Annual Report and Accounts 2014

Nationwide
On your side

Shelter helps millions of people every year struggling with homelessness and bad housing – and campaigns to prevent it in the first place. Our corporate donations help fund Shelter's free national helpline and this year we are making a donation for votes we receive at the AGM. Employees have been involved too; on Nationwide's Christmas Shelter day they raised £12,000 and packed 632 shoe boxes full of presents for Shelter to distribute to the families they work with.

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Strategic Report

The Strategic Report on pages 4 to 39 has been approved by the Board of Directors and signed on its behalf by:

Graham Beale
Chief Executive
27 May 2014

Our new current account FlexPlus, which offers a range of benefits for a monthly fee of just £10, was rated the UK's best packaged current account by *Which?* magazine. Over 220,000 people have rated it highly enough to choose it for themselves and their families.

Society Highlights

Group Results 2010-2014		2014	2013	2012	2011	2010
Our Members						
Customer satisfaction lead over next high street competitor (note 1)	%	**4.2**	2.3	1.8	0.8	(0.1)
Market share						
Gross residential mortgage lending	%	**14.9**	15.1	13.0	9.5	8.7
Growth in member deposits	%	**12.1**	-	7.7	7.0	-
Current accounts	%	**6.2**	5.7	5.1	4.9	4.7
Customer balances						
Loans and advances to customers	£bn	**166.6**	159.6	154.2	149.4	152.4
Member deposit balances	£bn	**130.5**	125.6	125.6	122.6	120.9
Our People						
Employee engagement score	%	**77**	68	69	64	55
Our Business						
Cost income ratio (note 2)						
Underlying	%	**52.5**	55.9	62.2	65.1	60.7
Statutory	%	**56.6**	61.2	64.8	62.6	61.5
Profit before tax (note 2)						
Underlying	£m	**924**	433	267	244	212
Statutory	£m	**677**	168	166	285	341
Total assets	£bn	**189.9**	190.7	196.1	189.0	191.4
Core Tier 1 ratio (note 3)	%	**-**	12.3	12.5	12.5	12.2
Common Equity Tier 1 ratio (note 3)	%	**14.5**	9.1	-	-	-
Leverage ratio	%	**3.3**	2.2	-	-	-

Notes:

1. Source: GfK NOP's Financial Research Survey (FRS), 3 months rolling average of interviews for March 2010, March 2011, March 2012, March 2013 and March 2014, proportion of extremely/very satisfied customers minus proportion of extremely/very/fairly dissatisfied customers summed across current account, mortgage and savings. High street peer group defined as Barclays, Halifax, HSBC, Lloyds TSB, NatWest and Santander. Lead is not statistically significant for March 2011, March 2012 or March 2013.
2. Comparatives have been restated in accordance with IAS 19 Employee Benefits (Revised). Refer to note 1 to the accounts for further details.
3. The Common Equity Tier 1 (CET 1) ratio is the CRD IV equivalent of the Core Tier 1 ratio reported under Basel II. We have shown the 2013 CET 1 ratio on a proforma basis for comparison purposes.
4. The Hay Group Financial Services industry benchmark is based on data collected from approximately 55 companies around the world within the Financial Services industry. It includes data from over 850,000 employees who work in these companies and is updated annually.

Underlying results

These results have been prepared in line with International Financial Reporting Standards (IFRSs) as adopted by the European Union. 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 distortion of one off volatility and items which are not reflective of the Group's ongoing business activities.

Underlying profit before tax for 2014 equates to statutory profit before tax adjusted for fair value losses from derivatives and hedge accounting of £51 million, a £104 million charge relating to Financial Services Compensation Scheme (FSCS) levies, transformation costs of £75 million and a charge of £17 million in relation to the bank levy.

Employee engagement of:

77%

13% ahead of industry norm (note 4)

Delivering a lead of

4.2%

for customer satisfaction

Providing

1 in 5

UK First Time Buyer mortgages

Statutory profit before tax:

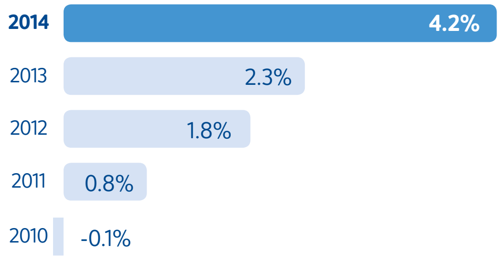
£677 million

CET 1 ratio of:

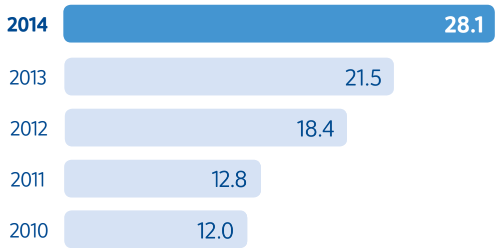
14.5%

Our Members

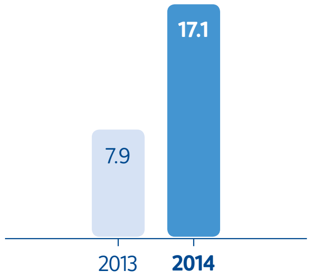
Customer satisfaction lead over next high street competitor (note 1)



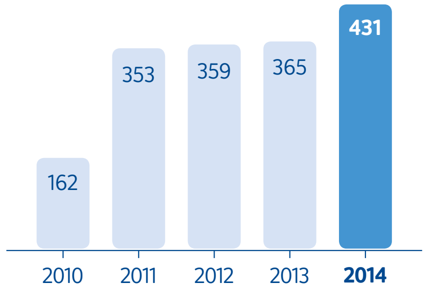
Gross mortgage lending (£bn)



Loyalty Saver balances (£bn)



Current account openings (000's)



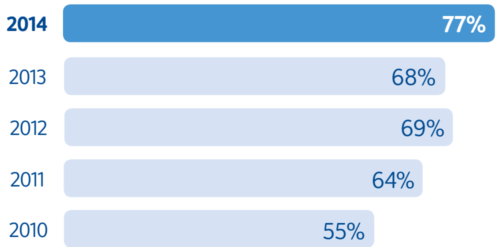
WINNER
Consumer Moneyfacts Awards 2014
Current Account Provider of the Year

moneynet awards
WINNER 2014
Best Packaged Current Account

THE SUNDAY TIMES
25 BEST BIG COMPANIES TO WORK FOR 2014

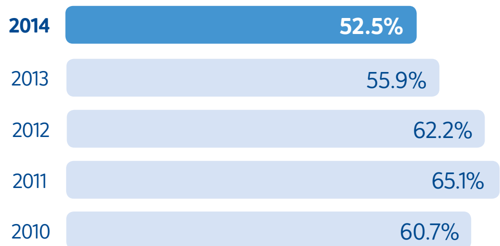
Our People

Employee engagement

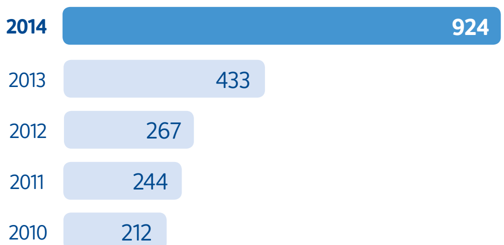


Our Business

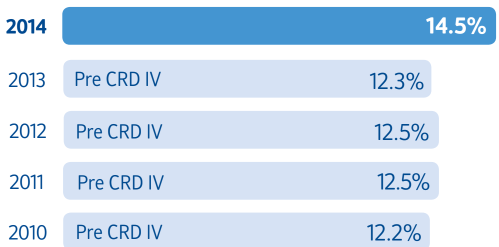
Underlying cost income ratio (note 2)



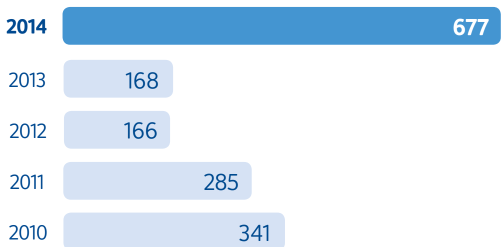
Underlying profit before tax (£m) (note 2)



CET 1 ratio



Statutory profit before tax (£m) (note 2)



Chairman's Statement

The strengths of our business model

The past year has marked something of a turning point for the UK economy; unemployment is falling and the housing market is more buoyant than 12 months ago, with transactions moving back towards long term norms.

I joined the Board of Nationwide in 2005 and became Chairman in 2007, just before the financial crisis caused such distress across the whole world, including the UK. A number of banks failed to survive the crisis, and the industry has struggled ever since to rebuild both its credibility and financial strength. Indeed, even now we continue to see banks accused of malpractice and being fined by regulators.

Nationwide has proved different from many of our competitors, with the strength of our business model allowing us to survive intact, to build our market shares and to deliver consistent long term value to our members. We are a well-run, member-focused business, based on a mutual model that allows us to take a long term view. We have a stable, high quality executive team that has steered us through the financial crisis and has allowed us to emerge in fine shape for the future.

This strength is evident in our latest financial results, which are approaching levels last seen before the financial crisis struck. Our underlying profit before tax has risen to £924 million, with statutory profit before tax increasing to £677 million. Alongside our improved financial performance, we have high levels of liquidity and have made further significant strides in ensuring that our business is amongst the best capitalised in the UK, delivered through higher profitability, disposal of non-core assets and our success in issuing new capital instruments during the year.

Our members approved the issue of core capital deferred shares (CCDS) at the 2012 Annual General Meeting, and our inaugural issuance of £550 million was listed in December 2013. This was an important moment for Nationwide and, potentially, for the whole sector, since CCDS is a completely new type of core capital that is entirely consistent with mutuality and which provides building societies with increased capital flexibility to support growth in the years ahead.

A business fit for the future

Throughout the financial crisis we took the decision that Nationwide could not afford to stand still; not only did we need to grow our business, we recognised that we needed to overhaul and replace many of our core technology systems in order to provide members with access to improved products and services. This has involved significant expense and commitment, but our members are now seeing the benefits. The most obvious example was the delivery of our new core banking system, which has allowed us to expand our range of banking services and accounts, putting us in an even stronger position to offer members an alternative to the established banks.

However, the pace of change is speeding up, with the take up of digital services spreading and companies from all sectors reshaping their business models to meet growing demands from customers. The financial services sector is no exception, with customers now using a whole range of mobile and digital devices to buy new products and service their accounts. We have already invested heavily in providing digital services to our members, with ongoing developments to our online bank, our mobile banking app and a totally revised website, and we will continue to do so in the coming years. In order to remain successful we will embrace the digital world, aiming to delight new and existing members through the quality of our products and services. The role of our branches is evolving, and they will always remain a core part of our service, delivering help and advice to our members and providing face to face access to our people.

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Delivering value to our members

As a mutually owned business it is imperative that we are able to deliver ongoing, long term benefit to both new and existing members. I am proud of our record over the past year, during which we have focused on providing mortgages to first time buyers and making our best mortgage deals available exclusively to existing borrowers. Our approach allows us to fulfil our core aim of helping people to buy their homes and to deliver sustainable value to our loyal members.

The Bank of England base rate has remained at historic lows, which has continued to impact the interest rates on savings accounts across the industry. We are not immune from the general conditions prevailing in the market, but we have continued to deliver value to our savers through a range of product and service initiatives. Amongst our key achievements over the year, we have continued to offer our Loyalty Saver account, which offers industry leading interest rates to our most loyal customers and now has balances of over £17 billion. In addition, we have simplified our savings range and provided improved online access to accounts for new and existing members, benefiting over 1.5 million saving members.

Engaging with our members

As the world's largest building society we never forget that you, our members, are also our owners, and we make a point of actively seeking your feedback on how we are performing and how you think we can improve. One of the most effective means of doing this is our series of Talkback events, which provide members with an opportunity to make suggestions and comments to our executive managers and directors. Over the past year we have held seven face to face events across the country, attended by 1,000 members, and have also invited members to join online Talkback sessions.

In order to ensure we receive more frequent feedback on how we are doing, we commission a survey that involves telephone and online contact with around 16,000 members each month. We also engage with over 6,000 members who are registered for our online customer research panel, 'Nationwide Connect'.

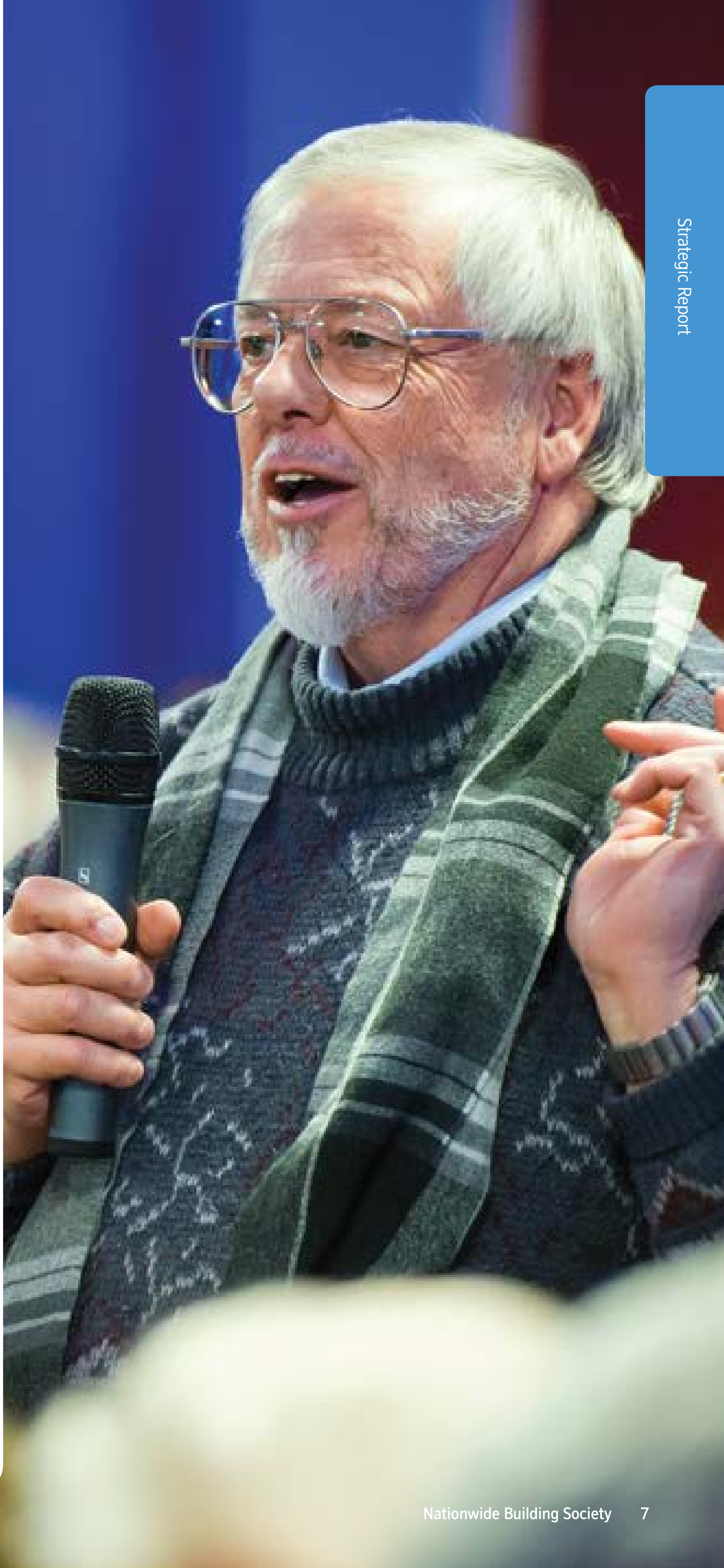
We have responded to the rapid growth of social media by launching our 24x7 Twitter listening service, which allows us to gain almost instant feedback on our day to day delivery of products and services. We are constantly on the lookout for additional ways of engaging with our members and will continue to offer new methods of digital interaction as they become available.

Taken together, the combination of face to face, telephone and online feedback provides our directors with an excellent insight into how our members view Nationwide, and helps drive effective business decision making and the development of member focused products.

Developments in regulation

Regulators have continued to promote financial stability as their key aim, seeking to protect the taxpayer in the event of a future financial crisis. We are fully supportive of their objectives, although they must be balanced against the requirement to have a banking sector that is able to support the provision of credit to the wider economy.

Talkback Southampton
Members attending the Member Talkback we held in Southampton. These events are an opportunity for our members to hear from and ask questions of our directors.



In the UK, the Financial Services (Banking Reform) Act confirmed that banks will have to ring-fence their retail activities by 2019. We are pleased that the Government has recognised that the Building Societies Act already provides a robust and effective framework which largely restricts building societies to their core purpose of providing savings, home finance and financial services to members. As such, the sector will continue to operate under our existing legal framework which has stood the test of time, with no material change being required.

Standards of personal behaviour in the banking industry remain in the spotlight. There are plans to replace the existing Approved Persons regime and the Financial Conduct Authority is placing more emphasis on firms' cultures in supporting good customer outcomes. The banking industry itself has also recognised the need to do more to restore public trust, with Sir Richard Lambert developing proposals for a self-regulatory body to help these efforts. Nationwide has played a leading role in the process and is fully supportive of his recommendations. We are confident that our business is focused solely on the needs of our members, we have never been in a stronger position to provide a mutual alternative to the banks and we have ambitious plans for the future.

Adding value to our communities

In my report last year I introduced the aims of 'Living on your side', our five year citizenship strategy which reflects the priorities of our members and employees and supports our business objectives: housing ('Your Home'), saving ('Your Money') and investing into local communities ('Your Community'). In addition, we seek to conduct our business responsibly by managing our impact on the environment, by creating a great place to work and by engaging our supply chain in our citizenship efforts. This area of focus we call 'Your Society'.

I am pleased to say that we have made excellent progress in each of these areas over the past year:

Your Home

We have helped a further 200,000 people into a home they can call their own. In addition to providing mortgages to large numbers of first time buyers, we have launched a new partnership with the Elderly Accommodation Counsel designed to help vulnerable elderly people to stay in their own homes, and have continued our work with Shelter, supporting over 4,000 people during the year.

Your Money

We have surpassed our target of helping over 186,000 people to start saving during the year and have supported a number of charities aimed at improving numeracy skills. Of particular note we have worked with Talking Numbers, helping young people develop their skills in everyday situations, and are a founding partner of the National Numeracy Campaign, which focuses on improving skills amongst adults.

Your Community

I am delighted that over the past year we have supported our communities by unlocking and investing £4 million through a combination of member and employee activity, with highlights including:

- more than a million members have taken part in our Community Match scheme, where branch customers vote for a local cause to receive a donation of £500
- over half of our employees are involved in volunteering of some nature, ranking Nationwide in the top four employers in the UK, and
- over 4,000 of our employees have signed up to our Every Penny Helps scheme, which rounds down their monthly salary payment to the nearest pound and collects the surplus pennies for charity.

Your Society

As a member owned business, we aim to run our business as you would want us to. This means managing our environmental impact and continuing to operate ethically in all we do. As a result, we have achieved the Carbon Trust Standard Accreditation for the management and reduction of our operational carbon emissions over the past three years. We have also diverted 94% of our operational waste from landfill and we now use almost 21% less water than we did three years ago. This year we have become a Living Wage employer and are committed to ensuring that everyone working regularly on our sites, including contractors, is paid a Living Wage as a minimum.

Dedication of our employees

The provision of an exceptional customer experience at all times and through all of our business channels – branches, online and over the telephone – is central to our purpose. I am immensely proud to see our success being recognised through both internal and external surveys, and would like to put on record my thanks

to our people for their continued dedication and focus on the needs of our members. We expect a lot from our people, and consequently invest heavily in creating a working environment where our people can flourish; this focus has been recognised during the year, with Nationwide being ranked at number eleven in The Sunday Times' Top 25 Big Companies to Work for in the UK.

Your Board of directors

There were no changes to our Board of directors during the past year. However there are two forthcoming changes. Alan Dickinson has indicated that he does not wish to stand for re-election at the forthcoming Annual General Meeting. Alan has been a non executive director with Nationwide since 2010, joining the Board at what was a tumultuous time for the financial services industry and an important period for Nationwide. His support and counsel has been much appreciated and his depth of knowledge of the financial services industry has been invaluable. On behalf of the Board I would like to thank Alan for the contribution he has made to the Society over the last four years and we wish him well for the future.

As previously announced I will be retiring from the Board after the July 2015 Annual General Meeting. In recent months we have been conducting a wide ranging search for my successor with a view to identifying a candidate who has the right combination of financial services experience and customer focused values. I am pleased to inform you that on 1 September 2014 David Roberts will be joining the Board as Chairman Elect with a view to succeeding me in 2015. He has previously held a number of senior positions across the industry most recently as Deputy Chairman of Lloyds Banking Group and will bring a wealth of retail financial services experience to the Board.

Geoffrey Howe
Chairman
27 May 2014

Chief Executive's Review

Staying true to our mutual heritage

Our performance over the past year is in line with our strategy of being a modern mutual: looking after the needs of savers, home owners and providing a whole range of financial services and products. Our mortgage lending was up 31% on last year, we have increased our member deposit balances by £4.9 billion and we have opened over 430,000 new current accounts. We have achieved this level of performance by concentrating on the needs of our existing and new members, aiming to provide ongoing good value and exceptional service at all times.

Our financial results reflect this success, with an increase in underlying profit of 113% to £924 million. Statutory profit has increased by 303% to £677 million. In addition to stronger retained earnings, we have strengthened our balance sheet further with a new form of capital: core capital deferred shares (CCDS), and disposed of a number of non-core assets. As a result, we have a top of peer group Common Equity Tier 1 (CET1) ratio of 14.5% and a leverage ratio of 3.3%.

Supporting our members in the housing market

Over the past 12 months we have played a major role in providing finance to the UK housing market, with gross and net lending both increased year on year and in excess of our par market share. Total gross mortgage lending was up 31% at £28.1 billion (2013: £21.5 billion), accounting for 14.9% of all mortgage lending, whilst our net lending for the year was £9.9 billion, up 52% year on year (2013: £6.5 billion) and representing a market share of 70.8%. We have 1.5 million mortgage accounts and our residential lending portfolio now stands at £145.7 billion (2013: £135.6 billion).

Consistent with our mutual heritage we have continued to support first time buyers; during the year we have helped 58,100 people take their first steps into home ownership, an increase of 37% on last year (2013: 42,500), and representing over one in five of all first time buyer mortgages in the UK. Throughout the year we have supported the Government's Help to Buy shared equity scheme, accounting for over 31% of all cases advanced, and our Save to Buy[1] proposition offers access to 95% LTV mortgages, our equivalent of the Government's second phase of Help to Buy. Our lending at above 90% LTV remains low, representing only 2.4% of the total value of our lending during the year.

In addition to our support for first time buyers, we have continued with our policy of rewarding our members by providing a loyalty discount to our mortgage rates to existing mortgage customers wishing to move, switch product or take a further advance. We have also maintained our Base Mortgage Rate (BMR) at 2% above the Bank of England (BoE) base rate. We estimate that this has delivered member benefit in the region of £800 million per annum when compared with the standard variable rate charged by other major lenders, equivalent to a saving of around £1,100 for our average BMR borrower.

As patterns of housing tenure continue to evolve, with greater numbers of people choosing to rent rather than buy, our subsidiary, The Mortgage Works (TMW), has continued to be a leading provider of high quality loans to the buy to let sector. Over the past year TMW gross advances accounted for £3.7 billion (2013: £3.3 billion) of our total mortgage lending, representing a market share of 16%, with net lending of £1.7 billion. Our total specialist mortgage book now stands at £26.3 billion (2013: £24.9 billion), representing 18.1% of our total residential lending portfolio (2013: 18.4%).

Delivering value to our savers

We have offered a choice of competitive savings products throughout the year and we have seen our member deposit balances grow by £4.9 billion to £130.5 billion. In line with our core purpose of looking after our members we have focused our efforts on rewarding the loyalty of our existing members. Our Loyalty Saver product, which pays higher rates of interest according to length of membership, has been particularly popular and has attracted balances of £9.2 billion during the year, taking the total balances held in this account to £17.1 billion. We estimate that the member value from Loyalty Saver was in the region of £130 million during the year.

[1] Through Nationwide's Save to Buy scheme customers have access to a dedicated savings account to help save for a deposit towards their home and a competitive interest rate on their mortgage when ready to buy. The Save to Buy mortgage is only available for a loan to value of 85% to 95%.

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For many years we have campaigned for changes to the structure of tax-free savings in the UK. We are delighted that in the recent Budget the Chancellor reacted to our calls by increasing both the amount that can be saved into an ISA and allowing people to switch freely between stocks and shares and cash ISAs. In a market where interest rates paid on retail savings have declined, this will provide a timely boost for savers and remove structural anomalies.

We believe that savers should be presented with simple, transparent products. To that end, we have continued our policy of simplifying our savings range for both existing and new accounts, removing notice and complicated bonus arrangements, while making all accounts accessible online. To date over 1.5 million customers have benefited from this change and we have done this without reducing interest rates as a consequence. During the year we also launched our '2 clicks' service, which allows our online bank members to open most of our savings accounts with only two clicks of a mouse. Our overall approach and the quality of our products and service were recently recognised with Nationwide being named as the Moneyfacts 'High Street Savings Provider of the Year'.

A meaningful alternative to the established banks

The past year has seen an acceleration in our drive to diversify our business through the provision of personal banking services to new and existing members. We have opened over 430,000 new current accounts, an 18% increase on last year (2013: 365,000), with the latest additions to our product range, FlexDirect and FlexPlus, proving popular. In addition, over 98,000 existing current account members upgraded their account to FlexPlus, thereby gaining access to a comprehensive range of benefits including interest on credit balances, worldwide travel insurance, breakdown cover and extended appliance warranties. The quality of our current account offering is demonstrated by the number of awards we have won:

- each of our full service current accounts was rated as 5 star by Defaqto
- Nationwide was named as the Consumer Moneyfacts 'Current Account Provider of the Year', and
- FlexPlus has been rated as the number one packaged account by *Which?* magazine and as the Best Packaged Current Account in the Moneynet Personal Finance Awards.

We now have 5.5 million current accounts, and our market share of main standard and packaged accounts as at February 2014 had risen over the year to 6.2% (2013: 5.7%).

As a challenger to the established banks, we welcome the drive to facilitate easier current account switching for customers. The industry-wide seven day account switcher initiative launched in September, and Payments Council data indicates that our monthly share of switching had reached 10.8% in March.

Our total gross lending of personal loans was £1.2 billion (2013: £1.2 billion), representing a market share for the year of 4.8%. Our total outstanding balances have reached £1.9 billion (2013: £1.8 billion), taking our market share to 3.8% (2013: 3.6%).

Talkback Southampton

The credit card market over the past year was very competitive, with aggressive pricing and increasingly long interest free periods being used to attract customers. Against this backdrop, we have grown our credit card business more slowly than in previous years, with 272,000 new accounts opened over the past 12 months (2013: 350,000). Our credit card outstanding balances have increased by 12.9% to £1.7 billion. Moneynet named our Select card as the 'Best All Round Credit Card', and we were named as the organisation with the 'Most Responsible Credit Card Lending Practices' in the Card and Payment Awards for the seventh successive year.

This was the first year following the implementation of the Retail Distribution Review (RDR) and also the introduction of a new reward structure for regulated sales advisers. We have experienced a reduction in the volume of our protection and investment sales, which were down 40% at 104,000 (2013: 174,000). We have refined our processes as we have adapted to RDR, and by the year end investment sales per adviser had recovered back towards pre RDR levels.

Continued focus on member service

The provision of excellent member service is central to our values. Getting the basics right is critical to ensuring that our members trust us with their money, and our success in this area is evidenced by the fact that despite accounting for over 10% of the mortgages and savings market and 6% of the current account market, we accounted for only 3.6% of total industry complaints. Of all complaints about Nationwide referred to the Financial Ombudsman Service 10% are upheld, compared with the industry as a whole where 51% are upheld.

True success in delighting customers means having a culture that is focused entirely on delivering the right customer outcomes every time. This requires a mindset that puts our members, who are also our owners, at the centre of our thinking at all times. A number of recent surveys have suggested that we are leading the way in this area:

- the Reputation Institute's annual RepTrak survey ranked us as having the best reputation of UK banks and building societies
- the Human Era Index ranked us as the top financial services provider and in the top ten brands in the UK.

These findings are backed up by Nationwide being ranked number one for combined product service satisfaction amongst our high street peer group for two and a half years[2], and our internal surveys show a continued improvement in satisfaction for our branch and telephone channels. We publish our track record on member service on our website on a quarterly basis; your.nationwide.co.uk/stats

People

At Nationwide we are proud of our people and the manner in which they bring our brand to life for our members. It is vital that our people are fully engaged in the aims of the Society and are provided with the tools to allow them to provide exceptional customer service. I am therefore delighted that Nationwide has been recognised as the eleventh best big company to work for by The Sunday Times, ahead of all other banks and building societies, and has been ranked as one of the top 50 places for women to work in the UK. This external recognition reinforces what our own people are telling us through our internal 'ViewPoint' survey, which shows levels of employee engagement and enablement that are well above the benchmarks set for high performing companies.

Strong financial performance

Our business continues to be supported by the strength of our balance sheet. In line with our mutual status and focus on the provision of mortgages and savings to our members, over 90% of our lending is secured on UK residential property and approximately 80% of our funding is raised from retail sources.

Our financial performance builds on our success in growing the Society and delivering great service. Strong business volumes, combined with a strengthening in our net interest margin, have contributed to a 16% increase in income to £2,895 million (2013: £2,485 million). Our underlying profit for the year was £924 million (2013: £433 million), an increase of 113%, and statutory profit before tax was £677 million (2013: £168 million), an increase of 303%. Costs have increased by 9% reflecting the significant growth of our business and continued investment. However, this has been more than offset by the growth in our income, resulting in our underlying cost income ratio falling to a record low of 52.5% (2013: 55.9%).

This level of financial performance underpins our promise to be safe and secure. As a mutual we aim to optimise, rather than maximise, profit, retaining sufficient earnings to support future growth, sustain strong capital ratios and to allow us to invest in the business to provide the services that our members demand. Our performance this year is in line with this aim and helps us to deliver a long term, sustainable business that operates purely in the interests of our members.

Our prudent approach to mortgage lending is evident in our three month mortgage arrears ratio of 0.63%, which compares favourably with the industry average of 1.59%. We have made significant progress in reducing our exposure to non-core commercial real estate by reducing our balances by 24% over the past year; our total exposure now stands at £7.8 billion (2013: £10.2 billion) and since the year end we have reduced our

[2] Source: GfK NOP's Financial Research Survey (FRS), 30 months of interviews conducted between October 2011 and March 2014, proportion of extremely/very satisfied customers minus proportion of extremely/very/fairly dissatisfied customers summed across current account, mortgage and savings. Our high street peer group is defined as Barclays, Halifax, HSBC, Lloyds TSB, NatWest and Santander.

exposure by a further £0.7 billion through the sale of non UK commercial real estate assets. Alongside this deleveraging, we have seen a modest improvement in the outlook for the commercial real estate sector and, as a consequence, our commercial impairment charge has reduced to £309 million (2013: £493 million). Total provision charges for all impairments have fallen by 35% to £383 million (2013: £591 million).

Capital strength, securing the future of mutuality

We have continued to place emphasis on preserving the strength of our balance sheet through our conservative approach to lending and prudent management of our business. Since the financial crisis of 2008 banks and building societies have been required to increase both the quality and quantity of capital to support their businesses, and over the past 12 months we have made great strides in both these areas.

In December we issued £550 million of core capital deferred shares (CCDS), a new capital instrument that qualifies as Common Equity, the highest quality of capital, and which does not compromise our mutual business model and contains 'mutual friendly' features, namely: one member one vote, capped distributions and capped participation in residual assets. Our successful launch of CCDS supports our mutual status, demonstrating our ability to access capital in the market and providing greater flexibility over the long term management of our business. In addition, this instrument may be suitable for other building societies, thereby supporting the long term health of the mutual sector in the UK and across Europe. In March we made a further improvement to our capital position through an inaugural £1 billion issue of Additional Tier 1 capital, the first sterling issue of this form of capital by any institution. Both issues were oversubscribed, demonstrating widespread investor support for Nationwide and the strength of our mutual business model.

As a result of our strong financial performance and capital issuance, our Common Equity Tier 1 ratio has grown by 5.4 percentage points to 14.5% (2013 proforma: 9.1%), the strongest ratio amongst our peer group of UK banking competitors[3]. As a result of the reduction in our non UK commercial real estate exposures since the year end, this figure will improve by a further 0.5%. Our leverage ratio has now exceeded 3% on both unadjusted and PRA adjusted bases (3.3% and 3.2% respectively), meaning we have achieved our agreed PRA target ratio.

Whilst our progress in strengthening our capital ratios through business performance and capital issuances provides evidence of our ability to manage our capital resources, we remain alert to the ongoing regulatory debate on leverage ratios which may result in higher leverage ratio requirements in future, even for low risk institutions such as Nationwide. In this context it will be important that we monitor developments and plan our business in order to be able to accommodate any new requirements that may emerge.

Progress of our strategy and future plans

We remain committed to mutuality, providing outstanding retail financial services to a growing member base and expanding our presence in the personal current account market to establish a market share in proportion to our shares in mortgages and savings.

Member behaviours and expectations are changing, with an increasing use of internet and mobile channels, and we will ensure that we respond accordingly. We have already seen a significant uptake of our digital services: we have over 2.6 million active users of our digital services, with over 620,000 log-ons each day to our internet bank, almost half of which are made through our mobile banking app, and products bought through our internet bank are up 60% year on year. In November 2013 we became, in conjunction with Visa, the first organisation in the UK to offer V.me, a new digital wallet designed to make online shopping more convenient and secure. We are developing a number of future enhancements to our digital payment services, including a mobile person to business payments service in partnership with Zapp and a person to person payments facility through Paym. These new services are due to become available during the course of 2015.

Even in an increasingly digital world our branches will be a key element of our service, although their role is likely to develop with more time spent on the provision of advice and sales support and less on transactional activity. We have recently taken an important step with the launch of Nationwide Now, a service which will boost our branch capacity by delivering help and advice to our customers via a real time video link to an adviser based at a central location. Early indications are that this is breathing new life into some of our more marginal branches.

Over the past five years we have renewed our infrastructure through the delivery of a new banking platform, new data centre, new payments platform, new website and a mobile banking service. Whilst these programmes have improved customer service and increased technical resilience, it is likely that over the next few years the pace of change will speed up, with an increasing number of smaller initiatives to enable Nationwide to operate in an evolving digital society.

At the same time we will not lose sight of the fact that some members prefer branches and telephone channels to digital services, and we will continue to operate and maintain these channels to ensure that we meet the needs of all of our members.

[3] Peer group consists of Santander UK, HSBC, Lloyds Banking Group, Barclays and Royal Bank of Scotland.

Outlook

We expect the UK economy to continue to improve over the coming year. Despite this improvement, we do not expect the Bank of England base rate to rise imminently given the low rate of inflation, and future rises when they occur will be gradual in nature. The health of the UK housing market has been the subject of much commentary in recent months, with the annual growth of house prices now above 10% and at its highest since 2007. All regions are now experiencing some growth, but the big increases are mainly centred on London and the South East and there are few signs of affordability being stretched in other UK regions.

In the recent Budget the Chancellor made substantial revisions to ISAs and announced proposals for National Savings and Investments (NS&I) to issue pensioner bonds in 2015. We believe that the changes to ISAs will result in more savings into cash ISAs, but that we may see some deposit outflows to NS&I if rates on the pension bonds are above the normal market range and we are therefore unable to compete.

Our business performance is strong, and we believe it will improve further over the coming year, with a further increase in margins and a continued growth in our banking products. The future is not without challenges; the whole industry needs to evolve its approach to delivering compliant solutions in a fast moving digital world, and the demand for further increases in capital requirements cannot be ruled out. However, we are very confident that we are in an excellent position to deliver more value to more members in the coming years, sharing the benefits of mutuality more widely and presenting the only truly national alternative to the established banks.

Graham Beale

Graham Beale
Chief Executive
27 May 2014

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Financial Review

Income statement overview

Profit after tax on a statutory basis is set out below. In addition, certain aspects of the results are presented to reflect management's view of our underlying profit performance.

Underlying profit equates to statutory profit before tax adjusted for charges in respect of the Financial Services Compensation Scheme (FSCS), bank levy, transformation costs and fair value losses from derivatives and hedge accounting as set out below.

Year to 4 April 2014	**Statutory profit**	**FSCS and bank levy**	**Transformation costs**	**Losses from derivatives and hedge accounting**	**Underlying profit**
	£m	**£m**	**£m**	**£m**	**£m**
Net interest income	**2,403**	**-**	**-**	**-**	**2,403**
Other income	**492**	**-**	**-**	**-**	**492**
Movements on derivatives and hedge accounting	**(51)**	**-**	**-**	**51**	**-**
Total income	**2,844**	**-**	**-**	**51**	**2,895**
Administrative expenses	**(1,611)**	**17**	**75**	**-**	**(1,519)**
Pre provision underlying profit	**1,233**	**17**	**75**	**51**	**1,376**
Impairment losses	**(383)**	**-**	**-**	**-**	**(383)**
Provisions for liabilities and charges	**(173)**	**104**	**-**	**-**	**(69)**
Profit before tax	**677**	**121**	**75**	**51**	**924**
Tax	**(128)**				
Profit after tax	**549**				

Year to 4 April 2013*	Statutory profit	FSCS and bank levy	Transformation costs	Losses from derivatives and hedge accounting	Underlying profit
	£m	£m	£m	£m	£m
Net interest income	1,981	-	-	-	1,981
Other income	504	-	-	-	504
Movements on derivatives and hedge accounting	(165)	-	-	165	-
Total income	2,320	-	-	165	2,485
Administrative expenses	(1,420)	16	16	-	(1,388)
Pre provision underlying profit	900	16	16	165	1,097
Impairment losses	(591)	-	-	-	(591)
Provisions for liabilities and charges	(141)	68	-	-	(73)
Profit before tax	168	84	16	165	433
Tax	10				
Profit after tax	178				

*Comparatives have been restated in accordance with IAS 19 (Revised) Employee Benefits. Refer to note 1 for further details.

Financial Review continued

Statutory profit before tax for the year ended 4 April 2014 was £677 million, up 303% compared with the prior year (2013: £168 million). Underlying profit, which reflects management's view of performance on a like for like basis across years, was £924 million, up 113% compared with the prior year (2013: £433 million). Increased profitability was driven mainly by the continued improvement in net interest income and reduced impairment charges, offset in part by increased administrative expenses.

Net interest income

	Year to 4 April 2014	Year to 4 April 2013*
	£m	£m
Net interest income	**2,403**	1,981
Weighted average total assets	**191,604**	193,832
	%	%
Net interest margin (NIM)	**1.25**	1.02

*Comparatives have been restated in accordance with IAS 19 (Revised) Employee Benefits. Refer to note 1 for further details.

Net interest income for the year was £2,403 million, £422 million higher than the prior year, driven largely by retail asset growth and reduced costs of retail funding. Weighted average total assets are 1.1% lower, as planned reductions of non-core treasury and commercial assets have more than offset the growth in retail lending balances. Net interest margin improved by 23 basis points on an annualised basis to 1.25%. Margin recovery has continued throughout the year and our point-in-time NIM at the end of 2013/14 was approximately 1.40%.

Mortgage balances have grown by around £10 billion during the year and the margin performance has continued to benefit from re-pricing of maturing longer term fixed rate balances onto higher current market rates. Base Mortgage Rate (BMR) balances peaked in May 2013 and now constitute a decreasing proportion of our mortgage book, whilst continuing to represent a significant distribution of value to members with a headline pay rate of 2.5%. Total BMR balances at 4 April 2014 amounted to £52 billion (2013: £54 billion).

The most significant drivers of our higher margin were maturing fixed mortgage deals re-pricing onto higher margin products and lower retail funding costs which reflect reduced demand across the market for retail savings, in part as a consequence of the availability of the Funding for Lending Scheme (FLS), and growth in our personal current account credit balances by approximately £1.5 billion over the course of the year. The section of the FLS which provides funding linked to net residential mortgage lending has now been withdrawn and we do not expect to make any further drawings under FLS; our total drawings to date are £8.5 billion and we estimate our utilisation of the scheme contributed approximately 2 basis points (2013: less than 1 basis point) to our net interest margin for the year. We estimate that the marginal cost of retail funding has fallen by around 80 basis points since FLS was launched.

