70%	16	15
70% - 80%	19	17
80% - 90%	15	15
90% - 100%	6	8
>100%	2	2
	100	100
Average loan to value of stock (indexed)	62	62
Average loan to value of new business	67	70
<b>New business profile:</b>		
First time buyers	17	22
Home movers	32	43
Remortgagers	26	10
Buy to let	25	25
	100	100

The new business profile and average loan to value of new business above exclude further advances.

## 35 Credit risk – loans and advances to customers (continued)

Performance of the mortgage books has remained strong with the number of residential mortgages three or more months in arrears as a proportion of total mortgages reducing to 0.73% at 4 April 2012 (2011: 0.77%). This compares favourably with the industry average of 1.96% (2011: 2.09%).

The number of Group borrowers in possession, including acquired societies, of 1,097 (2011: 938) represents 0.08% of the total portfolio (2011: 0.07%).

The tables below provide further information on retail loans and advances by payment due status:

	2012				
	Prime lending	Specialist lending	Consumer banking	Total	
	£m	£m	£m	£m	%
Not impaired:					
Neither past due nor impaired	103,149	21,285	2,860	127,294	97
Past due up to 3 months but not impaired	1,873	1,189	48	3,110	2
Impaired	567	784	60	1,411	1
	105,589	23,258	2,968	131,815	100

	2011				
	Prime lending	Specialist lending	Consumer banking	Total	
	£m	£m	£m	£m	%
Not impaired:					
Neither past due nor impaired	101,763	18,204	2,335	122,302	96
Past due up to 3 months but not impaired	1,934	1,348	37	3,319	3
Impaired	572	833	94	1,499	1
	104,269	20,385	2,466	127,120	100

The status past due up to three months but not impaired includes any asset where a payment due is received late or missed. The amount represents 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 three months past due have collective impairment allowances set aside to cover credit losses. 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.

# Notes to the Accounts continued

## 35 Credit risk – loans and advances to customers (continued)

Impaired retail assets are further analysed as follows:

	2012				
	Prime lending	Specialist lending	Consumer banking	Total	%
£m	£m	£m	£m	%	
<b>Impaired status:</b>					
Past due 3 to 6 months	<b>268</b>	<b>279</b>	<b>37</b>	<b>584</b>	<b>41</b>
Past due 6 to 12 months	<b>184</b>	<b>200</b>	<b>23</b>	<b>407</b>	<b>29</b>
Past due over 12 months	<b>85</b>	<b>138</b>	-	<b>223</b>	<b>16</b>
Possessions	<b>30</b>	<b>167</b>	-	<b>197</b>	<b>14</b>
	<b>567</b>	<b>784</b>	<b>60</b>	<b>1,411</b>	<b>100</b>

	2011				
	Prime lending	Specialist lending	Consumer banking	Total	%
£m	£m	£m	£m	%	
<b>Impaired status:</b>					
Past due 3 to 6 months	<b>271</b>	<b>290</b>	<b>50</b>	<b>611</b>	<b>41</b>
Past due 6 to 12 months	<b>187</b>	<b>228</b>	<b>44</b>	<b>459</b>	<b>30</b>
Past due over 12 months	<b>81</b>	<b>185</b>	-	<b>266</b>	<b>18</b>
Possessions	<b>33</b>	<b>130</b>	-	<b>163</b>	<b>11</b>
	<b>572</b>	<b>833</b>	<b>94</b>	<b>1,499</b>	<b>100</b>

Possession balances represent loans against which the Group has taken ownership of properties pending their sale. Possession is only enforced once all other recovery options have been exhausted and this is reflected in the Group's possession rate which is approximately 50% of the market average.

The Group offers a number of support options to both secured and unsecured customers. The credit policies and provisioning treatment relating to these activities have been proactively reviewed over the year ended 4 April 2012 to ensure alignment to FSA defined good practice. The options offered may be classified into three categories:

- Change in terms
- Forbearance
- Repair.

### Change in terms

Changes in terms relate to a concession or permanent change, which results in amended monthly cash flows. The options available include payment holidays, interest only conversions and term extensions.

Performing customers with loans on standard terms and conditions effective before March 2010, who are not experiencing financial difficulty and meet required criteria (including credit score), are permitted to apply for a payment holiday and make reduced or nil payments for an agreed period of time of up to 12 months (depending on reason). As at 4 April 2012 1,848 accounts (2011: 2,313 accounts) were subject to a payment holiday. The performance of customers who have taken a payment holiday is reflected within the Group's provisioning methodology.

## 35 Credit risk – loans and advances to customers (continued)

Interest only conversions allow performing customers meeting required criteria to apply for an interest only conversion, normally reducing their monthly commitment. The Group's policy has progressively tightened during the year ended 4 April 2012, with LTV initially capped at 75% in April 2011 and then repayment vehicle options were restricted to sale of residence only (minimum £150,000 equity and maximum LTV 66%) in July 2011. This facility was completely withdrawn in March 2012. During the year ended 4 April 2012 7,083 accounts (2011: 8,442 accounts) converted to interest only. The performance of interest only conversions is in line with that of the wider portfolio and therefore no adjustment is made to the Group's provisioning methodology for these loans.

The Group allows performing customers to apply to extend the term of their mortgage. During the year ended 4 April 2012 15,032 accounts (2011: 13,964 accounts) extended their term. The performance of term extensions is in line with that of the wider portfolio and therefore no adjustment is made to the Group's provisioning methodology for these loans.

### Forbearance

The only forbearance option which the Group offers customers in financial distress is an interest only concession. Interest only concessions are offered to customers on a temporary basis with formal periodic review. The concession allows the customer to reduce monthly payments to cover interest only, typically for six months, and if made, the arrears status of the account will not increase, and will remain as at the beginning of the concession. As at 4 April 2012, 2,474 accounts (2011: 2,802 accounts) representing 0.2% (2011: 0.3%) of

total prime mortgage balances were on this concession. The Group's provisioning methodology was adjusted during the year ended 4 April 2012 to reflect latest performance on these accounts.

### Repair

When a customer emerges from financial difficulty, the Group offers the ability to capitalise arrears, resulting in the account being repaired. 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, or if they are able to overpay such that six months' payments are made in a four month period. During the year ended 4 April 2012, 546 accounts (2011: 785 accounts) had an arrears capitalisation. Once capitalised the loans are categorised as not impaired as long as contractual repayments are maintained. Capitalised accounts have a higher than average propensity to roll into arrears and this is recognised within the Group's provisioning methodology.

For those customers who are unable to repay their capital at term expiry, they may be offered a term extension. These extensions are typically on a capital and interest basis over a relatively short term, normally less than five years, and aim to recover the outstanding balance as quickly as possible whilst ensuring the monthly payment remains manageable to the customer. During the year ended 4 April 2012, 2,417 accounts (2011: 1,739 accounts) had an extension at term expiry. No provisioning methodology adjustment is made for these accounts as a result of the low balance and LTV profile.

The options outlined above apply predominantly to the prime originated portfolio. Over the course of the year ended 4 April 2012, the following prime mortgages were subject to such options:

	2012		2011	
	£m	% of total prime loans and advances	£m	% of total prime loans and advances
Change in terms	1,967	2.0	2,334	2.3
Forbearance	815	0.8	913	0.9
Repair	118	0.1	127	0.1

# Notes to the Accounts continued

## 35 Credit risk – loans and advances to customers (continued)

Collateral held against past due or impaired retail residential mortgages is shown below:

	2012			
	Prime lending		Specialist lending	
	£m	%	£m	%
Past due but not impaired	1,867	100	1,172	99
Impaired	532	99	595	96
Possessions	29	96	138	83
	2,428	100	1,905	97

	2011			
	Prime lending		Specialist lending	
	£m	%	£m	%
Past due but not impaired	1,928	100	1,334	99
Impaired	535	99	676	96
Possessions	31	94	116	89
	2,494	100	2,126	97

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 tables above, is the cover over the asset.

Negative equity on retail residential mortgages is as follows:

	2012		2011	
	Prime lending	Specialist lending	Prime lending	Specialist lending
	£m	£m	£m	£m
Past due but not impaired	6	17	6	14
Impaired	5	22	4	27
Possessions	1	29	2	14
	12	68	12	55

### Consumer banking

In consumer banking, the delinquent balances more than 30 days in arrears have shown an improvement across all products.

Percentage of accounts more than 30 days in arrears	2012	2011
	%	%
FlexAccount	9.18	10.46
Personal loans	3.14	5.45
Credit card	2.72	3.36

## 35 Credit risk – loans and advances to customers (continued)

Unsecured customers have limited forbearance options. Credit card customers experiencing financial distress may agree a payment plan, which is typically less than the minimum payment. Additionally credit card and personal loan customers who have maintained the required payment performance over a sustained period may be re-aged. The volume of payment plans and re-aging is low and therefore no specific treatment is made within the Group's provisioning methodology.

### *b) Commercial lending and other lending operations*

Commercial lending comprises loans secured on commercial property, loans to Registered Social Landlords and loans advanced in relation to Project Finance. Other lending operations includes £262 million (2011: £241 million) of secured lending relating to a European commercial loan portfolio and a loan secured by a senior ABS reference portfolio, and unsecured lending of £231 million (2011: £251 million) relating to a student loan portfolio. These investments were acquired by the Treasury Division and are therefore held within the head office functions business segment.

The Group's commercial loan portfolio comprises the following:

	2012		2011	
	£m	%	£m	%
Property Finance	<b>11,580</b>	<b>54</b>	12,282	56
Registered Social Landlords	<b>8,450</b>	<b>39</b>	8,210	37
Project Finance	<b>1,478</b>	<b>7</b>	1,531	7
	<b>21,508</b>	<b>100</b>	22,023	100

Loans to Registered Social Landlords are secured on residential property and loans advanced in relation to Project Finance are secured on cash flows from government backed contracts. The Group has never suffered losses on lending in these markets and there are currently no arrears of three months or more on these portfolios. The Group's Property Finance

portfolio is well diversified by industry type and by borrower, with no significant exposure to development finance.

The proportion of Property Finance cases three months or more in arrears as at 4 April 2012 was 4.39%, and equates to 359 cases (2011: 3.45%, 306 cases).

An analysis of Property Finance lending is provided below:

	2012		2011	
	£m	%	£m	%
Retail	<b>3,574</b>	<b>31</b>	3,860	31
Office	<b>2,519</b>	<b>22</b>	2,821	23
Residential	<b>2,446</b>	<b>21</b>	2,366	19
Industrial and warehouse	<b>1,929</b>	<b>17</b>	2,059	17
Leisure and hotel	<b>1,101</b>	<b>9</b>	1,164	10
Other	<b>11</b>	-	12	-
	<b>11,580</b>	<b>100</b>	12,282	100

In terms of counterparty concentration, the largest single commercial customer, including undrawn commitments, represents only 1% (2011: 1%) of the total book.

# Notes to the Accounts continued

## 35 Credit risk – loans and advances to customers (continued)

The tables below provide further information on the commercial lending and other lending operations by payment due status:

	2012			
	Commercial		Other operations	
	£m	%	£m	%
Not impaired:				
Neither past due nor impaired	19,081	89	448	91
Past due up to 3 months but not impaired	669	3	4	1
Impaired	1,758	8	41	8
	21,508	100	493	100

	2011			
	Commercial		Other operations	
	£m	%	£m	%
Not impaired				
Neither past due nor impaired	20,212	92	436	89
Past due up to 3 months but not impaired	391	2	4	1
Impaired	1,420	6	52	10
	22,023	100	492	100

The status past due up to three 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. The analysis includes commercial mortgage assets totalling £1.1 billion (2011: £1.2 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 £138 million (2011: £141 million) in the above analysis have been fair valued in this way and are therefore unlikely to contribute any significant further losses to the Group.

The £41 million (2011: £52 million) of impaired balances in other operations includes £30 million (2011: £41 million) relating to a European commercial loan portfolio and £11 million (2011: £11 million) relating to the unsecured student loan portfolio.

Impaired commercial and other operations assets are further analysed as follows:

	2012			
	Commercial		Other operations	
	£m	%	£m	%
Impaired status:				
Past due 0 to 3 months	836	47	-	-
Past due 3 to 6 months	139	8	1	2
Past due 6 to 12 months	295	17	2	5
Past due over 12 months	487	28	38	93
Possessions	1	-	-	-
	1,758	100	41	100

## 35 Credit risk – loans and advances to customers (continued)

	2011			
	Commercial		Other operations	
	£m	%	£m	%
<b>Impaired status:</b>				
Past due 0 to 3 months	695	49	-	-
Past due 3 to 6 months	111	8	4	8
Past due 6 to 12 months	235	16	8	15
Past due over 12 months	378	27	40	77
Possessions	1	-	-	-
	1,420	100	52	100

Commercial assets totalling £1,450 million (2011: £1,152 million) not subject to fair value adjustments have individual provisions against them.

Possession balances represent loans against which Nationwide has taken ownership of properties pending their sale. Assets over which possession has been taken are realised in an orderly manner via open market or auction sales to derive the maximum benefit for all interested parties, and any surplus proceeds distributed in accordance with the relevant insolvency regulations. The Group does not normally occupy repossessed properties for its business use or use assets obtained in its operations.

### Commercial forbearance

All commercial credit facilities are reviewed annually as a minimum and the Group has detailed processes to identify customers exhibiting, or who may be vulnerable to, financial distress and which prompt more frequent review where appropriate. Where such customers are identified, they are typically transferred at an early stage to the Specialist Commercial Support Unit to ensure that early warning signs are acted upon, appropriate action is taken and, where possible, the Group works with the customer to try to resolve the issues and to restore the loan to a financially viable position.

The forbearance requests the Group receives are principally attributable to:

- Customers suffering temporary cash flow problems that impact the ability to service payments under existing terms. Such problems may be due to loss of tenants, void costs or the costs of securing new tenants such as refurbishments or the provision of rent free incentives.
- Breaches of documented loan to value, interest cover ratio or debt service cover ratio covenants caused by a fall in property values, the loss of income or increased repayments due to interest rate rises or scheduled increases in capital repayments.
- Inability to fulfil the obligation to fully repay at contractual maturity.

The Group's standard policy and approach to consider such requests is contained in the Arrears Management Policy and the Commercial Lending Credit Policy. Implementation is controlled through the governance and control framework, which includes early warning and watch list procedures for managing and monitoring the performance of these customers.

All forbearance requests are dealt with in the same way as new lending applications and our appetite for consenting to forbearance reflects our expectations for future property and rental values and the likelihood of further voids and likely void periods, based upon prevailing and expected economic conditions. The Group's assessment of future serviceability and full repayment includes a cash flow analysis taking these factors into account. Due allowance is made in each assessment for any hedging arrangements in place but for all floating rate exposures the assessment is based on the assumption of a standard stressed interest rate affording significant margin above prevailing floating and long term swap rates, which is itself reviewed on a regular basis.

Forbearance to address short term cash flow difficulties will typically be through the provision of a temporary amendment to the payment profile to align repayments with the secure income stream. In such cases there would be no element of debt or interest forgiveness and the Group would have to be satisfied with the ability to maintain payments and fully repay over time.

Forbearance to address covenant breaches would normally entail either a temporary or permanent waiver or amendment of the affected covenant. Each case would be considered on its own merits and the Group's response will depend upon both the risk profile of the transaction and the degree of protection provided by other covenants.

# Notes to the Accounts continued

## 35 Credit risk – loans and advances to customers (continued)

The provision of extended facilities on maturity does not always represent forbearance. However, despite the exit position faced often looking far less attractive than that originally envisaged, the Group will still seek to support customers by providing refinancing over extended terms where the customer's ability to continue to service the debt and improve the risk profile over time can be evidenced.

The permanent waiver of either interest or capital or debt for equity swaps will only be considered in the most exceptional circumstances.