Net interest income for the year includes £45 million of losses (2013: £139 million gain), primarily arising from the sale of around £1.1 billion of treasury assets in line with our ongoing strategy to reduce non-core exposures, a charge for fair value adjustments of £23 million (2013: £48 million gain), and a £30 million gain (2013: £44 million) from updated effective interest rate assumptions relating to recognition of mortgage and savings interest.

During the year we raised approximately £1.5 billion through issuance of CET1 (CCDS – core capital deferred shares) and AT1 capital securities. The returns paid to investors on these securities will be treated as an appropriation of profit after tax, reflecting their categorisation as capital instruments, and hence are not reflected in our interest margin. The first distributions for CCDS, in respect of 2013/14, and AT1 capital securities in respect of the period from issue to the payment date, totalling £49 million, will become payable in June 2014 and will be reflected in the 2014/15 financial statements.

Other income

	Year to 4 April 2014	Year to 4 April 2013
	£m	£m
Current account and savings	**111**	114
Protection and investments	**82**	122
General insurance	**101**	126
Mortgage	**30**	41
Credit card	**29**	28
Commercial	**17**	18
Gain on redemption of subscribed capital	**125**	43
Other	**(3)**	12
Total underlying other income	**492**	504
Losses from derivatives and hedge accounting	**(51)**	(165)
Total statutory other income	**441**	339

Total underlying other income of £492 million is 2% down overall year on year and includes gains from the redemption of subscribed capital of £125 million (2013: £43 million). Excluding this non-recurring item, other income has reduced by £94 million, including a £40 million reduction in net protection and investment income as a result of a change to customer pricing on protection policies and the impact of the Retail Distribution Review which came into force on 1 January 2013.

The £25 million reduction in general insurance is driven by a one-off commission benefit of around £20 million relating to general insurance which was taken in the prior year. The 'Other' category for 2013 includes a £7 million profit on the sale of equity investments relating to participation in an industry wide credit card service operation.

Details of fair value losses relating to derivatives and hedge accounting are provided in note 8 to the accounts.

Administrative expenses

	Year to 4 April 2014	Year to 4 April 2013*
	£m	£m
Employee costs	**636**	604
Other administrative expenses	**601**	568
Administrative expenses (underlying)	**1,237**	1,172
Depreciation, amortisation and impairment	**282**	216
Total underlying administrative expenses	**1,519**	1,388
Transformation costs	**75**	16
Bank levy	**17**	16
Total statutory administrative expenses	**1,611**	1,420
	%	%
Cost income ratio – underlying basis	**52.5**	55.9
Cost income ratio – statutory basis	**56.6**	61.2

*Comparatives have been restated in accordance with IAS 19 (Revised) Employee Benefits. Refer to note 1 for further details.

Financial Review continued

Underlying administrative expenses have increased by 9% to £1,519 million, largely driven by ongoing investment in the business, general inflation and increased levels of business activity. At a statutory level administrative expenses have increased by 13% to £1,611 million.

Investment spend during the year has included revenue costs of £23 million associated with the implementation of the Mortgage Market Review and the Current Account Switching Service. In addition, depreciation and amortisation for the year includes the first full year's charge of £50 million (2013: £11 million) relating to our new banking platform which became operational in October 2012.

The year on year increase in employee costs reflects the impact of annual pay awards averaging 2.4% and 2.5% respectively in each of the last two years, combined with a 1.5% increase in employee numbers year on year.

Increased levels of business activity are evident across many aspects of our operations, including financial transactions (up 14%), mortgage lending (up 31%) and current account sales (up 18%).

Transformation costs include £39 million relating to our ongoing programme to integrate distribution and account administration relating to our Dunfermline, Derbyshire and Cheshire brands.

Under the programme the branch network will be rationalised and re-branded 'Nationwide' to eliminate unnecessary duplication whilst preserving levels of physical access for members as a whole. Account administration will be migrated onto Nationwide core systems. Costs relate to asset write downs, provision for ongoing onerous lease contracts and headcount reductions. The programme is expected to deliver annualised costs savings in excess of £25 million and additional income of £10 million on completion.

The other significant transformation programme is the execution of our strategic programme to source IT application and support activities through strategic delivery partners and to transform the way these activities are performed. Costs charged in the year for this programme were £30 million and relate to the commercial processes, transition activity, provision of technical infrastructure and headcount reductions. The programme is expected to deliver annualised cost savings in the region of £50 million.

Income growth of 16% continues to run well ahead of cost growth, resulting in a reduction in both our statutory and underlying cost income ratios to 56.6% (2013: 61.2%) and 52.5% (2013: 55.9%) respectively. Cost growth is expected to moderate in 2014/15.

Impairment losses

	Year to 4 April 2014	Year to 4 April 2013
	£m	£m
Residential lending	**-**	16
Consumer banking	**60**	79
Retail lending	**60**	95
Commercial lending	**309**	493
Other lending	**11**	1
Impairment losses on loans and advances to customers	**380**	589
Impairment losses on investment securities	**3**	2
Total	**383**	591

Impairment losses for the year of £383 million are £208 million (35%) lower than 2013 primarily as a result of a significant improvement in the level of impairment suffered on our commercial lending portfolio.

Residential mortgage impairments have benefited from house price growth of 9.5% over the course of the financial year and continuing low levels of arrears reflecting relatively benign, and now improving, levels of unemployment and our prudent underwriting approach. In addition the continuation of the low interest rate environment is supporting stability of repayment obligations at unusually low levels by historic standards. These factors have contributed to a zero charge for residential impairments (2013: £16 million). In calculating mortgage loss provisions house price inflation based on movements in the Nationwide House Price Index (HPI) to the balance sheet date are factored in, but no recognition for anticipated future house price inflation is included.

Nationwide has maintained a consistent philosophy to retail lending over many years with a focus on prudent underwriting criteria. We place a heavy emphasis on managing the LTV profile of new secured lending, including restricting the volume of higher LTV lending and ensuring such loans are only advanced to customers with a high credit score and strong affordability assessments. As a result of our approach, our mortgage arrears have outperformed industry averages by a significant margin and this continues to be the case.

Consumer banking impairments are down 24% at £60 million (2013: £79 million) including a credit of £27 million (2013: £nil) relating to an update to model assumptions for late stage recoveries on defaulted balances to reflect recent experience. Excluding this adjustment, the implied underlying increase in consumer banking impairment of around 10% is attributable to balance growth with no significant change in portfolio performance.

Commercial lending impairments relate exclusively to commercial real estate (CRE) lending, with no arrears in our social housing and Project Finance portfolios. The decrease in the impairment charge to £309 million reflects a £2.4 billion reduction in CRE exposures and stabilisation of CRE market conditions with a consequent improvement in investor sentiment towards the sector, allowing a wider range of exit options at improved valuations on all but the most severely distressed exposures.

Other lending relates to loans historically originated by our Treasury Division and includes a portfolio of £176 million (2013: £219 million) which primarily comprises secured lending relating to a European commercial loan portfolio and a revolving loan facility secured by a portfolio of asset backed securities. The charge of £11 million (2013: £1 million) relates to the impairment of individual under-performing exposures.

Provisions for liabilities and charges

	Year to 4 April 2014	Year to 4 April 2013
	£m	£m
Underlying provisions for liabilities and charges – customer redress	**69**	73
FSCS levies	**104**	68
Total provisions for liabilities and charges	**173**	141

The charge for customer redress provisions of £69 million (2013: £73 million) relates to estimated costs of remediation and redress in relation to past sales of financial products and post sales administration, including compliance with consumer credit legislation and other regulatory matters.

More information, including details of the increase in the FSCS charge, is included in note 26 to the accounts.

Taxation

The statutory reported tax charge for the year of £128 million (2013: £10 million credit) represents an effective tax rate of 18.9%, which is lower than the statutory rate in the UK of 23%. 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. Further information is provided in notes 12 and 21.

During the year our income statement bore taxes of £345 million (2013: £258 million) including irrecoverable VAT, bank levy, employment and property taxes, all of which are charged to profit before tax as part of administrative expenses and depreciation. With the exception of the bank levy, all of these amounts are recognised in arriving at underlying profit.

Financial Review continued

Balance sheet

Assets

	4 April 2014		4 April 2013		Change
	£m	**%**	£m	%	%
Residential mortgages	**145,660**	***87***	135,558	*85*	7
Commercial lending	**18,164**	***11***	21,329	*13*	(15)
Consumer banking and other lending	**4,038**	***2***	3,924	*2*	3
	167,862	***100***	160,811	*100*	4
Impairment provision	**(1,288)**		(1,224)		5
Loans and advances to customers	**166,574**		159,587		4
Other financial assets	**21,285**		28,941		(26)
Other non-financial assets	**2,067**		2,190		(6)
Total assets	**189,926**		190,718		-
Key ratios	**%**		%		
Return on assets	**0.29**		0.09		0.20pp
Asset quality					
Residential mortgages					
Proportion of residential mortgage accounts 3 months+ in arrears	**0.63**		0.72		(0.09)pp
Average indexed loan to value of residential mortgage book	**48**		51		(3)pp
Average loan to value of new residential lending	**69**		67		2pp
Commercial Property Finance					
Total CRE gross balances (£m)	**7,764**		10,192		(24)
Impaired balances (£m)	**3,065**		2,715		13
Total provision as % of impaired balances	**33**		35		(2)pp

Residential mortgages

Residential mortgages include prime and specialist loans, with the specialist portfolio primarily comprising buy to let (BTL) lending. We delivered gross mortgage lending during the year of £28.1 billion (2013: £21.5 billion), representing a market share of 14.9% (2013: 15.1%). Mortgage balances grew by £10.1 billion of which £8.7 billion (86%) was prime lending and £1.4 billion (14%) related to BTL. This mix of lending is consistent with prior years and maintains our stock of residential lending at 82% prime, 18% specialist (2013: 82% prime, 18% specialist). The loan to value (LTV) profile of new lending, weighted by a volume basis, was broadly consistent with the prior year at 69% (2013: 67%), and the average LTV of the portfolio at 4 April 2014 was 48% (2013: 51%). Our residential mortgage arrears fell from 0.72% at the end of last year to 0.63% at 4 April 2014 and continue to be significantly lower than the Council of Mortgage Lenders (CML) industry averages. Full details of our lending risks are provided in the Business and Risk Report.

Commercial lending

Commercial lending includes commercial real estate (CRE) loans of £7.8 billion (2013: £10.2 billion), loans to housing associations of £8.1 billion (2013: £8.2 billion) and a portfolio of loans made under the Government's Project Finance initiative amounting to £1.4 billion (2013: £1.5 billion). The balance sheet total for commercial lending quoted above includes £0.9 billion (2013: £1.4 billion) of fair value adjustments relating to loans where the Group has hedged associated financial risks, typically interest rate risk.

We have undertaken limited amounts of new lending with total gross advances during the year of £65 million. Activity has been concentrated on ongoing management of the existing portfolio with particular focus on managed work out of weak and distressed CRE exposures. This has resulted in a reduction of £2.4 billion of CRE balances during the year, bringing our gross exposure down from £10.2 billion at the end of last year to £7.8 billion at 4 April 2014. In addition, since the year end, we have sold over 90% of our non-UK CRE portfolio representing gross loans of £694 million as at 4 April 2014, with net sales proceeds in line with their carrying value; the sale will be recognised in the first quarter of 2014/15 and will increase our CET1 ratio by an estimated 0.5%.

The level of impaired balances as a proportion of our total CRE exposure has risen from 26% to 39%, reflecting a reduction in the portfolio size and new impairment cases. Whilst we are seeing continued credit risk migration, the rate of deterioration within the portfolio, including the volume of new problem cases emerging, has slowed, reflecting stabilisation in market conditions and the increased proportion of the book which has now been subjected to detailed scrutiny and challenge. Whilst provision coverage is lower at 33% (2013: 35%), the aggregate coverage across the impaired portfolio including collateral valuations has improved from 94% at the end of last year to 102% at 4 April 2014.

Consumer banking and other lending

This comprises retail balances relating to personal loans of £1.9 billion (2013: £1.8 billion), credit cards of £1.7 billion (2013: £1.5 billion) and current account overdrafts of £0.3 billion (2013: £0.2 billion), together with £0.2 billion relating to two portfolios of European business loans originated and managed by our Treasury Division (2013: £0.4 billion including £0.2 billion of student loan exposure sold on 24 April 2013). We have seen steady growth in unsecured retail lending across all three products reflecting our strategy to increase current account market share and serve members across a full range of retail financial services. Delinquency within unsecured portfolios remains stable with full details provided in the Business and Risk Report.

Other financial assets

Other financial assets total £21.3 billion (2013: £28.9 billion) and comprise liquidity and investment assets held by our Treasury Division amounting to £18.0 billion (2013: £23.8 billion), derivatives with positive fair values of £3.0 billion (2013: £4.2 billion) and fair value adjustments and other assets of £0.3 billion (2013: £0.9 billion).

Treasury assets include our on balance sheet primary liquidity amounting to £12.3 billion (2013: £16.9 billion), substantially comprising UK gilts and cash held at the Bank of England, which is held to meet regulatory requirements, and other investment securities and loans to banks of £5.7 billion (2013: £6.9 billion), some of which are eligible as security with central banks to support our broader ongoing management of liquidity. The reduction in treasury liquidity and investment assets totalling £5.8 billion reflects the replacement of on balance sheet primary liquidity with equivalent off balance sheet liquidity in the form of FLS, together with divestment of approximately £1.1 billion of legacy investment assets in line with our ongoing strategy of deleverage of assets which no longer meet risk appetite or regulatory benchmarks. During the financial year an additional £6 billion was drawn down from the FLS scheme and this underpinned our primary liquidity ratio which was 11.9% at 4 April 2014 (2013: 11.1%). Full details of our treasury portfolios are included in the sections of the Business and Risk Report which discuss treasury assets, liquidity and financial risks.

Derivative instruments relate to interest rate and other swaps we use to hedge financial risks inherent in our core business. The fall in value is driven by a combination of interest rate movements and an overall reduction of derivatives with an outstanding maturity of less than one year.

Liabilities

	4 April 2014	4 April 2013	Change
	£m	£m	%
Member deposits	**130,468**	125,574	4
Debt securities in issue	**28,557**	33,429	(15)
Other financial liabilities	**20,621**	23,816	(13)
Other liabilities	**1,374**	1,319	4
Total liabilities	**181,020**	184,138	(2)
Total members' interests and equity	**8,906**	6,580	35
Total members' interests, equity and liabilities	**189,926**	190,718	-
Key ratios	**%**	%	
Primary liquidity ratio	**11.9**	11.1	0.8pp
Wholesale funding ratio	**19.6**	22.5	(2.9)pp

Financial Review continued

Member deposits

Member deposits increased by £4.9 billion to £130.5 billion (2013: £125.6 billion) due to retail inflows and capitalised interest on members' accounts of £1.7 billion (2013: £2.3 billion). We attracted total retail inflows, including non-member balances (categorised within other financial liabilities above), of £2.9 billion (2013: £2.2 billion – outflow). We estimate our share of the balance growth in the UK savings market for the year to be 12.1%.

Debt securities in issue

Debt securities in issue of £28.6 billion (2013: £33.4 billion) are used to raise funding in wholesale markets to finance our core activities. The reduction in outstanding amounts at 4 April 2014 reflects re-financing of natural maturities with drawings under FLS in preference to funding with market counterparties. In the context of our overall funding position, we have made moderate use of FLS, drawing a total of £8.5 billion to date, and the benefits of this cheaper form of funding have been passed on to members through lower mortgage rates in line with the purpose of the scheme. FLS drawings have a contractual maturity of four years but are fully flexible allowing early repayment without penalty at any time.

The reduction in our wholesale funding ratio to 19.6% (2013: 22.5%) reflects this re-financing of wholesale maturities, with off balance sheet FLS drawings which are excluded from the calculation but which we view as flexible wholesale term funding.

Other financial liabilities

Other financial liabilities include customer and bank deposits of £15.3 billion (2013: £16.0 billion), permanent interest bearing shares (PIBS) of £0.6 billion (2013: £1.3 billion), subordinated debt of £2.3 billion (2013: £2.5 billion) and derivatives and fair value adjustments of £2.4 billion (2013: £4.0 billion).

The reduction in PIBS reflects the repurchase in September and October 2013 of £506 million of these capital securities which will become ineligible for regulatory capital purposes on a phased basis under CRD IV, generating a gain of £125 million which is included in other income. This transaction was undertaken as part of the ongoing management of our capital position as we transition to new regulatory capital requirements. We also redeemed $225 million (£138 million sterling equivalent) of subordinated notes in January 2014 at contractual maturity which accounts for the majority of the movement in outstanding subordinated debt during the year. The reported values of PIBS and subordinated debt include adjustments to fair value these liabilities as prevailing interest rates change and these valuation adjustments, which are disclosed in the relevant notes to the accounts, have also contributed to overall movements in our financial liabilities.

Derivatives and fair value adjustments of £2.4 billion (2013: £4.0 billion) included in financial liabilities largely comprise interest rate and other derivatives taken out to hedge our core lending and funding activities. The negative value of these positions has reduced significantly over the course of the year as the upward trend in market interest rates has improved valuations of derivatives used to hedge fixed rate assets.

Capital structure

	4 April 2014 £m/% CRD IV[1]	*4 April 2013 £m/% CRD IV Proforma*	4 April 2013 £m/% Basel II
Capital resources			
Common Equity Tier 1 capital	**5,849**	*4,551*	5,454
Total Tier 1 capital (transitional)	**7,433**	*5,488*	6,894
Total regulatory capital (transitional)	**9,704**	*7,746*	8,496
Risk weighted assets (RWAs)	**40,455**	*50,285*	44,440
CRD IV capital ratios (unadjusted)			
Common Equity Tier 1 (CET1) ratio	**14.5%**	*9.1%*	12.3%
Leverage ratio	**3.3%**	*2.2%*	
PRA adjusted ratios			
PRA adjusted CET1 ratio	**11.2%**		
PRA adjusted leverage ratio	**3.2%**		

[1] Capital resources, RWAs and ratios above are reported under CRD IV on an 'end point' basis with the exception of total Tier 1 and total regulatory capital, which include grandfathered legacy Tier 1 and 2 instruments under transitional rules.

We reported our capital position under the Basel II framework last year. Basel III was implemented through the Capital Requirements Regulation and Directive, together 'CRD IV', and became effective on 1 January 2014. The table above includes prior year amounts on the previously reported Basel II basis and under CRD IV on a proforma basis to aid comparability. The concept of leverage was not captured under Basel II and so was not reported in the prior year. PRA adjusted measures, which are explained further in the Capital Management Report, were not established until 20 June 2013, and so are also not relevant to prior reporting periods.

The impact of CRD IV is complex but in summary tends to reduce capital resources by imposing risk based deductions which were not recognised under Basel II and restricting eligibility of non-core capital instruments either entirely or on a phased basis under transitional rules which extend to 31 December 2021. CRD IV also increases risk weighted assets through a variety of adjustments designed to capture risks associated with the valuation or ultimate realisation of assets which were deemed not to be recognised sufficiently under Basel II. Given these differences in the basis of measurement of our capital position, and the fact that only Basel III is relevant to the regulatory assessment today, the analysis below focuses on the movement in CRD IV measures only.

Our CET1 capital resources have increased over the financial year by approximately £1.3 billion. This increase includes £531 million of net proceeds from our inaugural issue of CCDS in December 2013 and retained earnings of £549 million. The remainder of the increase relates primarily to a £201 million reduction in the adjustment for unrealised fair value deficits on our 'available for sale' portfolio held in Treasury, as a proportion of the assets that have been sold during the year, and the fair value of the remainder has increased as market prices have improved.

Our total capital resources have increased over the financial year by approximately £2.2 billion. The balance of the increase in capital resources relates to our issue of £1 billion of Additional Tier 1 capital securities in March 2014 net of other more minor adjustments, including a reduced level of outstanding permanent interest bearing shares (PIBS) following our redemption of PIBS in September and October 2013.

The issue of CCDS represented a strategically important landmark for Nationwide and is discussed in the Chairman's and Chief Executive's Reports. CCDS are fully qualifying common equity capital instruments under Basel III, but importantly incorporate features which are consistent with a mutual ownership structure. In particular, CCDS holders are members of the Society and the Board acknowledges a fiduciary responsibility towards them; they are subject to the 'one member, one vote' principle in line with other membership interests (although for other reasons in practice their votes are unlikely ever to be exercised in general meetings); the investment returns available to CCDS holders are subject to an inflation linked cap thus mitigating the risk of over distribution; and finally the distribution available to CCDS investors in the event the Society is wound up is restricted to their original investment thus avoiding any incentive to lobby for demutualisation.

Risk weighted assets reduced significantly over the year due to the deleverage of legacy treasury and CRE assets; the total deleverage across these two asset classes during the year amounted to approximately £3.5 billion in gross terms and £5.2 billion in risk weighted terms. In addition ongoing credit risk migration within the CRE portfolio tends to reduce RWAs as exposures are treated as deductions from capital, and hence carry a zero risk weight, when they are classified as in default.

The movements described above have resulted in an increase in our CET1 ratio from 9.1% to 14.5%, and in our leverage ratio from 2.2% to 3.3%, on a like for like basis over the course of the year. On a PRA adjusted basis our CET1 and leverage ratios were 11.2% and 3.2% compared with regulatory targets of 7% and 3% respectively. The regulatory adjustment to our leverage ratio is modest and relates to an asset valuation adjustment of £127 million. The adjustment to our CET1 ratio is more significant due to the fact that for this measure the regulator also introduces a risk weight floor of 15% for residential mortgages, leading to an increase in our RWAs of £10.6 billion (26%).

More details of the capital position are included in the Capital Management Report.

Strategic Review

1 Business model and corporate strategy

Nationwide is the world's largest building society, with over 14 million members, who are also our owners. Our core purpose is enshrined in legislation and has remained broadly unchanged for over 160 years: safeguarding members' financial interests, helping them to save, helping them to buy their own homes and helping them to make the most of their money.

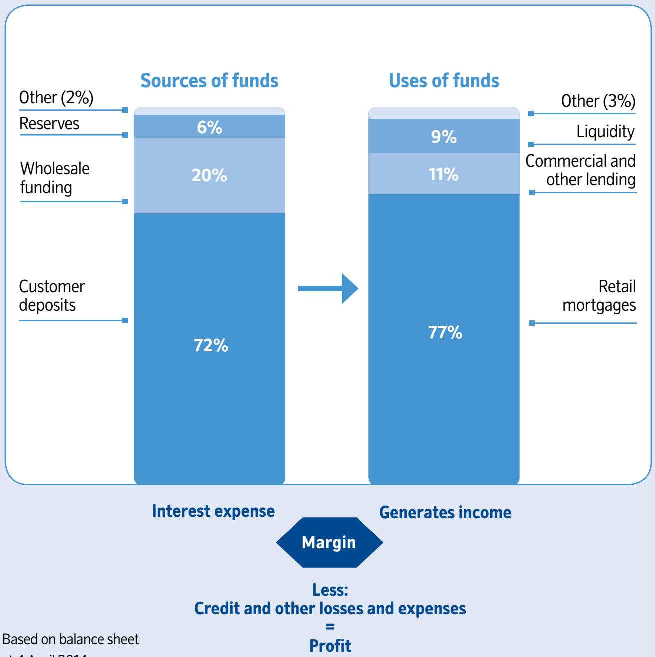
Nationwide offers the only truly national alternative to the UK's large established banks. We are run solely for the benefit of our members, distributing value in a different manner from the plc banks. Whereas banks seek to maximise profits to pay dividends to their shareholders, who may or may not be their customers, Nationwide delivers value through a combination of enhanced service and better long term pricing. As such, we do not have to balance the needs of shareholders with those of customers; for us they are one and the same – our members.

Whilst we have an alternative approach to the banks, as a business we do need to make profits. Our difference is that as a mutual we aim to optimise, not maximise, our profit. We retain only sufficient earnings to ensure the safety and security of our business by supplementing our capital base, supporting future growth, delivering stable earnings to remunerate external capital providers, and allowing us to invest in the business to provide excellent products and an industry leading customer experience for members. Our values, heritage and quality of service are our key differentiators and are at the core of our Society. For this reason, we invest heavily in our culture and our people, who are committed to ensuring the right customer outcomes.

Our low risk business model is predominantly focused on the provision of retail financial services, almost exclusively in the UK. Reflecting the traditional building society model, our balance sheet continues to comprise primarily residential mortgages funded through retail savings and, to a lesser extent, wholesale funding.

We are one of the top three mortgages and savings providers in the UK, with over 11% of the UK residential mortgage market and 10% of the total UK retail savings balances. We generate a margin on the difference between the rate paid on funding and the rates and fees charged for mortgages and other lending. Around 80% of our income is derived from the spread between rates charged to borrowers and rates paid on funding; the balance relates to ancillary fees charged for originating and servicing customer relationships net of amounts paid to third party suppliers who support this activity. This income covers the costs of administering our business, including credit losses and the cost of capital.

Our business model



Based on balance sheet at 4 April 2014

We have long recognised that in order to offer a true alternative it is important that we diversify our business model by offering a full range of personal banking services to new and existing members. In addition to providing members with an enhanced proposition, this helps us to support our business through a diversified income base and allows us to build deeper relationships with our members. We took our first steps in offering current accounts in 1987 and have made steady progress since then in building our market share. Over the past five years we have replaced our core banking system, which has allowed us to expand the range of current accounts we can offer, and we have plans to broaden our range further in the coming years. We also offer a competitive line of consumer lending products, financial planning services, general insurance and protection products, and undertake a limited range of specialist activities including buy to let lending, commercial lending and deposit taking for SMEs.

Our Treasury Division manages our balance sheet in a safe and secure way, ensuring that the day-to-day financial risks which we face are minimised. Under legislation we are not permitted to speculate or trade on financial markets and our use of derivatives is restricted to mitigation of financial risks inherent in our core business, primarily interest rate risk.

We manage our business infrastructure efficiently to ensure that our members' money is not wasted. We are operating in a dynamic market for financial services, with customer preferences evolving at an ever increasing pace. In particular, the demand for digital services is growing rapidly and we aim to remain at the forefront of innovation whilst ensuring that we balance the needs of all elements of our member base. We are focused on providing a simple and efficient business with processes that support our customers, provide flexibility to manage growing volumes of transactions and allow us to respond rapidly to changes in the environment.

Our vision is to be the 1st choice for financial services

We monitor our progress towards achieving our vision through three perspectives:

- our members
- our people
- our business

Strategic Review continued

2 Our members

Our goal is to:

- be the clear number 1 for customer satisfaction
- protect and grow our market shares in: mortgages, savings and current accounts
- grow and deepen our relationships with our members.

Be the clear number 1 for customer satisfaction

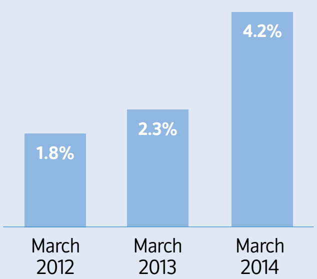
Delivering an exceptional customer experience is central to our philosophy. Our mutual model is based on providing long term good value, but it is also vital that we meet and exceed the service expectations of our members. In particular, we must innovate to provide new services which our members demand and ensure that we are 'easy to do business with'.

We have set ourselves a target of achieving and maintaining a consistent customer satisfaction lead over our high street competitors, with the aim by 2019 of the lead rising to 6%. At the end of 2013/14 our lead stands ahead of our annual target at 4.2%.

We will aim to increase our lead by focusing on a number of critical areas:

- promotion of our brand based on our heritage values of honesty, trust and transparency
- consistent delivery of long term good value
- offering a growing range of digital and mobile services, but mindful of the needs of existing members who wish to continue using more traditional channels
- providing an exceptional member experience.

Customer satisfaction lead* over next high street competitor



2019 target = 6%

Protect and grow our market shares

Mortgages and savings

Providing mortgages and savings is at the core of being a building society. We have been a leading provider for over 160 years and our current shares of the total balances of mortgages and savings in the UK are 11.7% and 10.6% respectively.

Our strategic objective is to maintain our prominent position in the savings market, using long term good value and service as our differentiators. We aim to maintain a market share of at least 10% and seek to match the inflows from savings with high quality new mortgage lending. Our current forecasts of the growth prospects in each market suggest that this will lead us to deliver a mortgage market share in excess of 12% over the medium term. We believe that these market shares will sustain our position as a leading supporter of these markets, allowing us to exploit economies of scale to provide both good value and exceptional service to our members.

Current accounts

A central part of our long term strategy is to grow our share of current accounts to establish a market share in proportion to our shares in mortgages and savings, thereby diversifying our business and extending the price and service benefits of mutuality across a broader set of member relationships.

We gauge our success by measuring our annual business flows and market shares:

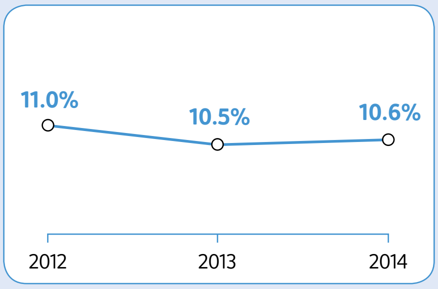
Savings:
During 2013/14 we grew our member deposit balances by £4.9 billion, representing a market share of 12.1%

Mortgages:
Our share of gross mortgage lending over the year was 14.9%, during which we provided one in five of all first time buyer mortgages in the UK

Current accounts:
Over the past year we have opened 430,000 accounts which has taken our share of all main and packaged current accounts from 5.7% to 6.2%.

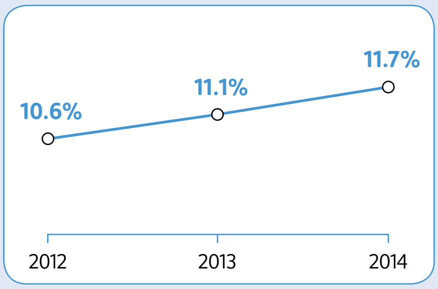
*Lead is not statistically significant for March 2012 or March 2013.
Source: GfK NOP's Financial Research Survey (FRS), 3 months rolling average of interviews for March 2012, March 2013 and March 2014, proportion of extremely/very satisfied customers minus proportion of extremely/very/fairly dissatisfied customers summed across current account, mortgage and savings. High street peer group defined as Barclays, Halifax, HSBC, Lloyds TSB, NatWest and Santander.

Savings balance market share



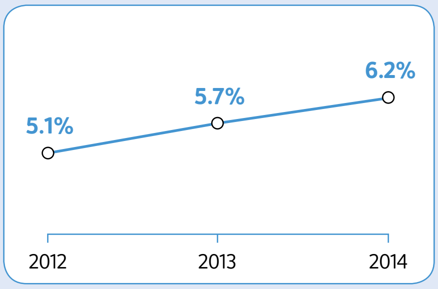
2019 target ≥10%

Mortgage balance market share



2019 target = c12% to balance retail savings flows

Current accounts market share



2019 target = 8.5%

Grow and deepen our relationships with our members

We are aiming to move from relationships centred on the purchase of single products to one where we build lifetime relationships with our members. Our strategy incorporates the development of a suite of products and services to support members at key stages of their lives, ranging from the opening of their first savings accounts, helping them to buy their own homes and the provision of retirement and estate planning. In short, we want to extend the benefits of mutuality by providing more services to more members and ensure that we support members at all stages of their lives.

Over the past year we have sought to develop deeper relationships and reward membership in a number of ways, including the provision of Loyalty Saver, which now has balances of over £17 billion, and the simplification of our savings range, which benefited over 1.5 million saving members. We estimate that the member value from Loyalty Saver alone was in the region of £130 million during the year. We provided exclusive access to our best mortgage deals to existing members and our BMR promise delivered member value estimated at around £800 million.

We measure our success by monitoring the number of our members with whom we have active and substantial relationships. Our targets are based around deepening relationships with existing members and the recruitment of new members.

Looking forward

We are confident that we will be able to deliver our strategic targets, although recognise that we face a number of challenges:

- customer expectations, particularly for digital services and speed of access, will become increasingly demanding
- we must balance the requirements of members who demand more digital services with those who prefer to use traditional channels
- regulation and compliance rules were largely designed in a world of physical interaction, and the industry will need to design processes and systems which deliver compliant solutions in a digital world
- delivering the many rapid and ongoing changes to our business processes may pose challenges.

Strategic Review continued

3 Our people

Our goal is to:

- engage and enable our people to deliver an exceptional member experience.

Our people are central to our delivery of a consistently exceptional member experience. Our people strategy is built around ensuring that Nationwide is a great place to work so that we can attract and retain great people. We enable our people to deliver an exceptional customer experience and empower them through our culture and values. These are captured and delivered through PRIDE:

Putting members first

Rewarding membership

Inspiring trust

Doing the right thing

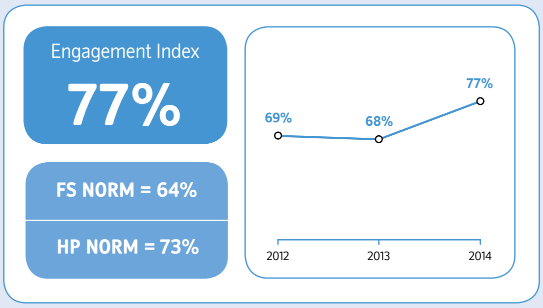
Excelling at service

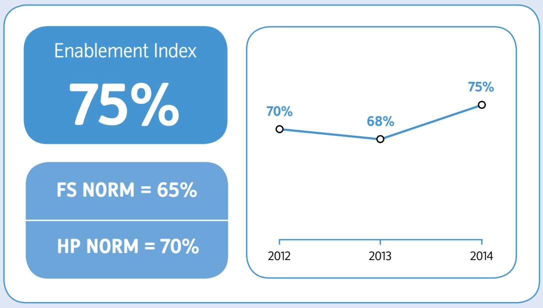
We measure our success in the delivery of a great place to work through an independently run annual employee survey and we seek to exceed high performing benchmark scores across all industries. The latest results show that the enablement and engagement of our people are at record highs of 75% and 77% respectively, both surpassing high performing company norms.

To underpin our strategic goal, we focus on the development, performance, reward and diversity of our workforce.

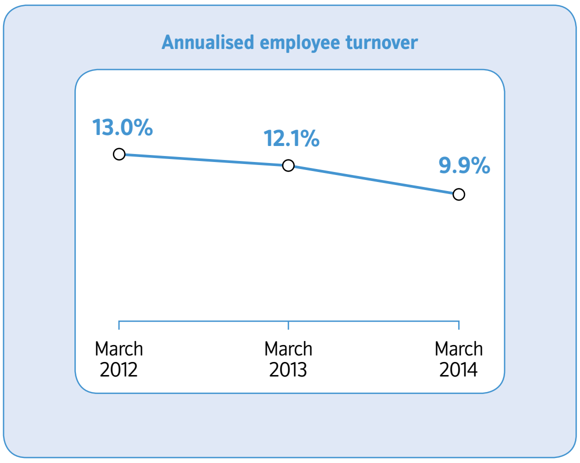
Learning, talent and leadership development

Over the past year we have invested over £11 million in employee development. We operate a number of programmes which help our people develop their skills as their careers progress, with an overall aim of providing a pipeline of talented people to deliver an exceptional customer experience and to lead the business in the future. We recruit people across a broad range of roles, with tailored programmes encompassing all levels from apprenticeships and a management trainee scheme through to focused development for our divisional directors. We have made significant strides in building and developing our talent pipeline and in retaining our people: over the past year we filled 65% of all senior executive vacancies from existing employees, up from 34% in 2009. We operate an ongoing programme of job-specific skills development; in the past year we delivered over 53,000 delegate days of training for our people, and saw over 300,000 online training modules completed.





Benchmarks measured against are:
FS Norm = Financial services normalised scores
HP Norm = High performance normalised scores



Performance, reward and recognition

Reward packages for all of our people are set at or around market median, with each employee rewarded according to their contribution to the business. Employees participate in bonus schemes which, in the main, are based upon the achievement of corporate objectives of customer satisfaction, growth of the business and our financial performance. In addition, we offer a range of retirement benefits and access to a flexible benefits scheme.

Diversity and inclusion

As a major employer at both national and local levels and as a customer facing organisation, we strive to have a workforce that represents both our communities and our membership. We have a range of initiatives supporting our diversity and inclusion regardless of gender, ethnicity, sexual orientation, age and disability. Each initiative is sponsored by a member of the Society's Executive Committee and is supported both by employees and the Nationwide Group Staff Union (NGSU), with whom we maintain a strong and constructive dialogue as we develop our approach to diversity and inclusion.

We have made significant progress in the representation of women amongst our senior executive population, up from 23.3% in 2012 to 27.4% in 2014.

We have had external recognition of the successful execution of our diversity and inclusion strategies from a number of external parties over the past year:

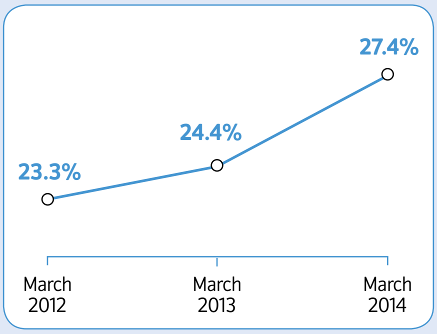
- we were recognised as one of the 25 Best Big Companies to Work For by The Sunday Times
- we were named as one of the top 50 Employers for Women in the UK by The Times in partnership with Opportunity Now
- Stonewall – Top 100 Employers 2014, the definitive list of Britain's most gay-friendly workplaces
- Race for Opportunity – Top 10 Private Sector Organisations for Gender and Top 10 Private Sector Organisations for Race.

Looking forward

It is vital that as the economic recovery continues and the job market strengthens, we continue to deliver an employee proposition that allows us to attract and retain talented people.

We will continue to invest in our people as they are the key to delivering our corporate strategy. We will develop our approach to strategic workforce planning, continue to invest in our leadership capabilities and ensure that our people are able to deliver an exceptional member experience in a more digital workplace.

Percentage of females in executive management roles



Strategic Review continued

4 Our business

Our goal is to:

- run a low risk business model
- deliver optimal levels of profitability
- ensure capital strength with market leading CET1 ratio and leverage ratio above PRA requirements
- deliver operational efficiency and prudent cost management, targeting a cost income ratio of 45-50%.

Run a low risk business model

Our core purpose is to provide mortgage finance funded primarily by retail savings deposits. Under statute, at least 75% of our lending must relate to mortgages secured on residential property. Our prescribed business model is therefore concentrated towards relatively low risk secured loans, and we reinforce this risk profile through the application of consistent and prudent lending policies.

In order to ensure that we maintain a conservatively positioned balance sheet, we monitor the average risk weight attached to our assets under regulatory capital rules, with a risk appetite requirement of top quartile performance relative to our peer group of large retail banking groups.

Deliver optimal levels of profitability

As a mutual we aim to optimise, rather than maximise, our profit. The precise level of profit that we need to retain in the business will depend on many factors, including any changes to minimum capital levels we are required to hold. The Group's current view is that over the medium term progression towards a level of profit after tax in excess of £1 billion will allow us to deliver value to our members, support growth and investment, and meet our current expectations of emerging regulatory capital requirements.

Ensure capital strength with market leading CET1 ratio and leverage ratio above PRA requirements

A core purpose of our business is to provide a safe and secure home for our members' savings. Strong capital ratios and resources comfortably in excess of both current and emerging regulatory requirements are therefore key objectives of our strategy in order to meet the expectations of our members.

Our medium term target is to have a CET1 ratio in excess of 16%, which we believe will result in us being one of the most secure institutions within our peer group. In addition, in light of increasing importance being placed on non-risk based leverage ratios within regulatory capital frameworks, we are targeting a leverage ratio of in excess of 4% in the medium term, well above the existing 3% requirement.

As summarised in the Capital Management Report, we have achieved significant progress in strengthening our capital metrics during the year through the planned reduction of non-core portfolios, increased profitability and the issuance of £550 million of CCDS and £1 billion of AT1 securities. At 4 April 2014 our CET1 and leverage ratios were 14.5% and 3.3% respectively.

We expect our capital ratios to grow further as retained earnings increase towards optimal levels and we continue executing on our strategy of managing down non-core portfolios.

We will continue to engage with regulators and policy makers to understand any potential regulatory changes that may impact capital ratios.

Deliver operational efficiency and prudent cost management, targeting a cost income ratio of 45-50%

In order to provide ongoing and consistent value to our members, it is important that we run our business efficiently and manage costs prudently. We track progress against this by targeting an underlying cost income ratio of between 45% and 50% by no later than 2019.

Over the past year our income has increased by over 16%, whilst our costs have increased by 9%. As a result our underlying cost income ratio has reduced to 52.5% from 55.9% in 2012/13. Cost growth in recent years has been mitigated by savings from our Cost Optimisation Programme which concluded at the end of our last financial year, having delivered annualised benefits of over £200 million, in line with the target we established at the outset.

Notwithstanding our focus on efficiency, we continue to see cost pressures within the business arising from sustained levels of technology investment, increased regulation and volume growth, partially as a result of growing market shares. We expect to see these trends continue, although we also expect cost growth in 2014/15 to be lower than for 2013/14.

To achieve our strategic goal we will continue to enhance our cost management capabilities and prioritise investment to target operational efficiency, as well as product and service innovations and meeting evolving regulatory requirements.

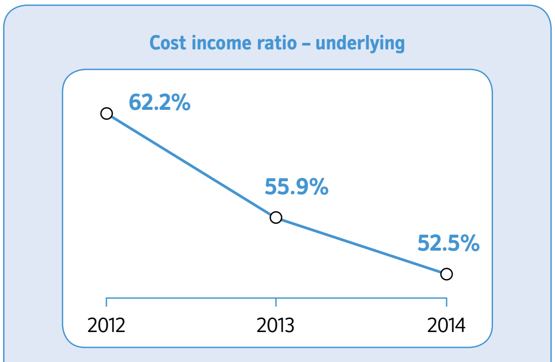
Looking forward

Our business performance is strong, and we believe it will improve further over the coming year, with an increase in margins and a continued growth in profitability towards optimal levels.

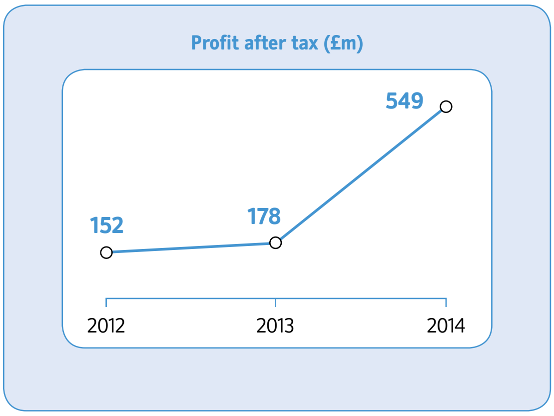
Strengthening financial results have improved our financial risk profile but we remain alert to the following challenges:

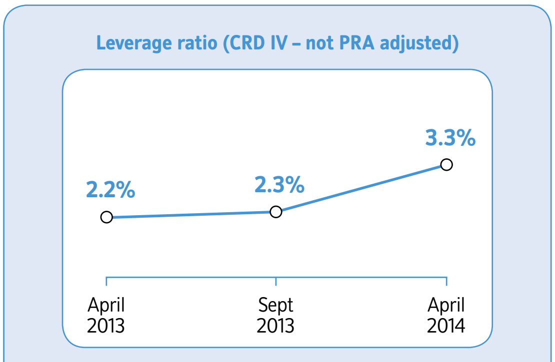
- regulatory requirements may be increased. For example, the minimum leverage ratio, may be set at a higher level than at present. We need to plan our business to accommodate potential increases in requirements
- there is a risk of increased exposure to credit losses in the event that house price inflation causes the UK economy to overheat. We will keep this under review as the situation develops and will maintain our prudent underwriting stance to keep credit losses low
- we expect increased competition from mainstream UK banks as they focus on both service delivery and non investment activities.

Performance and medium term targets

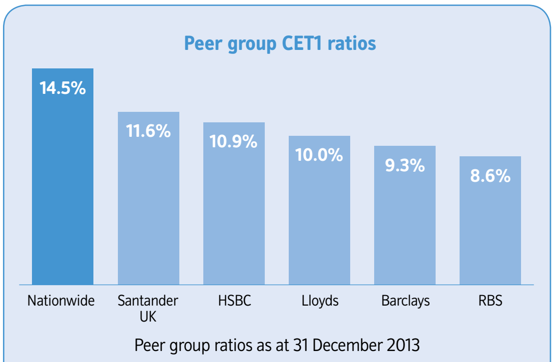


2019 target = 45-50%





2019 target ≥4%



2019 target ≥16%

Risk Overview

In common with other retail financial services organisations, our business model results in a number of inherent risks which are continuously monitored and managed. These are categorised as follows:

- **Lending** – The risk that a borrower or counterparty fails to pay interest or to repay principal on a loan or other financial instrument (e.g. a bond) on time.
- **Financial** – The risk of the Group having inadequate earnings, cash flow or capital to meet current or future requirements and expectations.
- **Operational** – The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.
- **Customer and compliance** – The risk that we fail to design and implement operational arrangements, systems and controls to maintain legal and regulatory compliance, deliver fair customer outcomes and achieve a positive experience for our customers.
- **Strategic** – The risk of significant loss or damage arising from business decisions that impact the long-term interests of the membership, or from an inability to adapt to external developments.

Over the last year, many of Nationwide's risks have reduced substantially. Many of the highest risk commercial and treasury credit exposures have been written down or liquidated. The rest of our credit exposures are performing well, and our capital reserves have been increased both by rising profitability and substantial capital issuance. Market sentiment has become more positive, further increasing our confidence in the business. This year we have also made steady improvements to our controls and our frameworks for managing risks.

Although the condition of the business has strengthened, risks remain. Current positive market conditions may reverse, driven either by UK or overseas events; or resurgent competition may put pressure on our operating margins. It is also almost certain that regulators' and customers' expectations will increase, and their tolerance for failure will reduce. The pace of change and the standards of consistency now required present conduct and operational risks.

Credit rating agencies are reviewing their approach to rating firms' financial strength, which could result in changes to Nationwide's credit ratings. The business is well positioned to adjust to such changes.

Financial strength improving

Managing financial risk is a fundamental part of what we do. Over the past few years, our exposure to financial risk has decreased as our profitability has improved, we have successfully issued new capital and we have been deleveraging our highest risk credit exposures.

A strong capital and funding base is critical to be able to absorb shocks to the business and to meet liquidity and capital regulatory requirements. Improving profitability and successful capital issuances have built up our Common Equity Tier 1 capital ratio to 14.5%, the highest in our peer group, and enabled us to exceed the regulatory requirement for a 3% leverage ratio.

Credit asset quality strengthened

Residential mortgages remain at the heart of our mutual business model, supplemented by consumer lending and property-based commercial lending.

Our portfolios of prime and buy to let mortgages have continued to strengthen. Group mortgage arrears rates (3 months and over) reduced during the year to 0.63% (2013: 0.72%) comfortably lower than the Council of Mortgage Lenders industry figures of 1.59% (2013: 1.89%). Average loan to value also fell to 58% (2013: 62%).

During 2013/14, we also made significant progress reducing our riskiest commercial real estate, specialist mortgage and treasury credit exposures. Total commercial loan impairment losses fell to £309 million (2013: £493 million) and commercial real estate exposures reduced to £7.8 billion (2013: £10.2 billion). Treasury exposures which were originated before the financial crisis, and now fall outside of our current policy, were reduced to £1.8 billion (2013: £2.9 billion).

Financial and lending risks are focused on potential reversals in market conditions

Our balance sheet has strengthened significantly. Management actions have been complemented by improving market conditions. However, we consider the current economic environment could pose three main risks to our continuing ability to manage financial and lending risks:

- UK house prices may prove to be a 'bubble' that bursts; accompanied by a reversal in the UK economy, this could increase credit losses significantly
- resurgent competition could squeeze core margins below sustainable levels
- wider global financial developments, for example the re-emergence of tensions within the Eurozone, could disrupt financial markets impacting the cost and availability of funding.

Regulatory risks

Dealing with regulation is an unavoidable part of running a modern financial institution. Nationwide's business model and member focus has put us in a good position to meet the regulators' expectations of our conduct.

Looking forward, a challenging programme of changes to regulatory, legal and financial reporting standards is planned. These include European regulation, for example the Mortgage Credit Directive, rising standards for conduct and the development of more intensive concurrent stress testing under the Financial Policy Committee.

The regulatory environment presents two top and emerging risks:

- increasing standards for conduct could restrict our channels, services or proposition
- regulatory requirements, for example the minimum leverage ratio, could increase to levels higher than the current business model can support.

Digital transformation

The pace of technological development is creating a period of significant change in financial services. Our aim is to make the most of new technology to achieve our goal of being number one for customer service. We have already successfully delivered a new banking system, mortgage system and mobile banking alongside a number of other technology changes. These changes bring a cluster of operational risks.

During 2013/14 we have made steady improvement in the effectiveness of risk controls across the business, increasing the rigour and consistency of risk management and widening understanding of these processes. There is still more to do, but these processes are proving generally effective. The key current challenge is to maintain the stability and availability of our services, particularly our payments, internet and mobile banking services.

As we continue to invest in new technology, there are three areas that pose a risk to achieving our goals:

- rising customer expectations could exceed our ability to provide highly reliable, widely available services
- executing changes to business processes to adapt to the new environment could disrupt our business or our customers
- building a new digital proposition that appeals to new members could compromise the services that are valued by longer established members.

More detail on our top and emerging risks and risk management at Nationwide can be found in the Business and Risk Report (page 86).

Living on your side: our citizenship strategy

We are two years into our five year citizenship strategy called ‘Living on your side’ which we built around feedback we received from you, our members. And this year has seen us make strong progress against the targets we set ourselves.

Our citizenship strategy focuses on three areas where we feel we can have a significant impact – money management, housing and supporting our members’ local communities – respectively **Your Money, Your Home** and **Your Community**.

In addition, we seek to conduct our business responsibly, by managing our impact on the environment, by creating a great place to work and by ensuring everything we do is ethically grounded. This area of focus we call **Your Society**.

The following pages tell you how we have performed in all four areas.

This is something we do together

A great deal of our citizenship activity is conducted by our employees, both through fundraising and volunteering. Employee involvement has over the course of **Living on your side** gone up from 6% in 2012, to 30% in 2013, to 56% in 2014.

The scale of our employees' involvement also reflects that we have provided more opportunities to get involved and that we offer employees two days’ paid leave each year to pursue volunteering opportunities.

It also helps that so many of our employees genuinely believe in our mutual values and are committed to bringing them to life outside of work as well as in their day jobs.

Our membership get involved too

Two million members joined in our citizenship activity last year by nominating or voting for the local charities we should support or by attending citizenship events or projects.

Independent recognition

For us citizenship is not something extra we do, it characterises everything we do. So we were delighted to be recognised as the UK’s top financial services brand in research conducted in 2013 to identify those brands that take a human approach.*

We retained our Platinum status in the Business in the Community’s Corporate Responsibility Index and also earned their 'Big Tick' for Education. The London Benchmarking Group placed us top in the UK’s financial services sector for employee involvement and fourth overall, within the index.

Governance

While our citizenship strategy is owned by all our employees, overall accountability for it rests with our senior management team and the Board of directors. As shown in the table below.

* Source: Lippincott – Human Era Index

Issue	Responsibility	Position
Occupational health and safety	Graham Beale	Chief Executive
Human rights	Graham Beale	Chief Executive
Employee engagement	Alison Robb	Group Director
Citizenship	Alison Robb	Group Director
Members/customers	Chris Rhodes	Executive Director, Group Retail
Supply chain	Tony Prestedge	Chief Operating Officer
Environment	Tony Prestedge	Chief Operating Officer

Your Society

As your building society, we have a responsibility to conduct our business as you would want us to. That means managing our environmental impact. It means creating a working environment where our people can flourish. And it means ensuring we operate ethically.

The environment

Our main environmental impacts come from our use of energy, water and the production of office waste. The table below shows our targets and how we are doing against them.

This year we are proud to have achieved Carbon Trust Standard Accreditation for the management and reduction of our operational carbon emissions over the last three years. We have registered for participation in Phase Two of the Carbon Reduction Commitment (CRC) scheme and will have to monitor and report on our energy use for a further five years.

One of our main areas of focus this year has been to reduce the amount of waste we send to landfill. Employees have sorted their waste into separate containers for onward recycling or processing into fuel. 'Oscar' (our food digester) was installed in our canteen in June and has already 'eaten' ten tonnes of food waste, using natural enzymes to convert waste into water.

We continue to do what we can to help our members reduce their impact on the environment. Our Green Home Guide, full of energy saving tips and useful contacts, is available online. We also offer further mortgage advances at special rates for energy efficient home improvements. Members who bank with us can sign up to paperless statements and opt to receive their member meetings information by email.

Workplace

We were delighted that this year we were placed 11th in The Sunday Times' list of the Top 25 Big Companies to work for. None of our major banking competitors made the list. In our own anonymous employee survey to which over 90% of our employees responded, our employees' sense of engagement and enablement rose to 77% and 75% respectively. These scores are high even amongst organisations classified as high performing.

Ethical policies

Operating ethically towards all our various stakeholders, in particular members and our employees remains an integral part of our culture. Last year saw us introduce a new rewards scheme into our retail network and contact centres. We have removed sales targets and made customer satisfaction an even more important factor in calculating the bonus our people receive. Our teams can now direct their customers to the most convenient channel available – with no concerns over the impact on their own earnings. Altogether, the new scheme is better for our members; and our people are obviously happier with a scheme that rewards them for helping members.

In addition, working closely with the Nationwide Group Staff Union, we had made a formal commitment to becoming an accredited Living Wage Employer. We had already made this commitment to our own employees, but we are now committing to extend it to everyone working regularly on our premises. This includes temporary workers, contractors and service providers such as cleaning and catering staff.

Environmental impact

	Target	How are we doing?
Energy	Ensure our 2021 carbon emissions remain at or below our 2011 baseline levels.	Our carbon footprint for 2014 was 49,318 tonnes of carbon dioxide. That is 15% below the 2011 level.
Water	Reduce the water consumption of our operations by 10% by 2015 from our 2011 baseline.	We now use 20% less water than in 2011.
Waste	Achieve zero waste to landfill by 2015.	Last year we diverted 94% of our operational waste from landfill. This is compared to just 40% in 2011.

When calculating our carbon emissions we have used the Carbon Trust's 2013 conversion factors.

Your Money

We are committed to empowering one million people to start saving by 2017. People can only start saving if they are comfortable with numbers and have adequate money management skills. That is why so much of what we do in this area is about supporting financial education.

Our target for 2013/14 was to help 186,650 people start saving and we are delighted that we actually helped over 200,000 people.

Talking Numbers

20% of 11 year olds (circa 110,000 a year) leave primary school with numeracy skills below the expected standard. (National Numeracy)

In 2013 42% of pupils failed to achieve at least a grade C in GCSE Maths, the minimum level expected by the government. (Department of Education)

It is against this background that in February we launched a new initiative called Talking Numbers, which aims to help 200,000 young people improve their numeracy skills by 2017. Working with teachers and partner organisations, Talking Numbers will help young people develop their number skills in everyday scenarios – from shopping for bargains to working out ingredients for baking.

National Numeracy

17 million adults, almost half of the working age population, have numeracy skills equivalent to those expected of a primary school child. (National Numeracy)

What Talking Numbers aims to do for children, the National Numeracy campaign aims to achieve for adults. We are now well into our four year partnership with the campaign that aims to improve the numeracy skills of over one million adults.

The Money Advice Trust

Another key focus has been supporting the Money Advice Trust. We provided £65,000 to their 2013/14 Innovation Grants Programme, which for example is funding the development of financial education materials for deaf and blind, blind and partially sighted people. We provided an additional £20,000 to support their general activities including their frontline service, the National Debtline.

Three other highlights

- We completed our second year of sponsorship of the 'Your Money' column in First News – the weekly newspaper for young people, which now has over a million readers.
- We continued to develop new resources for our Nationwide Education site, which remains a treasure trove of games, exercises, quizzes and factsheets. Over 50,000 resources are now downloaded every month.
- We simplified our savings accounts range and brought out four simple new accounts with no introductory bonuses that can be opened and managed however the customer chooses – online or in branch.

Case study – The MoneyLive centre at Safeside in Birmingham

Using an experiential learning centre built as a virtual village, MoneyLive puts young people into real situations like a home, a shop or a Nationwide branch to provide an interactive, engaging and fun way to learn more about managing money. Nationwide and community volunteers work together to provide different skill sessions both within the demo branch and across the whole village.

Gabriel from Heartlands Academy in Birmingham commented: "Exciting, different… We don't usually talk about banking in school but we've learnt what it's like in real life." Fellow pupil, Nadia observed: "Lots of the things we learn in school regarding maths wouldn't come up in everyday lives. Now I can find a balance and know even negative numbers make it in to your bills."

With over 10,000 young people due to visit each year, we are hoping that MoneyLive will have a major impact on young people's money skills.

Your Home

We are committed to helping 750,000 people into a home they can call their own by 2017. That means helping first time buyers, supporting the crucial rental market, providing lending for affordable housing and helping the homeless or those at risk of losing their homes.

For 2013/14 our target was to help 170,000 people into a home they can call their own. During the last year we actually helped more than 200,000 people into a home they can call their own.

First time buyers

We helped around one in five first time buyers in the UK take their first step onto the property ladder in 2013/14. Given that many people buy their first home with a partner or family, we estimate that this performance helped around 116,489 people move into a first home of their own.

Partnership with Shelter

Our four year partnership with Shelter is also making a difference. The charity not only helps vulnerable people who are actually homeless but also intervenes to help those who are at risk of being made homeless. We help fund important services such as their helpline.

The private rental market is not only growing, it is changing. A third of tenants are now families with children, and as many as four in ten tenants receive some housing benefit to pay their rent. We have worked with Shelter to bring more stability to the lives of tenants by promoting longer term tenancies and lifting restrictions on those renting on housing benefit. In 2013 we became the first major buy-to-let lender to allow our borrowers to let to tenants receiving housing benefit.

Employees have also got involved. On Nationwide's Christmas Shelter day they raised £12,000 for the charity and delivered 632 shoe boxes full of presents for Shelter to distribute to disadvantaged families.

Partnership with British Gas

Our buy-to-let mortgage business is conducted through our subsidiary, The Mortgage Works (UK) plc. To help the landlords we lend to fulfil one of their key responsibilities, we have extended The Mortgage Works' partnership with British Gas to provide free gas safety checks on all buy-to-let mortgage completions.

Supporting affordable housing

We have been one of the major lenders to housing associations over the last 20 years. We were also the first lender to commit over £9 billion to the affordable housing sector. And we continue to support a variety of partners, especially social landlords.

Working with The Nationwide Foundation

The Nationwide Foundation's 'Decent, Affordable Homes' strategy aligns with the Living on your side's 'Your Home' agenda. It is focused on bringing empty properties back into use as homes, improving living conditions for vulnerable tenants within the private rental sector and supporting alternative, scalable housing models.

You can read more about what The Nationwide Foundation is doing in these areas on page 39.

Case study – Supporting the Elderly Accommodation Counsel's FirstStop Advice Line

John has muscular dystrophy and his local authority has provided him with care in his own home for the last ten years. When he was advised that they could no longer continue to fund this care and that he may need to move into a residential home, he contacted FirstStop.

FirstStop's national advice line was able to put him in contact with its specialist partner Independent Age who advised him on the law around community care. They also put him in touch with local partner Age UK Norfolk who offered John hands-on support.

With the information, advice and support provided by FirstStop, John feels much more confident in sorting out his care needs. This will enable him to retain his independence and ultimately stay in his own home.

EAC FirstStop
Advice for older people

Your Community

Our goal is to channel £15 million into local communities by 2017 through the donations we make, through employee and customer fundraising and volunteering and by unlocking other stakeholder funding. Critically, our employees and members tell us which charities to support.

In 2013/14 our target was to channel £2.9 million into local communities. We actually achieved £3.9 million.

Member involvement

We estimate over two million members have in some way joined in our citizenship activity. On the 'Your Society' pages at nationwide.co.uk, members can nominate charities they would like us to support and over 10,000 of you have done just that.

Over 7,000 members take part each month voting for a different regional charity in our online Big Local scheme. One million members have taken part in our in branch Community Match scheme where one of three local causes, all nominated by members, can receive a £500 donation as voted for by branch users. The scheme is now promoted in over 545 of our branches.

Since 2005 our AGM vote has raised hundreds of thousands of pounds for charity with a donation given for each vote received. Last year over 850,000 members voted, resulting in a donation of over £175,000 to Macmillan Cancer Support. The funding was used to support people living with cancer who are struggling to keep up with mortgage and rent payments. This year, Shelter will benefit from our donation as you vote.

Employee involvement

Our target for employee involvement for 2013/14 was 40%. So we are delighted that this year we have seen it pass the 50% mark, putting us fourth in the UK across all sectors (based on firms with 2,000+ staff). Our people certainly managed some spectacular feats of fundraising:

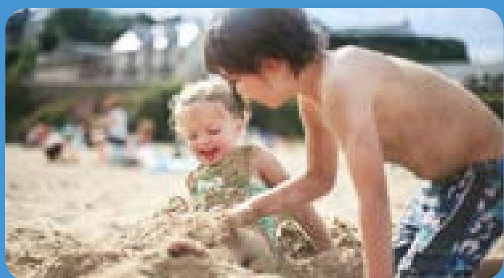
- £133,000 for Macmillan Cancer Support in just one day on their Biggest ever Coffee Morning.
- £135,000 for Children in Need, raised by employees and members across all our big administrative sites and 523 branches. 183 volunteers at one of our call centres took in a further £115,000 of public donations.
- £96,000 for Sports Relief, with five of our contact centres supporting the TV show on the night, 500 volunteers and the greatest number of phone lines we have ever manned bringing in another £200,000 of public donations.

Every Penny Helps

Sometimes a small change can make a big difference. Especially when lots of people make that change. Over 4,000 of our employees have signed up to our Every Penny Helps scheme, which rounds down their monthly salary payment to the nearest pound and collects the surplus pennies for charity. In 2014 that resulted in a £25,000 donation to Macmillan Cancer Support.

Case study – Scotty's Little Soldiers

Set up by Army Widow Nikki Scott, Scotty's Little Soldiers is dedicated to supporting the children of men and women killed while serving in the British armed forces. It was one of many charities that received a donation through our branch based Community Match scheme and our Wisbech branch have decided to raise money for it throughout 2014. The branch's Customer Service Manager, Kate Stratton, fell in love with Scotty's because 'it has holiday homes in Blackpool and Great Yarmouth and organises birthday and Christmas presents for the kids, so it doesn't just support the children financially, it helps to put a smile back on their faces'.



The Nationwide Foundation

Nationwide is the main benefactor of The Nationwide Foundation, an independent registered charity which is funding charitable work to create decent affordable homes for people in need.

The Nationwide Foundation is a registered charity (no.1065552) and a company limited by guarantee registered in England and Wales (no.3451979).

In 2013, The Nationwide Foundation launched its 'Decent, Affordable Homes' funding strategy. By offering grants and social investments to charitable organisations The Nationwide Foundation is working to:

- bring empty properties into use as homes for people in need
- improve the living conditions of vulnerable tenants in the private rented sector
- support alternative, scalable housing models to provide more affordable homes and ensure that their value is recognised by other funders, lenders or government.

Bringing empty properties into use as homes for people in need

Despite the current housing shortage, the UK has an estimated 300,000 long-term empty homes. In 2013/14 The Nationwide Foundation awarded funding of over £720,000 to organisations which turn empty properties into homes for people in need and make them available at a rate they can afford. It also raises awareness of the issue to encourage increased support for this activity.

Improving the living conditions of vulnerable tenants in private rented sector homes

The private rented sector is Britain's fastest growing housing sector, yet living conditions for many tenants are poor and insecure. The Nationwide Foundation is supporting Generation Rent, a campaigning organisation representing private rented tenants. Generation Rent is working towards a vision of well-managed, secure, decent and affordable privately rented homes. In 2013/14 Generation Rent carried out research revealing the challenges facing private rented tenants and began its campaign for meaningful changes that will enable renting to become a more satisfactory tenure.

Alternative, scalable housing models

The Nationwide Foundation is supporting the development of alternative housing models which provide better access to affordable housing for those who need it. Work supported in 2013/14 included funding the provision of specialist homes for people with learning disabilities, funding a pilot scheme that aims to increase the supply of social rent homes, and funding research and development into a specialist affordable housing investment fund. The Foundation also continued its support of the community land trust sector.

As The Nationwide Foundation enters the second year of its strategy, it will focus on influencing policymakers to bring about the conditions for more decent, affordable homes in the UK.

Case study – Golden Lane Housing (GLH)

GLH provides specialist housing for people with a learning disability. A social investment from The Nationwide Foundation has helped GLH raise £10 million to purchase and adapt homes for 99 people who now live independently with support in a decent, affordable home.

Sarah, James, Claire, and Elizabeth moved into their new home in May 2013.

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Governance

Our new redesigned website now makes it much easier to get the online help you need, whether that’s a product, a service or a step-by-step guide. Our Mobile Banking app continues to be highly rated on the app stores, perhaps not surprisingly, as we continue to update and upgrade it in response to your feedback. Our new Homebuyer’s Companion app, full of useful tips and tools, has also been well received.

Board of Directors

As at 4 April 2014

1 Graham Beale BSc, ACA (55)

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

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 Chairman of the Financial Conduct Authority Practitioner Panel and a member of the Building Societies Association Council.

2 Rita Clifton CBE MA (Cantab), FRSA (56)

Term of Office:
Non Executive Director of Nationwide Building Society since July 2012.

Independent: Yes

Skills and experience (including directorships)
Rita holds a number of non executive roles including at BUPA, ASOS and Populus and is a former non executive director of Dixons Retail plc. She is also a fellow of WWF-UK, and sits on the Assurance and Advisory Board for BP's carbon off-setting programme. Rita has over 20 years' senior management experience in a range of roles, with an expertise in demonstrating how brand is an integral part of long-term business strategy and in analysing and understanding consumer perceptions and behaviour. Her executive career has been in advertising, strategic marketing and market research; she was previously Chairman and Chief Executive at Interbrand UK Ltd, and prior to that Vice Chairman at Saatchi & Saatchi. During her career Rita has advised, at the most senior level, some of the UK's best known organisations, including British Airways, Barclays, BT, Citigroup, Visa and the British Army.

3 Alan Dickinson MBA, BSc (Hons), FSS, FCIB, FCIBS (63)

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, 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 Governor of the charity Motability and Honorary Treasurer of Surrey County Cricket Club and a non executive director of Carpetright plc, Willis Limited and Brown Shipley & Co Limited.

4 Geoffrey Howe MA (Cantab) (64)

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 Michael Jary MA (Oxon), MBA, FRAS (50)

Term of Office:
Non Executive Director of Nationwide Building Society since January 2009.

Independent: Yes

Skills and experience (including directorships)
Michael is Chairman of Fairtrade Foundation, the charity working for better prices and decent conditions for farmers in the developing world. He is also Chairman of Duchy Originals, the organic food company founded by HRH The Prince of Wales, and of The Prince's Social Enterprises, a group which gifts its profits to The Prince of Wales's Charitable Foundation. He is a partner and one of the founding team of OC&C Strategy Consultants, a global strategy consulting firm, and an expert in retail and consumer industries.

6 Mitchel Lenson MBA, BA (Hons), ACIB, FSI (59)

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

Independent: Yes

Skills and experience (including directorships)
Mitchel has spent over 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 Committee for both the Corporate and Investment Bank and the Private Client and Asset Management Division. He has also previously served as Managing Director, Global Head of Operations & Operations IT at UBS Warburg and as Director, Group Operations at Credit Suisse First Boston. 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 continued

As at 4 April 2014

7 Lynne Peacock BA (Hons) (60)

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 over 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.

8 Roger Perkin MA (Cantab), FCA (65)

Term of Office:
Non Executive Director of Nationwide Building Society since April 2010 and Senior Independent Director since July 2012.

Independent: Yes

Skills and experience (including directorships)

Roger is a former partner at Ernst & Young LLP and spent 40 years in the accounting profession. During his time at Ernst & Young he worked with many blue chip clients and advised boards across the spectrum of financial services, including banking, insurance, fund management and private equity. He is also a non executive director at Electra Private Equity plc and Tullett Prebon plc, chairing the Audit Committee of both companies, and Friends Life Limited. Additionally, he is a trustee of two charities, Chiddingstone Castle and Crime Reduction Initiatives.

9 Tony Prestedge (44)

Term of Office:
Executive Director of Nationwide Building Society since August 2007.

Skills and experience (including directorships)

Tony is Nationwide's Group Chief Operating Officer and was previously Executive Director Group Development. He previously 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 Services and Product Operations, Telephone Channels, Digital Development, Transformation Delivery, Technology, Payments and Property Services. Tony is a board member of Opportunity Now.

10 Mark Rennison BA, FCA (53)

Term of Office:
Executive Director of Nationwide Building Society since February 2007.

Skills and experience (including directorships)

Mark, a chartered accountant, is the Group Finance Director with responsibility for Finance, Treasury and Corporate Development. 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; whilst in professional practice, Mark also worked extensively with group treasury operations, leasing and asset finance businesses.

11 Chris Rhodes BSc (Hons), ACA (51)

Term of Office:
Executive Director of Nationwide Building Society since April 2009.

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 Retail Director and his responsibilities include Nationwide's retail product range, distribution 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. Chris is a non executive director of Visa Europe Limited and a board member of National Numeracy.

Board of Directors continued

As at 4 April 2014

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

Directors' Report

For the year ended 4 April 2014

The directors have pleasure in presenting their Annual Report and Accounts for the year ended 4 April 2014.

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 (IFRSs) 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, underlying results which allow comparison between 2014 and 2013 are given in the Strategic Report and the Financial and Risk 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 Strategic Report of this Annual Report and Accounts, which also includes the Chairman's Statement and the Chief Executive's Review, and are incorporated into this report by reference.

Business objectives

The Group's vision is to be the first choice for financial services in the UK. The principal purpose of the Society and its subsidiaries (the Group) is to safeguard its members' financial interests, help them to save, help them to buy their own homes and help them to make the most of their money. The Group aims to run a low risk business model, providing a full range of personal financial services including mortgages, savings, banking and insurance. The Group also undertakes a limited range of specialist activities including buy to let lending, commercial lending and deposit taking for SMEs.

Strategic Report, future developments and key performance indicators

The Group's business and future plans are reviewed in the Strategic Report. This report also includes the Group's principal key performance indicators.

Profits and capital

Profit before tax for the year ended 4 April 2014 was £677 million (2013: £168 million). The profit after tax transferred to the general reserve was £549 million (2013: £178 million).

Total Group reserves at 4 April 2014 were £7,383 million (2013: £6,580 million). Further details on the movements of reserves are given in the Group statement of movements in members' interests and equity.

Gross capital at 4 April 2014 was £11,776 million (2013: £10,424 million) including £531 million (2013: £nil) of core capital deferred shares (CCDS), £992 million (2013: £nil) of other equity instruments, £2,269 million (2013: £2,540 million) of subordinated debt and £601 million (2013: £1,304 million) of subscribed capital. The ratio of gross capital as a percentage of shares and borrowings at 4 April 2014 was 6.8% (2013: 6.0%) and the free capital ratio was 5.9% (2013: 5.1%). The Annual Business Statement gives an explanation of these ratios.

In December 2013 the Society issued 5,500,000 new £1 CCDS at £100 per share. The gross proceeds of the issuance were £550 million (£531 million net of issuance costs). The directors have declared an unconditional final distribution of £5.50 per CCDS in respect of the financial year ended 4 April 2014, amounting in aggregate to £30 million, for payment in full on 20 June 2014. The distribution will be recognised in the statement of movements in members' interests and equity in the financial year ending 4 April 2015.

On 4 March 2014 the Society announced the issuance of £1,000 million (£992 million net of issuance costs) of new Additional Tier 1 (AT1) capital. The AT1 securities pay a fully discretionary, non-cumulative fixed coupon at an initial rate of 6.875% per annum. The rate will reset on 20 June 2019 and every five years thereafter to the five year mid swap rate plus 4.88%. Coupons are paid semi-annually in June and December. The first coupon payment of £19 million, covering the period to 19 June 2014, is expected to be paid on 20 June 2014 and will be recognised in the statement of movements in members' interests and equity in the financial year ending 4 April 2015.

Mortgage arrears

The Group mortgage portfolios at 4 April 2014 included 2,349 mortgage accounts (2013: 2,415), including those in possession, where payments were more than 12 months in arrears. The total amount of principal loans outstanding in these cases was £314 million (2013: £334 million). The total amount of arrears in these cases was £27 million (2013: £28 million) or 0.02% (2013: 0.02%) of total mortgage balances. The mortgage arrears methodology is based on the Council of Mortgage Lenders' 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 £1,815,557 (2013: £1,468,133), including £858,333 (2013: £567,500) to the Nationwide Foundation, further details on the Foundation are provided in the relevant section of the Strategic Report. In addition the Society has contributed employee time for volunteering programmes at a cost of £1,342,178 (2013: £382,875), resulting in a total commitment to the community of £3,157,735 (2013: £1,851,008). No contributions were made for political purposes. 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 balances, and to transfer any surplus to the Big Lottery Fund for the benefit of good causes which have a social or environmental purpose.

Directors' Report continued

The Society transferred £3,781,868 on 5 April 2013 to the Reclaim Fund Limited, the administrators of the unclaimed assets scheme. Subsequent to the year end the Society transferred an additional £6,060,550 to the scheme on 7 April 2014 so that total contributions from inception to that date are £46,438,892.

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 12 days at 4 April 2014 (2013: 15 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 risk management objectives and policies of the Group are shown in the Financial and Risk Review.

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
- operational risk
- customer and compliance risk
- strategic risk.

The Group has established a number of committees and policies to manage these risks. These are set out in the Financial and Risk Review and in the Report of the Directors on Corporate Governance.

The Financial and Risk Review also details those risks which are considered the Group's top and emerging risks that could affect the delivery of the Corporate Plan.

Employees

Nationwide has a culture focused on delivering an exceptional customer experience at all times. This culture is underpinned by PRIDE:

- Putting members first
- Rewarding membership
- Inspiring trust
- Doing the right thing
- Excelling at service

PRIDE is understood by all our employees, supports the delivery of our member promise of being 'On your side' and is the combination of principles, values and behaviours which form the basis of our employment proposition and our ability to achieve fair customer outcomes. As a key element of our corporate strategy, we aim to achieve industry leading levels of employee engagement and enablement, maintaining our unique culture as the leading mutual financial services organisation.

If we are to deliver our strategic aims, we must maintain an inclusive culture in which employees can perform to their full potential. As a national organisation with local representation, the Society aims to contribute to each of its communities; our Corporate Citizenship strategy enables employees to support those communities through our volunteering programme.

We have continued to invest heavily in the development of leaders and employees at every level of the Society, with a particular focus on identifying and developing key talent to ensure we have the capabilities and succession required to deliver our strategy. In addition, we recognise that we must also deliver a steady flow of new talent to our business, and actively recruit from external sources. This includes award winning graduate programmes and apprenticeship schemes.

We have a range of ongoing initiatives supporting our diversity policies on gender, ethnicity, sexual orientation, age and disability. Our approach to diversity and inclusion is widely recognised and has led to a number of awards including being named as one of the top 50 employers for women by The Sunday Times and inclusion in the Stonewall Top 100 index. In addition, the 2013 Business in the Community gender and race survey resulted in Nationwide being the only financial services organisation in the Top Ten Private Organisations list, receiving platinum and gold for our work in gender and race respectively.

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.

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

For further details on the Society's people strategy please see the 'Our People' section of the Strategic Review.

Environment

As a business we remain committed to managing our environmental impacts. We have created a bold vision to be a leader in 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. We have committed ourselves to ensure our carbon emissions are no higher in 2020 than our 2010/11 baseline, against the background of increasing business volumes.

We measure carbon emissions from our use of electricity and gas and the fuel used in our fleet vehicles. The majority of emissions are from the energy we use to provide financial services to our members. Energy is used to power our IT infrastructure, our branches and our administration centres. More of our members are opting to use online banking, increasing the challenge of maintaining our energy consumption below the 2010/11 baseline. Nevertheless, we have made excellent progress through our investment in energy management, our branch refurbishments and modernisation of IT infrastructure and storage.

Further details of our activities can be found in our citizenship strategy report and on Nationwide Building Society's website at nationwide.co.uk (citizenship section). A summary of our greenhouse gas emissions performance is as follows:

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.

As required by the Building Societies Act 1986 (the Act), the directors have prepared an Annual Report and Accounts which gives 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 provides details of directors' emoluments in accordance with Part VIII of the Act and regulations made under it. The Act states that the requirements under international accounting standards achieve a fair presentation. In preparing the Annual Report and Accounts, the directors have:

- selected appropriate accounting policies and applied them consistently
- made judgements and estimates that are reasonable and prudent
- stated whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements
- prepared the financial statements on the going concern basis.

	2013/14	2012/13	Baseline year (2010/11)
Carbon dioxide (CO_2e) in tonnes[1]			
Scope 1 emissions[4]			
Energy	**4,020**	4,008	4,890
Travel	**2,208**	2,105	2,448
Scope 2 emissions[5]			
Electricity	**43,090**	43,975	50,802
Total Scope 1 and 2 emissions	**49,318**	50,088	58,140
Total carbon dioxide (CO_2e) in tonnes per FTE	**2.80**	2.96	3.46
Waste diverted from landfill	**94%**	83%	43%
Water use (cubic metres)	**205,254**	193,271	259,718

Notes:

1. CO_2e is an abbreviation of 'carbon dioxide equivalent' and is the internationally recognised measure of greenhouse emissions.
2. When calculating our carbon emissions we have used the Carbon Trust's 2013 conversion factors.
3. Our carbon footprint has been restated for all years in order to account for material changes to the conversion factors provided by Defra for company reporting purposes.
4. Scope 1 covers direct combustion of fuels and company owned vehicles.
5. Scope 2 covers emissions from electricity and steam purchased for own use.

Directors' Report continued

As required by the Disclosure and Transparency Rules of the Financial Conduct Authority the directors have included a management report containing a fair review of the business and a description of the principal risks and uncertainties facing the Group. This information is contained in the Strategic Report and the Financial and Risk Review. In addition to the Annual Report and Accounts, as required by the Act the directors have prepared an Annual Business Statement and a Directors' Report, each containing prescribed information relating to the business of the Society and its connected undertakings.

The British Bankers' Association Code for Financial Reporting Disclosure (the BBA Code), published in September 2010, 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 2013/14 financial statements and 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:

- further development of the improved risk disclosures following the recommendations on qualitative principles and best practice of the Enhanced Disclosure Task Force
- best practice and recommendations in accordance with the regulator's hot topics such as including further quantitative and qualitative disclosures regarding forbearance activities and providing granularity around the disclosure of the fair value of loans at amortised cost
- the inclusion of a Strategic Report in compliance with the disclosure requirements of the 2012 UK Corporate Governance Code to provide additional context to the financial statements with insight into the business model and the Group's main corporate objectives, and
- Ensuring that, taken as a whole, the Annual Report and Accounts are fair, balanced and understandable and provide the user with the necessary information required to assess the Group's performance, business model and strategy.

A copy of the Annual Report and Accounts can be found on Nationwide Building Society's website at 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.

The Group will publish information in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013 on its website at nationwide.co.uk

Directors' statement pursuant to the disclosure and transparency rules

The directors confirm that, to the best of each director'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 Strategic Report and the Financial and Risk 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 Building Societies Act
- establish and maintain systems of control of its business, records, 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 have satisfied 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 the management of 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, its financial position and capital structure, factors likely to affect its future development and performance and its approach to risk management are described in the Strategic Report and the Financial and Risk Review.

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 ratios and its total capital resources are comfortably in excess of PRA requirements.