A number of commercial Property Finance loans, characterised by either a covenant breach, payment default or loan maturity were restructured during the year ended 4 April 2012. Of these loans, £354 million (2011: £745 million) had debt restructure terms which fell outside the Group's 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 2012 there were £587 million (2011: £806 million) of loans that were restructured due to covenant breaches or distress. Total loan exposures of £62 million (2011: £167 million) restructured during the year carry observed credit impairment provisions of £18 million (2011: £36 million). In addition loans of £264 million (2011: £62 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.

### *Commercial collateral*

Collateral held against past due or impaired commercial lending	2012		2011	
	£m	%	£m	%
Past due but not impaired	<b>631</b>	<b>94</b>	363	93
Impaired	<b>1,157</b>	<b>66</b>	1,050	74
	<b>1,788</b>	<b>74</b>	1,413	78

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.

A borrower level analysis by loan to value ratio of the Group's commercial portfolio is provided below. Project Finance data and one commercial loan secured on floating charges are excluded as these loans are secured on the basis of cash flows rather than property.

LTV Band	2012		2011	
	£m	%	£m	%
<50%	<b>2,769</b>	<b>14</b>	2,572	13
50% - 70%	<b>5,980</b>	<b>30</b>	6,349	31
70% - 90%	<b>8,016</b>	<b>40</b>	8,180	40
90% - 100%	<b>615</b>	<b>3</b>	983	5
>100%	<b>2,563</b>	<b>13</b>	2,372	11
	<b>19,943</b>	<b>100</b>	20,456	100

## 35 Credit risk – loans and advances to customers (continued)

The value of collateral used in determining the LTV ratios is based on the most recent obtained valuation. Commercial lending policy requires a professional valuation report for all properties to be charged as security. Nationwide reserves the right to request a revaluation of any property currently charged in support of facilities advanced or upon an act of default. Whilst a revaluation is not automatically obtained, the merits of obtaining a revaluation are considered at each

facility review and whenever a report is submitted to Risk Management Division. Particular attention is paid to the status of the facilities, for instance whether it is, or is likely to be, a bad and doubtful debt case where our assessment of expected loss would benefit from revised valuations, or there are factors affecting the property that might alter the case assessment and the most appropriate action to take.

Negative equity on commercial lending	2012	2011
	£m	£m
Past due but not impaired	38	28
Impaired	600	369
Possessions	-	1
	638	398

## 36 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 classification of liquid assets has been modified to better reflect the management of the portfolios and bring the analysis in line with FSA definitions in BIPRU 12. The portfolio is now categorised between core liquidity and non-core. Previously, the same portfolio of

assets had been classified between liquidity and investment assets, which reflected the legacy investment strategies.

Core liquidity comprises cash and highly rated debt securities issued by governments or multilateral development banks. The non-core portfolio comprises available for sale assets held for investment purposes, plus clearing amounts. Analysis of each of these portfolios by credit rating and by location of issuer is given below.

	2012	AAA	AA	A	Other	UK	US	Europe	Other
	£bn	%	%	%	%	%	%	%	%
Cash	8.1	100	-	-	-	100	-	-	-
Gilts	12.8	100	-	-	-	100	-	-	-
Non-domestic government bonds	2.4	54	46	-	-	-	46	54	-
Supranational bonds	1.5	100	-	-	-	9	4	86	1
<b>Core liquidity portfolio total</b>	<b>24.8</b>	<b>96</b>	<b>4</b>	<b>-</b>	<b>-</b>	<b>85</b>	<b>5</b>	<b>10</b>	<b>-</b>
Loans and advances to banks	2.9	-	23	77	-	31	17	17	35
Residential mortgage backed securities (RMBS)	2.1	41	27	23	9	45	4	41	10
Commercial mortgage backed securities (CMBS)	0.5	-	24	58	18	67	-	33	-
Covered bonds	0.9	54	23	12	11	28	3	63	6
Collateralised loan obligations	0.6	6	89	5	-	31	69	-	-
Financial institution bonds	1.4	-	9	64	27	20	14	50	16
US student loans	0.7	40	28	22	10	-	100	-	-
Other	0.4	32	20	18	30	25	61	14	-
<b>Non-core portfolio total</b>	<b>9.5</b>	<b>19</b>	<b>27</b>	<b>45</b>	<b>9</b>	<b>32</b>	<b>22</b>	<b>30</b>	<b>16</b>
<b>Total</b>	<b>34.3</b>	<b>74</b>	<b>10</b>	<b>13</b>	<b>3</b>	<b>70</b>	<b>10</b>	<b>16</b>	<b>4</b>

# Notes to the Accounts continued

## 36 Credit risk – treasury financial instruments (continued)

	April 2011	AAA	AA	A	Other	UK	US	Europe	Other
	£bn	%	%	%	%	%	%	%	%
Cash	6.1	100	-	-	-	100	-	-	-
Gilts	8.6	100	-	-	-	100	-	-	-
Non-domestic government bonds	2.2	100	-	-	-	-	40	60	-
Supranational bonds	1.8	100	-	-	-	-	-	100	-
Core liquidity portfolio total	18.7	100	-	-	-	79	5	16	-
Loans and advances to banks	4.2	-	38	62	-	73	-	15	12
Residential mortgage backed securities (RMBS)	2.8	75	15	5	5	49	4	43	4
Commercial mortgage backed securities (CMBS)	0.6	39	23	16	22	66	14	20	-
Covered bonds	0.7	67	18	8	7	-	4	88	8
Collateralised loan obligations	0.6	6	82	12	-	26	74	-	-
Financial institution bonds	3.0	11	18	51	20	20	11	56	13
US student loans	0.7	68	6	17	9	-	100	-	-
Other	0.6	43	14	13	30	68	28	3	1
Non-core portfolio total	13.2	31	25	35	9	46	14	32	8
Total	31.9	71	11	15	3	65	9	23	3

All assets shown above, other than cash and loans and advances to banks, are classified as investment securities available for sale.

Ratings are obtained from Standard & Poor's in the majority of cases, from Moody's if there is no Standard & Poor's rating available, and internal ratings are used if neither is available.

Nationwide has £75 million of exposure to monoline insured transactions. Further details are included in the treasury asset quality section of the Business Review.

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 £31 million (2011: £66 million) has been recognised in the income statement in respect of the treasury core liquidity and non-core portfolios. In addition, an impairment of £7 million (2011: £nil) was recognised on investments in equity shares (see note 18).

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.

### Derivative financial instruments

The fair value of derivative assets at 4 April 2012 was £4.2 billion (2011: £4.0 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 and securities 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 the Group, it is included as a liability within deposits from banks. Where cash collateral is given to mitigate the risk inherent in amounts due from the Group, it is included as an asset in loans and advances to banks. Where securities collateral is received the securities are not recognised in the accounts as the Group does not obtain the risks and rewards of the securities. Where securities collateral is given, the securities have not been derecognised as the Group has retained substantially all the risks and rewards of ownership.

## 36 Credit risk – treasury financial instruments (continued)

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:

	2012			2011		
	AA	A	Total	AA	A	Total
	£bn	£bn	£bn	£bn	£bn	£bn
Gross positive fair value of contracts	0.6	3.6	4.2	1.8	2.2	4.0
Netting benefits	(0.3)	(1.7)	(2.0)	(0.8)	(0.5)	(1.3)
Net current credit exposure	0.3	1.9	2.2	1.0	1.7	2.7
Collateral held	-	(1.1)	(1.1)	(0.1)	(0.9)	(1.0)
Net derivative credit exposure	0.3	0.8	1.1	0.9	0.8	1.7

Collateral on certain derivative assets with a fair value of £1.1 billion (2011: £1.7 billion) is only triggered when the counterparty rating falls to a specified rating level. At 4 April 2012 the trigger event has not occurred and these assets are uncollateralised as a consequence. Our exposure to such counterparties is to AA or A rated banks.

A credit and debit valuation adjustment policy is applied to our derivative exposures. As a consequence of the netting and collateral benefits no credit valuation adjustment has been made on derivative assets nor has any debit valuation adjustment to reflect own credit risk been taken in our derivative liabilities.