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.

Fair, balanced and understandable

The directors are satisfied that the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable, and provide the information necessary for members and other stakeholders to assess the Group's performance, strategy and business model.

Details of the governance procedures which have been embedded to support this can be found in the Audit Committee report.

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)

Graham Beale
(Chief Executive)

Tony Prestedge
(Chief Operating Officer)

Mark Rennison
(Group Finance Director)

Chris Rhodes
(Group Retail Director)

Rita Clifton

Alan Dickinson

Michael Jary

Mitchel Lenson

Lynne Peacock

Roger Perkin

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 all of the directors will stand for re-election at the 2014 AGM, with the exception of Alan Dickinson who has indicated his intention not to seek re-election at the meeting.

Michael Jary acquired 836 core capital deferred shares in Nationwide Building Society on 9 January 2014. None of the directors has any other beneficial interest in equity shares in, or debentures of, any connected undertaking of the Society. 50% of awards to Directors from the 2013/14 Annual and 2011-14 Medium Term Performance Pay Plans will be linked to the value of the Society's core capital deferred shares, details of which have been provided in the Report of Directors on Remuneration.

The auditors

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

Geoffrey Howe
Chairman, 27 May 2014

Report of the Directors on Corporate Governance

For the year ended 4 April 2014

Dear Member,

As Chairman of your Board one of my principal responsibilities is to ensure that Nationwide maintains high standards of governance in the interests of all our members.

The environment in which Nationwide operates has continued to evolve over the past 12 months and has seen the culmination of a number of years' development with the listing of core capital deferred shares (CCDS) in December 2013. This new form of capital addresses some of the new regulatory requirements whilst at the same time being consistent with our mutual ethos and provides sufficient flexibility to raise capital in an increasingly demanding and competitive landscape.

Although CCDS are listed on the London Stock Exchange, your Board remains committed to maintaining Nationwide's position as the world's largest building society and to continue the tradition built over 160 years in looking after our members' interests. We aim to deliver great value to our members as a modern, mutual building society for many years to come.

During the period under review we have complied with the Building Societies Association's guidance on the revised UK Corporate Governance Code (the Code) and set out in this report is a fuller explanation of how the principles and provisions of the Code have been applied by your Board, covering leadership, effectiveness, accountability, remuneration and relations with members/CCDS holders.

A copy of the Code is available at nationwide.co.uk. Details of the Group's business model and strategies for delivering our objectives are set out in the Strategic Report.

The governance framework by which your Board continues to provide strong and effective leadership has continued to develop. During the year we commenced the search for my replacement and on 2 May 2014 it was announced that David Roberts would join the Board as Chairman Elect on 1 September 2014 with the intention of taking over as Chairman upon my retirement at the AGM in July 2015.

This year I have asked my Board colleagues, Roger Perkin and Alan Dickinson to contribute to this report by outlining the work of the Audit Committee and Board Risk Committee respectively, as well as setting out my own account of the work of the Nomination Committee.

Good progress has been made on the equality and diversity agenda and externally we have been recognised as an upper quartile employer by external bodies, Opportunity Now, Race for Opportunity and Stonewall. We remain committed to the recommendations of the Lord Davies review and are active participants of the Government's 'Think, Act, Report' scheme. We seek to embrace the opportunities that this agenda presents, ensuring we continue towards implementing diversity and inclusion best practice, with the agenda continuing to be given the space for discussion and action at Board level.

Further details on our diversity policy are set out in the Strategic Report.

Thank you for your continued support and I look forward to serving you during what will undoubtedly be another challenging year ahead, but one for which we are well prepared and we will continue to strive to be the first choice for financial services in the UK.

Geoffrey Howe
Chairman

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Leadership

The principles of the UK Corporate Governance Code are that:

- **every company should be headed by an effective Board collectively responsible for the long term success of the Group**
- **there should be a clear division of responsibilities at the head of the Group between the running of the Board and the Executive responsibility for the running of the Group's business. No one individual should have unfettered powers of decision**
- **the Chairman is responsible for the leadership of the Board and ensuring its effectiveness on all aspects of its role and**
- **as part of their role as members of a unitary board, non executive directors should constructively challenge and help develop proposals on strategy.**

The Group's governance structure is based on the leadership principles in the Code. The key activities of the Board and its committees are documented and planned on an annual basis and form the structure within which the Board operates. The Board's primary role is to focus on the formulation of strategy and review of business performance and also to ensure that risks are identified and managed, and that a sound system of internal controls is in place. The Board regularly monitors performance against delivery of the Corporate Plan which sets out the Group's strategy for the next five years and is approved in March each year. The Corporate Plan is assessed on the basis of current and prospective market conditions and it is the Board's role to establish the guidelines within which the business is managed with the aim of ensuring the Group's long term success. In a fast moving and evolving market place it is important for the Board to ensure that it is aware of changing demands and to be able to respond to them in a timely and appropriate way.

The Board's terms of reference are reviewed on an annual basis and include a number of specific matters reserved to the Board. A copy is available at nationwide.co.uk, along with the terms of reference of the Board's principal committees. The structure and an overview of the roles of the Board committees are set out below.

Board

Formulate strategy, control and review of business performance

Ensure risks are appropriately identified, managed and a sound system of internal controls and set risk appetite

Remuneration Committee

Lynne Peacock (Chairman)
Michael Jary
Rita Clifton

Determine and agree the framework for remuneration of the Chairman, executive directors and senior executives

Nomination Committee

Geoffrey Howe (Chairman)
Roger Perkin
Alan Dickinson
Lynne Peacock

Review the structure, size and composition of the Board, undertake succession planning and identify candidates to fill Board vacancies

Audit Committee

Roger Perkin (Chairman)
Alan Dickinson
Rita Clifton
Lynne Peacock

Review the adequacy of the systems of financial and business control maintained by the Group. Review of financial reporting and recommend its approval by the Board

Board Risk Committee

Alan Dickinson (Chairman)
Roger Perkin
Lynne Peacock
Mitchel Lenson

Review the risk management framework to ensure that it is appropriate to mitigate current and prospective risks arising from the Group's business activities and future agreed strategy and ensure it operates within agreed risk appetite

Chief Executive

Graham Beale

Responsible for the management of the Society's business not contained within the matters reserved to the Board

Results Approval Committee

Geoffrey Howe (Chairman)
Roger Perkin
Graham Beale
Mark Rennison

Review and execute the decisions made by the Board in relation to periodic financial reporting

Executive Committee

Graham Beale (Chairman)
Mark Rennison
Tony Prestedge
Chris Rhodes
Alison Robb
Graeme Hughes
Iain Laing
Julia Dunn

Direct and co-ordinate the management of the business within the strategy, policies, objectives, frameworks, budget and authority approved by the Board

Board IT Strategy and Transformation Committee

Mitchel Lenson (Chairman)
Alan Dickinson
Roger Perkin
Michael Jary

Provide oversight of the strategic investment portfolio and delivery of the transformation business case, the IT Strategy, architecture, delivery road map, governance controls and expenditure programmes of over £50 million

Report of the Directors on Corporate Governance continued

The Chairman and Chief Executive roles are separate and have been clearly defined, set out in writing and approved by the Board and are available at nationwide.co.uk. The Chairman is responsible for providing strong leadership of the Board and ensuring a high quality of decision making at Board level. The Chairman encourages open and honest debate and constructive challenge, as well as leading the process of setting the strategic direction and promoting the long term success of the Society. The Chief Executive is responsible for directing and co-ordinating the management of the Group's business and is supported by the Executive Committee. The role of the Executive Committee is to direct and co-ordinate the management of the business within the strategy, policies, objectives, frameworks, budget and authority approved by the Board.

Details of the skills, experiences and other directorships, together with committee memberships are set out in the Board of directors section of this report. All of the non executive directors are considered to be independent based upon the guidance in the Code, including the Chairman at the time of his appointment.

The role of the non executive director is to use their skills and experience to bring an independent view to support and challenge the work and recommendations of the executive team. The letters of appointment and additional job information summaries set out the roles and responsibilities of the non executive directors. Each non executive director was selected to bring not only a broad range of business knowledge and experience but also to provide specific skills in key areas such as information technology, strategy, brand, finance, risk and banking. Amongst their key responsibilities are to monitor business performance and provide constructive challenge, advice and recommendations on matters relating to the strategy and performance of the Group, present and future availability of resources, and standards of conduct, compliance and control.

Roger Perkin is the Senior Independent Director (SID) and his role is to support the Chairman in leading and managing the Board, to act as an intermediary for other Directors, and to ensure the views of members and other stakeholders are conveyed. He is also responsible for leading the annual evaluation of the Chairman's performance and has been instrumental in leading the search for a successor to Geoffrey Howe, who will retire in July 2015.

Board members' individual responsibilities are set out in the Group's High Level Business Control Manual. This document includes details of the governance and management structure and management's delegated authorities.

As part of the ongoing governance arrangements the Chairman and the non executive directors meet at least twice a year without the executive directors present.

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

The Board held 13 meetings during the year, including an annual strategy conference in September. A Board forward agenda has been developed which sets out the main issues to be considered in the year ahead and this is supplemented by topical issues on any items requiring Board consideration.

Current directors	Board	Audit Committee	Nomination Committee	Remuneration Committee	Board Risk Committee	Board IT Strategy & Transformation Committee	Results Approval Committee
Graham Beale*	13 (13)	-	-	-	-	-	2 (2)
Rita Clifton	13 (13)	7 (7)	-	9 (10)	-	-	-
Alan Dickinson	12 (13)	7 (7)	5 (7)	-	5 (6)	3 (4)	-
Geoffrey Howe	13 (13)	-	7 (7)	-	-	-	2 (2)
Michael Jary	13 (13)	-	-	10 (10)	-	3 (4)	-
Mitchel Lenson	13 (13)	-	-	-	6 (6)	4 (4)	-
Lynne Peacock	13 (13)	6 (7)	7 (7)	10 (10)	6 (6)	-	-
Roger Perkin	13 (13)	7 (7)	7 (7)	-	6 (6)	2 (4)	2 (2)
Tony Prestedge*	13 (13)	-	-	-	-	-	-
Mark Rennison*	13 (13)	-	-	-	-	-	2 (2)
Chris Rhodes*	13 (13)	-	-	-	-	-	-

*Executive directors

The following items were reviewed on a regular basis during the period under review:

- Monthly reports from the Chief Executive and Group Finance Director covering business performance, customer service, regulatory and market developments and the financial position including capital, liquidity and funding
- Review of the interim and annual results and the interim management statement
- Papers on business strategy
- Papers on the development and subsequent issuance of CCDS, AT1 and related issues
- Papers on the business strategy and Corporate Plan
- Reports on the Group's overall risk profile relative to its stated risk appetite and limits and quarterly updates from the Chief Risk Officer and Chief Compliance Officer
- Reports on member engagement and customer experience
- Papers on people related developments
- Regulatory reports
- Minutes and reports from the chairs of the Board committees and governance updates.

Effectiveness

The principles of the Code are that:

- **the Board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the Group to enable them to discharge their respective duties and responsibilities effectively**
- **there should be a formal, rigorous and transparent procedure for the appointment of new directors to the Board**
- **all directors should be able to allocate sufficient time to the Group to discharge their responsibilities effectively**
- **all directors should receive induction on joining the Board and should regularly update and refresh their skills and knowledge**
- **the Board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties**
- **the Board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors**
- **all directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.**

The Board has a composition and succession plan which is reviewed on an annual basis by the Nomination Committee and the Board. It provides guidance on the structure, size and composition of the Board and its committees and the identification and selection of suitable candidates for appointment to the Board and its committees.

During the year Roger Perkin, in his role as SID, led a process in conjunction with the Nomination Committee to instigate a search to identify a new non executive director who will succeed the Chairman in July 2015. A role specification was drawn up and JCA Group were engaged to assist in the process. JCA Group has no other connection with the Group. A shortlist of candidates was formulated and interviews held with suitably qualified and experienced candidates and details of the outcome of this process are set out in the Chairman’s letter above. There were no other Board changes during the year. Alan Dickinson has indicated he will not be seeking re-election at the AGM in July 2014.

All directors must meet the tests of fitness and propriety laid down by the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA), in addition to fulfilling the requirements of the role specification, and must be registered as an ‘approved person’ in order to fulfil their controlled function as a director.

Members of Nationwide also have the right to nominate candidates for election to the Board, subject to Nationwide’s rules and compliance with the PRA’s and FCA's requirements. No such nominations had been received by 4 April 2014, which was the deadline for the AGM in 2014.

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

Non executive directors are expected to commit at least 30 days per annum in exercise of their duties. However, this is a minimum requirement and they each spend longer than this when taking into account the number of Board and committee meetings, training sessions, branch and administration centre visits and meetings with the regulators. Committee chairs' time commitment is significantly more than 30 days per annum.

The Nomination Committee considers on an annual basis that each non executive director continues to allocate sufficient time to discharge their responsibilities effectively.

The Board has a comprehensive induction and development programme for both new and current directors. A structured and tailored induction programme enables new directors to make an early and effective contribution. A formal training and development framework for non executive directors has been established and the Board also receives regular, at least quarterly, training sessions to address a range of both Group specific and market related issues. During the year a number of such sessions were held covering the sales framework, continuing obligations, approved persons and the Mortgage Market Review.

The Chairman meets with each non executive director twice a year to review performance and to discuss development and training opportunities using both internal and external resource. This process ensures a two way feedback mechanism to assess how the Board is working and how the director is contributing both now and in the future and provides a valuable input into the analysis of the Board’s ongoing performance.

Report of the Directors on Corporate Governance continued

The Chairman spends a minimum of two and a half days a week on the Group's business and has not changed his other directorships during the year, details of which are set out in the Annual Business Statement. Following the annual evaluation of the Chairman's performance by the SID, in conjunction with the other directors, it was concluded that he continues to fulfil his role very effectively and allocates sufficient time to meet the increasing demands placed upon the Chairman of a large retail financial services business.

Executive directors' performance was assessed against agreed objectives set by the Chief Executive, whose performance was in turn evaluated by the Chairman. Details of how the executive directors' performance is measured, monitored and assessed are set out in the Report of the Directors on Remuneration.

During the year the Board agreed to carry out an internal effectiveness review, following the external evaluation carried out in the previous year. The Chairman and Group Secretary developed a questionnaire which focused on a number of key areas including the boardroom, Board composition/succession, strategy and performance, risk management, relations with key stakeholders/regulators and Board committees. The results of the questionnaire were collated and formed the basis of a paper and Board discussion at which a number of recommendations were made to the form and content of the agenda for Board meetings, including more detailed analysis of the Society's peer group together with a number of ways of better utilising the non executive directors knowledge and experience to support Board discussions. The output from the previous year's external evaluation carried out by Dr Tracy Long from Boardroom Review focused on Board dynamics, Board composition and strategic debate. An update on progress with the recommended actions was presented by the Chairman in December.

Each of the principal Board committees carry out separate evaluations of their own performance, led by the committee chairs, with input provided by each committee member and regular attendees. Recommendations from the evaluations are implemented during the year, as appropriate.

All directors have access to the services and advice of Simon Waite, the Group Secretary and are able to obtain independent, professional advice on matters relating to their responsibilities. Under the Society's Rules, 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.

The Board has in place a conflicts of interest policy which incorporates procedures for reviewing and, as appropriate, authorising situations where conflict arises. Directors are required 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 SID has been delegated with the authority to authorise interests and directors notify such interests as and when they arise and these are confirmed on an annual basis with the Nomination Committee reviewing the Register of Interests in April each year.

Good progress has been maintained in respect of the development of the Group's talent and succession strategy to extend and strengthen the talent pipeline and increase the available pool of talent for senior executive and director roles. A full account of talent and succession matters has been presented to the Board and Nomination Committee during the year.

The Executive Committee executes the talent strategy and during the year a comprehensive review of senior executive talent was carried out.

The Board continues to comply with the Code provision which recommends that each of the directors stands for re-election on an annual basis and accordingly all directors will stand for re-election in 2014.

Accountability

The principles of the Code are that:

- **the Board should present a fair, balanced and understandable assessment of the Group's position and prospects**
- **the Board is responsible for determining the nature and extent of the significant risks it is willing to take to achieve strategic objectives**
- **the Board should maintain sound risk management and internal control systems**
- **the Board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal controls and for maintaining an appropriate relationship with the Group's auditors.**

The Board is committed to providing members with a transparent assessment of the Society's position and prospects and this is reported through this report and the Interim Financial Statements and Interim Management Statements.

The arrangements established by the Board for the application of risk management and internal control principles are set out in the Board Risk Committee Report and Business and Risk Report.

The Board has delegated to the Audit Committee oversight of the management of the relationship with the Society's auditors, details of which are set out in the Audit Committee Report.

The Board is responsible for the Group's system of internal control, which is designed to facilitate effective and efficient operations and to ensure the quality of internal and external reporting and compliance with applicable laws and regulations. In establishing and reviewing the system of internal control, the directors consider the nature and extent of the risks facing the Group, the likelihood of a risk event occurring and the costs of control. A system of internal control is designed to manage, rather than eliminate, the risk of failure to achieve business objectives, and can therefore only provide reasonable but not absolute assurance against the risk of material misstatement or loss.

The directors and senior management are committed to maintaining a robust control framework as the foundation for the delivery of effective risk management. They acknowledge their responsibilities in relation to the Group's system of internal control and for reviewing its effectiveness. The Group's Enterprise Risk Management Framework (ERMF) defines mandatory controls for all material risk types, and the requirement for all colleagues to comply with policies within the framework.

The process for risk identification, measurement and control is integrated into the Group's ERMF. The Group is forward looking in its risk identification processes to ensure emerging risks are identified. The risk identification, measurement and control process also identifies whether the controls in place result in an acceptable level of risk. At Group level, a consolidated risk report is reviewed and regularly debated by the Executive Risk Committee, Board Risk Committee and the Board to ensure that they are satisfied with the overall risk profile, risk accountabilities and mitigating actions. The report provides a monthly view of the Group's overall risk profile, key risks and management actions, together with performance against risk appetite and an assessment of emerging risks which could affect the Group's performance over the life of the Corporate Plan. This process has been in place for the year under review and up to the date of the approval of the Annual Report and is regularly reviewed by the Board. Information regarding the main features of the internal control and risk management systems in relation to the financial reporting process is provided within the Business and Risk Report.

An annual effectiveness review is undertaken as part of the ERMF. The review includes all components of the overarching framework and the frameworks for the principal risks. The elements covered in the review are risk appetite, the governance structure, the risk culture and the extent to which this has been instilled, the integration of risk with strategy, capital and the business planning process.

The purpose of the review is to evaluate the effectiveness of the Group's control framework, with regard to its material risks, to ensure management actions are in place to address key gaps or weaknesses in the control framework and to discharge its obligations under the guidance relating to the principle and provision set out in the Code. Risk assessment and reporting consider all material controls, including financial, operational and compliance controls. Business areas and head office functions assess the controls in place to address all material risk exposures across all risk types, supported by a rolling plan of risk control self-assessment.

In addition, Group Internal Audit provides the Audit Committee with an audit opinion of the control environment based on work carried out during the year.

The process complies with the Internal Control Guidance for Directors on the Combined Code issued by the Financial Reporting Council, and the conclusions are reported to and reviewed by the Board. The review found that, overall, the Group is well controlled and that the control environment has improved year-on-year. No significant remedial actions were required as a consequence of the review; however, we continue to develop and revise the ERMF to ensure that it is appropriate for the size and complexity of the organisation in light of emerging developments and regulatory change.

The effectiveness of the internal control system is reviewed regularly by the Board and the Audit Committee through regular reporting that includes information about reviews conducted by the Risk Division, the Compliance Division and Group Internal Audit. The Audit Committee receives reports from the Company's auditor, PricewaterhouseCoopers LLP, and has a discussion with the auditor at least once a year without executives present, to ensure that there are no unresolved issues of concern.

During the year, the Audit Committee in conjunction with the Board Risk Committee concluded that the Group's systems of internal control and risk management were effective, and recommended that the Board approve them accordingly.

Remuneration

The principles of the Code are that:

- **levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the Group successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance**
- **there should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.**

The Remuneration Committee has been delegated with the authority from the Board for determining the framework for the remuneration of the Chairman, the executive directors and the other senior executives of the Society. A comprehensive review of its activities in the year is set out in the Report of the Directors on Remuneration.

Report of the Directors on Corporate Governance continued

Relations with members

The principles of the Code are that:

- **there should be a dialogue with members/shareholders based on the mutual understanding of objectives. The Board as a whole has responsibility for ensuring that a satisfactory dialogue with members/shareholders takes place**
- **the Board should use the AGM to communicate with investors to encourage their participation.**

As a mutual, Nationwide has a membership of over 14 million individuals and actively seeks the views of members in various ways and the Board reviews member engagement activity.

Member TalkBack events (both face-to-face and online) give members an opportunity to ask questions or express views to directors. During the financial year TalkBack sessions were held in Cardiff, Leicester, Milton Keynes, London, Birmingham, Brighton and Portsmouth.

A total of one thousand members attended and they were able to hear the latest news about Nationwide and meet with our directors and senior managers. This direct contact, which has taken place each year since 1997, helps promote good corporate governance by assisting directors in their understanding of members' requirements, which may then be discussed at Board level. The roots of many of our products and services can be traced back to these events.

As in other recent years, the Group has actively sought to increase online engagement with its members through further development of the 'Your Nationwide' website. The site provides members with access to a wide range of information, including our latest performance figures for customer service and complaints, while inviting them to regularly interact with the Group in Online TalkBack opportunities and to make product and service suggestions. A catalogue of some of the major changes the Group has made in response to members' suggestions is published online in the 'You Asked, We Acted' section of 'Your Nationwide'.

Our monthly members' e-newsletter has continued to be popular and now reaches over two million members each month. We are encouraging even more members to register an email address so they may receive regular communication about Nationwide in this way.

In branches and online, the Member Suggestion Scheme continues to enable members to express their views on an ongoing basis.

An external accredited research company continues to contact customers every month to gather feedback on their experiences for the Society's Service Tracker. Over the past year there has been contact by telephone with around 12,000 customers each month. We have enrolled over 6,000 members to our online customer research panel called 'Nationwide Connect'. These members give feedback on a variety of topics, complete surveys and help shape how we communicate with other members, including at AGM time.

The Group will send out AGM packs to in the region of 7.7 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/agm 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 Group'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 chairs of the principal Board committees are available to answer questions.

CCDS Holders

Following the issuance of CCDS, the Group has a new set of stakeholders who contribute directly to its capital base. Our existing shareholding members do not contribute to the capital base in the same way and their relationship with Nationwide is based around the provision of personal financial services. The Board of directors is required to exercise its fiduciary duties to ensure that the interests of shareholding members and CCDS holders are appropriately balanced.

CCDS holders have contributed to the capital of the business and are at risk for the full amount of their investment; they receive a return that reflects this risk profile. CCDS holder returns are governed by a published distribution policy and are subject to a cap upon the return payable.

The voting rights of members are governed by the principle of one member, one vote. However, CCDS holders are only entitled to one vote in total for all issued CCDS as the CCDS are held via a custodian who has agreed to waive this voting right.

Geoffrey Howe
on behalf of the Board
Chairman
27 May 2014

Audit Committee Report

Summary of responsibilities
Financial reporting and external audit, internal controls and risk management systems, internal audit, compliance oversight, whistleblowing, fraud and bribery prevention.

Governance
The Committee was in place throughout the year and held seven meetings. The Committee Chairman provides a formal report to the Board three times a year.

Committee members
Roger Perkin (Chairman)
Alan Dickinson
Lynne Peacock
Rita Clifton

Regular attendees
Geoffrey Howe (Chairman of the Board)
Graham Beale (Chief Executive)
Mark Rennison (Group Finance Director)
Iain Laing (Chief Risk Officer)
Julia Dunn (Chief Compliance Officer)
Anne Obey (Chief Internal Auditor)
Michele Faull (Divisional Director – Financial Reporting)

Other attendees
Representatives from PricewaterhouseCoopers LLP (external auditors)

Dear Member,

The key purpose of the Audit Committee is to monitor the integrity of the financial statements of the Group, and to keep under review the effectiveness of internal controls and risk management systems, including those relating to regulatory compliance. It is also responsible for overseeing the relationship of the Group with its external auditor. During the year, the Committee's meetings covered the following areas:

Financial reporting

The Committee reviewed and recommended Board approval of the interim half year and year end financial statements, and also the Interim Management Statement published in February 2014. In considering the interim and year end financial statements, we discussed in detail management's analysis and conclusions on key areas of judgement; this year the more significant matters related to:

- Impairment provisions for loan portfolios: The performance of the commercial loan book has improved in the year as market conditions have stabilised and the level of provisions against the commercial loan book has moderated during the year, but provisions remain a key area of judgement and the Committee has reviewed in some detail the results of management's work to assess the likelihood of losses against these loans and the appropriate level of provisions. We also considered the level of provisions against other loan portfolios including retail lending (mortgages and unsecured lending) and assets held by the Treasury Division. The conclusions reached were that appropriate assumptions had been applied and judgements made in provision calculations, and the Committee agreed with management's judgements on the provisions made.
- Provisions for customer redress, which also require significant judgements: In line with much of the industry we have reviewed compliance with various regulatory matters including consumer credit legislation. The Committee discussed the assumptions used, again agreeing with the judgements made and the overall provisions recognised.
- The calculation of fair values for derivative instruments including compliance with requirements for hedge accounting for those instruments and the balances hedged: This is a complex area, and the Committee discussed the factors affecting these items and the resulting accounting. The adjustments arising in the year were less significant than in previous years, and the Committee was satisfied that appropriate accounting entries had been reflected in the financial statements.
- Auditing standards require the auditors to consider the risk of management override of controls. The principal areas where there could be material impact from this risk are in respect of the key judgemental areas in the financial statements which are discussed above.
- The Committee was specifically tasked by the directors to advise the Board on whether the 2014 Annual Report and Accounts are fair, balanced and understandable, this being a requirement now set out in the UK Corporate Governance Code. The Committee did this by satisfying itself that a robust governance process of review and challenge had been embedded at different levels within the Group with the specific objective of ensuring that this requirement was met. The Committee examined the outputs of the process undertaken, including attestations from a designated results approval group.

Report of the Directors on Corporate Governance continued

This working group, comprising a number of group and divisional directors and senior managers who reviewed the Annual Report and Accounts in their entirety, confirmed that they were, in their view, clear, consistent, balanced, open and focused on material items. After consideration of all relevant information, the Committee concluded that it could recommend to the directors that the 2014 Annual Report and Accounts are fair, balanced and understandable.

In concluding on these matters we also considered the views of PricewaterhouseCoopers LLP (PwC), the external auditors. There were no disagreements between management and the audit firm. In addition, before recommending approval of the interim and year end financial statements the Committee considered factors relevant to the preparation of the accounts on the basis that Nationwide will continue as a going concern. These factors include profitability, performance against the capital plan agreed with the Prudential Regulation Authority and other capital considerations, the availability of funding and liquidity and the risk and implications of a rating agency downgrade. The conclusions from this review were that the profitability, balance sheet and capital position are robust and that it was appropriate to prepare the accounts on a going concern basis.

External auditors

As well as discussing the views of the external audit firm on the accounting matters set out above, the Committee is responsible for oversight of the relationship with the external audit firm. This included:

- reviewing the proposed audit plan in advance of the annual audit, when we discussed the auditors' views on key risks and the audit approach to a number of elements of the financial statements
- approving the audit engagement letter and the proposed audit fee for the year
- reviewing formal reports provided by the audit firm following their review of the interim financial statements and audit of the annual financial statements
- considering how the objectivity and independence of the external auditor is safeguarded. The Group has a formal policy for the appointment of the external audit firm 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 PwC for non-audit work, we consider whether the firm is demonstrably the most appropriate firm for the work and evaluate threats to independence including the risk of self-review (or involvement in management decisions). We also consider the significance of the fees involved in the assignment and the cumulative annual value of fees paid to the firm. We are sensitive to the level of non-audit fees paid and the potential for high levels of fees over a sustained period to affect objectivity, and we reviewed a schedule of individual and cumulative fees for non-audit work at each Committee meeting in the year. The fees paid to PwC for audit and non-audit services are set out in the Notes to the Accounts. As a further safeguard to independence, we held a private discussion with the external auditors during the year to ensure that the auditors had an opportunity to raise any relevant issues directly with Committee members
- carrying out a formal assessment of the effectiveness of the external audit firm, which included consideration of the expertise, resources and independence of the firm, and of the effectiveness of the audit process. This took into account the views of a number of stakeholders including Audit Committee members. The Committee concluded that the audit was carried out effectively, with appropriate challenge of management, a clear understanding of key areas of judgement in the accounts and good quality, comprehensive reporting
- considering whether the reappointment of the audit firm should be recommended, and also whether the audit should be put out to tender. In deciding whether a tender was appropriate, we considered the length of tenure of PwC as auditor to the Group and also the regular rotation of the audit partner. The audit partner is due for rotation in 2014. PwC has been auditor to the Group since 1991, and the last audit re-tender was in 2003. We continue to be fully satisfied with the quality of the audit, and with the objectivity and independence of PwC, and have therefore recommended reappointment of PwC at the Annual General Meeting. The UK Corporate Governance Code requires the audit contract to be put out to tender at least every ten years, with transitional provisions for compliance which mean that the contract will be re-tendered no later than 2019. In addition, proposals for mandatory audit firm rotation have recently been adopted by the European Parliament, and once UK implementation has been finalised we will consider the implications for the Group's audit arrangements.

Internal Audit

The Audit Committee approved the audit plan for the year, and discussed in detail quarterly reports from Group Internal Audit as well as an annual report giving the opinion of the Chief Internal Auditor on the effectiveness of internal control. Reports from Group Internal Audit include significant findings from their work, thematic analysis of audit results and key issues, and the effectiveness with which management addresses any control weaknesses reported. We also carried out a formal assessment of the effectiveness of the audit function, which included reviewing information on audit plan delivery and efficiency; results of internal audit quality assurance activity; resourcing and recruitment including specialist skills, qualifications and training; financial budget and feedback from Audit Committee members and attendees and senior management.

We also held a number of workshops with Group Internal Audit during the year, discussing key risks and priorities for audit work as well as progress in implementing the strategy for development of the audit function and work to embed any changes needed to comply with new guidance for internal audit in financial institutions. I met monthly with the Chief Internal Auditor, as well as spending time with the Group Internal Audit Division, and as a Committee we held a private discussion with the Chief Internal Auditor.

Compliance

The Committee approved the annual Compliance Oversight Plan, and discussed quarterly reports and an annual report setting out the results of compliance reviews, significant issues and themes arising and the effectiveness of action take to resolve any issues. Information is also provided on progress in delivering the plan, and on resources available to deliver the appropriate level of oversight work. We also held a private discussion with the Chief Compliance Officer.

Monitoring the effectiveness of internal controls is one of the key responsibilities of the Audit Committee. As well as receiving comprehensive reporting on control effectiveness from Group Internal Audit and from Compliance, we considered a number of other matters during the year, including reports from the external auditors and progress in developing the financial controls framework.

Other activities – during the year the Committee also:

- carried out a review of its effectiveness, including a detailed review of its work against published guidance and best practice, and consideration of questionnaires completed by Committee members and attendees. The conclusion of this review was that the Committee is operating effectively
- reviewed the operation of the whistleblowing arrangements in place to enable employees to raise concerns in confidence. This included a summary of the concerns raised with thematic analysis; no new significant matters were noted in the year, and there was no material change in the number of reports
- received a series of updates from management, either in Committee meetings or in workshops, on relevant business and technical subjects, including hedge accounting, new accounting standards and further enhancements to the financial controls framework
- held a discussion with representatives of the PRA, discussing Nationwide's strategy and key risks, the role of the Audit Committee and the role and effectiveness of Group Internal Audit.

In addition to Committee meetings, members of the Committee regularly meet with management in various areas of Nationwide's business to ensure that they have an in-depth understanding of the business and risks. Individual members of the Committee also met with representatives of the PRA and the FCA during the year.

Reporting to the Board

Immediately following each Audit Committee meeting, I provided a verbal update to the Board of directors on matters discussed by the Audit Committee. I also presented a formal written paper to the Board three times during the year, setting out matters considered by the Committee and conclusions reached.

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

Roger Perkin
Chairman – Audit Committee

Report of the Directors on Corporate Governance continued

Board Risk Committee Report

Summary of responsibilities

Advising the Board on risk-related matters and risk governance.

ERMF including risk appetite, risk monitoring, and risk adjustments to remuneration.

Oversight of risk management.

Governance

The Committee was in place throughout the year and held six meetings. The Committee provides a formal report to the Board on a quarterly basis. The Committee oversees the Executive Risk Committee, which is the management committee responsible for ensuring a co-ordinated approach across all risks. Executive Risk Committee sits above the first line risk committees and is supported by second line Group Risk & Compliance Committee in consideration of all risks across the Group.

Further detail about the ERMF including three lines of defence, risk appetite and the risk committee structure can be found in the Business and Risk Report.

Committee members

Alan Dickinson (Chairman)

Roger Perkin

Mitchel Lenson

Lynne Peacock

Other attendees

Geoffrey Howe (Chairman of the Board)

Graham Beale (Chief Executive)

Mark Rennison (Group Finance Director)

Iain Laing (Chief Risk Officer)

Julia Dunn (Chief Compliance Officer)

Dear Member,

The key purpose of the Board Risk Committee is to provide oversight and advice to the Board in relation to matters of risk. This allows for a subset of non executive directors as members to provide more focus on risk than would be possible in Board meetings. In addition to the regular attendees we invite subject matter experts to present to us on a variety of topics.

At each meeting we look at the current and emerging risk exposures of the Group, future risk strategy, including determination of risk appetite, and risk frameworks. The work of the Committee covers core duties, deep dives and updates on specific issues (e.g. changes in regulation), and risk reporting.

Core duties included annual reviews of the ERMF, our appetite for risk, capital adequacy, liquidity adequacy, recovery and resolution plans, how we manage and monitor specific risks on a rolling programme, and stress testing.

Deep dives during the year covered a variety of topics across different risk categories. These give Committee members the opportunity to focus on specific topics, to understand the risks and issues, and to see that appropriate developments are underway to manage or mitigate the risks. Topics covered in the year included the sales framework (advised and non-advised), the potential threats from cyber attacks, commercial lending, information management, and third party management.

Updates to the Committee covered developments in the risk control self-assessment programme, scenario analysis of operational risks and developments in the customer and compliance risk category.

Specific topics covered in the year included the potential impact from increases in interest rates, retail mortgage lending, changes in mortgage regulations, risk adjustments to remuneration, and communications with the regulators. In addition we keep abreast of wider developments such as discussion papers from regulators and industry bodies.

Risk reporting is comprehensive across all risk categories, with more granular risks (from lower level committee reporting) escalated where appropriate. In addition, we also consider longer term risks to delivering the Corporate Plan and emerging issues that could present risks in the future and have full access to all risk appetite metrics and limits monitored by risk committees such as the Group's Lending Committee. Top and emerging risks are presented within the Business and Risk Report.

Formal interaction with the Board gives the opportunity to present a quarterly report on the activities of the Committee in that quarter and anticipated activities for the coming quarter. This is also accompanied by reports from both the Chief Risk Officer and Chief Compliance Officer presenting updates of their respective areas.

The operation of the Committee has changed little during the year. The annual effectiveness review was co-ordinated by the Group Risk Director and some minor revisions were made to our terms of reference. The Committee has now been in existence for over four years; while in the early years there were a number of developments in the role and composition of the Committee, under the Risk Management Framework established two years ago we have entered a period where the framework is maturing. In the year, we have also had stability of members and attendees, with one exception; in September 2013, I was delighted to welcome Julia Dunn to join the Committee as an attendee following her appointment as Chief Compliance Officer to enhance the coverage of conduct and compliance risks.

Governance in action – my fellow Committee members and I derive considerable value from discussing the risks and related issues with executive and operational management. Robust discussions take place where challenge is the norm and as a result we see practical demonstrations of the Group's core control, risk identification and risk mitigation processes.

The last 12 months has seen considerable progress in risk management at Nationwide. In particular, this is seen in an expanded oversight function, tightened controls for lending risks in preparation for the mortgage market review implementation, reducing leverage within our commercial portfolio, and in our strengthened capital position.

Looking forward, the Committee will particularly focus on risk data management and stress testing over the next 12 months. We shall continue to keep IT transformation and the ever-present risk of cyber attacks under close scrutiny as well as the wider risks to delivering the Corporate Plan. We will also be following developments to enhance the management of conduct risks under the new management team.

It is clear that regulatory and industry expectations continue to rise; the Committee is fully engaged with management to see continued strengthening of risk management at Nationwide in line with best practice and to safeguard members' interests.

Alan Dickinson
Chairman – Board Risk Committee

Report of the Directors on Corporate Governance continued

Nomination Committee Report

Summary of responsibilities

- Regularly review the structure, size and composition of the Board, as set out in the Board Composition and Succession Plan
- Review all appointments to the Board and its committees and the appointment of all group and divisional directors
- Give full consideration to succession planning for Board members and for group and divisional directors.

Governance

The Nomination Committee was in place throughout the year and held seven meetings. The Committee is chaired by the Chairman of the Society and although he is not deemed to be independent, the other three members are independent non executive directors, in accordance with the provisions of the Code. The SID led the process for the appointment of a successor to the Chairman.

Committee members

Geoffrey Howe (Chairman)

Roger Perkin

Alan Dickinson

Lynne Peacock

Other attendees

Graham Beale (Chief Executive)

Alison Robb (Group Director)

Dear Member,

There has been a period of stability in the composition of the Board over the past couple of years and the target has been for a Board membership of 11 to 12 directors.

As at 4 April 2014 your Board consisted of six non executive directors, four executive directors and myself, as Chairman. As recently announced a further non executive director has been appointed following the search for my successor and David Roberts will join the Board on 1 September 2014 as Chairman Elect and will stand for election at the AGM in 2015 following which, subject to members approval, he will succeed me as Chair of the Group. Alan Dickinson has indicated his intention not to stand for re-election at the AGM in 2014 and consideration is also being given to the replacement of Michael Jary who will retire at the AGM in 2015 by which time he will have served over six years.

During the year the Committee has addressed a wide range of issues within its remit and has developed a forward agenda of items for consideration. Specific attention has been paid to succession planning, covering non executive and executive directors, as well as group and divisional directors, and to the search for my successor.

Papers discussed during the year include those relating to prospective group and divisional director appointments and departures, the time commitment of non executive directors, the annual effectiveness process for the Board and its committees, changes to governance requirements and the Board Composition and Succession Policy.

Following on from the Committee's review of its own performance it was agreed that consideration be given to the succession and development opportunities at the divisional director level as this is an important element of the executive director succession policy. Talent forums led by our business leaders are in place to identity and develop talent across the whole business. Our corporate talent programmes continue to deliver successful outcomes and are available at every level of the talent pipeline, including our emerging talent programmes for graduates and apprentices and programmes for managers, senior managers and executives.

During the year, the Board continued to focus on improving diversity in senior positions and is on track to meet its objective of 25 per cent female representation by 2015 as recommended by the Lord Davies Review. The following chart details the percentage of women employed at various levels of seniority within Nationwide as at April 2014 compared to the previous three years.

	April 2011			April 2012			April 2013			April 2014		
Population	Male	Female	% Female	Male	Female	% Female	Male	Female	% Female	Male	Female	% Female
Board Members	11	1	8%	11	2	15%	9	2	18%	**9**	**2**	**18%**
Executive Committee	6	1	14%	7	1	13%	6	1	14%	**6**	**2**	**25%**
Divisional Directors	13	2	13%	16	4	20%	17	6	26%	**16**	**4**	**20%**
Total	30	4	12%	34	7	17%	32	9	22%	**31**	**8**	**21%**

The Board and the Nomination Committee recognises that senior management is a group from which future directors may be selected. To improve the diversity in these roles, the Group has implemented a variety of initiatives which include:

- a women's network focused on the progression of women in the workplace
- mandatory diverse shortlists for senior appointments, and
- balanced talent pools and development programmes.

More information on the diversity programmes, including our ambitious objectives can be found in the Strategic Report.

Geoffrey Howe
Chairman – Nomination Committee

Governance

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Report of the Directors on Remuneration

For the year ended 4 April 2014

Introduction

Dear Member

I am pleased to present the Remuneration Committee's report which sets out the work of the Committee over the past 12 months and includes the base salary, performance pay and benefits for the directors for the year to 4 April 2014.

Nationwide is committed to best practice in corporate governance, and so we have revised this report in line with the new legislation on executive pay disclosure to the extent it is appropriate to a mutual organisation. The main change is that the report has been divided into two distinct sections: the first (our Policy Report) sets out Nationwide's remuneration policy for directors that will apply from the 2014 AGM. The second (our Annual Report on Remuneration) outlines our approach during 2013/14 and how we propose to implement our policy in 2014/15.

A separate member vote will be held on each report at the 2014 AGM. The remuneration policy will be subject to an advisory vote every three years (or earlier if changes are made to our policy) and it is intended that no payments to directors will be made outside of this policy unless as a result of regulatory change. The Annual Report on Remuneration will continue to be subject to an annual advisory vote.

New regulatory standards limit the amount of performance pay to 100% of total fixed remuneration (base salary, pension payments and other benefits). In light of these new standards, other comparable organisations have introduced fixed pay allowances and/or sought to double the amount of performance pay they can offer. We are not looking to adopt either of these approaches and can operate within the prescribed limits. In order to comply with best practice some elements of performance pay are deferred and, in addition, we are making use of the recently issued core capital deferred shares (CCDS) to align our directors' rewards with the future performance of Nationwide.

This year we have undertaken a strategic review of remuneration with the aim of simplifying our performance pay arrangements and ensuring that the performance measures better reflect the interests of our members. In undertaking the review we have also taken account of best practice and regulatory developments, including the relevant provisions of CRD IV.

As a result, we intend to introduce one simplified performance pay plan to replace the current annual and medium term plans. The Committee also agreed to reduce the maximum performance pay opportunity to remain within the limit prescribed under regulatory standards. For the avoidance of doubt we will not be asking our members to increase this limit.

The leadership team has delivered another strong performance this year. In addition to growing and deepening our customer relationships we have improved our financial performance and strengthened our balance sheet. At the same time we have also maintained our 1st position for customer satisfaction throughout the year.

It is in this context that I would like to share with you our remuneration policies and practices for our executive team, including the payments to our executive directors in respect of our performance during 2013/14.

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

Lynne Peacock
Chair of the Remuneration Committee

Remuneration policy

Remuneration policy for executive directors

Our pay policy and framework is consistent with market practice for senior executive roles and enables us to motivate, reward and retain our leadership team to deliver value for our members. Our intention is to reward our executives at a level which is fair but not excessive. In summary:

- Base salaries are reviewed annually and are set taking into account current market pay levels
- We believe in pay for performance, and operate performance pay plans which reward our executive directors for the achievement of challenging key performance objectives based on our Corporate Plan
- The performance of executive directors is assessed against a balanced scorecard of measures which focus on delivering benefits for our members and reflect our mutual interests. This approach means that executive directors are not encouraged to focus on performance in a single area at the expense of other priorities
- The Remuneration Committee seeks input from our Audit and Risk Committees when determining incentive payments to ensure the level of reward is appropriately adjusted for risk
- The award levels as a percentage of base salary under our performance pay plans are at the lower end when compared with our main competitors. This means that the maximum potential total remuneration levels for our executive directors are substantially below the market median
- Our performance pay plans incorporate features to encourage sound risk management practices. These features include deferral of part of our performance pay and the ability of the Remuneration Committee 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.

The policy summarised in the table on the following pages will apply from the 2014 AGM.

Report of the Directors on Remuneration continued

Summary of remuneration policy for executive directors

		Purpose	Operation	Opportunity	Performance metrics
Fixed remuneration	Base salary	Provides base salary that is market competitive and reflects the size of the role.	Base salary is normally reviewed on an annual basis. Any changes are normally effective from 1 April.	Whilst there is no maximum, base salaries are set taking into account market data for similar roles in the financial services sector. Other factors considered include the individual's skills, experience and performance and the approach being taken on salaries in the wider organisation.	Not applicable.
	Benefits	Provides a market competitive package as part of fixed remuneration.	Benefits include a car allowance, access to shared drivers when required, fuel allowance, healthcare and insurance benefits. Other benefits may be provided to enable recruitment/retention or relocation.	Whilst there is no maximum value to the benefits provided, benefits are reviewed regularly to ensure they remain appropriate. The value of benefits may vary depending on service providers, cost and market conditions. Additional benefits may be provided if considered necessary to secure/ retain an individual.	Not applicable.
	Pension	Provides post-retirement benefits for participants in a cost efficient manner.	Executive directors receive a cash allowance in lieu of pension. G J Beale and M M Rennison are deferred members of the Group's defined benefit plans. We would continue to honour defined benefit pension arrangements in the event of an individual being promoted to the Board who retains a contractual entitlement to such a pension benefit.	Cash allowances are set as a percentage of base salary in accordance with pre-existing terms of employment. The maximum pension allowance payable is 40% of base salary. The defined benefit plans are no longer open to new joiners and would only be used for an executive director where an individual is promoted to the Board with an existing entitlement. The maximum accrual rate that would apply under existing defined benefit schemes is 1/60th of their pensionable salary for each year of service.	Not applicable.

Summary of remuneration policy for executive directors (continued)					
		Purpose	**Operation**	**Opportunity**	**Performance metrics**
Performance pay	Directors' Performance Pay Plan	Rewards achievement of individual and corporate targets for a single financial year, with payment spread over the longer-term.	At the end of the one year performance period an award is made to reflect achievement against performance metrics. The award is paid across four payment dates. 40% of the award is paid after the end of the performance period as detailed below. • 50% is payable in cash • 50% is subject to a six month retention period with the value linked to the performance of the Society's CCDS. 60% of the award is deferred by between three to five years as detailed below. • 50% is deferred in cash payable at the end of year three • 50% is paid at the end of year five and subject to an additional six month deferral period. The final value will be linked to the performance of the Society's CCDS. The Remuneration Committee may reduce or cancel payments if it believes that the plan outcomes are not representative of the overall performance of the Society. (note 1)	The Corporate Plan targets need to be achieved to generate a 'target' award, and considerably exceeded to generate the maximum award. The maximum value varies by role but will not exceed the limit laid down by regulatory standards. (note 2)	Detailed performance measures are approved by the Remuneration Committee to reflect corporate priorities. (note 3) Performance is assessed against a broad range of financial, strategic and individual measures, with performance being assessed over one year. The weighting of performance measures will be reviewed annually, with the Committee having the ability to adjust the weighting from year to year to recognise particular financial and strategic priorities. However, no less than 75% of the award will be based on Society (as opposed to individual) performance measures. The Committee sets the performance targets each year, achievement of which it considers would represent stretching performance in the context of the Corporate Plan. The Remuneration Committee has discretion to make adjustments to performance targets to reflect significant one-off items which occur during the performance period.

Notes:

1. In determining out-turns under our performance pay plans, the Committee takes into account performance against targets. In doing so, the Committee considers performance on a risk-adjusted basis, evaluating progress against defined measures of risk within the context of our Group Risk Appetite. This is a formalised process, which also includes input and feedback from the Audit and Risk Committees. In this manner, the Committee has discretion to reduce an employee's performance pay to reflect inappropriate risk management behaviour.

   In addition, the Committee regularly reviews whether prior year payments remain supported by the overall performance of the Society. In certain circumstances the Committee has discretion under malus provisions to reduce or cancel all or part of these payments. Such circumstances may include, for example, material misstatement, or under-performance which may be directly attributed to management decisions.

   The Committee may also decide to introduce and operate clawback, in appropriate circumstances and where legally possible, in respect of performance pay awards (whether paid in cash or CCDS) that have vested and been paid out.

2. Regulations currently require that the maximum level of performance pay cannot exceed 100% of total fixed remuneration (base salary, pension payments and other benefits). For the purpose of calculating the value of performance pay for this ratio, a discount can be applied on up to 25% of the performance pay element, to take account of the payment timescale (time value of money), provided it is paid in instruments that are deferred for at least five years. Details of how the discount factor may be calculated can be found at www.eba.europa.eu

3. Performance measures are selected by the Committee each year to reflect the priorities of the Society. The Committee sets targets based on those measures at a level which it considers appropriately stretching in relation to the Corporate Plan and overall risk appetite.

Report of the Directors on Remuneration continued

Summary of remuneration policy for executive directors (continued)					
		Purpose	**Operation**	**Opportunity**	**Performance metrics**
Other	Regulation	Provision to ensure regulatory compliance.	In the event that regulatory standards change, the Remuneration Committee has discretion to make any changes to ensure regulatory compliance, even if a revised policy has not been put to members for an advisory vote. Any such changes would be included in the policy report at the next Annual General Meeting.		

Remuneration arrangements throughout the Society

The remuneration policy for our executive directors is designed in line with the remuneration philosophy and principles that underpin remuneration for the wider Society. Within this framework, whilst there are differences in reward opportunity across seniority levels, individuals are incentivised towards consistent business goals and objectives, in addition to appropriate individual goals.

Prior contractual commitments and awards under legacy incentive plans

Any contractual commitments or performance pay awards entered into before the current disclosure regulations came into force or before a person became a director will be honoured.

There are outstanding awards which apply to directors made under arrangements which are not part of the forward looking policy effective from the AGM. Payments will be made under these legacy plans, following the AGM (in satisfaction of these historic awards), and therefore they form part of this policy.

In particular, individuals may hold outstanding awards under our previously operated Annual Performance Pay Plan (APPP) and Medium Term Performance Pay Plan (MTPPP). Outstanding awards under these plans will continue to be paid out, subject to performance and other conditions where relevant, in line with their original payment schedules.

For reference, the table below summarises the key features of these two plans.

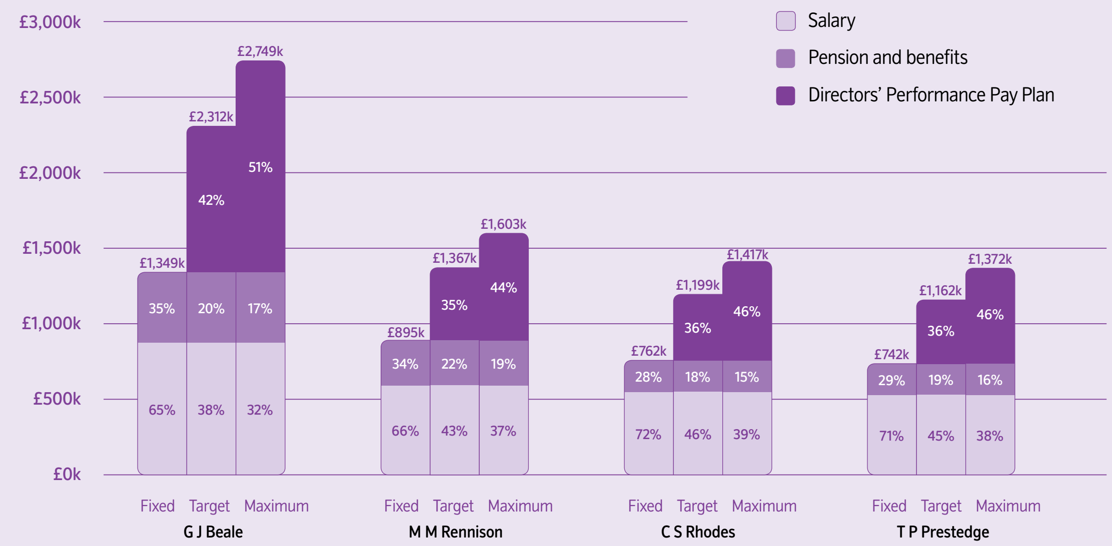
	APPP	**MTPPP**
Overview	Annual Performance Pay Plan, which rewarded performance over the relevant financial year	Medium Term Performance Pay Plan, which rewarded performance over a three year period
Operation	Delivered in cash, with half released in June following the year end and the remaining half in December	Delivered in cash, with two thirds released in the final year of the three year cycle, with the remaining one third being deferred for an additional year
Maximum opportunity	CEO – 80% of base salary Other directors – 54% of base salary	CEO – 120% of base salary Other directors – 81% of base salary
Performance measures	Subject to performance against a range of equally weighted financial and strategic measures based on the Society's Corporate Plan, and individual performance objectives	Subject to performance against a range of performance measures, including cumulative underlying profit, cumulative non-margin income, cost income ratio and customer satisfaction To ensure a strong capital base, all outstanding MTPPP awards would be cancelled if the Society's Core Tier 1 ratio fell below a minimum level set by the Board, unless the Remuneration Committee determines there is a due case for discretion.

The Remuneration Committee reserves the right to reduce (including to zero) or defer any payments made and has discretion to reduce the size of payments made to take into account risk or other factors.

What our executive directors could earn in 2014/15 based on performance

The chart below illustrates the amounts that executive directors would be paid under three different performance scenarios:

- **Fixed remuneration** – this shows the fixed elements of pay (base salary, pensions and benefits)
- **Target** – assuming we deliver target levels of performance against the measures set out in our Directors' Performance Pay Plan
- **Maximum** – assuming our Directors' Performance Pay Plan pays out in full. This would only occur where performance has been truly exceptional across all of the measures set.



	Breakdown of fixed remuneration £'000			
	G J Beale	**M M Rennison**	**C S Rhodes**	**T P Prestedge**
Salary	875	590	546	525
Pension	350	195	180	173
Benefits	124	110	36	44
Total fixed remuneration	**1,349**	**895**	**762**	**742**

Recruitment policy

If a new executive director is recruited, the Remuneration Committee will as far as possible determine their ongoing remuneration package as set out in the policy table.

On the appointment of a new executive director, the Remuneration Committee would consider whether it was necessary to offer a higher maximum award level under the Directors' Performance Pay Plan, in order to secure the desired candidate. Any such increase would remain within the overall limit laid down by regulatory standards and would only be applicable for the period of 12 months following appointment.

The Remuneration Committee may also consider whether it is necessary to offer any one-off arrangements to 'buy out' performance pay and any other remuneration arrangements. In making any such offer, the Committee will ensure that the 'buy out' is on materially similar terms to the arrangements being forfeited in terms of their value and vesting dates. Where performance conditions applied to the original awards, performance conditions will also apply to the 'buy out'. Where possible, any 'buy out' will be structured within the parameters of our existing performance pay plans. If there is not sufficient scope to compensate the individual through our existing performance plans, an individual tailored plan would be put in place.

Although our intention would be to offer any new director benefits in line with the policy set out in the policy table, if individual circumstances required this, the Remuneration Committee would consider offering a new recruit such additional benefits as might be required to secure their services.

Report of the Directors on Remuneration continued

Service contracts and policy on payments to departing directors

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
C S Rhodes	20 April 2009	20 April 2009

Executive directors' terms and conditions of employment are detailed in their individual contracts which include a notice period of 12 months from the Society to the individual and a notice period of six months from the individual to the Society. The notice period offered to any new recruit would be in line with this approach. Each contract includes a provision for a termination payment in lieu of notice up to a maximum of 12 months' base salary and benefits, with the exception of C S Rhodes whose contract provides for payment in lieu of notice up to a maximum of 12 months' base salary only. The settlement offered to an executive director on termination will depend on the circumstances of their departure.

Leaver by mutual consent

If an individual leaves by mutual consent, e.g. for redundancy/ succession planning purposes, they would, subject to approval by the Committee on an individual basis, normally be offered a payment in lieu of notice covering 12 months' base salary, contractual benefits, pension accrual (or cash alternative, on a cost neutral basis for the Society) and pension allowance, subject to mitigation (as described below).

In respect of the performance pay plan from 2014/15:

- retained awards and deferred plan payments are paid at the usual payment date although the Remuneration Committee will have discretion to accelerate payment to the leaving date in exceptional circumstances
- deferred payments are pro rated to reflect the period of employment with the Society as a proportion of the initial three year plan period
- the Remuneration Committee may reduce or cancel payments if it believes that the plan outcomes are not representative of the overall performance of the Society.

In respect of performance pay plans in operation for financial years prior to 2014/15, some awards are retained or deferred. For these plans, the following would be offered:

- a pro rated award to reflect the period of employment in respect of the medium term performance pay cycle finishing in the year of departure. Payment would be subject to normal performance conditions and paid on the normal dates for the plan
- any outstanding deferred payments under the Annual Performance Pay Plan or Medium Term Performance Pay Plan would be paid on the normal payment dates, subject to continued performance adjustment requirements.

Depending on the individual circumstances, the Remuneration Committee retains discretion to allow a departing director to continue to participate in other outstanding cycles of the performance pay plan, to waive the application of the Early Retirement Factor under the Pension Scheme, or to make any other compensatory award that might be deemed appropriate.

Leavers for other reasons

Individuals who leave in other circumstances e.g. resignation, would receive only contractual payments to which they are entitled and would not receive any payment in respect of performance pay plans, unless the Remuneration Committee determines there is a due case for discretion.

Mitigation

The Remuneration Committee's policy is that payments in lieu of notice should be made in monthly instalments and subject to mitigation (where contractually enforceable), although the Committee has discretion to waive this if this is considered appropriate in individual circumstances. All of the current executive director contracts allow for mitigation with the exception of G J Beale, whose contract reflects practice from the time of his appointment, and as such there is no provision for mitigation.

Consideration of employment conditions elsewhere in the Society

The pay and conditions of the broader employee population are taken into account when determining executive remuneration. The Remuneration Committee reviews base salary levels, other elements of fixed remuneration and details of performance pay plans offered to all employees each year, and is always mindful of ensuring that the pay policy for senior roles is consistent with the culture and values of the Society as a whole.

Our policy is to offer packages which are competitive with the financial services market in which we operate and where individuals are rewarded for delivering value to members.

The individual elements of remuneration offered vary between the different roles, for example the Directors' Performance Pay Plan is only offered to our most senior employees and benefits provision is tailored to reflect typical market practice for different roles.

A copy of the policy was shared with the Nationwide Group Staff Union in advance of publication. However, there was no formal consultation. Those employees who are also members of the Society will be able to vote on the Policy Report and the Annual Report on Remuneration.

Remuneration policy for non executive directors

Summary of remuneration policy for non executive directors			
	Purpose	**Operation**	**Opportunity**
Chairman's fee	Provide a market competitive fee level for role.	The Chairman's fee is normally reviewed and approved by the Remuneration Committee on an annual basis. Any changes are typically effective from 1 April.	Whilst there is no maximum level, fees are set taking into account practice at other organisations as well as the time commitment for the role at Nationwide.
Non executive director fees	Provide a market competitive fee level for role.	Non executive director fees are normally reviewed and approved by the Executive Committee and the Chairman on an annual basis. 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.	

Consideration of member views

At recent AGMs we have received a significant majority vote in favour of our remuneration reports. We are also mindful of views expressed by individual members regarding specific aspects of the policy. When taking decisions on remuneration policy, the Remuneration Committee is always conscious of the need to ensure executives are motivated and rewarded to deliver value for our members. In simplifying our pay arrangements and reducing the overall performance pay opportunity, we have sought to align our remuneration framework with the interests of our members.

Annual Report on Remuneration

Base salary

There has been no general increase to base salaries since 1 April 2011 although two executive directors were awarded increases in 2013 to reflect increased responsibilities following the restructure of the executive team. For 2014 the Committee has determined that base salaries will be increased to take account of the reduced levels of performance pay, and to also include an inflationary increase.

The table below sets out the base salary levels for executive directors which were in effect during the year, and the salaries as at 1 April 2014.

Base salary	2014/15	2013/14
G J Beale	**£875,000**	**£825,000**
T P Prestedge	**£525,000**	**£500,000**
M M Rennison	**£590,000**	**£560,000**
C S Rhodes	**£546,000**	**£520,000**

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Report of the Directors on Remuneration continued

Performance pay

In the 2013/14 performance year, the Society operated two performance pay plans for executive directors:

- the Annual Performance Pay Plan, which rewards performance against targets over the financial year
- the Medium Term Performance Pay Plan, which is the deferred element of performance pay and rewards performance over the medium term.

These plans measure the Society's performance against a range of financial, strategic and individual measures. Payments are made at the discretion of the Remuneration Committee who may reduce or cancel payments if it believes that the plan outcomes are not representative of the overall performance of the Society.

Annual Performance Pay Plan – outcomes for 2013/14

The Annual Performance Pay Plan has two performance elements. For the 2013/14 plan the measures were:

Performance against the Corporate Plan (60% of the award)

Based on a range of equally weighted financial and strategic measures to reflect the Society's progress in achieving its Corporate Plan:

- underlying profit
- number of main current accounts
- customer satisfaction rating.

+

Individual performance (40% of the award)

Individual performance objectives reflecting each individual's contribution towards the delivery of the Corporate Plan.

The Corporate Plan has to be achieved in order to generate a 'target' payout and considerably exceeded to generate the maximum payout. The performance targets for each measure have not been disclosed due to commercial sensitivity.

In reviewing the Society's performance against our annual key performance indicators, the Committee scrutinised performance and determined another strong performance had been delivered by the executive team.

Measure	Weighting (% bonus)	Maximum potential performance pay (% salary)		Performance relative to targets	Commentary	Performance pay achieved (% salary)	
		CEO	Executive directors			CEO	Executive directors
Underlying profit	20%	16%	10.8%	Above target	Up over 113% at £924 million	15.8%	10.7%
Number of main current accounts	20%	16%	10.8%	Above target	New account openings up 18% year on year	10.5%	7.5%
Customer satisfaction rating	20%	16%	10.8%	Above target	1st in our peer group	12.4%	8.6%
Total performance pay achieved based on Group performance						**38.7%**	**26.8%**

50% of awards will be paid in cash in June 2014. The remaining 50% of awards are linked to the performance of the Society's CCDS. This element is subject to a six month retention period and so will be paid to participants in December 2014.

Medium Term Performance Pay Plan – outcomes for the 2011-2014 plan

The Medium Term Performance Pay Plan rewards sustained performance and the achievement of challenging financial targets over a three year performance cycle. A new three year performance cycle started each year. For the 2011-2014 award cycle the measures were:

Performance measures (100% of the award)

The plan measures the Society's performance over a three year period against the following equally weighted factors:

- cumulative underlying profit over the three year period
- cumulative non-margin income over the three year period
- cost income ratio achieved for the last year of the three year period
- customer satisfaction rating achieved at the end of the three year period.

+

Risk criteria

All outstanding medium term performance pay awards will be cancelled if the Group's Core Tier 1 capital ratio falls below a minimum level set by the Board.

Achievement of this measure ensures that the Group maintains a strong capital base that is consistent with our risk appetite and regulatory standards for the business.

The Corporate Plan has to be achieved in order to generate a 'target' payout and considerably exceeded to generate the maximum payout. The performance targets for each measure have not been disclosed due to commercial sensitivity.

In reviewing the Society's performance over the three year medium term performance pay cycle, the Committee determined another strong performance had been delivered by the executive team.

Measure	Weighting (% bonus)	Maximum potential performance pay (% salary)		Performance relative to targets	Commentary	Performance pay achieved (% salary)	
		CEO	Executive directors			CEO	Executive directors
Cumulative underlying profit	25%	30%	20.25%	Above target	Performance marginally above target	18.8%	13.5%
Cumulative non-margin income	25%	30%	20.25%	Above target	Strong performance against target	21.2%	15.0%
Cost income ratio achieved in final year	25%	30%	20.25%	Above target	Performance marginally above target	19.9%	14.2%
Customer satisfaction rating at end of the period	25%	30%	20.25%	Maximum	1st in our peer group	30%	20.25%
Total performance pay achieved						**89.9%**	**62.95%**

In addition, the Committee confirmed that the risk criteria for the Medium Term Performance Pay Plan had been met.

Two thirds of each individual's award vests in June 2014 and the remaining one third is deferred for an additional year until June 2015. For each portion vesting, 50% will be paid in cash in the respective June. The remaining 50% of each portion is linked to the performance of the Society's CCDS. These elements are subject to a six month retention period and so will be paid to participants in the following December.

Report of the Directors on Remuneration continued

Directors' Performance Pay Plan – operation for 2014/15

From 2014/15, we are replacing previous performance pay plans with a simplified single plan featuring increased deferral periods and a reduction in the overall opportunity. This de-gearing of the package and the overall reduction in the level of performance pay opportunity reflects the Society's low risk appetite. The maximum award levels under the performance pay plans are shown below.

	Maximum award levels (% of base salary)			
	Previous policy (2013/14)			New policy (2014/15 onwards)
	Annual Performance Pay Plan	Medium Term Performance Pay Plan	Total of Performance Pay Plans	Directors' Performance Pay Plan
	2013/14	2013-2016		2014/15
CEO	**80%**	**120%**	**200%**	**160%**
Other directors	**54%**	**81%**	**135%**	**120%**

The new single plan rewards individual performance and attainment of challenging strategic and financial corporate metrics.

The measures will fall within the following broad areas and ensure focus on delivering benefits for our members:

Member measures (75% of award)	+	Individual performance (25% of award)
Customer satisfaction (25%)		Individual performance objectives reflecting each individual's contribution towards the delivery of the Corporate Plan
Growing customer relationships (25%)		
Financial efficiency (25%)		

CEO remuneration for the past five years

The table below shows details of the Chief Executive Officer's (CEO) remuneration for the previous five years.

	Total remuneration £'000	Annual performance pay earned as % of maximum available	Medium term performance pay earned as % of maximum available
2013/14	**2,571**	**83.3%**	**74.9%**
2012/13	2,258	60.6%	41.7%
2011/12	2,251	60.6%	40.7%
2010/11	1,961	75.4%	76.9%
2009/10	1,539	33.8%	61.7%

Change in remuneration of CEO

The change in remuneration (base salary, benefits and annual performance pay only) for the CEO from 2012/13 to 2013/14 compared to the average for all other employees is set out in the table below. The CEO requested that his performance pay in 2012/13 be capped at levels no greater than 2011/12. If the CEO had received the full performance pay entitlement, last year his 2012/13 annual performance pay would have been £534,005.

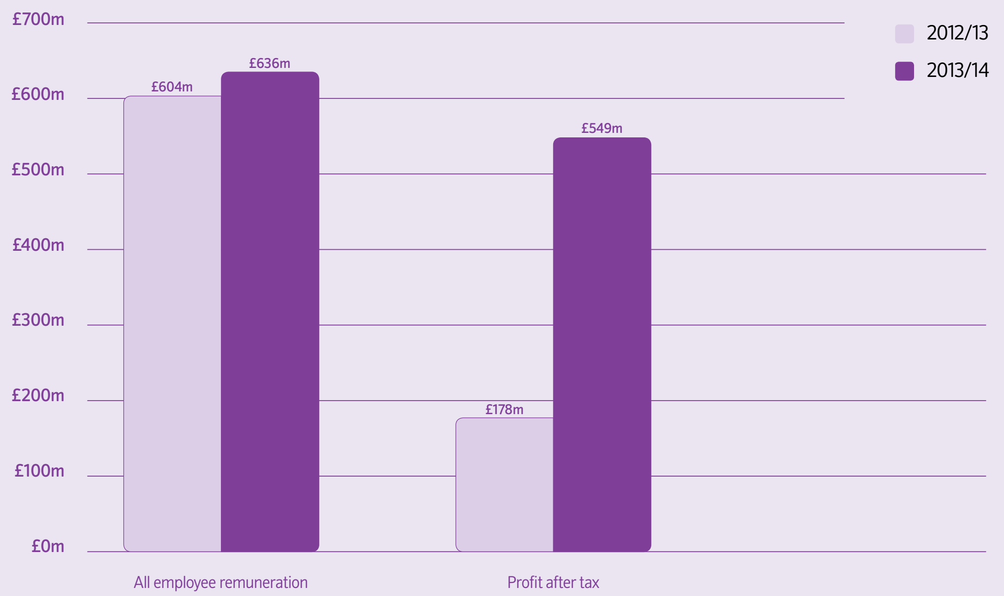
Compared to this amount the 2013/14 annual performance pay has increased by 2.98% as shown in the second row in the table below. In the 2012/13 performance year a one-off payment of £500 per employee was made to all employees excluding directors based on our customer service performance, this has been excluded from the average employee annual performance pay analysis below.

	Salary	Benefits	Annual performance pay
CEO (actual: 2012/13 bonus waived)	No change	-0.69%	+37.52%
CEO (if 2012/13 bonus entitlement paid)	No change	-0.69%	+2.98%
Average employee	+4.81%	+0.11%	+0.89%

Relative importance of spend on pay

The chart below illustrates the amount spent on remuneration paid to all employees of the Group, compared with profit after tax.

All employee remuneration compared with profit after tax



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Report of the Directors on Remuneration continued

Executive directors' remuneration – Audited information

Certain tables in the following section have been audited by PricewaterhouseCoopers LLP.

The table below shows the remuneration received for the years ended 4 April 2014 and 4 April 2013 as required to be reported under the Building Societies Act 1986. The Society has voluntarily adopted the Large and Medium-Sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013.

Table of single total figure of remuneration for each executive director (Audited)

Executive directors	Fixed remuneration			Variable remuneration		Total pay package
	Salary	Benefits (note 1)	Pension allowance	Annual performance pay (notes 2,3)	Medium term performance pay (notes 2,3)	
2014	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
G J Beale	**825**	**124**	**330**	**550**	**742**	**2,571**
T P Prestedge	**500**	**44**	**165**	**218**	**315**	**1,242**
M M Rennison	**560**	**110**	**185**	**257**	**352**	**1,464**
C S Rhodes	**520**	**36**	**172**	**227**	**327**	**1,282**
	2,405	**314**	**852**	**1,252**	**1,736**	**6,559**
2013						
G J Beale	825	127	330	400	576	2,258
T P Prestedge	470	46	155	233	274	1,178
M M Rennison	560	122	185	250	331	1,448
C S Rhodes	470	36	155	210	274	1,145
	2,325	331	825	1,093	1,455	6,029

Notes:

1. Taxable benefits include private medical cover, car allowance and the use of a company vehicle and driver when required for business purposes.
2. G J Beale requested that his performance pay in 2013 was capped at levels no greater than 2012. Consequently the Remuneration Committee reduced his potential annual and medium term performance pay by £209,088.
3. The components of the value of variable remuneration and the details of the performance measures are described earlier in this report in the sections headed: Annual Performance Pay Plan – outcomes for 2013/14 and Medium Term Performance Pay Plan – outcomes for 2011-2014.

Former executive director M P V Wyles

M P V Wyles stepped down as an executive director on 3 December 2012. The £105,000 negotiated settlement reflects a payment of £164,000 for his 2011-2014 Medium Term Performance Pay Plan net of a performance adjustment of £59,000, as previously disclosed in 2012/13, which was made in relation to the deferred element of his 2012/13 Annual Performance Pay Plan and his 2010-2013 Medium Term Performance Pay Plan. The 2013/14 pension amount includes an additional amount of £302,000 to augment his pension benefit accrued at Portman Building Society and in line with the Portman pension scheme conventions.

In 2012/13 M P V Wyles had received £470,000 salary, benefits and pensions allowance before he stepped down from the Board and a contractual settlement of £1,373,000 that was accrued including other payments that he was entitled to including salary for the balance of his notice period, his 2012/13 annual performance pay and his payment under the 2010-2013 Medium Term Performance Pay Plan.

The following table shows his remuneration and contractual and other settlements in the current and previous year.

Table of single total figure of remuneration for former executive director (Audited)

Former executive director	Salary	Benefits	Pension	Total pay package	Negotiated settlements	Total including settlements
M P V Wyles	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
2014	**-**	**-**	**302**	**302**	**105**	**407**
2013	318	41	111	470	1,373	1,843

Audited information: Executive directors' pensions

G J Beale and M M Rennison have ceased ongoing participation of the Society's defined benefit pension plans and have become deferred members. No executive director accrued any additional pension entitlement during the year. The change in accrued pensions shown in the table below is as a result of inflationary increases that are required by legislation. The decrease in transfer values over the year reflect changes in the assumptions used to calculate pension transfer values for individual pension fund members. The normal retirement age for the Society's pension plans range from 60 to 65.

Table of the value of pension benefits for executive directors (Audited)

Executive directors	Accrued pension at 4.4.14	Accrued pension at 4.4.13	Transfer value at 4.4.14	Transfer value at 4.4.13	Change in transfer value (note 1)	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**	**£'000**
G J Beale	**282**	274	**6,132**	6,242	**(110)**	**-**	**-**	**-**
M M Rennison	**57**	56	**1,211**	1,241	**(30)**	**-**	**-**	**-**

Note:

1. The transfer value basis is set by the Nationwide Pension Fund Trustee and is based on financial market conditions at the calculation date. Since 4 April 2013 the yields on long dated government bonds have increased which acts to lower the value placed on pension benefits. This has had the impact of decreasing transfer values for all pension fund members, including executive directors.

Explanations:

(a) and (b) show deferred pension entitlements at 4 April 2014 and 2013 respectively.
(c) is the transfer value of the deferred pension in (a) calculated at 4 April 2014.
(d) is the transfer value of the deferred pension in (b) calculated at 4 April 2013.
(e) is the increase in pension built up during the year. A zero figure means that, after allowing for inflation, no additional pension was built up.

Report of the Directors on Remuneration continued

Other directorships

Executive directors and members of senior management may be invited to become non executive directors of other companies, subject to the agreement of the Society. These appointments provide an opportunity to gain broader experience outside Nationwide and therefore benefit the Society. Providing that appointments are not likely to lead to a conflict of interest, executive directors may accept non executive appointments and retain the fees received. With effect from 1 July 2014, the number of external appointments that executive and non executive directors can hold will be limited as required under CRD IV.

C S Rhodes was appointed as a director of Visa Europe Limited and Visa Europe Services Incorporated from 1 May 2013, for which he has received total fees of £16,800 for services during the year ended 4 April 2014. These fees have been voluntarily assigned to the Group.

Payments for loss of office

No directors received any payments for loss of office during the year.

Payments to past directors

M P V Wyles stepped down from the Board on 3 December 2012. Details of his arrangements are provided in the section headed 'Former executive director M P V Wyles'.

Remuneration of eight highest paid senior executive officers – excluding main Board

The pay details of the eight highest paid senior executive officers who are not main Board directors are set out below. This is part of our ongoing commitment to transparency and meeting sector best practice on remuneration disclosure.

2014	Senior executive officers							
	1 £'000	2 £'000	3 £'000	4 £'000	5 £'000	6 £'000	7 £'000	8 £'000
Fixed (note 1)	358	323	317	242	263	139	231	232
Variable								
Cash bonus	248	271	256	233	199	116	184	177
Deferred cash bonus	62	66	63	47	46	30	43	42
Total variable	310	337	319	280	245	146	227	219
Contractual severance	-	-	-	-	-	203	-	-
Total remuneration	668	660	636	522	508	488	458	451

Note:

1. Fixed remuneration includes base salary and car allowance.

Chairman and non executive directors

The fee policy was last reviewed in March 2014 and changes have been made to the level of basic fee, and some specific committee fees, to ensure that these remain competitive in the context of the external market.

Fee policy	Fees for 2014/15	Fees for 2013/14
Chairman (note 1)	£310,000	£300,000
Basic fee	£62,000	£60,000
Senior Independent Director (note 2)	£30,000	£15,000
Chairman of the Audit Committee or Board Risk Committee	£35,000	£35,000
Member of the Audit Committee or Board Risk Committee	£12,500	£10,000
Remuneration Committee Chairman	£25,000	£25,000
Remuneration Committee member	£12,500	£10,000
Nomination Committee member	£3,000	£2,500

Notes:

1. David Roberts will succeed Geoffrey Howe as Chairman with effect from the conclusion of the AGM in July 2015. He will join Nationwide's Board as a non executive director and Chairman Elect on 1 September 2014. For the period following 1 September 2014 he will receive a fee of £150,000 per annum for the role of Chairman Elect. He will then take up the role of Chairman the day after the July 2015 AGM.
2. The Senior Independent Director fee of £30,000 from 2014/15 is inclusive of committee membership fees. Committee Chairman fees will continue to be paid.

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

Report of the Directors on Remuneration continued

Audited information: Single total figure of executive remuneration for non executive directors

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

Audited	**2014**	2013
	Society and Group Fees (note 1) £'000	Society and Group Fees (note 2, 3) £'000
G M T Howe (Chairman)	**300**	300
Ms R Clifton	**80**	60
A P Dickinson	**112**	112
M K Jary	**74**	74
M A Lenson	**85**	85
Mrs L M Peacock	**107**	96
R K Perkin (Senior Independent Director)	**127**	122
Ms S Taverne	**-**	27
R P Walther (Joint Deputy Chairman)	**-**	43
Total	**885**	919
Pension payments to past directors in respect of services as directors (note 4)	**285**	402

Notes:

1. There was no increase in the fee policy for non executive directors in 2013/14. Certain non executive directors received additional fees in the year due to their additional board committee responsibilities.
2. R P Walther and Ms S Taverne retired from the Board on 19 July 2012 and Ms R Clifton was appointed to the Board on 1 July 2012.
3. In addition to his non executive director fees in 2013, R P Walther also received additional fees as Chairman of the Investment Sub-Committee/ Investment adviser of the Nationwide Pension Scheme (£15,000).
4. 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.

Remuneration Committee Terms of Reference

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 PRA 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 performance pay plans operated by the Society for the benefit of employees within the Committee's remit, and approving the total annual payments under such plans.

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 2013. 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: Lynne Peacock (Chairman of the Remuneration Committee), Michael Jary and Rita Clifton.

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

- undertaking a strategic review of remuneration, with the aim of simplifying our performance pay arrangements, and reviewing the performance measures used, to ensure they better reflect the Society's focus on our members
- agreeing the performance targets for awards to be made under the Annual Performance Pay Plan and Medium Term Performance Pay Plan, taking into account the Corporate Plan
- reviewing the outcome of the performance pay plan awards which were paid in respect of the year
- ongoing work in relation to the PRA 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
- agreeing the approach for executive director base salary increases for 2014/15.

The Committee is attended by Geoffrey Howe (Chairman of the Board), and is supported by the Group Director, People, Customer, Communication & Commercial, the Corporate HR Director and where appropriate the CEO, 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 performance pay 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. During the year the Committee received advice on market rates of pay, best practice and remuneration trends from Deloitte LLP, who were appointed by the Committee following a tender process.

Deloitte is a member of the Remuneration Consultants Group and as such, voluntarily operates under the code of conduct in relation to executive remuneration consulting in the UK.

As well as advising the Remuneration Committee, Deloitte also provided tax, corporate finance, risk, internal audit and consulting services to the Society during the year. The Remuneration Committee is satisfied that the advice received is objective and independent, and reviews annually all other services provided by Deloitte to ensure this continues to be the case. Deloitte's fees are charged on a time and expenses basis. Their fees for advice provided to the Committee during 2013/14 were £291,295.

Voting at AGM

A resolution to approve the 2012/13 Directors' Remuneration Report was passed at the 2013 AGM. Votes were cast as follows:

Votes in favour	798,323 (91.2%)
Votes against	64,351 (7.4%)
Votes withheld	12,372 (1.4%)

Lynne Peacock
Chair of the Remuneration Committee
27 May 2014

Financial and Risk Review

All disclosures in this section (pages 86 to 168) are unaudited except the tables marked as audited.

We helped around one in five first time buyers in the UK take their first step onto the property ladder in 2013/14. And to all those people we helped, we sent a welcome box packed full of essentials like mugs, teabags and biscuits when they moved in.

Business and Risk Report

Introduction and key risks

Overview

This Business and Risk Report explains in greater detail the Group's business, the risks it is exposed to and how it manages those risks. As the risks of the organisation are managed on a Group basis, and given the dominant position of the Society within the Group structure, the disclosures in the Business and Risk Report are on a consolidated basis covering the activities of both the Group and the Society.

The Group is organised into three business streams: Retail, Commercial and Head Office functions. The Group is predominantly a retail focused operation which trades almost exclusively within the UK, with the exception of wholesale funding and liquidity management activities. Wholesale funding is accessed by the Group from both UK and overseas markets. The Group's liquidity position is actively managed from the UK.

The Group's operations incorporate a commercial property lending business and a treasury portfolio which includes loans to banks, cash, investment securities and derivatives.