# Notes to the Accounts

continued

## 37 Liquidity risk

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.

At 4 April 2012 Residual maturity	Repayable on demand	Up to 3 months	3-12 months	1-5 years	More than 5 years	Total
	£m	£m	£m	£m	£m	£m
<b>Assets</b>						
Cash	8,126	-	-	-	-	8,126
Loans and advances to banks	2,197	377	-	148	192	2,914
Investment securities – available for sale	-	144	1,756	6,261	15,164	23,325
Loans and advances to customers	835	1,775	4,750	26,926	119,883	154,169
Derivative financial instruments	-	164	650	1,735	1,627	4,176
Other financial assets	-	70	307	555	427	1,359
<b>Total financial assets</b>	<b>11,158</b>	<b>2,530</b>	<b>7,463</b>	<b>35,625</b>	<b>137,293</b>	<b>194,069</b>
<b>Liabilities</b>						
Shares	67,469	7,614	28,794	21,267	473	125,617
Deposits from banks	836	314	53	2,145	22	3,370
Other deposits	356	2,582	1,049	2,260	652	6,899
Due to customers	3,791	467	1,212	363	-	5,833
Debt securities in issue	-	8,258	6,147	16,142	8,307	38,854
Derivative financial instruments	-	116	288	1,294	2,589	4,287
Other financial liabilities	-	2	36	240	-	278
Subordinated liabilities	-	-	-	438	1,206	1,644
Subscribed capital	-	-	349	329	947	1,625
<b>Total financial liabilities</b>	<b>72,452</b>	<b>19,353</b>	<b>37,928</b>	<b>44,478</b>	<b>14,196</b>	<b>188,407</b>
<b>Net liquidity gap</b>	<b>(61,294)</b>	<b>(16,823)</b>	<b>(30,465)</b>	<b>(8,853)</b>	<b>123,097</b>	<b>5,662</b>

## 37 Liquidity risk (continued)

At 4 April 2011 Residual maturity	Repayable on demand	Up to 3 months	3-12 months	1-5 years	More than 5 years	Total
	£m	£m	£m	£m	£m	£m
<b>Assets</b>						
Cash	6,130	-	-	-	-	6,130
Loans and advances to banks	2,424	1,570	-	-	187	4,181
Investment securities – available for sale	34	445	1,808	8,217	11,036	21,540
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	134	1,089	489	1,737
<b>Total financial assets</b>	<b>9,283</b>	<b>4,234</b>	<b>7,740</b>	<b>36,862</b>	<b>128,847</b>	<b>186,966</b>
<b>Liabilities</b>						
Shares	67,435	7,284	20,091	27,361	381	122,552
Deposits from banks	1,048	410	84	1,204	-	2,746
Other deposits	300	2,328	1,034	1,223	924	5,809
Due to customers	4,744	391	459	168	-	5,762
Debt securities in issue	1	7,262	8,219	15,824	6,502	37,808
Derivative financial instruments	-	67	282	1,703	1,182	3,234
Other financial liabilities	-	(1)	(6)	49	(23)	19
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>30,544</b>	<b>48,524</b>	<b>11,076</b>	<b>181,413</b>
<b>Net liquidity gap</b>	<b>(64,245)</b>	<b>(13,507)</b>	<b>(22,804)</b>	<b>(11,662)</b>	<b>117,771</b>	<b>5,553</b>

The comparatives have been reclassified as described in note 1.

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.

The analysis above excludes certain other assets, including property, plant and equipment, intangible assets, investment property, other assets, deferred tax assets and accrued income and expenses prepaid, and certain other liabilities including provisions for liabilities and charges, accruals and deferred income, current tax liabilities, other liabilities and retirement benefit obligations.

# Notes to the Accounts continued

## 37 Liquidity risk (continued)

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

Gross contractual cash flows 2012	Repayable on demand	Up to 3 months	3-12 months	1-5 years	More than 5 years	Total
	£m	£m	£m	£m	£m	£m
Shares	67,469	7,925	29,412	22,250	495	127,551
Deposits from banks	836	332	104	2,281	24	3,577
Other deposits	356	2,623	1,129	2,481	703	7,292
Due to customers	3,791	481	1,235	386	-	5,893
Debt securities in issue	-	8,013	6,438	20,045	9,236	43,732
Derivative financial instruments	-	395	977	2,575	751	4,698
Other financial liabilities	-	4	42	255	-	301
Subordinated liabilities	-	4	290	841	954	2,089
Subscribed capital	-	10	431	588	1,143	2,172
<b>Total financial liabilities</b>	<b>72,452</b>	<b>19,787</b>	<b>40,058</b>	<b>51,702</b>	<b>13,306</b>	<b>197,305</b>
<b>Off balance sheet commitments</b>	<b>3,029</b>	<b>184</b>	<b>371</b>	<b>1,084</b>	<b>622</b>	<b>5,290</b>

Gross contractual cash flows 2011	Repayable on demand	Up to 3 months	3-12 months	1-5 years	More than 5 years	Total
	£m	£m	£m	£m	£m	£m
Shares	67,435	7,552	20,680	28,510	397	124,574
Deposits from banks	1,048	420	110	1,270	-	2,848
Other deposits	300	2,358	1,089	1,392	988	6,127
Due to customers	4,744	397	467	177	-	5,785
Debt securities in issue	1	7,497	8,764	17,409	6,949	40,620
Derivative financial instruments	-	536	1,048	1,766	334	3,684
Other financial liabilities	-	(1)	(6)	49	(24)	18
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>18,771</b>	<b>32,708</b>	<b>52,492</b>	<b>11,047</b>	<b>188,546</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>

The comparatives have been reclassified as described in note 1.

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.

## 38 Classification and measurement

The following tables summarise the classification of carrying amounts of the Group's primary financial assets and liabilities.

2012 Group	Available for sale	Loans and receivables	Fair value through income statement	Liabilities at amortised cost	Total
	£m	£m	£m	£m	£m
<b>Financial assets</b>					
Cash	-	8,126	-	-	8,126
Loans and advances to banks	-	2,914	-	-	2,914
Investment securities	23,325	-	-	-	23,325
Derivative financial instruments	-	-	4,176	-	4,176
Fair value adjustment for portfolio hedged risk	-	1,330	-	-	1,330
Loans and advances to customers	-	154,169	-	-	154,169
Investments in equity shares	29	-	-	-	29
<b>Total financial assets</b>	<b>23,354</b>	<b>166,539</b>	<b>4,176</b>	<b>-</b>	<b>194,069</b>
Other non-financial assets					2,060
<b>Total assets</b>					<b>196,129</b>
<b>Financial liabilities</b>					
Shares	-	-	-	125,617	125,617
Deposits from banks	-	-	-	3,370	3,370
Other deposits	-	-	2,890	4,009	6,899
Due to customers	-	-	-	5,833	5,833
Fair value adjustment for portfolio hedged risk	-	-	-	278	278
Debt securities in issue	-	-	-	38,854	38,854
Derivative financial instruments	-	-	4,287	-	4,287
Subordinated liabilities	-	-	-	1,644	1,644
Subscribed capital	-	-	-	1,625	1,625
<b>Total financial liabilities</b>	<b>-</b>	<b>-</b>	<b>7,177</b>	<b>181,230</b>	<b>188,407</b>
Other non-financial liabilities					1,563
<b>Total liabilities</b>					<b>189,970</b>

# Notes to the Accounts continued

## 38 Classification and measurement (continued)

2011 Group	Available for sale	Loans and receivables	Fair value through income statement	Liabilities at 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
Fair value adjustment for portfolio hedged risk	-	1,634	-	-	1,634
Loans and advances to customers	-	149,417	-	-	149,417
Investments in equity shares	103	-	-	-	103
Total financial assets	21,643	161,362	3,961	-	186,966
Other non-financial assets					1,987
<b>Total assets</b>					<b>188,953</b>
<b>Financial liabilities</b>					
Shares	-	-	-	122,552	122,552
Deposits from banks	-	-	-	2,746	2,746
Other deposits	-	-	2,125	3,684	5,809
Due to customers	-	-	-	5,762	5,762
Fair value adjustment for portfolio hedged risk	-	-	-	19	19
Debt securities in issue	-	-	-	37,808	37,808
Derivative financial instruments	-	-	3,234	-	3,234
Subordinated liabilities	-	-	-	1,973	1,973
Subscribed capital	-	-	-	1,510	1,510
Total financial liabilities	-	-	5,359	176,054	181,413
Other non-financial liabilities					1,298
<b>Total liabilities</b>					<b>182,711</b>

The comparatives have been reclassified as described in note 1.