The chart below shows the Group's business model and how these activities are reflected in its risk measures. The regulatory capital risk weightings below indicate the relative risks each area carries as at 4 April 2014. Please see the Capital Management section of this report for further details regarding the Group's capital position.

Nationwide Group

Operating Segment	Retail	Commercial	Head office (including Treasury)
Activities	▪ Prime residential lending ▪ Specialist residential lending ▪ Consumer banking ▪ Savings products ▪ Insurance ▪ Investments	▪ Commercial lending business ▪ Commercial real estate ▪ Social housing ▪ Project Finance	▪ Treasury including funding, liquidity and market risk management ▪ Head office functions ▪ Central support functions
Regulatory Risk Weighted Assets as at 4 April 2014	**£m**	**£m**	**£m**
Credit risk	**22,004**	**9,061**	**5,599**
Operational risk	**3,542**	**111**	**109**
Market risk	**-**	**-**	**29**

Introduction and key risks (continued)

Principal risks

Whilst the Group accepts that all of its business activities involve risk, it seeks to protect its members by managing the risks that arise from its activities appropriately. The principal risks inherent within the business are described in the table below:

Risk category	Definition
Lending	The risk that a borrower or counterparty fails to pay interest or to repay principal on a loan or other financial instrument (e.g. a bond) on time. Lending risk also encompasses extension risk and concentration risk.
Financial	The risk of the Group 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, which may be exposed by changes in market rates, market conditions or the Group's own credit profile.
Operational	The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.
Customer and compliance	The risk that the organisation fails to design and implement operational arrangements, systems and controls such that it can maintain legal and regulatory compliance, deliver fair customer outcomes and achieve a positive experience for customers.
Strategic	The risk of significant loss or damage arising from business decisions that impact the long-term interests of the membership, or from an inability to adapt to external developments.

In addition to these principal categories of risk, model risk, which the Group is exposed to, is managed under a separate framework across all risk categories and business areas where risk models are used.

Risk category	Definition
Model risk	The risk that an adverse outcome occurs as a direct result of weaknesses or failures in the design or use of a model. The adverse consequences include financial loss, poor business or strategic decision making, or damage to the Group's reputation.

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 governance committees and by the Chief Risk Officer.

In addition to these principal risks that are inherent in the Group's business it identifies, monitors and manages the top and emerging risks that could affect delivery of the Corporate Plan as an integral element of its risk and management strategy.

Top and emerging risks

The Group's top and emerging risks are identified through the process outlined in the Risk Governance section, and are closely tracked throughout the governance structure. The Group continues to keep these risks under close observation through risk reporting and metrics where appropriate.

The Group sees three themes to its top and emerging risks: continuing to contain financial and lending risks, evolving with the new regulatory environment and managing the operational risks driven by digital transformation.

Business and Risk Report continued

Introduction and key risks (continued)

Continuing to contain financial and lending risks

Managing financial and lending risks is a fundamental part of what Nationwide does. Over the past few years, the Group's exposure to financial risk has decreased as its profitability has improved. The Group has successfully issued new capital and has been deleveraging its highest risk lending books. The current economic environment poses three main risks to the Group's continuing ability to manage financial and lending risks:

- **The housing price bubble bursting, accompanied by a reversal in the UK economy, could increase credit losses significantly**

  Government policies, the low interest rate environment, and a significant flow of overseas buyers stimulate the housing market. There is a risk that these conditions may reverse, increasing credit losses in the Group's mortgage portfolios and depressing the wider economy.

- **Resurgent competition could squeeze core margins below sustainable levels**

  The margin earned on the Group's core products may be squeezed through increased competition. Several of the Group's competitors have announced strategic changes, reducing their international and investment banking activities to refocus on the UK retail banking market where they have set ambitious growth objectives.

- **Wider global financial developments, for example the re-emergence of tensions within the Eurozone, might increase the Group's funding costs**

  The global economy has strengthened in the past 12 months. However, uncertainties remain over the sustainability of this recovery. The risk of Eurozone break up has broadly receded. However, it remains a possibility. Whilst the Eurozone has emerged from recession, risks to economic growth persist and could affect the outlook. In addition, the political issues arising on the edge of Europe pose risks to the wider economic outlook and investor sentiment.

Evolving with the new regulatory environment

Dealing with regulation is an unavoidable part of running a modern financial institution. Nationwide's business model and member focus puts it in a good position to meet the regulator's expectations of conduct and the Group has seen proportionately less enforcement action and customer redress than its competitors. There are two key areas in the regulatory environment that pose a risk to achievement of the Group's goals:

- **Increasing standards for conduct could restrict the Group's channels, services or proposition**

  The FCA is still evolving its approach to conduct risk but is already significantly more assertive than its predecessor. The digitisation of the Group's proposition provides further challenges where legislation and processes are carried forward into the digital age. The Group will design and implement appropriate controls and process in order to continue to provide the services that its members value against the changing regulatory backdrop.

- **Regulatory standards, for example the minimum leverage ratio, could increase**

  The regulatory expectations and requirements set for financial services providers are still undergoing change as national and international regulatory initiatives develop. There is a risk that further increases in capital and leverage requirements have the potential to adversely impact the building society model, constraining growth or forcing retrenchment.

Managing the operational risks driven by digital transformation

The pace of technological development is creating a period of significant change in financial services. The Group's aim is to make the most of new technology to achieve its goal of being number one for customer service. The Group has already successfully delivered a new banking system, mortgage system and mobile banking alongside a number of other technology changes. As the Group continues to invest in new technology there are three areas that pose a risk to achieving its goals:

- **Rising customer expectations could exceed the Group's ability to provide highly reliable, widely available services**

  The rise of digital banking is changing customer expectations of the availability of banking services. As digital changes make transactions easier and more convenient the Group expects customers to transact more, and in many different ways. The Group needs to ensure it manages service provision ahead of rising customer expectations to maintain its goal of being number one for customer service. The Group has a programme in place to ensure that while developing its digital proposition it also increases IT resilience and round-the-clock service availability.

- **Executing changes to business processes to adapt to the new environment could disrupt the Group's business or its customers**

  The Group will make significant investment in transforming its products and delivery channels to meet evolving consumer and regulatory expectations. The complexity of these transformation activities may increase the inherent risk of system failures or errors and the Group will need to ensure controls to manage this remain effective in order to underpin its services to members.

- **Building a new digital proposition that appeals to new members could compromise the services that are valued by longer established members**

  The Group faces a challenge to strengthen its appeal to customers who have affinity to new, digital technologies whilst still providing market leading service to those members who value traditional services, such as its branch network and contact centres.

The Group's business and managing risks in it

The following sections contain detailed analysis of the Group's business, principally its balance sheet, and provide further analysis in the context of the principal risks and top and emerging risks identified above. Information is given regarding management and mitigation of risks. This review covers:

- Loans and advances and lending risks
- Treasury assets and treasury credit risks
- Financial risk management
- Market risk management
- Pension obligation risks
- Operational risks
- Customer and compliance risks
- Strategic risks

Details on the Group's risk governance framework are also provided.

Loans and advances and lending risks

Loans and advances to customers

Loans and advances to customers account for 87.7% (2013: 87.0%) of the Group's total assets. Lending remains concentrated on high quality secured products with residential mortgages accounting for 87.3% of the Group's gross loans and advances to customers. This is an increase from 2013 (85.0%) reflecting the Group's strategy of exiting non-core commercial lending.

Loans and advances to customers	**2014**		2013	
	£m	**%**	£m	%
Prime residential mortgages	**119,319**	**71.5**	110,619	69.4
Specialist residential mortgages	**26,341**	**15.8**	24,939	15.6
Total residential mortgages	**145,660**	**87.3**	135,558	85.0
Commercial lending	**17,284**	**10.3**	19,916	12.5
Other lending	**176**	**0.1**	436	0.3
Consumer banking	**3,862**	**2.3**	3,488	2.2
Gross balances	**166,982**	**100.0**	159,398	100.0
Impairment provisions	**(1,288)**		(1,224)	
Fair value adjustment for micro hedged risk	**880**		1,413	
Total	**166,574**		159,587	

Lending risk

Lending risk is considered by reference to the four main types of lending the Group provides and relates to the risk that a borrower or counterparty fails to pay interest or to repay principal on a loan or other financial instrument. Lending risk includes all aspects of credit risk including concentration risk and extension risk.

Risk category	**Portfolio**
Retail (secured)	Residential mortgages including prime mortgage and specialist lending.
Retail (unsecured)	Consumer banking including personal loans, credit card and banking portfolios.
Commercial	Commercial lending portfolio.
Treasury	Treasury liquidity and discretionary portfolios.

Financial and Risk Review

Business and Risk Report continued

Loans and advances and lending risks (continued)

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. Lending risk portfolios are managed within concentration limits and are subjected to stress testing and scenario analysis to simulate potential outcomes and calculate their associated impact.

Each of the above portfolios is considered in turn below.

Residential mortgage lending and credit risks

Overview

The make-up of prime and specialist mortgage lending is as follows:

(Audited)	**2014**		2013	
	£m	**%**	£m	%
Buy to let	**21,932**	**83**	20,081	80
Self-certified	**2,960**	**11**	3,297	13
Near prime	**1,037**	**4**	1,162	5
Sub prime	**412**	**2**	399	2
Specialist lending	**26,341**	**100**	24,939	100
Prime lending	**119,319**		110,619	
Total residential mortgages	**145,660**		135,558	

The Group's residential mortgages include both prime and specialist loans. Prime residential mortgages are mainly Nationwide branded advances made through the Group's branch network and intermediary channels.

All new specialist lending is originated through The Mortgage Works (UK) plc (TMW), exclusively in the buy to let market. Self-certified lending was originated historically by TMW, UCB Home Loans Corporation Limited (UCB) and Derbyshire Home Loans Limited, but this type of lending was discontinued in 2009.

The majority of near prime and sub prime balances were acquired from the Derbyshire and Cheshire building societies.

Prime mortgage assets purchased from the Bank of Ireland in December 2011, although acquired by TMW, are categorised as prime business. New specialist lending is restricted to buy to let.

The major risk on retail mortgages is credit risk. The Group's prudent approach to new business means that impairments are low and rising house prices have further improved the position. The impairment position is summarised below:

	2014		2013	
	£m	**%**	£m	%
Prime book:				
Impaired balances/% of book	**504**	**0.42**	564	0.51
Impairment provisions/coverage	**18**	**3.6**	32	5.7
Impairment credit for the year	**-**		(6)	
Specialist lending:				
Impaired balances/% of book	**651**	**2.47**	726	2.91
Impairment provisions/coverage	**84**	**12.9**	133	18.3
Impairment charge for the year	**-**		22	

Residential mortgage lending and credit risks (continued)

Impairment charges and provisions have reduced in both prime and specialist lending books reflecting increases in the House Prices Index (HPI), the Group's prudent underwriting discipline and its approach to managing cases individually. The sections below provide greater detail on credit concentrations and performance on the book.

Significant events/environment

Over the past year UK house prices have increased by 9.5% with growth in most geographical areas albeit that the biggest rises have been in London and the South East. This growth has eased credit risk pressures to date but is being kept under close review.

The Group is committed to supporting the housing market and first time buyers in particular. As a result, the average loan to value (LTV) of new residential mortgage lending has increased to 69% (2013: 67%) calculated on a volume basis. The Group's strategy is supported by a robust affordability assessment and credit scoring process that ensures that asset quality remains within the Group's risk appetite. The success of these controls is demonstrated by the continuing low arrears and impairment performance of the secured portfolios.

The Group has supported government initiatives in the housing market, accepting applications under the Help to Buy shared equity scheme. In doing so, the proportion of the Group's new lending which is on new build property has increased. The Group is closely monitoring the volume of lending within both the Help to Buy scheme and on new build properties to ensure unreasonable concentrations of lending are not introduced into the portfolio.

Initiatives to support the first time buyer market continue to include the Save to Buy product, which enables customers to access products up to 95% LTV where they have demonstrated a track record of saving prior to applying for the mortgage. The availability of the deposit and being able to demonstrate that the mortgage is affordable are critical factors in the mortgage application.

TMW has strategically adjusted its product range in order to attract larger loans. This has resulted in the average specialist loan size increasing by approximately £15,000 in the last 12 months and an increased proportion of lending in the South East where property prices are higher. Industry leading controls to reduce the potential misuse of buy to let mortgages for residential lending have proven to be effective. Despite increased competition TMW has maintained a strong market presence with around 17% market share in 2013/14.

Geographical concentration

Residential mortgages are only secured against UK properties. The geographical split of the book for the year ended 4 April 2014 is shown below:

Geographical analysis *(Audited)*	**2014**	2013
	%	%
Greater London	**32**	22
Central England	**19**	22
Northern England	**16**	20
South East England (excluding London)	**12**	11
South West England	**9**	9
Scotland	**7**	9
Wales and Northern Ireland	**5**	7
Total	**100**	100

Loan to value (LTV)

All borrowing applications are subject to appropriate credit risk underwriting processes, including an affordability assessment.

For secured loans, pricing will typically vary by LTV. Higher LTV products are typically subject to higher interest rates commensurate with the associated risk.

LTV of loan stock and new business	**2014**	2013
	%	%
Average loan to value of stock (indexed) by volume	**48**	51
Average loan to value of new business by volume	**69**	67
Average loan to value of stock (indexed) by value	**58**	62
Average loan to value of new business by value	**73**	71

Note: The average value of new business above excludes further advances.

Business and Risk Report continued

Residential mortgage lending and credit risks (continued)

LTV is measured both on a volume basis (i.e. number of loans) and by value (based on mortgage balance at balance sheet date for stock and at inception for new business). The average LTV on the overall stock (indexed) has reduced by 3% to 48% (2013: 51%), and average LTV of new business has increased by 2% to 69% (2013: 67%) on a volume basis with similar movements in value based LTV.

The details in the remainder of this section use value based calculations to allow analysis of the balance sheet.

New business by borrower type	**2014**	2013
	%	%
Home movers	**32**	36
First time buyers	**31**	26
Remortgagers	**22**	22
Other	**1**	-
Buy to let	**14**	16
	100	100

Note: The new business profile of new business above excludes further advances.

The proportion of first time buyers has increased over the year, as the Group has actively supported this segment of the market as part of the wider Nationwide Citizenship agenda. Competitive pricing to this segment, predominantly within a higher LTV range (80% - 90%) has been used in conjunction with other initiatives such as the running of first time buyer clinics to support first time buyers through their journey of buying their first home. This focus on first time buyers at higher LTVs has driven the increase in LTV on new lending.

The table below sets out the LTV profile for new business:

New residential lending – distribution of loans by original LTV band	**2014**	2013
	%	%
Loan to value analysis:		
0% - 60%	**19**	21
60% - 75%	**38**	38
75% - 80%	**10**	12
80% - 85%	**15**	18
85% - 90%	**16**	9
90% - 95%	**2**	2
>95%	**-**	-
	100	100

Residential mortgage lending and credit risks (continued)

The table below shows LTVs for the Group's residential mortgage portfolio split between performing and non-performing loans and by geographical segment. Average LTVs are calculated on a weighted value basis. Non-performing accounts include all impaired loans and also loans which are past due but not yet impaired; performing loans are neither past due nor impaired.

Residential mortgage balances by LTV and region *(Audited)*	**Greater London**	**Central England**	**Northern England**	**South East England (excluding London)**	**South West England**	**Scotland**	**Wales and Northern Ireland**	**Total**	
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**%**
2014									
Performing loans									
Fully collateralised									
LTV ratio:									
<50%	**16,771**	**7,405**	**5,587**	**5,916**	**4,165**	**2,664**	**1,899**	**44,407**	
50-60%	**8,889**	**3,576**	**2,758**	**2,764**	**1,839**	**1,305**	**832**	**21,963**	
60-70%	**10,703**	**5,097**	**4,240**	**3,712**	**2,615**	**1,915**	**1,155**	**29,437**	
70-80%	**6,418**	**6,196**	**5,860**	**3,721**	**2,917**	**2,456**	**1,492**	**29,060**	
80-90%	**1,972**	**3,213**	**3,401**	**1,488**	**1,359**	**1,352**	**915**	**13,700**	
90-100%	**38**	**424**	**1,102**	**72**	**108**	**244**	**331**	**2,319**	
	44,791	**25,911**	**22,948**	**17,673**	**13,003**	**9,936**	**6,624**	**140,886**	**96**
Partially collateralised									
– >100% LTV (A)	**7**	**31**	**188**	**4**	**8**	**56**	**510**	**804**	**1**
– collateral value on A	***5***	***29***	***177***	***3***	***6***	***53***	***414***	***687***	
Total performing loans	**44,798**	**25,942**	**23,136**	**17,677**	**13,011**	**9,992**	**7,134**	**141,690**	**97**
Non-performing loans									
Fully collateralised									
LTV ratio:									
<50%	**366**	**149**	**110**	**104**	**62**	**50**	**50**	**891**	
50-60%	**229**	**85**	**69**	**59**	**34**	**26**	**25**	**527**	
60-70%	**292**	**139**	**114**	**87**	**58**	**40**	**37**	**767**	
70-80%	**187**	**162**	**157**	**95**	**70**	**61**	**42**	**774**	
80-90%	**55**	**134**	**146**	**63**	**53**	**38**	**37**	**526**	
90-100%	**5**	**67**	**127**	**14**	**16**	**20**	**38**	**287**	
	1,134	**736**	**723**	**422**	**293**	**235**	**229**	**3,772**	**2**
Partially collateralised									
– >100% LTV (B)	**2**	**14**	**52**	**3**	**3**	**10**	**114**	**198**	**1**
– collateral value on B	***2***	***13***	***47***	***2***	***2***	***10***	***86***	***162***	
Total non-performing loans	**1,136**	**750**	**775**	**425**	**296**	**245**	**343**	**3,970**	**3**
Total residential mortgages	**45,934**	**26,692**	**23,911**	**18,102**	**13,307**	**10,237**	**7,477**	**145,660**	**100**

Business and Risk Report continued

Residential mortgage lending and credit risks (continued)

Residential mortgage balances by LTV and region *(Audited)*	Greater London	Central England	Northern England	South East England (excluding London)	South West England	Scotland	Wales and Northern Ireland	Total	
	£m	£m	£m	£m	£m	£m	£m	£m	%
2013									
Performing loans									
Fully collateralised									
LTV ratio:									
<50%	13,083	6,609	5,034	5,121	3,756	2,348	1,738	37,689	
50-60%	5,593	2,778	2,177	1,992	1,447	1,028	701	15,716	
60-70%	8,002	3,929	3,103	2,787	2,005	1,353	927	22,106	
70-80%	8,627	5,118	4,535	3,308	2,496	1,802	1,160	27,046	
80-90%	4,399	4,140	4,151	2,506	1,853	1,908	1,064	20,021	
90-100%	448	1,587	2,110	674	550	688	524	6,581	
	40,152	24,161	21,110	16,388	12,107	9,127	6,114	129,159	95
Partially collateralised									
– >100% LTV (A)	19	222	823	47	52	225	733	2,121	2
– collateral value on A	*17*	*213*	*782*	*45*	*50*	*212*	*594*	*1,913*	
Total performing loans	40,171	24,383	21,933	16,435	12,159	9,352	6,847	131,280	97
Non-performing loans									
Fully collateralised									
LTV ratio:									
<50%	290	140	105	90	60	43	47	775	
50-60%	157	70	57	46	29	20	23	402	
60-70%	239	105	86	66	45	29	28	598	
70-80%	303	147	126	76	64	46	40	802	
80-90%	195	162	151	92	62	52	42	756	
90-100%	53	133	160	55	49	32	38	520	
	1,237	757	685	425	309	222	218	3,853	2
Partially collateralised									
– >100% LTV (B)	10	58	143	16	11	33	154	425	1
– collateral value on B	*9*	*54*	*133*	*14*	*10*	*31*	*114*	*365*	
Total non-performing loans	1,247	815	828	441	320	255	372	4,278	3
Total residential mortgages	41,418	25,198	22,761	16,876	12,479	9,607	7,219	135,558	100

The Group's proportion of non-performing loans has decreased by 0.5% to 2.7% during the year. In addition, the proportion of all partially collateralised loans has reduced 1.1% to 0.7% with the shortfall in collateral on non-performing loans reduced to £36 million (2013: £60 million).

Residential mortgage lending and credit risks (continued)

Lending risk

Retail credit risk profile

Residential mortgage lending in the Group continues to have a low risk profile when compared to industry benchmarks helped by a composition which has remained broadly consistent over the years and comprises a large number of smaller loans which are broadly homogenous, have low volatility of credit risk outcomes and are intrinsically highly diversified. When assessing the credit risk profile the Group has regard to lead indicators such as concentration risk and LTV as noted above and also performance statistics on particular groups of loans including:

- arrears (particularly arrears of three months or over)
- impaired loans
- possession balances
- interest only mortgages
- negative equity loans.

Arrears

Reflecting the Group's low risk profile, performance of the mortgage books has remained strong with the number of residential mortgages more than three months in arrears reducing in both the specialist and prime mortgage books. The Group's overall arrears percentage of 0.63% compares favourably with the Council of Mortgage Lenders (CML) industry average of 1.59% (2013: 1.89% restated by CML).

Number of cases more than 3 months in arrears as % of total book	2014	2013
	%	%
Prime	**0.46**	0.53
Specialist	**1.53**	1.75
Group	**0.63**	0.72
CML industry average	**1.59**	1.89

Impaired loans

Impaired and non-performing loans are identified primarily by arrears status. Impaired accounts are those defined as greater than or equal to three months in arrears, and include accounts subject to possession, litigation and bankruptcy where arrears are greater than or equal to one month.

Non-performing accounts include all impaired loans and also loans which are past due but not impaired, including any asset where a payment due is received late or missed. The non-performing loan 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.

The table below provides information on residential mortgages by payment due status:

(Audited)	**2014**				2013			
	Prime lending	**Specialist lending**	**Total**		Prime lending	Specialist lending	Total	
	£m	**£m**	**£m**	**%**	£m	£m	£m	%
Performing:								
Neither past due nor impaired	**116,998**	**24,692**	**141,690**	**97.3**	108,221	23,059	131,280	96.8
Non-performing:								
Past due up to 3 months but not impaired	**1,817**	**998**	**2,815**	**1.9**	1,834	1,154	2,988	2.2
Impaired	**504**	**651**	**1,155**	**0.8**	564	726	1,290	1.0
Total	**119,319**	**26,341**	**145,660**	**100.0**	110,619	24,939	135,558	100.0
Impairment (credit)/charge for the year	**-**	**-**	**-**		(6)	22	16	

Business and Risk Report continued

Residential mortgage lending and credit risks (continued)

The Group has maintained the strong overall quality of its retail mortgage portfolio. Total residential impairments have reduced from £16 million in 2013 to £nil in 2014, benefiting from the rise in house prices over the year and the Group's continued focus on prudent underwriting criteria.

Individual impairment provisions are assigned to accounts in possession and a collective provision is assigned to all other accounts to estimate incurred but not identified losses. Impaired residential mortgages are further analysed as follows:

Impaired residential mortgage balances by payment due dates *(Audited)*	**2014**				2013			
	Prime lending	**Specialist lending**	**Total**		Prime lending	Specialist lending	Total	
	£m	**£m**	**£m**	**%**	£m	£m	£m	%
Impaired status:								
Past due 3 to 6 months	**225**	**269**	**494**	**43**	260	297	557	43
Past due 6 to 12 months	**164**	**183**	**347**	**30**	190	208	398	31
Past due over 12 months	**100**	**138**	**238**	**21**	96	134	230	18
Possessions	**15**	**61**	**76**	**6**	18	87	105	8
	504	**651**	**1,155**	**100**	564	726	1,290	100

Possession balances

Possession balances represent loans against which the Group has taken ownership of properties pending their sale. The Group's approach to dealing with customers in financial difficulty, combined with its historically cautious approach to lending, means that the Group only takes possession of properties as a last resort. This is illustrated by the number of properties that are taken into possession compared to industry benchmarks. The number of properties in possession has fallen over the year to 522 (2013: 600) due to strong property sales and reduced new possessions. This represents 0.03% of the Group's book compared to the industry average of 0.08%, as shown below:

Possessions as a percentage of total book (number of properties)	**2014**		2013
	Number of properties	**%**	%
Prime	**174**	**0.01**	0.02
Specialist	**348**	**0.14**	0.18
Group	**522**	**0.03**	0.04
CML industry average		**0.08**	0.10

Residential mortgage lending and credit risks (continued)

Interest only mortgages

The Group does not offer any new advances for prime residential mortgages on an interest only basis. However, the Group does still have historical balances which were originally advanced as interest only mortgages or where the Group agreed a change in terms to an interest only basis (this option was withdrawn in 2012).

Temporary interest only terms can be available to prime mortgage customers who are in forbearance. The majority of new specialist buy to let loans are advanced on an interest only basis.

The tables below provide details of the prime and specialist balances at year end which are on an interest only basis, analysed by maturity:

	Term expired (still open)	Due within one year	Due after one year and before two years	Due after more than two years	Total	% of total
	£m	£m	£m	£m	£m	%
2014						
Prime interest only mortgages	**57**	**364**	**507**	**24,650**	**25,578**	**21.4**
Specialist interest only mortgages	**62**	**85**	**157**	**22,691**	**22,995**	**87.3**
Total interest only mortgages	**119**	**449**	**664**	**47,341**	**48,573**	**33.3**
2013						
Prime interest only mortgages	58	423	496	28,122	29,099	26.3
Specialist interest only mortgages	30	66	105	20,734	20,935	83.9
Total interest only mortgages	88	489	601	48,856	50,034	36.9

Note: The tables above include the full amount of residential mortgage balances even when only part of the loan is on interest only terms.

The proportion of the Group's total interest only loan balances, as a proportion of total residential mortgages during the year is 33.3% (2013: 36.9%), with the interest only proportion of prime mortgages falling to 21.4% of the total prime mortgage book (2013: 26.3%) offset by the increase in proportion of interest only specialist lending reflecting growth in the buy to let market.

Negative equity loans

Collateral held against residential mortgages is the Group's principal method of mitigating credit risk on residential mortgages.

Negative equity, being the excess of loan balances over collateral held, on non-performing residential mortgages is shown below. The value of negative equity has reduced significantly due to the growth in house prices over the year.

Negative equity of residential mortgages	**2014**		2013	
	Prime lending	**Specialist lending**	Prime lending	Specialist lending
	£m	**£m**	£m	£m
Past due but not impaired	**4**	**6**	5	13
Impaired	**3**	**16**	5	21
Possessions	**-**	**7**	1	15
	7	**29**	11	49

Note: Collateral held is capped at the amount outstanding on an individual loan basis.

Business and Risk Report continued

Residential mortgage lending and credit risks (continued)

Managing credit risk

The Group's approach is to reduce credit risk through sound underwriting. However, at times, despite this customers do face financial difficulty and in these cases the Group seeks to find a solution to mitigate losses to the Group and to support residential mortgage customers. The options offered to customers are classified into three categories:

- change in terms
- forbearance
- repair.

It should be noted that the methodology for calculating the number of renegotiated loans (covering all three categories above) has been updated during the period to reflect the PRA's guidance of what constitutes a renegotiated loan. As a result, the 2013 disclosures have been updated to reflect the new methodology. A loan is defined as having been renegotiated if the event has occurred at any point since January 2008 and it is still on the books at 4 April 2014, although the loan may have since returned to a normal status.

Change in terms

Changes in terms relate to a concession or permanent change, which results in an amended monthly cash flow; these are not offered as a means of forbearance. The options available include:

- payment holidays
- term extensions
- payment concessions
- permanent interest only conversions (withdrawn March 2012).

This table provides further details of the current balances on all loans which have been subject to changes in terms at any point since January 2008, by region. These figures include balances that have reverted to normal risk levels, e.g. loans where payment holidays have ended and payments have recommenced. It is possible to have had more than one type of change in term and in this instance they are shown in both categories.

Residential mortgage balances subject to change in terms since January 2008	Greater London	Central England	Northern England	South East England (excluding London)	South West England	Scotland	Wales and Northern Ireland	Total
	£m	£m	£m	£m	£m	£m	£m	£m
2014								
Payment holidays	**1,140**	**877**	**796**	**585**	**370**	**295**	**297**	**4,360**
Term extensions	**2,123**	**1,425**	**1,205**	**990**	**698**	**475**	**487**	**7,403**
Payment concessions	**272**	**174**	**166**	**105**	**71**	**41**	**61**	**890**
Interest only conversions	**769**	**361**	**328**	**286**	**204**	**100**	**161**	**2,209**
	4,304	**2,837**	**2,495**	**1,966**	**1,343**	**911**	**1,006**	**14,862**
Elimination of multiple events	**(471)**	**(332)**	**(283)**	**(229)**	**(149)**	**(86)**	**(124)**	**(1,674)**
Total	**3,833**	**2,505**	**2,212**	**1,737**	**1,194**	**825**	**882**	**13,188**
2013*								
Payment holidays	1,259	974	881	662	407	328	323	4,834
Term extensions	1,863	1,317	1,117	896	633	436	452	6,714
Payment concessions	261	172	159	103	67	42	58	862
Interest only conversions	850	394	350	315	226	108	169	2,412
	4,233	2,857	2,507	1,976	1,333	914	1,002	14,822
Elimination of multiple events	(468)	(338)	(282)	(234)	(148)	(84)	(121)	(1,675)
Total	3,765	2,519	2,225	1,742	1,185	830	881	13,147

*restated to reflect revised PRA guidance

Residential mortgage lending and credit risks (continued)

Payment holidays

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 2014, £4,360 million (2013: £4,834 million) of loans have been subject to payment holidays at any point since January 2008 and are still on the books at 4 April 2014. Only £98 million of loans (2013: £163 million) remain on a payment holiday as at 4 April 2014.

Term extensions

The Group allows performing customers to apply to extend the term of their mortgage. As at 4 April 2014, £7,403 million (2013: £6,714 million) of loans have been subject to term extensions at any point since January 2008 and are still on the books at 4 April 2014. During the year, £2,861 million of loans (2013: £2,844 million) were subject to a term extension. 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.

Payment concessions

Customers in arrears may be offered a temporary payment concession allowing them to make reduced or nil payments for an agreed period of time. During this period the arrears amounts are accrued and therefore no additional provision is required. As at 4 April 2014, £890 million (2013: £862 million) of loans have been subject to payment concessions at any point since January 2008 and are still on the books at 4 April 2014. Only £21 million of loans (2013: £29 million) remain subject to payment concessions as at 4 April 2014.

Interest only conversions

Interest only conversions allowed performing customers who met certain criteria to apply for an interest only conversion, normally reducing their monthly commitment. Following tightening of the Group's policy, the facility was completely withdrawn in March 2012, although a temporary interest only arrangement may be available under forbearance. As at 4 April 2014, £2,209 million (2013: £2,412 million) of loans have been subject to interest only conversions at any point since January 2008 and are still on the books at 4 April 2014. The option to permanently convert to an interest only loan was withdrawn in March 2012. 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.

Forbearance

Forbearance takes place when a concession is made on the contractual terms of a loan to a customer as a result of financial difficulties.

The only forbearance option which the Group offers customers in financial distress is a temporary interest only concession. Interest only concessions are offered to customers on a temporary basis with formal periodic review subject to an affordability assessment. 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 2014, £171 million of balances (2013: £265 million) representing 0.1% (2013: 0.2%) of total mortgage balances were on this concession. The Group's provisioning methodology reflects the latest performance on these accounts.

The table below provides details of the current balances of loans that have been subject to forbearance arrangements at any point since January 2008, by region. These balances are not included in the interest only balances in the change of terms table above.

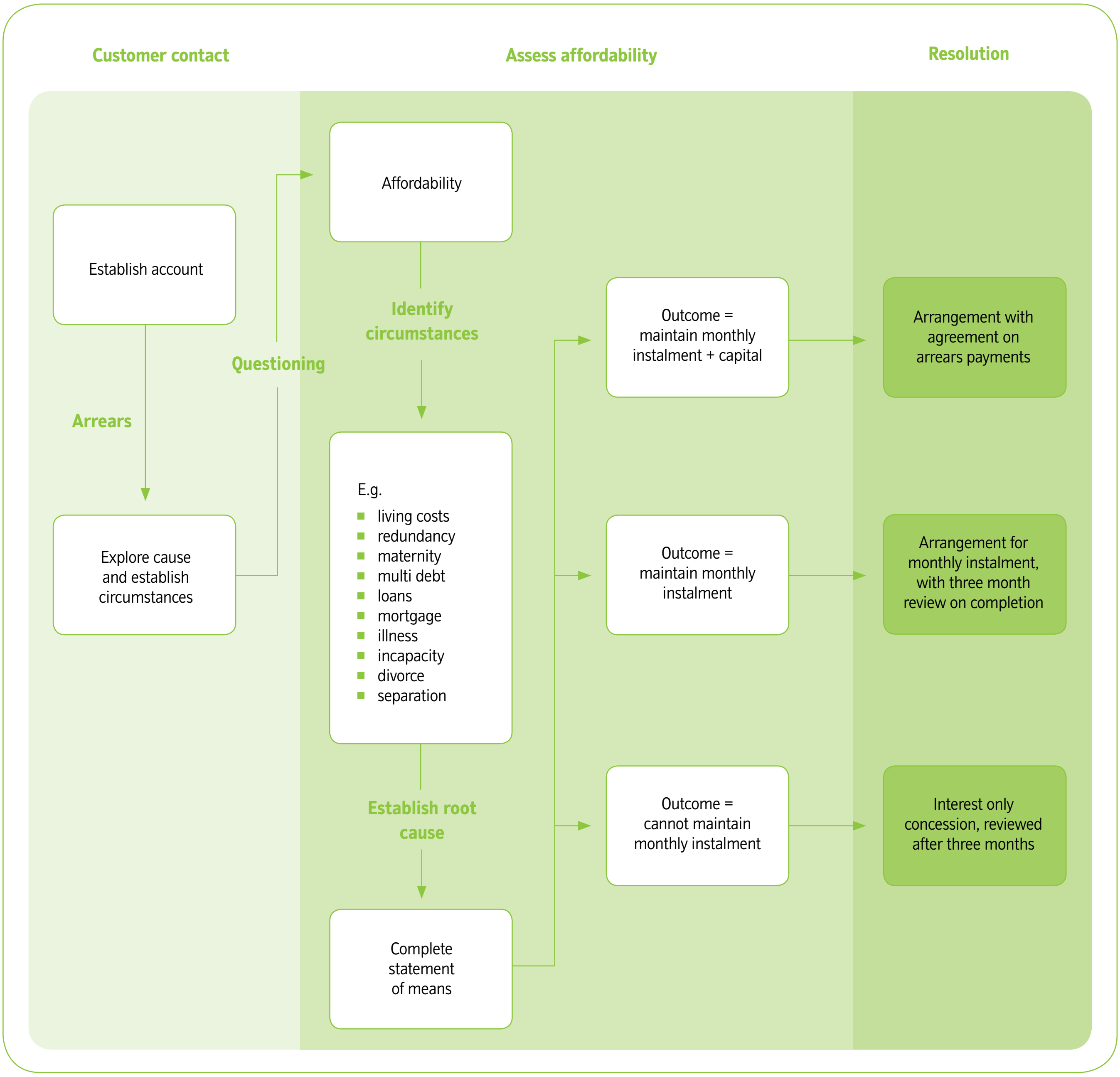
Residential mortgage balances subject to forbearance since January 2008	Greater London	Central England	Northern England	South East England (excluding London)	South West England	Scotland	Wales and Northern Ireland	Total
	£m	£m	£m	£m	£m	£m	£m	£m
2014								
Temporary interest only concessions	**379**	**364**	**363**	**202**	**128**	**107**	**124**	**1,667**
2013*								
Temporary interest only concessions	382	362	365	204	131	107	121	1,672

*restated to reflect revised PRA guidance

Business and Risk Report continued

Residential mortgage lending and credit risks (continued)

The following diagram shows the process which is carried out in deciding the appropriate action when a customer is seeking forbearance.



Residential mortgage lending and credit risks (continued)

Repair

The Group offers two forms of repair, capitalisation and term extension (at term expiry), as set out below.

Capitalisation

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 on 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. As at 4 April 2014, £420 million (2013: £442 million) of loans had an arrears capitalisation at any point since January 2008 and are still on the books at 4 April 2014. £7 million of loans (2013: £22 million) were capitalised during the year ended 4 April 2014. Once capitalised the loans are categorised as not impaired as long as contractual repayments are maintained.

Term extension (at term expiry)

Customers on interest only mortgages who are unable to repay their capital at term expiry 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. As at 4 April 2014, £1,142 million (2013: £1,028 million) of loans had an extension at term expiry at any point since January 2008 and are still on the books at 4 April 2014; of these £318 million of loans (2013: £164 million) had an extension at term expiry during the year ended 4 April 2014. No provisioning methodology adjustment is made for these accounts as a result of the low balance and LTV profile.

The table below provides details of the current balances of loans which have been repaired at any point since January 2008, by region. It is possible for a loan to have more than one category of repair and in the table below both are shown. Capitalisation amounts shown reflect the full amount of the loan.

Residential mortgage balances subject to term extensions since January 2008	Greater London	Central England	Northern England	South East England (excluding London)	South West England	Scotland	Wales and Northern Ireland	Total
	£m	£m	£m	£m	£m	£m	£m	£m
2014								
Capitalisations	**144**	**76**	**76**	**56**	**32**	**13**	**23**	**420**
Term extensions	**399**	**211**	**131**	**157**	**145**	**54**	**45**	**1,142**
	543	**287**	**207**	**213**	**177**	**67**	**68**	**1,562**
Elimination of multiple events	**(3)**	**(1)**	**-**	**(2)**	**-**	**-**	**(1)**	**(7)**
Total	**540**	**286**	**207**	**211**	**177**	**67**	**67**	**1,555**
2013								
Capitalisations	152	80	79	58	35	14	24	442
Term extensions	363	197	102	151	146	31	38	1,028
	515	277	181	209	181	45	62	1,470
Elimination of multiple events	(4)	(2)	(1)	(1)	(1)	-	-	(9)
Total	511	275	180	208	180	45	62	1,461

Business and Risk Report continued

Residential mortgage lending and credit risks (continued)

Total renegotiated loans

The table below shows the stock of loans still on the books as at 4 April 2014 that have been renegotiated at any point since January 2008:

	2014		2013*	
	£m	% of total residential mortgages	£m	% of total residential mortgages
Change in terms	13,188	9	13,147	10
Forbearance	1,667	1	1,672	1
Repair	1,555	1	1,461	1
	16,410	11	16,280	12
Elimination of multiple events	(1,266)		(1,244)	
Total	15,144	10	15,036	11

*restated to reflect revised PRA guidance

The table below splits by type, and region, the current balances of loans which have been renegotiated at any point since January 2008, together with the impairment provisions held on these renegotiated loans. Loans which are still on special terms at the balance sheet date are also disclosed. These comprise loans where the terms have been changed temporarily and which, as at balance sheet date, are still subject to payment holidays or concessions and forborne loans which are still on temporary interest only terms.

Residential mortgage balances subject to renegotiation since January 2008	Greater London	Central England	Northern England	South East England (excluding London)	South West England	Scotland	Wales and Northern Ireland	Total
	£m	£m	£m	£m	£m	£m	£m	£m
2014								
Prime	3,849	2,613	2,260	1,782	1,233	868	871	13,476
Specialist	556	278	287	210	151	73	113	1,668
Total	4,405	2,891	2,547	1,992	1,384	941	984	15,144
Of which loans are still on special terms:								
Prime	73	50	46	33	22	15	17	256
Specialist	9	7	7	4	2	1	4	34
Total	82	57	53	37	24	16	21	290
Total impairments on renegotiated loans:								
Individually assessed	-	1	1	-	-	1	2	5
Collectively assessed	1	4	5	2	1	1	6	20
Total	1	5	6	2	1	2	8	25

Note: Multiple events have been eliminated.

Residential mortgage lending and credit risks (continued)

Residential mortgage balances subject to renegotiation since January 2008	Greater London	Central England	Northern England	South East England (excluding London)	South West England	Scotland	Wales and Northern Ireland	Total
	£m	£m	£m	£m	£m	£m	£m	£m
2013								
Prime	3,835	2,652	2,303	1,811	1,247	876	875	13,599
Specialist	485	238	239	185	136	49	105	1,437
Total	4,320	2,890	2,542	1,996	1,383	925	980	15,036
Of which loans are still on special terms:								
Prime	100	70	67	47	30	24	22	360
Specialist	30	17	16	10	10	4	10	97
Total	130	87	83	57	40	28	32	457
Total impairments on renegotiated loans:								
Individually assessed	1	1	2	-	-	-	2	6
Collectively assessed	5	8	9	4	2	3	8	39
Total	6	9	11	4	2	3	10	45

Note: Multiple events have been eliminated.

Outlook for residential mortgage credit risk

The Mortgage Market Review (MMR) published by the Financial Conduct Authority required all mortgage lenders to enhance responsible lending controls for mortgages by 26 April 2014, to ensure that the mortgages are affordable and thus minimise the risk of detrimental outcomes for customers. While responsible lending is already central to the Group's lending policy, the Group has made changes to its systems and processes ahead of the regulatory deadline. These include the introduction of a more comprehensive and customer specific affordability assessment for both new mortgages and for significant changes to existing mortgage contracts. The current non-advised sales process will also be withdrawn and all mediated sales, i.e. face to face and telephone, will be subject to regulation as it constitutes an advisory sale.

The housing market has gathered pace, particularly in the second half of the year, both in activity and growth in house prices. This growth is particularly evident in London and is expanding into surrounding areas, with many other regions seeing more subdued growth. The Group has a limited exposure to the areas of London which have shown the most volatile movements, and analysis of new lending within these areas shows that key risk metrics (such as LTV and income multiples) have remained relatively stable during this growth period. At this stage the Group does not see signs of affordability being stretched but will keep the matter under close review. However, the Group is conscious that Government policies, the low interest rate environment and a significant flow of overseas buyers currently stimulate the housing market. The Group therefore actively monitors the risk that these conditions may reverse, increasing credit losses in its mortgages book and depressing the wider economy.

The Help to Buy shared equity scheme has resulted in a significant increase in the new build sector during the last six months, in which the Group has a significant share. The impact of this scheme is an issue which concerns valuers as they experience house values and purchase prices in this sector accelerating at rates which are outpacing adjacent second hand markets. The Group already has robust LTV and affordability controls in place for this sector and will be monitoring the volume of lending and purchase prices closely to ensure concentrations of lending or increased levels of credit risk are not introduced into the portfolio.

Business and Risk Report continued

Consumer banking and credit risks

Overview

Consumer banking includes balances relating to the unsecured portfolios for current accounts, credit cards and personal loans.

All books have increased in size year on year, as set out below. However total consumer banking as a share of total loans and advances to customers has remained stable at 2%.

Consumer banking balances *(Audited)*	**2014**		2013	
	£m	**%**	£m	%
FlexAccount	**300**	**8**	238	7
Personal loans	**1,907**	**49**	1,784	51
Credit cards	**1,655**	**43**	1,466	42
Total consumer banking	**3,862**	**100**	3,488	100

Credit risk

Credit risk on these books is linked to delinquency since no security is held against the loans. The Group monitors arrears status closely on these portfolios. The tables below provide further information on unsecured loans and advances by payment due status:

(Audited)	**2014**				
	Flex Account	**Personal loans**	**Credit card**	**Total**	
	£m	**£m**	**£m**	**£m**	**%**
Performing:					
Neither past due nor impaired	**255**	**1,809**	**1,565**	**3,629**	**94**
Non-performing:					
Past due up to 3 months	**16**	**16**	**24**	**56**	
Impaired:					
Past due 3 to 6 months	**5**	**17**	**20**	**42**	
Past due 6 to 12 months	**2**	**28**	**-**	**30**	
	23	**61**	**44**	**128**	**3**
Charged off	**22**	**37**	**46**	**105**	**3**
Total non-performing	**45**	**98**	**90**	**233**	
Total	**300**	**1,907**	**1,655**	**3,862**	**100**
Pre charge off non-performing balances proportion*	**8%**	**3%**	**3%**	**3%**	
Impairment provisions excluding charged off balances	**16**	**42**	**34**	**92**	
Impairment provisions on charged off balances	**15**	**30**	**36**	**81**	
Total impairment provisions	**31**	**72**	**70**	**173**	
Provision coverage ratio on non-performing loans	**69%**	**73%**	**78%**	**74%**	
Impairment losses for year	**14**	**26**	**20**	**60**	

*represents the non-performing balances as a percentage of total balances, excluding charged off balances from both the non-performing and total figures. This is included to allow comparison with 2013 data.

Consumer banking and credit risks (continued)

(Audited)	2013				
	Flex Account	Personal loans	Credit card	Total	
	£m	£m	£m	£m	%
Performing:					
Neither past due nor impaired	214	1,731	1,418	3,363	96
Non-performing:					
Past due up to 3 months	17	15	28	60	
Impaired:					
Past due 3 to 6 months	5	14	20	39	
Past due 6 to 12 months	2	24	-	26	
	24	53	48	125	4
Charged off	-	-	-	-	-
Total non-performing	24	53	48	125	
Total	238	1,784	1,466	3,488	100
Pre charge off non-performing balances proportion	10%	3%	3%	4%	
Impairment provisions excluding charged off balances	14	37	36	87	
Impairment provisions on charged off balances	-	-	-	-	
Total impairment provisions	14	37	36	87	
Provision coverage ratio on non-performing loans	58%	70%	75%	70%	
Impairment losses for year	15	26	38	79	

The Group has maintained the overall quality of its unsecured lending. The lower impairment losses for the year of £60 million (2013: £79 million) includes a reduction in impairments of £27 million, reflecting updated recovery assumptions in respect of previously charged off balances, in line with recent experience. As a result, in 2014 the Group has amended the accounting treatment of charged off accounts (accounts which have been closed to future transactions and are unable to re-establish their terms). These had previously been written off in full with subsequent recoveries taken to profit when received. For 2014 these amounts are included within non-performing consumer banking balances to the extent that the Group expects at least a partial recovery.

Impairment provisions on consumer banking are £173 million, up £86 million on 2013. This increase is driven by the change in treatment of charged off accounts. Impairment provisions excluding accounts charged off are £92 million, up £5 million on 2013, resulting in a like for like coverage ratio of 72% (2013: 70%), and reflecting the Group's continuing overall quality of its unsecured lending.

Non-performing loans (excluding charged off amounts) as a percentage of total balances (excluding charged off amounts) are 3% (2013: 4%), a 1% improvement on 2013 on a like for like basis.

Managing credit risks on consumer banking

The Group's approach is to reduce credit risk through good lending decisions. However, when customers do face financial difficulty the Group seeks to find a solution to mitigate losses to the Group and to support the customer through either a change in terms, forbearance or arrears management, as set out below.

Change in terms

Account performance is monitored on an ongoing basis using a range of factors including credit scores and information held by the credit reference agencies. For credit card and current account customers, this may result in proactive reduction of credit limits or other changes in terms. In addition to this, unsecured customers may be contacted by a specialist team to discuss their financial commitments and consider available options to improve their financial position in a sustainable manner.

Business and Risk Report continued

Consumer banking and credit risks (continued)

Forbearance

Limited forbearance options, which vary by product, are available to unsecured customers following a detailed review of their current circumstances. For credit card customers experiencing financial distress the Group may agree a repayment plan, which is typically less than the minimum contractual payment. For current account customers the Group may agree a reducing overdraft limit to lower their exposure over a manageable period. For personal loan customers with financial difficulties the Group may agree temporary reduced payments, or on completion of consecutive sustainable payments, a change in loan term may be available.

Arrears management

When a customer has, or expects to have, difficulty in meeting payments due, the Group will work with them to try to find a manageable solution. This will involve a full review of the customer's individual circumstances, including establishing the root cause behind the arrears, likely duration of this situation and monthly income and expenditure, before a plan to reduce arrears is agreed.

The Group will explore the range of options to alleviate payment difficulty and bring the account back into a sustainable position.

These will include:

- agreeing appropriate repayment plans
- temporary agreement for reduced payments, or
- terminating the agreement to avoid ongoing member detriment such as unsustainable fees and charges.

Outlook for consumer credit risk

From 1 April 2014 supervision of unsecured lending moved from the Office of Fair Trading to the Financial Conduct Authority. New rules have been published outlining responsible lending requirements. While responsible lending is already central to the Group's lending policy, further changes are planned to strengthen the affordability assessment across all unsecured lending products. It is acknowledged that this will reduce acceptance rates on applications but this minimises the risk of detrimental outcomes for customers, particularly in an environment with an increased likelihood of future interest rate rises.

The Group is also reviewing the impact of changes proposed in respect of the fees that can be charged when customers use 'chip and pin' services. These proposals have the potential to put the margins that the Group can charge in respect of its unsecured products under pressure and therefore the Group continues to monitor these proposals as they develop.

Commercial lending and credit risks

Overview

The Group's commercial loan portfolio represents 10.3% (2013: 12.5%) of the total loans and advances to customers and, on a gross basis, comprises the following:

Commercial lending balances *(Audited)*	**2014**		2013	
	£m	**%**	£m	%
Commercial real estate (CRE)	**7,764**	**45**	10,192	51
Registered social landlords	**8,063**	**47**	8,217	41
Project Finance	**1,457**	**8**	1,507	8
Total commercial lending	**17,284**	**100**	19,916	100
Fair value adjustment for micro hedged risk	**880**		1,413	
Total	**18,164**		21,329	

The Group's CRE portfolio is diversified by industry type, location and by borrower. The Group's exposure to CRE loans has reduced by £2,428 million (23.8%) to £7,764 million (2013: £10,192 million) over the year in line with its strategy of disposing of non-core assets.

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.

Since the year end the Group has concluded a sale of CRE loans, with a gross value at 4 April 2014 of £694 million (€841 million), representing over 90% of its exposure to the German real estate market. The sale price was in line with the carrying value of the assets. The disposal will be recognised in the first quarter of 2014/15 and improves the Common Equity Tier 1 (CET1) and leverage ratios by 0.5% and 0.1% respectively.

Commercial lending and credit risks (continued)

Impairment

No losses have been experienced on the registered social landlord or Project Finance portfolios and there is no non-performance within these portfolios. As a result, impairment provisions are only needed against the CRE portfolio, for which impairment provisions and impairment losses are set out in the table below:

(Audited)	**2014**	2013
	£m	£m
Gross balances	**7,764**	10,192
Impaired balances	**3,065**	2,715
Impaired balances as % of gross balances	**39%**	26%
Impairment provisions		
Individual	**921**	810
Collective	**80**	148
Total impairment provisions	**1,001**	958
Provision coverage ratios		
Individual provisions as % of impaired balances	**30%**	30%
Total provisions as % of impaired balances	**33%**	35%
Total provisions as % of total gross balances	**13%**	9%
Estimated collateral against impaired balances		
Estimated collateral on impaired loans	**2,216**	1,743
Estimated collateral as a % of impaired balances	**72%**	64%
Impairment losses for the year	**309**	493

Impairment losses on the Group's CRE portfolio have decreased by approximately 37% to £309 million. The reduction in impairments is due to several factors, including the UK commercial property market showing tentative signs of improvement in certain sectors and the progress made in resolving non-performing loans. Recovery prospects are case specific although the general trend of the London and prime property markets faring significantly better than regional locations and secondary properties is being maintained.

Impairment provisions at the year end reflect updated valuations and recovery assumptions and include new provisions on maturing facilities, typically originated in the 2005 - 2008 period.

Estimated (indexed) collateral cover as a percentage of impaired balances has risen to 72% (2013: 64%) which together with individual provisions coverage gives total credit protection of 102% of impaired balances (2013: 94%).

Significant events/environment

On the back of continued economic improvement, the commercial property sector is showing tentative signs of increasing investor confidence. However, despite a recent recovery in prime asset values, particularly in the London area, the broader commercial property market remains subdued, with capital values still around 33% below their pre-crisis peaks.

Recovery to date has been focused on prime assets with investor demand for secondary assets, outside the South East and off the major arterial connections, remaining weaker and being more dependent on micro economic factors.

Traditional lenders show limited appetite to fund new investment in secondary markets. Alternative funding sources of sufficient scale to fuel a significant recovery in this segment are lacking and therefore secondary asset recovery is expected to be more gradual than for prime sites.

Credit risk

Credit risk is linked to delinquency and availability of collateral to cover any loan balances. LTV's are monitored, along with loan concentrations and arrears.

Loan to value

The following table details the CRE loans and advances by level of collateral. The LTV ratio is calculated using the on balance sheet carrying amount of the loan divided by the indexed value of the

Business and Risk Report continued

Commercial lending and credit risks (continued)

most recent independent external collateral valuation. The Investment Property Databank (IPD) monthly index is used.

Non-performing loans include impaired loans and loans with arrears of less than three months which are not impaired. The reduction in total CRE loans reflects the ongoing planned reduction of non-core elements of the CRE portfolio. The decrease in performing loans reflects the reclassification of loans which have become impaired. Non-performing loans have remained stable at £3,130 million (2013: £3,122 million) reflecting reductions in exposures and stabilisation of impaired loans, which broadly offsets new instances of impairment.

CRE lending balances by LTV and region (*Audited*)

2014	London	South East	Rest of UK	Non UK*	Total	
	£m	£m	£m	£m	£m	%
Performing loans						
Fully collateralised						
LTV ratio:						
– less than 25%	168	46	43	-	257	
– 25% to 50%	590	171	361	-	1,122	
– 51% to 75%	1,034	391	502	87	2,014	
– 76% to 90%	201	87	307	62	657	
– 91% to 100%	18	14	106	3	141	
	2,011	709	1,319	152	4,191	54
Partially collateralised						
– more than 100% (A)	159	73	119	92	443	6
– *collateral value on A*	*147*	*56*	*84*	*86*	*373*	
Total performing loans	2,170	782	1,438	244	4,634	60
Non-performing loans						
Fully collateralised						
LTV ratio:						
– less than 25%	39	1	2	-	42	
– 25% to 50%	4	5	16	-	25	
– 51% to 75%	24	38	65	83	210	
– 76% to 90%	6	44	70	24	144	
– 91% to 100%	8	8	92	61	169	
	81	96	245	168	590	8
Partially collateralised						
– more than 100% (A)	179	358	1,656	347	2,540	32
– *collateral value on A*	*88*	*271*	*1,060*	*271*	*1,690*	
Total non-performing loans	260	454	1,901	515	3,130	40
Total CRE loans	2,430	1,236	3,339	759	7,764	100

*Since the year end the Group has sold CRE loans, with a gross value at 4 April 2014 of £694 million, representing over 90% of its remaining exposure to the German real estate market, at a price in line with the carrying value of the assets.

Commercial lending and credit risks (continued)

CRE lending balances by LTV and region *(Audited)*						
2013	London	South East	Rest of UK	Non UK	Total	
	£m	£m	£m	£m	£m	%
Performing loans						
Fully collateralised						
LTV ratio:						
– less than 25%	215	46	67	31	359	
– 25% to 50%	697	187	317	-	1,201	
– 51% to 75%	1,082	315	877	167	2,441	
– 76% to 90%	237	134	335	23	729	
– 91% to 100%	269	111	186	157	723	
	2,500	793	1,782	378	5,453	54
Partially collateralised						
– more than 100% (A)	132	376	809	300	1,617	16
– collateral value on A	*126*	*320*	*588*	*248*	*1,282*	
Total performing loans	2,632	1,169	2,591	678	7,070	70
Non-performing loans						
Fully collateralised						
LTV ratio:						
– less than 25%	-	1	12	1	14	
– 25% to 50%	7	3	17	-	27	
– 51% to 75%	24	5	60	58	147	
– 76% to 90%	11	62	38	16	127	
– 91% to 100%	22	5	189	18	234	
	64	76	316	93	549	5
Partially collateralised						
– more than 100% (A)	512	246	1,560	255	2,573	25
– collateral value on A	*301*	*147*	*964*	*168*	*1,580*	
Total non-performing loans	576	322	1,876	348	3,122	30
Total CRE loans	3,208	1,491	4,467	1,026	10,192	100

As a result of performing loans being reclassified as impaired, the overall proportion of partially collateralised non-performing loans has increased to 32% (2013: 25%). However, the shortfall on collateral for non-performing CRE loans has reduced by £143 million during the year to £850 million (2013: £993 million).

Business and Risk Report continued

Commercial lending and credit risks (continued)

The following table provides detail of the Group's sectoral and regional CRE concentrations together with an impairment analysis in respect of these concentrations:

CRE lending balances and impairment by type and region	2014				
	London	South East	Rest of UK	Non UK*	Total
	£m	£m	£m	£m	£m
Retail	884	450	1,215	277	2,826
Office	475	242	653	149	1,519
Residential	390	198	536	122	1,246
Industrial & warehouse	405	206	557	127	1,295
Leisure & hotel	248	126	341	78	793
Other	28	14	37	6	85
Total CRE lending	2,430	1,236	3,339	759	7,764
Impairment provision					
Retail	32	42	186	113	373
Office	48	24	146	14	232
Residential	9	5	36	8	58
Industrial & warehouse	4	10	159	26	199
Leisure & hotel	42	21	73	3	139
Other	-	-	-	-	-
Total impairment provision	135	102	600	164	1,001
Provision coverage ratios	5.6%	8.3%	18.0%	21.6%	12.9%

*Since the year end the Group has sold CRE loans, with a gross value at 4 April 2014 of £694 million, representing over 90% of its remaining exposure to the German real estate market, at a price in line with the carrying value of the assets.

Commercial lending and credit risks (continued)

CRE lending balances and impairment by type and region	2013				
	London	South East	Rest of UK	Non UK	Total
	£m	£m	£m	£m	£m
Retail	992	461	1,381	317	3,151
Office	731	340	1,017	234	2,322
Residential	537	250	748	172	1,707
Industrial & warehouse	530	246	738	169	1,683
Leisure & hotel	366	170	509	117	1,162
Other	52	24	74	17	167
Total CRE lending	3,208	1,491	4,467	1,026	10,192
Impairment provision					
Retail	27	27	143	83	280
Office	71	27	192	12	302
Residential	10	8	20	9	47
Industrial & warehouse	4	7	153	21	185
Leisure & hotel	65	27	49	3	144
Other	-	-	-	-	-
Total impairment provision	177	96	557	128	958
Provision coverage ratios	5.5%	6.4%	12.5%	12.6%	9.4%

The largest single commercial customer, including undrawn commitments, represents only 1.7% (2013: 1.5%) of the total book.

Over the year, funding liquidity in the lending market has improved with a number of new entrants and traditional lenders returning to the market. There are tentative signs of improvement in CRE both in London and the surrounding regions, albeit this recovery has not been seen in most of the depressed secondary and tertiary assets. As a result, provision coverage ratios in London have remained stable whilst the highest increase in coverage ratios has been seen in other regions.

Business and Risk Report continued

Commercial lending and credit risks (continued)

Credit performance

Arrears

The table below provides information on the commercial real estate lending by payment due status:

CRE lending balances by payment status *(Audited)*	**2014**		2013	
	£m	**%**	£m	%
Performing:				
Neither past due nor impaired	**4,634**	**60**	7,070	69
Non-performing:				
Past due up to 3 months but not impaired	**65**	**1**	407	4
Impaired	**3,065**	**39**	2,715	27
Total Non-performing	**3,130**		3,122	
Total	**7,764**	**100**	10,192	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 not impaired have collective impairment provisions set aside to cover credit losses.

Impairment

Impaired commercial assets are further analysed as follows:

(Audited)	**2014**		2013	
	£m	**%**	£m	%
Impaired:				
Past due 0 to 3 months	**2,125**	**69**	1,581	58
Past due 3 to 6 months	**152**	**5**	218	8
Past due 6 to 12 months	**334**	**11**	295	11
Past due over 12 months	**442**	**15**	620	23
Possessions	**12**	**-**	1	-
	3,065	**100**	2,715	100

Impaired loans include those balances which are more than 3 months in arrears, or have a provision against them. Of these balances, commercial assets totalling £2,988 million (2013: £2,629 million) have individual provisions against them.

Possession balances represent loans for which the Group has taken ownership of security pending sale. Assets in possession 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 occupy or otherwise use for any purposes any repossessed assets.

Managing commercial credit risk

The strategy for managing CRE credit risk reflects the challenging environment. The Group adopts robust credit management policies and processes designed to recognise and manage the risks arising, or likely to arise from the portfolio. 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 difficulties which prompt more frequent review, where appropriate.

Loans in financial difficulties are typically those which exhibit high loan to value, low interest cover or early stage arrears.

Where such customers are identified they are typically transferred, at an early stage, to specialist business and risk teams focused on re-structuring troubled facilities, exiting distressed loans and

Commercial lending and credit risks (continued)

minimising credit losses. In this respect, resources have been expanded and targeted to maintain a regime of close and continuous scrutiny over all high value assets with particular emphasis on those considered to exhibit higher risk characteristics.

As part of this control, there is great focus on assessing loans as they approach maturity in order to manage any refinance risk. Refinance risk is the risk that a borrower is unable to meet the scheduled repayment of a loan, due to the lack of availability of refinance or the absence of an active market for the underlying security.

To monitor and control this risk, a Loan Maturity Control Framework has been established to ensure that all loans within 12 months of their maturity date are assessed, in order to highlight potential issues as early as possible and initiate appropriate management activity in advance of the maturity date. In addition to the Loan Maturity Control Framework, 12 months prior to maturity, all loans are re-assessed against impairment loss event triggers to establish whether the loan is impaired.

In managing the portfolio the Group seeks to reduce higher risk exposures whilst avoiding excessive losses which would be caused by making early disposals in a depressed market. The reduction in both CRE exposures and year on year impairment charges demonstrates the success of this strategy.

The Group will seek to support customers and restructure non-performing or impaired loans, but only where the Group's assessment of future cash flows provides sufficient evidence to suggest that such an approach will serve to enhance prospects for full debt recovery.

The Group will, when necessary, refinance existing facilities at maturity but will classify loans according to its risk profile:

- restructures: these loans will be extended on current market terms, or
- distressed restructures: the terms for these loans may not fully meet current market terms and as a result will typically be classed as forborne.

Collateral

Although collateral can be an important mitigant of credit risk, it is the Group's practice to lend on the basis of the customer's ability to meet their obligations out of cash flow resources rather than rely on the value of the security offered. In the event of default the Group may use the collateral as a source of repayment.

Primary collateral is a fixed charge over freehold or long leasehold properties but may be supported by other liens, floating charges over company assets, and occasionally unsupported guarantees. The collateral will have a significant effect in mitigating the Group's exposure to credit risk.

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 and therefore no collateral is held on these loans.

The table below quantifies the estimated value of indexed collateral held against non-performing or impaired assets:

Collateral held against past due or impaired CRE lending balances *(Audited)*	**2014**		2013	
	£m	**%**	£m	%
Past due but not impaired	**64**	**98**	386	95
Impaired	**2,216**	**72**	1,743	64
	2,280	**73**	2,129	68

Note: Collateral held is capped at the amount outstanding on an individual loan basis.

The percentage, in the table above, is the cover over the asset. The indexed collateral value is based on the most recent valuation indexed using the IPD monthly index for the relevant property sector.

During the year a revised valuation policy has been implemented which stipulates the maximum period between formal valuations, relative to the risk profile of the lending. Particular attention is paid to the status of the facilities, for instance whether it is, or is likely to require an impairment review where the Group's assessment of potential loss would benefit from updated valuations, or there are factors affecting the property that might alter the case assessment and the most appropriate action to take.

Business and Risk Report continued

Commercial lending and credit risks (continued)

The level of negative equity based upon indexed property values for the non-performing and impaired assets is detailed below:

Negative equity on CRE lending balances	2014	2013
	£m	£m
Past due but not impaired	1	21
Impaired	840	971
Possessions	9	1
	850	993

Forbearance

Forbearance occurs when a concession is made on the contractual terms of a loan outside of the Group's normal prudent pricing parameters. In practice, the latter is defined as cases with a loan to value ratio greater than 80%.

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 policy and approach to considering forbearance requests is documented in its Forbearance and Arrears Management policies. Implementation is controlled through the governance and control framework, which includes early warning and watchlist procedures for managing and monitoring the performance of these customers.

All forbearance requests are assessed and approved by the independent credit team in the Risk Management Division. 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 available 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.

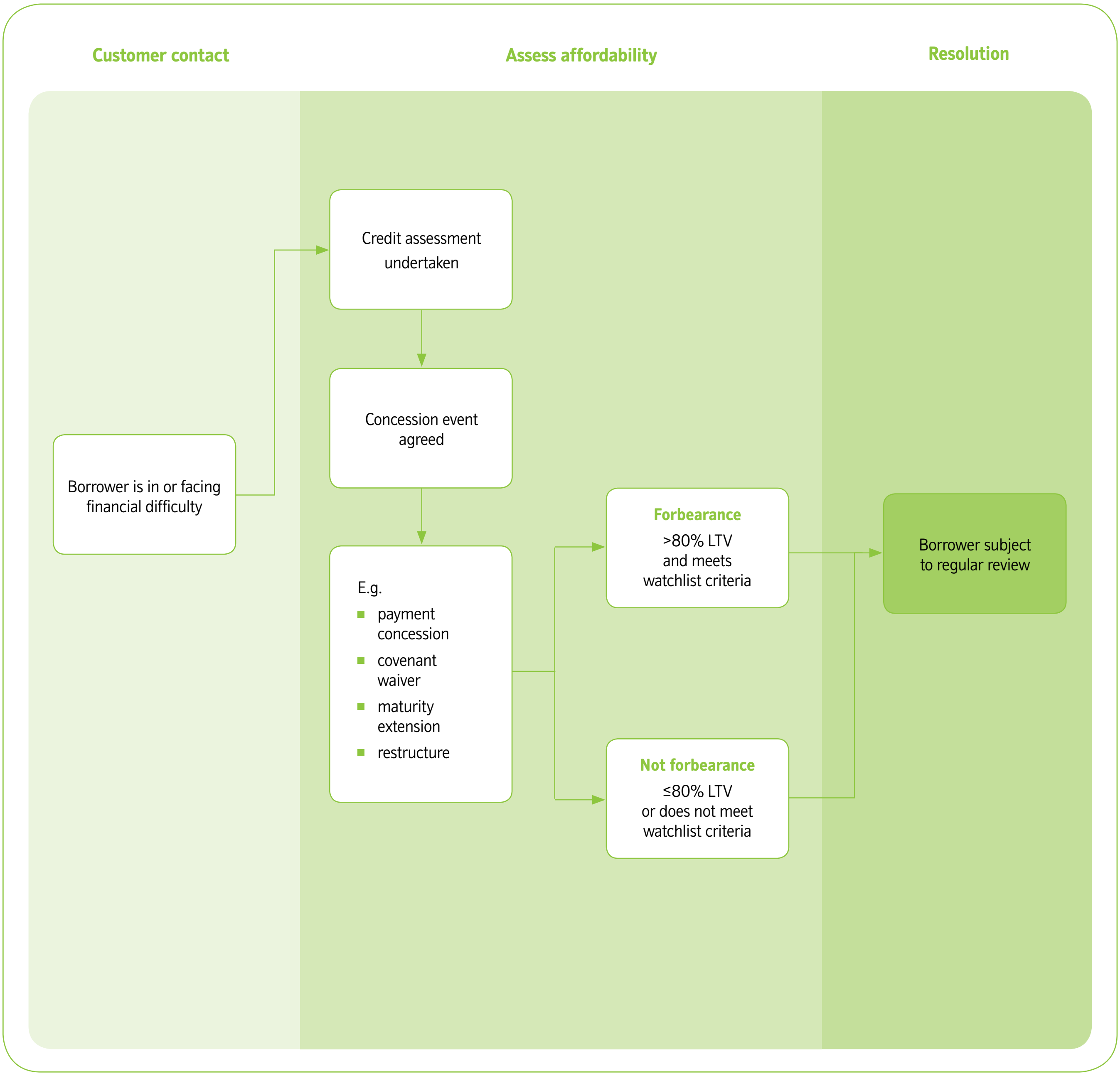
Forbearance to address covenant breaches would normally entail either a temporary or permanent waiver or amendment of the affected covenant. Each case would be considered on its own merits and the Group's response will depend upon the risk profile of the transaction.

The provision of extended facilities on maturity does not always represent forbearance. 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 and always in relation to cases which have been reclassified as impaired.

The following flowchart demonstrates the decision process for commercial forbearance:

Commercial lending and credit risks (continued)



Business and Risk Report continued

Commercial lending and credit risks (continued)

Loans restructured at maturity and subject to forbearance will typically include a contractual capital amortisation profile or a full cash sweep of surplus rental income to pay down the debt after permitted deductions for asset management fees and irrecoverable property costs. As long as the new contractual terms are maintained, these cases are, if applicable, no longer impaired and will not retain a forbearance classification.

The table below provides details of lending that has been subject to forbearance at any point since January 2008:

Lending subject to forbearance	2014		2013	
	£m	%	£m	%
Covenant breach	402	15	292	15
Extension at maturity	90	3	332	17
Revised repayment profile	-	-	48	3
Multiple forbearance events	1,985	73	800	41
Other	257	9	463	24
	2,734	100	1,935	100

The increase in lending subject to forbearance is driven primarily by cases which reached loan maturity in the year to 4 April 2014 where the borrower has been unable to secure refinancing or repay the facility due principally to the lack of available refinancing in the market or under performance against business plans. In those circumstances the Group may have allowed a further period of time to try and reach a mutually acceptable outcome.

In many cases up to date valuations obtained as part of an extension will have resulted in a breach of the underlying LTV covenant and hence these cases are now reported as showing multiple forbearance events. The maturity pipeline remains significant and the Group therefore expects a further increase in lending subject to forbearance which will only abate once refinance becomes more readily available for the CRE sector.

Outlook for commercial credit risks

The outlook for commercial credit risks is stable as a result of recent tentative improvements in market conditions, albeit that a number of challenges remain.

With the CRE sector continuing to absorb capital from the industry as a consequence of the performance of the market and changes to regulatory capital requirements, there are limited funds available to act as a stimulus to drive asset values up, particularly for secondary assets. As a result the spread between prime and secondary markets is likely to remain at current levels for some time.

In the year ahead £1.4 billion of CRE facilities are due to mature. Of this, £0.9 billion is under watch and has been assessed with individual provisions held against these loans of £0.5 billion. Of the remaining £0.5 billion almost all have an interest cover ratio of greater than 130%. The Group will continue its strategy of reducing exposures which are outside of its current risk appetite or do not align to its existing lending strategy.

Other lending risks

Overview

The total other lending portfolio of £176 million (2013: £219 million) represents 0.1% (2013: 0.3%) of the Group's loans and advances to customers. Included within this portfolio are secured loans relating to a European commercial loan facility which is held by one of the Group's subsidiaries, Cromarty CLO Ltd (Cromarty), and a revolving loan facility secured by a portfolio of asset backed securities.

The Group's unsecured lending in relation to a student loan portfolio (2013: £217 million) was sold on 24 April 2013.

The table below provides further information on other lending balances by payment due status:

(Audited)	**2014**		2013	
	£m	**%**	£m	%
Performing:				
Neither past due nor impaired	**69**	**40**	397	91
Non-performing:				
Past due up to 3 months but not impaired	**-**	**-**	6	1
Impaired	**107**	**60**	33	8
Total Non-performing	**107**	**60**	39	9
Total	**176**	**100**	436	100
Impairment provisions/coverage ratio	**12**	**11**	10	30
Impairment losses for the year	**11**		1	

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.

The other lending impairment charge of £11 million (2013: £1 million) includes £8 million arising on the European commercial loan portfolio and £3 million in relation to a first loss exposure on the portfolio of asset backed securities securing the revolving loan facility.

The £107 million (2013: £33 million) of impaired balances in other lending includes £25 million (2013: £27 million) relating to the European commercial loan portfolio and £82 million (2013: £nil) relating to a first loss exposure on the portfolio of asset backed securities securing the revolving loan facility. The lower provision coverage ratio in 2014 is as a result of the inclusion of the entire revolving loan facility balance due to the impairment charge taken on the first loss exposure on the portfolio. 2013 impaired balances included £6 million relating to the unsecured student loan portfolio which was sold in April 2013.

Impaired other lending assets are further analysed as follows:

(Audited)	**2014**		2013	
	£m	**%**	£m	%
Impaired:				
Past due 0 to 3 months	**82**	**77**	-	-
Past due 3 to 6 months	**-**	**-**	1	3
Past due 6 to 12 months	**8**	**7**	2	6
Past due over 12 months	**17**	**16**	30	91
Possessions	**-**	**-**	-	-
	107	**100**	33	100

Business and Risk Report continued

Other lending risks (continued)

Managing other lending risk

The Group adopts robust credit management policies and processes designed to recognise and manage the risks arising, or likely to arise, from its other lending portfolio. As with other categories of loans, the Group will work with the customer to try to resolve any issues and to restore the loan to a financially viable position.

Forbearance

Cromarty holds a portfolio of loans to companies and although the terms of the interest payments of the Society's loan to Cromarty are aggregated so that it does not have a forbearance position, Cromarty does agree repayment terms for its borrowers that are within the definition of forbearance.

Forbearance in relation to Cromarty's borrowers that cannot demonstrate they have robust business models, material market shares and adequate cash flows tend to take the form of balance sheet restructures. Balance sheet restructures are often led by lenders and the terms attempt to balance the need to relieve companies of unsustainable debt burdens and to maximise returns for lenders. Restructures often result in principal reductions in debt outstanding, reduced margins on cash paying debt or the amendment of cash paying debt to payment in kind (PIK) debt.

As of 4 April 2014 12 borrowers (2013: 14 borrowers) in the Cromarty loan portfolio would be classed as in forbearance. Of the £38 million (2013: £43 million) of loans to these borrowers £31 million (2013: £28 million) has gone through a balance sheet restructure and £7 million (2013: £9 million) has completed an Amend and Extend request.

In addition, other lending includes a revolving loan facility of £82 million (2013: £83 million) which was re-categorised as under forbearance following management review and the decision to extend the loan facility. An impairment charge of £3 million (2013: £nil) has been recognised for the year ended 4 April 2014 against this facility.

Movements in all impaired loans by credit risk segment

The table below shows the movements throughout the year of all loans classified as impaired. The balance shown represents the entire financial asset rather than just the overdue elements.

(Audited)	Prime mortgages	Specialist mortgages	Consumer banking	Commercial lending	Other lending	Total
	£m	£m	£m	£m	£m	£m
At 5 April 2013	564	726	65	2,715	33	4,103
Classified as impaired during the year	**464**	**598**	**134**	**825**	**92**	**2,113**
Charged off balances*	-	-	**105**	-	-	**105**
Transferred from impaired to unimpaired	**(476)**	**(558)**	**(24)**	**(21)**	**(11)**	**(1,090)**
Amounts written off	**(40)**	**(114)**	**(92)**	**(362)**	-	**(608)**
Repayments	**(8)**	**(1)**	**(11)**	**(92)**	**(7)**	**(119)**
At 4 April 2014	**504**	**651**	**177**	**3,065**	**107**	**4,504**

*Further details regarding charged off balances are provided in the 'Consumer banking and credit risks' section.

Loans that were classified as impaired at any point during the year and loans that have transferred into or out of impaired are based on the relevant status at each month end, when compared to the previous month end. Amounts written off reflect cases where the loan has been removed from the books, for example a residential property repossessed and sold. Repayments reflect payments made by the customer, reducing the outstanding balance.

Consumer banking balances are written off when all avenues for recovering debt using internal resource have been exhausted or when accounts have reached a significant time in arrears. Write-offs have decreased from last year as the ultimate point of write-off has been deferred to reflect the longer period during which recoveries continue to be made, based on past experience.

Maximum exposure to credit risk

In addition to loans and advances to customers, the Group is exposed to credit risk on all other financial assets. For financial assets recognised on the balance sheet, the maximum exposure to credit risk represents the balance sheet carrying value after allowance for impairment. For off-balance sheet guarantees, the maximum exposure is the maximum amount that the Group would have to pay if the guarantees were to be called upon. For loan commitments and other credit related commitments that are irrevocable over the life of the respective facilities, the maximum exposure is the full amount of the committed facilities.

The following table presents the Group's maximum exposure to credit risk, reflecting the financial effects of collateral, credit enhancements and other actions taken to mitigate the Group's exposure.

(Audited)		**2014**	
	Carrying value	**Commitments**	**Maximum credit risk exposure**
	£m	**£m**	**£m**
Cash	**5,342**	**-**	**5,342**
Loans and advances to banks	**2,110**	**408**	**2,518**
Investment securities – AFS	**10,563**	**-**	**10,563**
Derivative financial instruments	**3,020**	**-**	**3,020**
Fair value adjustment for portfolio hedged risk	**221**	**-**	**221**
Loans and advances to customers	**166,574**	**7,415**	**173,989**
Investment in equity shares	**29**	**-**	**29**
	187,859	**7,823**	**195,682**

(Audited)		2013	
	Carrying value	Commitments	Maximum credit risk exposure
	£m	£m	£m
Cash	7,886	-	7,886
Loans and advances to banks	2,522	423	2,945
Investment securities – AFS	13,421	-	13,421
Derivative financial instruments	4,212	-	4,212
Fair value adjustment for portfolio hedged risk	872	-	872
Loans and advances to customers	159,587	6,736	166,323
Investment in equity shares	28	-	28
	188,528	7,159	195,687

In addition to the figures shown above, the Group has, as part of its retail operations, revocable commitments of £7,662 million (2013: £7,169 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.

The next section deals with Treasury assets which are also related to credit risks. Treasury assets account for the bulk of the Group's assets included above, after loans and advances to customers.

Business and Risk Report continued

Treasury assets and treasury credit risks

Overview

The following assets are included within the Group's treasury portfolio for liquidity management and, in the case of derivatives, market risk management. Total treasury assets represent 11.1% (2013: 14.7%) of Group assets.

Treasury asset balances *(Audited)*	**2014**	2013
	£bn	£bn
Cash	**5.3**	7.9
Loans and advances to banks	**2.1**	2.5
Investment securities	**10.6**	13.4
Treasury liquidity and investment portfolio	**18.0**	23.8
Derivative assets	**3.0**	4.2
Total treasury portfolio	**21.0**	28.0

Treasury assets include cash, loans and advances to banks and investment securities available for sale. In addition treasury assets include derivative assets; derivatives are classified as assets where their fair value is positive and liabilities where their fair value is negative. As at 4 April 2014 the Group had derivative liabilities of £2.4 billion (2013: £3.9 billion).

During the year, significant deleveraging of legacy treasury assets that are outside of current credit policy was undertaken. The total balance of out of policy assets reduced from £2.9 billion to £1.8 billion, through targeted sales, maturities and amortisation.

The Group considers 'out of policy' assets to be legacy assets (bought prior to the financial crisis) that are no longer approved in the Group's Treasury Credit Policy. These assets are still actively managed, with natural maturities reducing the balance of the assets over time. In addition, the Group assesses any opportunities for exit positions, whether via a sale or a tender offer, whilst being mindful of the financial implications of those potential exits on the Group.

Significant events/environment

Credit risk in the treasury asset portfolio has reduced significantly over the past financial year as economic and market conditions have improved and the risk of a Eurozone break-up has receded. Asset disposals have also removed some of the more vulnerable assets from the portfolio. Impairments have been within management expectations and the available for sale reserve deficit reduced over the year.

Treasury liquidity and investment portfolio

Group treasury assets held on the balance sheet at 4 April 2014 were £18.0 billion (2013: £23.8 billion) and are held in three separate portfolios: primary liquidity, other central bank eligible assets and other securities to better reflect the management of the portfolios and bring the analysis in line with PRA definitions in BIPRU 12 (for further details regarding the definitions of BIPRU 12 please see the 'Liquidity & funding' section).

Primary liquidity comprises cash and highly rated debt securities issued by governments or multi-lateral development banks. The remaining two portfolios comprise available for sale assets held for investment purposes and loans and advances to banks.

Analysis of each of these portfolios by credit rating and geographical location of the issuers is set out in the tables below. The tables show those assets held on the balance sheet only. The decrease in the primary liquidity portfolio is a consequence of liquidity management planning following the additional Funding for Lending Scheme (FLS) drawdowns during the year, which allowed the Group to reduce the volume of liquidity held on the balance sheet.