## 38 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 balance sheets at fair value:

2012	Group		Society	
	Carrying value	Fair value	Carrying value	Fair value
	£m	£m	£m	£m
<b>Financial assets</b>				
Loans and advances to banks	2,914	2,914	2,850	2,850
Loans and advances to customers:				
Residential mortgages	128,645	123,655	104,599	99,557
Consumer banking	2,888	2,900	2,888	2,900
Commercial lending	22,157	21,930	21,201	20,974
Other lending	479	480	80	80
<b>Financial liabilities</b>				
Shares	125,617	125,968	125,617	125,968
Deposits from banks	3,370	3,570	2,730	2,930
Other deposits	6,899	6,900	13,333	13,334
Due to customers	5,833	5,836	1,301	1,301
Debt securities in issue	38,854	38,684	28,735	29,464
Subordinated liabilities	1,644	1,513	1,644	1,513
Subscribed capital	1,625	1,121	1,625	1,121

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	5,809	5,811	13,113	13,115
Due to customers	5,762	5,762	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

The comparatives have been reclassified as described in note 1.

# Notes to the Accounts continued

## 38 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 debt 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:

2012 Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
<b>Financial assets</b>				
Investment securities – AFS	16,493	6,756	76	23,325
Investments in equity shares	9	-	20	29
Derivative financial instruments	-	3,942	234	4,176
	16,502	10,698	330	27,530
<b>Financial liabilities</b>				
Derivative financial instruments	-	(4,250)	(37)	(4,287)
Other deposits – PEBs	-	-	(2,890)	(2,890)
	-	(4,250)	(2,927)	(7,177)

2011 Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £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)

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.

## 38 Classification and measurement (continued)

The Group's Level 1 portfolio comprises highly rated government securities for which traded prices are readily available and within the year ended 4 April 2012, the Group has actively sought to increase this portfolio. There were no significant transfers between the Level 1 and 2 portfolios during the year.

Level 2 investment securities – AFS asset valuations are sourced from consensus pricing or other observable market prices. None of the Level 2 AFS assets are valued from models. Level 2 derivative assets and liabilities are valued from discounted cash flow models using yield curves based on observable market data.

The main constituents of the Level 3 portfolio are as follows:

### Investment securities – AFS

The Group's £76 million Level 3 investment securities – AFS at 4 April 2012 comprise £53 million of CDOs and £23 million of impaired UK CMBS assets. Substantially all of these securities are priced from internal models based on observable and unobservable performance assumptions.

### Investments in equity shares

Level 3 investments in equity shares consist primarily of an interest in a fund which is supported by zero coupon bonds of an A rated bank. External valuations are used to obtain the fair value of the instrument.

### Derivative financial instruments

Level 3 assets and liabilities in this category are equity linked derivatives with external counterparties which economically match the investment return payable by the Group to investors in the PEB product. The derivatives are linked to the performance of specified stock market indices and have been valued by an external third party.

### Other deposits – PEBs

This category relates to 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 external third party.

### Level 3 portfolio – movements analysis

The table below analyses movements in the Level 3 portfolio:

2012 Group	Investment securities – AFS	Investments in equity shares	Net derivative financial instruments	Other deposits – PEBs
	£m	£m	£m	£m
At 4 April 2011	95	98	12	(2,125)
Gain/(loss) recognised in the income statement:				
• Net interest income/(expense)	1	-	(53)	-
• Other (expense)/income	(9)	(7)	185	(179)
Loss recognised in other comprehensive income – fair value movement taken to equity	(6)	(6)	-	-
Issues	-	-	-	(635)
Additions	-	2	-	-
Settlements	-	(67)	53	49
Transfers out of Level 3	(5)	-	-	-
<b>At 4 April 2012</b>	<b>76</b>	<b>20</b>	<b>197</b>	<b>(2,890)</b>

# Notes to the Accounts continued

## 38 Classification and measurement (continued)

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)
(Loss)/gain recognised in the income statement:				
• Net interest	(3)	-	(31)	-
• Other (expense)/income	(15)	-	87	(56)
(Loss)/gain recognised in other comprehensive income – fair value movement taken to equity	(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)

The significant movements in Level 3 positions during the year ended 4 April 2012 are explained below:

- The increase in other deposits relates to growth in PEBs driven by strong stock market performance over the past 12 months and further investment into this product.

- Investments in equity shares have decreased in the year primarily as a result of the disposal of one of the Group's investments as described in note 18.
- The reduction in investment securities has been driven by decreases in asset prices, a further impairment relating to a UK CMBS asset and an increase in the availability of observable market prices resulting in the transfer of assets from Level 3 to Level 2.

### 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.

2012 Group	Carrying value	Increase in fair value	Decrease in fair value
	£m	£m	£m
<b>Investment securities – AFS:</b>			
• Collateralised debt obligations	53	16	(30)
• Commercial mortgage backed securities (CMBS)	23	16	(15)
<b>Investments in equity shares</b>	20	2	(4)
	96	34	(49)
Increases/(decreases) in fair value would be recognised in:			
• Income statement		23	(20)
• Statement of other comprehensive income (accumulated in the AFS reserve)		11	(29)
		34	(49)

## 38 Classification and measurement (continued)

2011 Group	Carrying value	Increase in fair value	Decrease in fair value
	£m	£m	£m
Investment securities – AFS:			
• Collateralised debt obligations	60	25	(36)
• Financial institutions	32	11	(21)
• Other investments	3	-	-
Investments in equity shares	98	2	(9)
	193	38	(66)
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)
		38	(66)

Reasonable alternative assumptions applied take account of the nature of valuation techniques used, as well as the availability and reliability of observable proxy and historic data. The scenarios applied are considered for each product and varied according to the quality of the data and variability of the underlying market.

Any 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. Any resultant impact is deemed by the Group to be insignificant so these items have therefore been excluded from the table above.

The sensitivities for other items are described below:

### **Investment securities – AFS**

- *Collateralised debt obligations*

Sensitivities on these assets, where there are no alternative pricing sources, have been calculated by applying a range of probable scenarios against our current valuation process, resulting in a range of possible prices.

- *Commercial mortgage backed securities*

Sensitivities on these assets, which are subject to impairment, have been derived from a modelled approach using estimated expected losses at legal maturity and risk adjusted discount rates.

- *Other investments*

The assets classified as other investments were transferred out of Level 3 during the year ended 4 April 2012 due to a greater depth of pricing information. This category related to a government guaranteed security where the preceding 12 months' movements 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 in the preceding 12 months.

# Notes to the Accounts

continued

## 39 Related party transactions

### Subsidiary, parent and ultimate controlling party

The Group is controlled by Nationwide Building Society, the ultimate parent, which is registered in England and Wales. Details of principal subsidiary undertakings can be found in note 19.

### 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:

	2012 £'000	2011 £'000 (restated)
Short term employee benefits	<b>6,068</b>	5,133
Post employment benefits	<b>4</b>	30
Other long term benefits	<b>1,650</b>	1,782
Contractual/other settlements	-	700
<b>Total key management personnel compensation for the year</b>	<b>7,722</b>	7,645

The 2011 short term employee benefits figure has been restated as explained in the Directors' Remuneration Report.

### 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 Subsidiaries		Group and Society Key management personnel	
	2012	2011	2012	2011
	£m	£m	£m	£m
<b>Loans payable to the Society</b>				
Loans outstanding at 5 April	20,010	18,460	0.6	0.9
Loans issued during the year	<b>8,024</b>	8,778	<b>0.2</b>	0.9
Loans impaired	<b>(8)</b>	(1)	-	-
Loan repayments during the year	<b>(3,457)</b>	(7,227)	<b>(0.2)</b>	(1.2)
Loans outstanding at 4 April	<b>24,569</b>	20,010	<b>0.6</b>	0.6
<b>Deposits payable by the Society</b>				
Deposits outstanding at 5 April	7,602	6,850	2.1	5.0
Deposits issued during the year	<b>960</b>	1,025	<b>9.0</b>	10.6
Deposit repayments during the year	<b>(1,772)</b>	(273)	<b>(7.5)</b>	(13.5)
Deposits outstanding at 4 April	<b>6,790</b>	7,602	<b>3.6</b>	2.1
<b>Net interest income</b>				
Interest receivable	<b>1,147</b>	965	-	-
Interest expense	<b>318</b>	250	-	0.1
<b>Other income and expenses</b>				
Dividends payable to the Society	<b>489</b>	61	-	-
Fees and expenses paid to the Society	<b>14</b>	-	-	-
<b>Other balance sheet items</b>				
Accrued income and expenses prepaid due to the Society	<b>1,196</b>	2,227	-	-
Other liabilities payable by the Society	<b>8,100</b>	3,476	-	-

## 39 Related party transactions (continued)

On 19 July 2011 the Group sold, at arm's length, private equity holdings with a carrying value of £65 million, to the Nationwide Pension Fund, a related party, for £68 million. The assets were included previously within investments in equity shares and the resulting profit of £3 million is included in income from investments.

### 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 19 July 2012 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.

The Society does not charge the net defined benefit cost to the subsidiary undertakings that participate in the Nationwide Pension Fund. The pension cost to these subsidiary undertakings equals the contributions payable to the Fund.

# Notes to the Accounts

continued

## 40 Notes to the cash flow statements

	Group		Society	
	2012 £m	2011 £m	2012 £m	2011 £m
<b>Non-cash items included in profit before tax</b>				
Net increase in impairment provisions	78	15	77	6
Impairment losses on investment securities	38	66	35	66
Depreciation and amortisation	180	150	180	149
Loss on sale of property, plant and equipment	3	-	3	-
Interest on subordinated liabilities	108	110	108	110
Interest on subscribed capital	96	96	96	96
Loss on the revaluation of land and buildings	6	1	6	-
Gain on the revaluation of investment properties	-	(1)	-	(1)
Gain on acquisition of retail mortgages portfolio	(96)	-	-	-
(Gains)/losses from derivatives and hedge accounting	(35)	(120)	56	(117)
	378	317	561	309
<b>Changes in operating assets</b>				
Loans and advances to banks	(5)	13	(5)	13
Investment securities	(1,215)	472	(1,222)	486
Derivative financial instruments and fair value adjustment for portfolio hedged risk	124	2,246	(644)	1,743
Deferred tax assets	(11)	143	(29)	143
Loans and advances to customers	(3,630)	2,997	(495)	4,777
Other operating assets	89	(101)	(3,495)	(1,109)
	(4,648)	5,770	(5,890)	6,053
<b>Changes in operating liabilities</b>				
Shares	3,065	1,609	3,065	1,609
Deposits from banks, customers and others	1,785	(3,308)	1,094	(3,071)
Derivative financial instruments and fair value adjustment for portfolio hedged risk	1,312	(1,882)	1,649	(2,355)
Debt securities in issue	1,046	1,006	(3,345)	(104)
Deferred tax liabilities	(8)	36	(7)	21
Retirement benefit obligations	217	(208)	217	(208)
Other operating liabilities	(25)	(73)	4,700	1,203
	7,392	(2,820)	7,373	(2,905)
<b>Cash and cash equivalents</b>				
Cash	8,126	6,130	8,126	6,130
Loans and advances to other banks repayable in 3 months or less	2,722	3,994	2,658	3,917
	10,848	10,124	10,784	10,047

Comparatives have been reclassified as described in note 1.

## 40 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 2012, amounted to £192 million (2011: £187 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.

## 41 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.

## 42 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

For the year ended 4 April 2012

## 1 Statutory percentages

	2012	Statutory limit
	%	%
Lending limit	<b>14.4</b>	25.0
Funding limit	<b>25.3</b>	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 and the Modification of the Lending Limit and Funding Limit Calculations Order 2004.

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

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.

Securitised assets and related liabilities are excluded from the lending limit and funding limit calculations in line with the Building Societies Act 1986 as updated by the Modification of the Lending Limit and Funding Limit Calculations Order 2004.

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.

## 2 Other percentages

	2012	2011
	%	%
As a percentage of shares and borrowings:		
• Gross capital	<b>5.2</b>	5.6
• Free capital	<b>4.5</b>	4.9
• Liquid assets	<b>19.0</b>	18.2
Profit for the financial year as a percentage of mean total assets	<b>0.09</b>	0.13
Management expenses as a percentage of mean total assets	<b>0.72</b>	0.67

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
- '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.

and advances to customers less property, plant and equipment and intangible fixed assets

- '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
- '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.

### 3 Information relating to directors and other officers (unaudited)

At 4 April 2012

Directors			
Name and date of birth	Occupation	Date of appointment	Other directorships
G M T Howe MA (Cantab) Chairman 3 September 1949	Company Director	1 January 2005	Gateway Electronic Components Limited Jardine Lloyd Thompson Group plc, Chairman Close Brothers Group plc The Cavendish School Charitable Trust Limited
G J Beale BSc, ACA 19 October 1958	Chief Executive Officer	5 April 2003	
R P Walther MA, FIA Deputy Chairman 31 July 1943	Company Director	1 July 2002	Denham Golf Club Limited
T P Prestedge 12 February 1970	Chief Operating Officer	28 August 2007	Nationwide Anglia Property Services Limited Opportunity Now
M M Rennison BA, FCA 9 August 1960	Group Finance Director	1 February 2007	Confederation Mortgage Services Limited Exeter Trust Limited First Nationwide LBS Mortgages Limited Nationwide Anglia Property Services Limited Nationwide Housing Trust Limited Nationwide Investments (No.1) Limited Nationwide Lease Finance Limited Nationwide Mortgage Corporation Limited Nationwide Syndications Limited Staffordshire Financial Services Limited NBS Fleet Services Limited Staffordshire Leasing Limited
C S Rhodes BSc (Hons), ACA 17 March 1963	Group Product & Marketing Director	20 April 2009	at.home nationwide Limited Derbyshire Home Loans Limited E-Mex Home Funding Limited Jubilee Mortgages Limited The Mortgage Works (UK) plc UCB Home Loans Corporation Limited The Nationwide Foundation
M P V Wyles ACII 25 August 1958	Group Distribution Director	28 August 2007	Confederation Mortgage Services Limited Exeter Trust Limited Jubilee Mortgages Limited LBS Mortgages Limited Staffordshire Financial Services Limited The Mortgage Works (UK) plc UCB Home Loans Corporation Limited Race for Opportunity

# Annual business statement continued

For the year ended 4 April 2012

## 3 Information relating to directors and other officers (unaudited) (continued) At 4 April 2012

Directors			
Name and date of birth	Occupation	Date of appointment	Other directorships
A P Dickinson MBA, BSc (Hons), FSS, FCIB, FCIBS 12 June 1950	Company Director	15 June 2010	Kennington Oval Limited Frogmore Property Company Limited Carpetright plc Motability (Governor)
M K Jary MA (Oxon), MBA, FRAS 15 June 1963	Management Consultant	1 January 2009	Duchy Originals Limited OC&C Peleus Advisors LLP OC&C Resources Limited OC&C Strategy Consultants LLP OC&C Strategy Consultants International (Netherlands) PCF Social Enterprises Limited
R K Perkin MA (Cantab), FCA 30 April 1948	Company Director	20 April 2010	Electra Private Equity plc Electra Private Equity Investments plc Crime Reduction Initiatives (Trustee) Bower Bequest Trustee Company Limited (Trustee)
Ms S Taverne 3 February 1960	Company Director	16 November 2005	FCE Bank plc Vlessing & Taverne Limited Foundation for Credit Counselling British Broadcasting Corporation Shakespeare Schools Festival (Trustee)
Mrs L M Peacock BA (Hons) 26 December 1953	Company Director	18 July 2011	Hawkins Residents Limited Scottish Water Scottish Water Business Stream Holdings Limited Scottish Water Horizons Holdings Limited Standard Life plc
M A Lenson MBA, BA (Hons), ACIB, FSI 17 September 1954	Company Director	18 July 2011	Eclipse Film Partners No.4 LLP Eclipse Film Partners No.39 LLP The Invicta Film Partnership No.37 LLP Elysian Fuels 1 LLP Elysian Fuels 2 LLP

Documents may be served on any of the directors  
c/o The Group Secretary, Nationwide Building Society,  
Nationwide House, Pipers Way, Swindon,  
Wiltshire SN38 1SN.

### 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 G J Beale, M M Rennison, T P Prestedge,  
M P V Wyles and C S Rhodes.

### 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.

### 3 Information relating to directors and other officers (unaudited) (continued)

At 4 April 2012

Officers		
Name	Occupation	Directorships
G P Hughes	Group Director (HR, Customer Experience & Corporate Affairs)	The Nationwide Foundation
Miss A J Robb	Group Director (Financial Reporting, Strategy & Planning)	NBS Fleet Services Limited Dunfermline BS Nominees Limited
I G Laing	Chief Risk Officer	Derbyshire Home Loans Limited E-Mex Home Funding Limited The Mortgage Works (UK) plc UCB Home Loans Corporation Limited
A J Alexander	Group Risk Director	Confederation Mortgage Services Limited Ethos Independent Financial Services Limited Exeter Trust Limited Jubilee Mortgages Limited Monument (Sutton) Limited Nationwide Healthcare Trustee Limited Nationwide Pension Fund Nominee Limited Nationwide Pension Fund Trustee Limited NBS Fleet Services Limited Staffordshire Financial Services Limited Staffordshire Leasing Limited The Derbyshire (Premises) Limited
Mrs D Bailey	Divisional Director (Group Services)	
L Banda	Divisional Director (Branch Network North)	MBL Financial Services Limited MBL Holdings Limited Mortgage Brain Limited Premier Processing Services Limited The Mortgage Trading Exchange Limited St Joseph's Catholic College
M Boyle	Divisional Director (Business Transformation)	
B P Glover	Divisional Director (Commercial)	at.home nationwide Limited Derbyshire Home Loans Limited E-Mex Home Funding Limited Longwide Limited Nationwide Housing Trust Limited Nationwide Lease Finance Limited Nationwide Mortgage Corporation Limited Nationwide Syndications Limited
M Goldman	Divisional Director (Central Retail)	
Mrs J Groves	Divisional Director (Customer Experience)	

# Annual business statement continued

For the year ended 4 April 2012

## 3 Information relating to directors and other officers (unaudited) (continued) At 4 April 2012

Officers		
Name	Occupation	Directorships
S Hamilton	Divisional Director (Enterprise Development)	
G M Heaton	Divisional Director (Branch Network South)	
T K Kaye	Divisional Director (Customer Operations)	
Mrs E J Kelly	Divisional Director (Group Legal & Compliance) (General Counsel)	
P J McCabe	Divisional Director (Core Platforms)	
A McQueen	Divisional Director (Customer Strategy & Marketing)	The Mortgage Works (UK) plc
R S Napier	Divisional Director (Mortgages & General Insurance)	Confederation Mortgage Services Limited Derbyshire Home Loans Limited E-Mex Home Funding Limited Exeter Trust Limited Jubilee Mortgages Limited LBS Mortgages Limited Staffordshire Financial Services Limited The Mortgage Works (UK) plc UCB Home Loans Corporation Limited
S G Nowell	Divisional Director (Business Protection)	
Mrs A Obey	Divisional Director (Audit) (Chief Internal Auditor)	Centre for Sustainable Energy (Trustee)
G Pilkington	Divisional Director (Banking)	Nationwide Trust Limited Visa UK Limited
L Raybould	Divisional Director (Financial Performance)	
P Stafford	Divisional Director (Governance & Risk, Group Operations)	Nationwide International Limited, Isle of Man Mid Devon Citizen's Advice Bureau (Trustee)
P A Townsend	Divisional Director (Treasury)	First Nationwide Nationwide Lease Finance Limited Nationwide Investments (No.1) Limited Nationwide Pension Fund Nominee Limited Nationwide Pension Fund Trustee Limited Moulton Finance Overseas BV Silverstone Funding (No.1) Limited Silverstone Master Issuer plc Silverstone PECOH Limited Silverstone Securitisation Holdings Limited

# Glossary

The following glossary defines the terminology used within the Annual Report and Accounts to assist the reader and to facilitate comparison with publications by other financial institutions:

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.
Average loan to value (LTV)	A ratio which expresses the total balance outstanding on mortgages to the aggregate value of the properties.
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 sufficient capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive and was implemented in the UK via the FSA Handbook.
Basel III	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.
Basis point	One hundredth of a percent (0.01 percent). 100 basis points is one percent. Used in quoting movements in interest rates and yields on securities.
BIPRU	The prudential sourcebook for banks, building societies and investment firms which sets out the FSA's capital requirements.
Buy to let mortgages	Buy to let mortgages are those mortgages offered to customers purchasing residential property as a rental investment.
Capital ratios	Key financial ratios measuring the Group's capital adequacy or financial strength. These include the Core Tier 1 ratio, Tier 1 ratio and total solvency ratio.
Capital requirements	Amount to be held by the Group to cover the risk of losses to a certain confidence level.
Capital resources	Capital held, allowable under regulatory rules, less certain regulatory adjustments and deductions that are required to be made. Capital includes the general reserve, revaluation reserve, collectively assessed impairment allowances for products measured on a standardised basis, permanent interest bearing shares and subordinated debt.
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).
Certificates of deposit	Bearer-negotiable instruments acknowledging the receipt of a fixed term deposit at a specified interest rate.
Claims management company (CMC)	A company providing advice or services to the public in respect of claims for compensation or restitution, for example in respect of claims that products have been mis-sold.
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 security backed by the repayments from a pool of commercial loans. The payments may be made to different classes of owners (in tranches).
Commercial lending	Loans secured on commercial property, loans to registered social landlords and loans relating to project finance.
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, which specifies the face amount paid to investors on the maturity date.

# Glossary

## continued

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) excluding permanent interest bearing shares (PIBS).
Core Tier 1 capital ratio	Core Tier 1 capital as a percentage of risk weighted assets.
Cost income ratio	A ratio that represents the proportion of management expenses (i.e. administrative expenses, depreciation and amortisation) to total income.
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 or other financial instrument.
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.
Currency swap	An arrangement in which two parties exchange specific principal amounts of different currencies at inception and subsequently interest payments on the principal amounts. Often, one party will pay a fixed rate of interest, while the other will pay a floating rate (though there are also fixed-fixed and floating-floating arrangements). At the maturity of the swap, the principal amounts are usually re-exchanged.
Current account	A non-fee paying debit card and cheque book account.
Customer deposits	Money deposited by individuals. Such funds are recorded as liabilities in the balance sheet within shares or due to customers.
Debit valuation adjustment	Adjustment for the effect of the Group's credit standing on the fair value of its financial liabilities.
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.
Default	Circumstances in which the probability of default is taken as 100% for the purposes of the calculation of regulatory capital and compliance with Basel II. This is defined as when a borrower reaches a predefined arrears status or where a borrower is considered unlikely to repay the credit obligation in full without the lender taking action such as realising security.
Deferred tax asset	Corporate income taxes recoverable in future periods as a result of deductible temporary differences (being differences between the accounting and tax base of an asset or liability that will result in tax deductible amounts in future periods) and the carry forward of tax losses and unused tax credits.
Deferred tax liability	Corporate income taxes payable in future periods as a result of taxable temporary differences (being differences between the accounting and tax base of an asset or liability that will result in taxable amounts in future periods).

Defined benefit obligation	The present value of expected future payments required to settle the obligations of a defined benefit plan resulting from employee service.
Defined benefit plan	A pension or other post retirement benefit plan under which the Group has an obligation to provide agreed benefits to current and former employees. The entity bears the risk that its obligation may increase or that the value of the assets in the fund may fall.
Defined contribution pension plan	A pension plan under which the Group pays fixed contributions as they fall due into a separate entity (a fund) and has no further legal or constructive obligations.
Delinquency	See arrears.
Derivative	A contract or agreement whose value changes with movements in an underlying index such as interest rates, foreign exchange rates, share prices or indices, and which requires no initial investment or an initial investment that is smaller than would be required for other types of contracts with a similar response to market factors. The principal types of derivatives are swaps, forwards, futures and options.
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.
Effective tax rate	The tax charge in the income statement as a percentage of profit before tax.
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.
Fair value adjustments – in respect of business combinations	Fair value adjustments arise on acquisition when assets and liabilities are acquired at fair values that are different from the carrying values in the acquired entity.
Final salary pension arrangements	A defined benefit pension arrangement where the pension payable is based on the employee's final pensionable salary.
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	A term generally applied to arrangements, for example interest only concessions, which are provided to support customers experiencing temporary financial difficulty. The aim of forbearance arrangements is to avoid foreclosure and repossession, and ensure sustainability of the customer's relationship with the Group.
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.
G10	The Group of Ten comprises the eleven industrial countries that have agreed to participate in the International Monetary Fund's (IMF's) General Arrangements to Borrow.
Gain on portfolio acquisition	The amount by which the initial fair value of the acquired assets exceeds the transaction price of the assets.
Gross capital	The aggregate of general reserve, revaluation reserve, available for sale reserve, subscribed capital and subordinated liabilities.
Gross lending	New lending advanced to customers during the year.

# Glossary

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IASB – International Accounting Standards Board	The independent standard setting body of the IFRS Foundation. Its members are responsible for the development and publication of International Financial Reporting Standards (IFRSs) and for approving Interpretations of IFRS as developed by the IFRS Interpretations Committee.
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 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.
Impairment losses	An impairment loss is the reduction in value that arises following an impairment review of an asset that determines that the recoverable amount is less than its carrying value.
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 whereby the value of the property is updated on a regular basis to reflect changes in the house price index (HPI).
Individual liquidity adequacy assessment (ILAA)	The process and document that define Nationwide's liquidity management framework, risk appetite and measurement.
Individual liquidity guidance (ILG)	Guidance from the FSA on a firm's required quantity of liquidity resources and funding profile.
Individually/collectively assessed impairment allowances	Assets are assessed individually for impairment where there is objective evidence that impairment loss has occurred. Collectively assessed assets are measured using appropriate statistical techniques where a portfolio comprises homogenous assets and the collective assessment takes account of losses that will have taken place but are not yet identified.
Interest rate option	A contract that gives the holder the right (but not the obligation) to buy or sell a given bond or enter an interest rate derivative at a fixed price on or before a specific date. Options are traded over the counter and are only used by the Group to hedge interest rate exposures.
Interest rate swap	A contract under which two counterparties agree to exchange periodic interest payments on a predetermined monetary principal, the notional amount.
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 as well as 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 grade	The highest range of credit ratings, from AAA to BBB, as measured by external credit rating agencies.
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.
Investment Property Databank (IPD) index	Measures the performance of the prime commercial real estate (CRE) market in the UK on a monthly basis, reporting on a number of key data series (including capital value returns, total returns, income returns, rental values and void rates) against the performance of other key asset classes including UK equities and UK gilts.
Level 1 fair values	Fair values derived from unadjusted quoted prices in active markets for identical assets or liabilities, e.g. G10 government securities.
Level 2 fair values	Fair values derived from inputs other than quoted prices either directly (i.e. a price) or indirectly (i.e. derived from prices), e.g. used for 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 values derived from inputs that are not based on observable market data (unobservable inputs), e.g. used for 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).
Libor (London Interbank Offered Rate)	A benchmark interest rate at which banks can borrow funds from other banks in the London interbank market.
Liquidity and funding risk	Liquidity risk is the risk that the Group is unable to meet its financial obligations as they fall due (including any unexpected adverse cash flow). Funding risk is the risk that the Group is unable to access funding markets or only do so at excessive cost.
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.
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 such that 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 risk that the value of, or net income arising from, the Group's assets and liabilities changes as a result of changes to interest rates or exchange rates.
Medium term notes (MTN)	Corporate notes continuously offered by a company to investors, through a dealer, across a range of maturity periods.
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).
Near prime	Loans to borrowers with marginally weakened credit histories such as a County Court Judgement (CCJ) or default less than or equal to £1,000 or with one missed mortgage payment in the last 12 months.
Negative equity	The difference between the outstanding balance on a loan and the current value of any security held where the security value is lower than the outstanding balance.
Net assets	The difference between total assets and total liabilities.
Net interest income	The difference between interest receivable on assets and similar income and interest paid on liabilities and similar charges.
Net interest margin	Net interest income as a percentage of weighted average total assets.
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 (OIS) rate	A rate reflecting the overnight interest typically earned or paid in respect of collateral exchanged. OIS is used in valuing collateralised interest rate derivatives.

# Glossary

continued

Over the counter (OTC)	Contracts that are traded (and privately negotiated) directly between two parties, without going through an exchange or other intermediary. They offer flexibility because, unlike standardised exchange-traded products, they can be tailored to fit specific needs
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.
Provision coverage ratio	The ratio of impairment allowances (provisions) to the corresponding loan balances.
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 cash 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)	An 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.
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 accept (or not accept) in order to safeguard the interests of the Society's members whilst achieving business objectives.
Risk-weighted assets (RWA)	The value of assets after adjustment under the Basel II capital rules to reflect the degree of risk they represent.
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.
Securitisation position	An investment in a securitisation structure.
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.
Sovereign exposures	Exposures to governments, ministries, departments of governments, embassies, consulates and exposures on account of cash balances and deposits with central banks.
Specialist residential lending	Consists of buy to let, self-certified and other non-standard mortgages.
Special purpose entities (SPEs)	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.
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 such as payment delinquencies and potentially more severe problems such as County Court Judgements (CCJs) or default greater than £1,000, more than one missed mortgage payment in the last 12 months or discharged bankruptcies. Sub prime borrowers may also display higher risk characteristics as measured by credit scores, or other criteria indicating heightened risk of default.
Subscribed capital	See permanent interest bearing shares (PIBS).
Tier 1 capital	A component of regulatory capital comprising general reserves from retained profits and permanent interest bearing shares (PIBS), less goodwill, intangible assets and other regulatory adjustments.
Tier 1 capital ratio	Tier 1 capital as a percentage of risk weighted assets.
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.
Trading book	A regulatory classification consisting of positions in financial instruments or commodities held by a bank with intention to trade. The Group does not run a trading book.
Transformation costs	Costs, included within administrative expenses, which are directly related to business combinations or the restructuring of parts of the business.
Unaudited	Financial information that has not been subjected to the audit procedures undertaken by the Group's auditor.
Underlying profit	The purpose of this measure is to reflect management's view of the Group's underlying performance for the reader of the Annual Report and Accounts with like for like comparisons of performance across years without the distortion of one off volatility and items which are not reflective of the Group's ongoing business activities. Underlying profit is not designed to measure sustainable levels of profitability as that potentially requires exclusion of non-recurring items even though they are closely related to (or even a direct consequence of) the Group's core business activities.
Unencumbered	Assets not used to secure liabilities or otherwise pledged.
Unfunded	Exposures where a commitment has been made to provide future funding but the funds have not been released.
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.
Wholesale funding	Wholesale funding comprises deposits from banks, other deposits and debt securities in issue.

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