Treasury assets and treasury credit risks (continued)

(Audited)	2014	AAA	AA	A	Other	UK	US	Europe	Other
	£bn	%	%	%	%	%	%	%	%
Primary liquidity portfolio:									
Cash	5.3	100	-	-	-	100	-	-	-
Gilts	4.5	100	-	-	-	100	-	-	-
Non-domestic government bonds	1.8	35	65	-	-	-	22	78	-
Supranational bonds	0.7	100	-	-	-	-	-	-	100
Domestic government bonds	-	-	-	-	-	-	-	-	-
Primary liquidity portfolio total	12.3	91	9	-	-	80	4	11	5
Other Central Bank eligible portfolio:									
Residential mortgage backed securities (RMBS)	0.8	42	29	17	12	12	-	88	-
Covered bonds	0.5	29	17	34	20	29	5	66	-
Other	0.1	54	-	-	46	-	-	100	-
Other Central Bank eligible portfolio total	1.4	38	22	23	17	18	2	80	-
Other portfolio:									
Loans and advances to banks	2.1	15	10	75	-	53	17	23	7
Residential mortgage backed securities (RMBS)	0.7	28	4	57	11	70	8	16	6
Commercial mortgage backed securities (CMBS)	0.2	-	24	38	38	40	29	31	-
Collateralised loan obligations	0.6	50	44	-	6	52	48	-	-
Financial institution bonds	0.1	-	-	100	-	-	-	-	100
Student loans	0.4	29	51	17	3	3	97	-	-
Other	0.2	-	29	6	65	26	48	26	-
Other portfolio total	4.3	23	19	51	7	49	29	17	5
Total	18.0	71	12	14	3	68	9	18	5

Business and Risk Report continued

Treasury assets and treasury credit risks (continued)

(Audited)	2013	AAA	AA	A	Other	UK	US	Europe	Other
	£bn	%	%	%	%	%	%	%	%
Primary liquidity portfolio:									
Cash	7.9	100	-	-	-	100	-	-	-
Gilts	5.6	100	-	-	-	100	-	-	-
Non-domestic government bonds	2.3	71	29	-	-	-	29	71	-
Supranational bonds	1.0	100	-	-	-	-	5	93	2
Domestic government bonds	0.1	100	-	-	-	100	-	-	-
Primary liquidity portfolio total	16.9	96	4	-	-	81	4	15	-
Other Central Bank eligible portfolio:									
Residential mortgage backed securities (RMBS)	0.8	34	35	20	11	8	-	92	-
Covered bonds	0.6	11	28	34	27	-	5	92	3
Financial institution bonds	0.1	-	-	79	21	24	29	47	-
Other	0.1	95	5	-	-	-	-	100	-
Other Central Bank eligible portfolio total	1.6	23	28	31	18	7	5	87	1
Other portfolio:									
Loans and advances to banks	2.5	13	23	64	-	46	18	22	14
Residential mortgage backed securities (RMBS)	0.8	18	13	40	29	60	9	23	8
Commercial mortgage backed securities (CMBS)	0.4	-	25	42	33	44	20	36	-
Collateralised loan obligations	0.7	17	79	4	-	31	69	-	-
Financial institution bonds	0.2	-	-	31	69	37	-	37	26
Student loans	0.5	22	52	14	12	-	100	-	-
Other	0.2	-	26	18	56	30	40	25	5
Other portfolio total	5.3	13	29	45	13	41	31	19	9
Total	23.8	73	12	12	3	66	11	21	2

The above analysis does not include off balance sheet funding, including £8.5 billion of primary liquidity representing short dated UK Treasury bills held as a result of FLS drawings. These are included in the analysis of funding in the Financial risk management section.

The quality and liquidity of treasury assets has been maintained with over 68% of the total portfolio held in primary liquidity exposures (2013: 71%). 97% of the total portfolio is rated A or above, with 83% rated AA or above (2013: 97% rated A or above, 85% rated AA or above). Ratings used above 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.

In assessing impairment the Group evaluates, among other factors, 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 £3 million (2013: £2 million) net of write backs has been recognised in the income statement in respect of the 'other' portfolios described above.

Collateral held as security for treasury assets is determined by the nature of the instrument. Treasury liquidity portfolio assets are generally unsecured with the exception of reverse repos, asset backed securities and similar instruments, which are secured by pools of financial assets. Within loans and advances to banks is a reverse repo of £0.1 billion (2013: £0.1 billion) which is secured by gilts.

Available for sale reserve

Out of a total of £18.0 billion (2013: £23.8 billion) on balance sheet treasury liquidity and investment portfolio, £10.6 billion (2013: £13.4 billion) are held as available for sale (AFS). Under IFRS these items are marked to market through other comprehensive income and fair value movements are accumulated in reserves. Of the £10.6 billion of AFS assets, only £71 million (2013: £60 million) are classified as Level 3 (valuation not based on observable market data) for the purposes of IFRS 13. Details of fair value movements can be found in the notes to the financial statements.

Treasury assets and treasury credit risks (continued)

The table below shows the AFS reserve compared to the carrying value for the treasury liquidity portfolio.

(Audited)	**2014**		2013	
	Fair value on balance sheet	**Cumulative AFS reserve**	Fair value on balance sheet	Cumulative AFS reserve
	£bn	**£bn**	£bn	£bn
Cash	**5.3**	**(note 1)**	7.9	(note 1)
Gilts	**4.5**	**(0.2)**	5.6	(0.7)
Non-domestic government bonds	**1.8**	**(0.1)**	2.3	(0.1)
Supranational bonds	**0.7**	**-**	1.0	(0.1)
US Medium term notes	**-**	**-**	0.1	-
Primary liquidity portfolio total	**12.3**	**(0.3)**	16.9	(0.9)
Residential mortgage backed securities (RMBS)	**0.8**	**-**	0.8	-
Covered bonds	**0.5**	**-**	0.6	-
Financial institutions bonds	**-**	**-**	0.1	-
Other investments	**0.1**	**-**	0.1	-
Other Central Bank eligible liquidity portfolio total – (note 2)	**1.4**	**-**	1.6	-
Loans and advances to banks	**2.1**	**(note 1)**	2.5	(note 1)
RMBS	**0.7**	**0.1**	0.8	0.3
Commercial mortgage backed securities (CMBS)	**0.2**	**-**	0.4	0.1
Covered bonds	**-**	**-**	-	-
Collateralised loan obligations (CLO)	**0.6**	**-**	0.7	-
Financial institutions bonds	**0.1**	**-**	0.2	-
Student loans	**0.4**	**-**	0.5	-
Other investments	**0.2**	**-**	0.2	-
Other portfolio total – (note 2)	**4.3**	**0.1**	5.3	0.4
Total treasury liquidity portfolio	**18.0**		23.8	
Positive AFS reserve before hedge accounting and taxation		**(0.2)**		(0.5)
Hedge accounting adjustment for interest rate risk		**0.3**		0.9
Taxation		**-**		(0.1)
Total value of negative AFS reserve (net)		**0.1**		0.3

Notes:
1. Not applicable
2. Including out of policy assets totalling £1.6 billion (2013: £2.7 billion)

As at 4 April 2014, the balance on the AFS reserve had improved to £51 million negative, net of tax (2013: £252 million negative). The improvement in the AFS reserve reflects general market movements and the disposal of assets in the non-primary liquidity portfolios.

The fair value movement of AFS assets that are not impaired has no effect on the Group's profit.

Business and Risk Report continued

Treasury assets and treasury credit risks (continued)

Country exposures

The Group holds £782 million (2013: £1,099 million) of securities which are domiciled in the peripheral Eurozone countries; these are held outside of primary liquidity. Of the £782 million, 72% is rated A or above and 39% is rated AA or above (2013: 58% rated A or above, 30% rated AA or above). This exposure has reduced by 29% in the year to 4 April 2014 resulting from disposals of Irish and Spanish investments, maturities and fair value and exchange rate movements.

The following tables summarise the Group's direct exposure to institutions, corporates and other issued securities domiciled in the peripheral Eurozone countries. The Group has no direct sovereign exposure to these countries. The exposures are shown at their balance sheet carrying values.

	Ireland	Italy	Portugal	Spain	Total
	£m	£m	£m	£m	£m
2014					
Mortgage backed securities	**14**	**75**	**49**	**299**	**437**
Covered bonds	**39**	**-**	**22**	**281**	**342**
Senior debt	**-**	**-**	**-**	**-**	**-**
Other assets	**-**	**-**	**-**	**-**	**-**
Other corporate	**-**	**3**	**-**	**-**	**3**
Total	**53**	**78**	**71**	**580**	**782**
2013					
Mortgage backed securities	144	90	50	335	619
Covered bonds	71	-	22	326	419
Senior debt	-	25	-	17	42
Other assets	-	3	-	2	5
Other corporate	11	3	-	-	14
Total	226	121	72	680	1,099

Note: Since the year end the Irish mortgage backed securities have been sold realising a loss of £1 million.

During the year the Group disposed of £130 million of Irish assets and £25 million of Spanish assets as part of an ongoing exercise to deleverage the balance sheet. There has been no new investment in the year.

None of the Group's exposures to the peripheral Eurozone countries detailed in the table above are in default, and the Group has not incurred any impairment on these assets in the year. The Group continues to monitor closely the exposures to these countries.

Country exposure in respect of other balance sheet items

The Group has further indirect exposure to peripheral Eurozone countries as a result of a €100 million loan to a Luxembourg SPV (2013: €100 million) included in loans and advances to customers – other lending, which has first loss exposure to a €1.5 billion portfolio (2013: €2 billion) of senior ranking European ABS assets. The sterling equivalent of the loan is £82 million (2013: £85 million). The geographical breakdown of this portfolio is as follows: UK 56%, Spain 14%, Germany 10%, Italy 7%, Netherlands 7%, Greece 4% and Portugal 2% (2013: UK 53%, Spain 13%, Germany 16%, Italy 7%, Netherlands 6%, Greece 3% and Portugal 2%). During the year the Group incurred a £3 million impairment charge on the loan in relation to the UK element of the portfolio.

Treasury assets and treasury credit risks (continued)

In addition to exposure to peripheral Eurozone countries, the Group's total exposures in respect of the other Eurozone, and rest of the world countries, are shown below at their balance sheet carrying value.

	Finland	France	Germany	Netherlands	Other Eurozone	Total Eurozone	USA	Rest of the world	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
2014									
Government bonds	**170**	**-**	**438**	**778**	**-**	**1,386**	**388**	**-**	**1,774**
Mortgage backed securities	**-**	**12**	**41**	**334**	**-**	**387**	**109**	**57**	**553**
Covered bonds	**-**	**-**	**-**	**-**	**-**	**-**	**27**	**-**	**27**
Senior debt	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**39**	**39**
Loans to banks	**-**	**103**	**151**	**-**	**-**	**254**	**364**	**385**	**1,003**
Other assets	**-**	**99**	**42**	**-**	**-**	**141**	**793**	**666**	**1,600**
Other corporate	**10**	**24**	**567**	**36**	**-**	**637**	**-**	**3**	**640**
Total	**180**	**238**	**1,239**	**1,148**	**-**	**2,805**	**1,681**	**1,150**	**5,636**
2013									
Government bonds	133	-	505	1,039	-	1,677	672	-	2,349
Mortgage backed securities	-	28	116	273	-	417	147	86	650
Covered bonds	21	-	89	18	-	128	29	21	178
Senior debt	21	33	-	50	9	113	57	42	212
Loans to banks	-	164	130	-	-	294	460	620	1,374
Other assets	-	109	-	-	-	109	1,085	1,001	2,195
Other corporate	10	44	840	16	-	910	-	-	910
Total	185	378	1,680	1,396	9	3,648	2,450	1,770	7,868

The movement in the balances in respect of Finland and the Netherlands reflects that these are still active markets for the Group, along with Germany and the USA. In addition, the above balances will be affected by movements such as pay downs of the assets and fair value and exchange rate adjustments.

Derivative financial instruments

The Group uses derivatives to reduce exposure to market risks, although the application of accounting rules can create volatility in the income statement in a particular financial year. The fair value of derivative assets at 4 April 2014 was £3.0 billion (2013: £4.2 billion) and the fair value of derivative liabilities was £2.4 billion (2013: £3.9 billion). The International Swaps and Derivatives Association (ISDA) Master Agreement is the Group'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. Collateral is paid or received on a regular basis (typically daily) to mitigate the mark to market exposures on derivatives.

The Group's CSAs are two-way agreements where both parties post collateral dependent on the exposure of the derivative. The only exception is within the Nationwide Covered Bond LLP where one way agreements have been entered into in favour of the Nationwide Covered Bond LLP. These CSAs are also subject to contingent rating triggers.

As a result of CSA netting agreements, outstanding transactions with the same counterparty can be offset and settled net following a default or other predetermined event. Additionally, the Group has entered into Global Master Repurchase Agreements and Global Master Securities Lending Agreements which provide for two way exchange of financial collateral. Under CSA arrangements netting benefits of £1.4 billion (2013: £2.2 billion) are available and under Global Master Repurchase and Securities Lending arrangements financial collateral held of £1.4 billion (2013: £1.6 billion) is available.

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Business and Risk Report continued

Treasury assets and treasury credit risks (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.

The following table shows the exposure to counterparty credit risk for derivative contracts after netting benefits and collateral:

(Audited)	**2014**			2013		
	AA	**A**	**Total**	AA	A	Total
	£bn	**£bn**	**£bn**	£bn	£bn	£bn
Gross positive fair value of contracts	**0.2**	**2.8**	**3.0**	0.5	3.7	4.2
Netting benefits	**(0.2)**	**(1.2)**	**(1.4)**	(0.3)	(1.9)	(2.2)
Net current credit exposure	**-**	**1.6**	**1.6**	0.2	1.8	2.0
Collateral held	**-**	**(1.4)**	**(1.4)**	(0.1)	(1.5)	(1.6)
Net derivative credit exposure	**-**	**0.2**	**0.2**	0.1	0.3	0.4

Cash is the only collateral currently held. Collateral on certain derivative assets with a fair value of £0.2 billion (2013: £0.4 billion) is only triggered when the counterparty rating falls to a specified rating level. At 4 April 2014 the trigger event had not occurred and these assets are uncollateralised as a consequence. The Group's exposure to such counterparties is to A rated or better banks.

Managing treasury credit risks

Credit risk within the Treasury Division arises primarily from the instruments held by Treasury for liquidity and investment purposes. For example, credit risk could arise due to global financial developments such as the re-emergence of tensions within the Eurozone, which could in turn increase the Group's funding costs.

This aspect of credit risk is managed by the Treasury Credit Risk 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 use of derivatives where 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.

A monthly review is undertaken of 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.

Credit risk in respect of derivatives is managed largely through the use of the Group's CSA and posting of collateral. Credit and debit valuation adjustments are applied to derivative exposures where they are not collateralised. Netting and collateral benefits result in the adjustment not being required for collateralised positions. With the exception of a small number of legacy positions, all derivative counterparty positions are subject to CSA agreements.

The Treasury Credit Risk function also monitors exposure concentrations against a variety of criteria including industry sector, asset class, individual counterparty and country of risk. The Group has no exposure to emerging markets, hedge funds or credit default swaps and the majority of exposure has an investment grade rating. The Group's exposure to investments from Eurozone countries is outlined in the country exposures section.

Outlook for treasury credit risks

An improving market environment continues to support the stable risk profile of the treasury asset portfolios. Assets showing signs of credit deterioration remain low and are reducing, with ongoing performance monitoring underpinned by robust risk governance processes. New investment activity remains limited to a small number of asset classes with the aim of supporting liquidity holdings, predominantly at senior AAA levels.

Financial risk management

The Group is exposed to the financial risks as follows:

Risk category	**Definition**
Liquidity and funding	Liquidity risk is the risk that the Group is unable to: - meet or settle its financial obligations as they fall due; and - maintain public and stakeholder confidence. Funding risk is the risk that the Group is unable to realise assets or otherwise raise funds on reasonable terms and/or within reasonable timescales.
Solvency (capital)	The risk that the Group fails to maintain sufficient capital to absorb losses throughout a full economic cycle and to maintain the confidence of current and prospective investors, members, the Board and regulators.
Market	The risk that the value of, or net income arising from, the Group's assets and liabilities are impacted as a result of balance sheet or market rate changes.
Pension	The risk that the Group's funding obligations for a number of defined benefit pension schemes expose the Group to longevity risk and various market risks including interest rate risk, inflation risk and equity risk within those schemes.

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 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.

Solvency risks are covered in the Capital Management Report.

Business and Risk Report continued

Financial risk management (continued)

In addition to credit risk (dealt with in the loans and advances and lending risk section) the Group is exposed to liquidity risk, interest rate risk, foreign exchange (FX) risk and equity risk.

The following table lists the Group's financial assets and liabilities and indicates its exposure to these risks, with the primary risk highlighted red.

		Non-traded risk sensitivity				
		Financial risk	Market risk			Lending risk
	2014 £bn	Liquidity risk	Interest rate risk	Foreign exchange risk	Equity risk*	Credit risk
Assets						
Cash	**5.3**					✓
Loans and advances to banks	**2.1**		✓	✓		✓
Investment securities – available for sale	**10.6**	✓	✓	✓		✓
Derivative financial instruments	**3.0**		✓	✓	✓	✓
Loans and advances to customers	**166.6**		✓	✓		✓
Liabilities						
Shares (customer deposits)	**130.5**	✓	✓	✓		
Deposits from banks	**2.0**	✓	✓	✓		
Other deposits (including PEB deposits)	**7.1**	✓	✓		✓	
Due to customers (including offshore deposits)	**6.2**	✓	✓	✓		
Debt securities in issue	**28.6**	✓	✓	✓		
Derivative financial instruments (liabilities)	**2.4**		✓	✓	✓	
Subordinated liabilities	**2.3**	✓	✓	✓		
Subscribed capital (PIBS)	**0.6**	✓	✓	✓		
Retirement benefit obligations	**0.2**		✓		✓	

*Equity risk is the risk to the Group of movement in share prices.

Funding strategy

The Group has a strong and well diversified funding base, which continues to be predominantly funded by retail deposits. Over the course of the financial year, the Group has continued to actively manage its balance sheet in response to conditions in both the retail and wholesale markets.

The Group aims to align its sources and uses of funding. As such, retail customer loans and advances are largely funded by customer deposits. Other assets including commercial customer loans, primary liquidity and other treasury assets are largely funded by wholesale debt and equity.

Financial risk management (continued)

These funding relationships are summarised below as at the balance sheet date:

	2014	2013	2012
	£bn	£bn	£bn
Assets			
Retail mortgages	**145.6**	135.6	129.6
Other lending	**21.0**	22.8	24.0
Primary liquidity	**12.3**	16.9	24.8
Other treasury liquidity portfolio	**5.7**	6.9	9.5
Other assets	**5.3**	8.5	8.3
	189.9	190.7	196.2
Liabilities and equity			
Retail funding	**135.9**	131.7	131.5
Wholesale funding	**37.7**	43.4	49.1
Capital and reserves	**11.5**	10.1	9.5
Other liabilities	**4.8**	5.5	6.1
	189.9	190.7	196.2

The Group loan to deposit ratio as at 4 April 2014 was 115.8% (2013: 115.4%).

The Group continues to maintain a high quality liquid asset portfolio consisting primarily of deposits at central banks and government bonds.

In April 2013 the Bank of England extended availability of the Funding for Lending Scheme (FLS) until January 2015 to boost lending to the UK economy. The Group continued to participate in the FLS in line with its support of the UK housing market, drawing a further £2.0 billion in the three months to 31 December 2013 and a further £4.0 billion ahead of the closure of the residential mortgage element of the scheme on 31 January 2014. This brought the total amount of the FLS facility used to £8.5 billion.

Business and Risk Report continued

Financial risk management (continued)

Liquidity

The Group ensures it has sufficient resources to meet day-to-day cash flow needs and to meet internal and regulatory liquidity requirements. These requirements are calibrated to ensure the Group has sufficient liquidity, both as to amount and quality, to meet financial obligations as they fall due during a range of stress scenarios across multiple risk drivers and time horizons.

In August 2013 the PRA notified firms meeting the minimum 7% core equity capital ratio of an increased relaxation to their stance on the definition of assets that count towards the Liquid Asset Buffer (LAB), which now allows an increased proportion of a firm's regulatory requirements to be met by collateral pledged with the Bank of England.

Liquid assets are held and managed centrally by the Group's Treasury Division to meet cash outflows in any entity across the Group with the exception of a small portfolio of assets held in its Irish branch, Nationwide (UK) Ireland (NUKI). These assets (£128 million sterling equivalent, 2013: £131 million) are held by NUKI to comply with Irish liquidity regulations.

The stock of liquid assets managed by the Group's Treasury Division falls into the five categories below. The amount is net of any liquidity holdings that are encumbered (through repurchase arrangements or other transactions) including assets held under reverse repurchase arrangements and collateral swaps.

The table below sets out the fair value of each of the five liquidity types as at 4 April 2014. The table is not a representation of the accounting balance sheet position as it includes off balance sheet liquidity (including self-issued RMBS, covered bonds and FLS treasury bills) and excludes any encumbered assets. The carrying value of the liquidity portfolio as per the accounting balance sheet is shown in the 'Treasury assets and treasury credit risks' section above.

	2014	2013
	£bn	£bn
Primary liquidity*	**20.8**	19.2
Other central bank eligible assets	**1.4**	1.4
Other securities	**3.0**	2.7
Self-issued RMBS and covered bonds	**14.0**	14.0
Whole mortgage loan pools pre-positioned at the Bank of England (BoE)	**2.1**	1.4
Total	**41.3**	38.7

*Primary liquidity includes off balance sheet items, primarily treasury bills held through FLS participation.
The average month end balance for primary liquidity during the year was £19.9 billion (2013: £21.0 billion).

Primary liquidity

The Group maintains a high quality primary liquidity portfolio through continued investment in highly liquid securities in line with the Liquid Asset Buffer (LAB) as defined by the PRA in BIPRU 12.7, comprising:

- reserves held at central banks; and
- highly rated debt securities issued by a restricted range of governments, central banks and multilateral development banks.

The Group's primary liquidity ratio measures primary liquidity as a proportion of shares and borrowings, including offshore deposits, held by the Group. The primary liquidity ratio is 11.9% as at 4 April 2014 (2013: 11.1%).

Central bank eligible assets

The Group holds a portfolio of other securities that are eligible for use in the funding operations of those central banks that it has access to which has remained stable in 2014. In terms of their relative liquidity characteristics, these assets may be viewed as the next liquidity tier below the primary liquidity portfolio.

Other securities

The Group holds other third party assets (such as RMBS) that are not eligible for central bank operations but can be monetised through repurchase agreements with third parties or through sale.

Self-issued RMBS and covered bonds

The Group holds undrawn AAA notes issued under the Group's asset-backed funding programmes. These self-issued securities represent eligible collateral for use in repurchase agreements with third parties or in central bank operations.

Whole mortgage loan pools pre-positioned at the Bank of England

The Group holds a stock of unencumbered whole mortgage loan pools at the Bank of England for use as collateral for contingency funding purposes.

Financial risk management (continued)

The table below sets out the sterling equivalent of the liquidity portfolio categorised by issuing currency.

	2014				2013			
	GBP	EUR	USD	Total	GBP	EUR	USD	Total
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Primary liquidity*	19.0	1.3	0.5	20.8	16.8	1.6	0.8	19.2
Other central bank eligible assets	0.2	1.2	-	1.4	0.1	1.3	-	1.4
Other securities	1.3	0.8	0.9	3.0	0.6	0.6	1.5	2.7
Self-issued RMBS and covered bonds	14.0	-	-	14.0	14.0	-	-	14.0
Whole mortgage loan pools pre-positioned at the BoE	2.1	-	-	2.1	1.4	-	-	1.4
Total	36.6	3.3	1.4	41.3	32.9	3.5	2.3	38.7

*Primary liquidity includes off balance sheet items, primarily treasury bills held through FLS participation.
The average month end balance for primary liquidity during the year was £19.9 billion (2013: £21.0 billion).

Wholesale funding

The Group maintains a strong franchise in retail and wholesale funding. The wholesale market is accessible using a range of unsecured and secured instruments enabling maintenance of a diversified funding base across a range of maturities. Together with a strong market share of retail funding, the Group has flexibility to access stable funding from the most cost-effective sources. Through the wholesale markets, the Group has direct active relationships with counterparties across a range of sectors, including banks, other financial institutions, corporates and investment funds.

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:

	2014		2013	
	£bn	%	£bn	%
Repo and other secured arrangements	-	-	1.2	2.8
Deposits, including PEB balances	9.2	24.4	8.7	20.0
Certificates of deposit	2.6	6.9	3.8	8.8
Commercial paper	3.5	9.3	4.0	9.2
Covered bonds	9.5	25.2	11.4	26.3
Medium term notes	5.1	13.5	4.7	10.8
Securitisations	6.9	18.3	7.6	17.5
Other	0.9	2.4	2.0	4.6
Total	37.7	100.0	43.4	100.0

During the period a combination of strong retail performance, low long term wholesale maturities and FLS access has contributed to a reduced long term wholesale funding appetite. New capital raised via CCDS and AT1 has also provided funding to the business.

The Group tendered £715 million of permanent interest bearing shares (PIBS) in September 2013 as part of its capital optimisation strategy reflected in the reduction of wholesale funding above. This resulted in the Group redeeming £506 million of PIBS with the consent of the PRA. The 68% participation rate contributed £125 million to profit in the year.

Business and Risk Report continued

Financial risk management (continued)

The table below sets out an analysis of the currency composition of the Group's wholesale funding:

	USD	EUR	GBP	Other	Total
	£bn	£bn	£bn	£bn	£bn
Repo and other secured arrangements	-	-	-	-	-
Deposits (including PEB balances)	0.2	0.9	8.1	-	9.2
Certificates of deposit	0.2	-	2.4	-	2.6
Commercial paper	2.9	0.6	-	-	3.5
Covered bonds	-	7.6	1.7	0.2	9.5
Medium term notes	0.9	2.6	1.4	0.2	5.1
Securitisations	3.4	0.9	2.6	-	6.9
Other	-	0.8	0.1	-	0.9
Total at 4 April 2014	**7.6**	**13.4**	**16.3**	**0.4**	**37.7**
Total at 4 April 2013	9.0	15.5	18.4	0.5	43.4

To mitigate against cross-currency refinancing risk, the Group ensures it holds a surplus in each respective currency over its requirements in those currencies for at least ten business days.

Maturity profiles – wholesale funding

Managing maturity profile is key to maintaining the Group's liquidity period-on-period. The table below sets out a breakdown of the residual maturity of the contractual cash flows for the wholesale funding book held on the balance sheet.

2014	Not more than one month	Over one month but not more than three months	Over three months but not more than six months	Over six months but not more than one year	Sub-total less than one year	Over one year but not more than two years	Over two years	Total
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Repo and other secured arrangements	-	-	-	-	-	-	-	-
Deposits, including PEB balances	3.4	1.4	0.6	0.7	6.1	1.3	1.8	9.2
Certificates of deposit	0.9	1.0	0.3	0.4	2.6	-	-	2.6
Commercial paper	1.2	1.8	0.5	-	3.5	-	-	3.5
Covered bonds	-	0.1	-	0.7	0.8	2.7	6.0	9.5
Medium term notes	-	-	0.1	1.5	1.6	0.2	3.3	5.1
Securitisations	-	-	-	3.3	3.3	1.7	1.9	6.9
Other	-	-	-	-	-	0.1	0.8	0.9
Total at 4 April 2014	**5.5**	**4.3**	**1.5**	**6.6**	**17.9**	**6.0**	**13.8**	**37.7**
Of which secured	-	0.1	-	4.0	4.1	4.4	7.9	16.4
Of which unsecured	5.5	4.2	1.5	2.6	13.8	1.6	5.9	21.3
% of total	14.6	11.4	4.0	17.5	47.5	15.9	36.6	100.0

Financial risk management (continued)

2013	Not more than one month	Over one month but not more than three months	Over three months but not more than six months	Over six months but not more than one year	Sub-total less than one year	Over one year but not more than two years	Over two years	Total
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Repo and other secured arrangements	-	-	0.2	-	0.2	1.0	-	1.2
Deposits, including PEB balances	3.1	1.3	0.9	0.5	5.8	0.1	2.8	8.7
Certificates of deposit	0.8	1.0	1.6	0.4	3.8	-	-	3.8
Commercial paper	1.0	2.0	1.0	-	4.0	-	-	4.0
Covered bonds	-	-	-	1.7	1.7	0.8	8.9	11.4
Medium term notes	-	0.1	-	0.2	0.3	1.6	2.8	4.7
Securitisations	-	-	-	0.4	0.4	3.4	3.8	7.6
Other	0.2	-	-	-	0.2	0.4	1.4	2.0
Total at 4 April 2013	5.1	4.4	3.7	3.2	16.4	7.3	19.7	43.4
Of which secured	0.2	-	-	2.1	2.3	5.5	14.1	21.9
Of which unsecured	4.9	4.4	3.7	1.1	14.1	1.8	5.6	21.5
% of total	11.8	10.1	8.5	7.4	37.8	16.8	45.4	100.0

As shown in the table above, the proportion of on balance sheet funding categorised as long term (>1 year to maturity), which excludes the FLS drawings is 52.5% (2013: 62.2%).

After including FLS drawings held off balance sheet, which have a flexible and maximum maturity of four years, the residual maturity profile of the Group's wholesale funding portfolio has decreased slightly to 34 months (2013: 36 months) and the proportion of funding that is categorised as long term has decreased to 61.3% (2013: 64.3%). As at 4 April 2014 the primary liquidity pool including FLS represented 116% (2013: 117%) of wholesale funding maturing in less than one year, assuming no rollovers.

Business and Risk Report continued

Financial risk management (continued)

Maturity of liquidity assets and liabilities

The table below segments the carrying value of financial assets and financial liabilities into relevant maturity groupings based on the remaining period to the contractual maturity date (residual maturity). In practice, customers are often repaid later than on the earliest date on which repayment can be required. Likewise, in practice, customer assets may be repaid ahead of their contractual maturity. Therefore, for forecasting purposes, the Group uses judgement and past performance of each asset and liability class to anticipate likely cash flow requirements of the Group.

Residual maturity 2014	**Due less than one month***	**Due between one and three months**	**Due between three and six months**	**Due between six and nine months**	**Due between nine and twelve months**	**Due between one and two years**	**Due between two and five years**	**Due over five years**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Assets									
Cash	5,342	-	-	-	-	-	-	-	5,342
Loans and advances to banks	1,647	-	-	-	-	61	87	315	2,110
Investment securities – available for sale	4	15	37	152	103	284	1,037	8,931	10,563
Loans and advances to customers	3,007	1,305	2,056	1,933	1,715	7,069	19,795	129,694	166,574
Derivative financial instruments	7	22	25	34	79	802	663	1,388	3,020
Other financial assets	-	1	3	2	3	25	68	148	250
Total financial assets	**10,007**	**1,343**	**2,121**	**2,121**	**1,900**	**8,241**	**21,650**	**140,476**	**187,859**
Liabilities									
Shares	90,633	3,076	6,409	5,118	8,025	10,903	3,035	3,269	130,468
Deposits from banks	1,579	310	35	31	8	21	-	-	1,984
Of which repo	-	-	-	-	-	-	-	-	-
Other deposits	1,777	1,066	537	304	357	1,293	1,801	-	7,135
Due to customers	3,865	504	1,308	291	204	22	14	-	6,208
Secured funding – ABS and covered bonds	6	106	60	3,302	672	4,471	3,067	5,705	17,389
Senior unsecured	2,107	2,811	915	191	1,729	196	1,493	1,726	11,168
Derivative financial instruments	34	27	40	55	43	120	543	1,529	2,391
Other financial liabilities	-	2	5	7	8	11	-	-	33
Subordinated liabilities	-	-	125	-	-	411	1,053	680	2,269
Subscribed capital	3	-	-	199	8	128	11	252	601
Total financial liabilities	**100,004**	**7,902**	**9,434**	**9,498**	**11,054**	**17,576**	**11,017**	**13,161**	**179,646**
Net liquidity gap	**(89,997)**	**(6,559)**	**(7,313)**	**(7,377)**	**(9,154)**	**(9,335)**	**10,633**	**127,315**	**8,213**

*Due less than one month includes amounts repayable on demand.

Financial risk management (continued)

Residual maturity 2013	Due less than one month*	Due between one and three months	Due between three and six months	Due between six and nine months	Due between nine and twelve months	Due between one and two years	Due between two and five years	Due over five years	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Assets									
Cash	7,886	-	-	-	-	-	-	-	7,886
Loans and advances to banks	2,189	-	-	-	-	148	-	185	2,522
Investment securities – available for sale	4	59	253	50	119	608	1,925	10,403	13,421
Loans and advances to customers	3,105	926	1,918	1,948	1,855	7,159	19,512	123,164	159,587
Derivative financial instruments	65	104	40	434	17	323	1,262	1,967	4,212
Other financial assets	-	20	33	20	6	30	507	292	908
Total financial assets	13,249	1,109	2,244	2,452	1,997	8,268	23,206	136,011	188,536
Liabilities									
Shares	81,135	4,733	9,030	4,736	6,480	14,970	2,907	1,583	125,574
Deposits from banks	1,756	180	202	40	8	1,001	-	43	3,230
Of which repo	*-*	*12*	*190*	*-*	*-*	*1,000*	*-*	*-*	*1,202*
Other deposits	1,334	1,078	867	222	257	856	2,133	-	6,747
Due to customers	3,812	846	864	207	112	105	14	-	5,960
Secured funding – ABS and covered bonds	6	45	22	2,156	42	8,394	4,030	6,177	20,872
Senior unsecured	1,825	3,100	2,649	272	314	1,850	872	1,675	12,557
Derivative financial instruments	11	46	73	51	20	103	1,021	2,560	3,885
Other financial liabilities	-	4	5	8	8	99	26	-	150
Subordinated liabilities	-	130	-	-	169	-	1,536	705	2,540
Subscribed capital	3	-	-	-	-	220	132	949	1,304
Total financial liabilities	89,882	10,162	13,712	7,692	7,410	27,598	12,671	13,692	182,819
Net liquidity gap	(76,633)	(9,053)	(11,468)	(5,240)	(5,413)	(19,330)	10,535	122,319	5,717

*Due less than one month includes amounts repayable on demand.

Liquidity has increased as a result of retained profits and the proceeds of capital issuances thus increasing the net surplus of assets over liabilities. 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.

Business and Risk Report continued

Financial risk management (continued)

The following is an analysis of gross undiscounted contractual cash flows payable under financial liabilities. The analysis of gross contractual cash flows differs from the analysis of residual maturity due to the inclusion of interest accrued at current rates for the average period until maturity, on the amounts outstanding at the balance sheet date.

Gross contractual cash flows 2014 *(Audited)*	**Due less than one month***	**Due between one and three months**	**Due between three and six months**	**Due between six and nine months**	**Due between nine and twelve months**	**Due between one and two years**	**Due between two and five years**	**Due more than five years**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Shares	**90,633**	**3,213**	**6,529**	**5,217**	**8,101**	**11,071**	**3,240**	**3,386**	**131,390**
Deposits from banks	**1,579**	**311**	**35**	**31**	**8**	**21**	**-**	**-**	**1,985**
Other deposits	**1,777**	**1,086**	**553**	**318**	**370**	**1,332**	**1,844**	**-**	**7,280**
Due to customers	**3,865**	**512**	**1,313**	**293**	**205**	**22**	**14**	**-**	**6,224**
Secured funding – ABS and covered bonds	**55**	**69**	**777**	**2,758**	**1,255**	**4,407**	**3,783**	**6,085**	**19,189**
Senior unsecured	**2,108**	**2,813**	**980**	**188**	**1,769**	**357**	**1,789**	**1,786**	**11,790**
Derivative financial instruments	**58**	**135**	**251**	**154**	**201**	**494**	**795**	**753**	**2,841**
Other financial liabilities	**-**	**2**	**5**	**7**	**8**	**11**	**-**	**-**	**33**
Subordinated liabilities	**16**	**4**	**49**	**4**	**60**	**502**	**1,422**	**703**	**2,760**
Subscribed capital	**1**	**5**	**12**	**7**	**212**	**22**	**201**	**327**	**787**
Total financial liabilities	**100,092**	**8,150**	**10,504**	**8,977**	**12,189**	**18,239**	**13,088**	**13,040**	**184,279**

Gross contractual cash flows 2013 *(Audited)*	Due less than one month*	Due between one and three months	Due between three and six months	Due between six and nine months	Due between nine and twelve months	Due between one and two years	Due between two and five years	Due more than five years	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Shares	81,135	4,946	9,209	4,880	6,595	15,213	3,092	1,663	126,733
Deposits from banks	1,756	187	208	45	13	1,012	3	45	3,269
Other deposits	1,334	1,102	886	239	273	907	2,198	-	6,939
Due to customers	3,812	855	868	209	113	106	14	-	5,977
Secured funding – ABS and covered bonds	58	4	80	2,295	256	4,913	8,388	6,745	22,739
Senior unsecured	1,813	3,116	2,698	277	433	1,807	1,431	1,949	13,524
Derivative financial instruments	75	187	311	183	212	738	1,445	960	4,111
Other financial liabilities	-	5	6	9	9	101	26	-	156
Subordinated liabilities	-	4	54	4	215	136	1,939	764	3,116
Subscribed capital	4	6	25	10	25	270	293	1,106	1,739
Total financial liabilities	89,987	10,412	14,345	8,151	8,144	25,203	18,829	13,232	188,303

*Due less than one month includes amounts repayable on demand.

Financial risk management (continued)

Asset encumbrance

From time to time the Group encumbers assets to support funding initiatives or serve as collateral. Secured funding, central bank operations and third party repurchase transactions are the three principal forms of encumbrance. Assets that have been utilised for such purposes are classified as encumbered and pledged assets which cannot be utilised for other purposes.

Group assets can be used to support funding or collateral requirements for secured funding, central bank operations or third party repurchase transactions. Assets that have been utilised for such purposes are classified as encumbered and pledged assets which cannot be utilised for other purposes. This includes excess collateral and collateral held in respect of undrawn self-issued notes in secured funding vehicles and cash collateral posted.

Other encumbered assets are those which cannot be utilised for secured funding due to legal or other reasons.

All other assets are defined as unencumbered assets. These comprise assets that are readily available to secure funding or meet collateral requirements and assets that are not subject to any restrictions but are not readily available for use.

Loans and advances to customers are only classified as available as collateral if they are already in such form that they can be used to raise funding without further management actions. All other loans and advances are conservatively classified as 'unencumbered – other', although, with management action, a proportion would be suitable for use in asset-backed funding transactions.

An analysis of the Group's encumbered and unencumbered on balance sheet assets as at 4 April 2014 is set out below:

	Encumbered		Unencumbered		Total
	Pledged as collateral	Other	Available as collateral	Other	
	£m	£m	£m	£m	£m
2014					
Cash	**-**	**4,615**	**539**	**188**	**5,342**
Loans and advances to banks	**887**	**325**	**-**	**898**	**2,110**
Investment securities – available for sale	**231**	**-**	**10,200**	**132**	**10,563**
Loans and advances to customers	**58,276**	**-**	**60,620**	**47,678**	**166,574**
Derivative financial instruments	**-**	**-**	**-**	**3,020**	**3,020**
Other financial assets	**-**	**-**	**-**	**250**	**250**
Non-financial assets	**-**	**-**	**-**	**2,067**	**2,067**
	59,394	**4,940**	**71,359**	**54,233**	**189,926**
2013					
Cash	-	3,788	3,848	250	7,886
Loans and advances to banks (Note)	1,588	201	-	733	2,522
Investment securities – available for sale (Note)	347	-	12,960	114	13,421
Loans and advances to customers	51,741	-	54,323	53,523	159,587
Derivative financial instruments	-	-	-	4,212	4,212
Other financial assets	-	-	-	900	900
Non-financial assets	-	-	-	2,190	2,190
	53,676	3,989	71,131	61,922	190,718

Note: This has been restated to include as encumbered £201 million of balances held with Central Banks for regulatory purposes within 'loans and advances to banks' and £116 million pledged as collateral under UK payment schemes within 'investment securities – available for sale'.

Business and Risk Report continued

Financial risk management (continued)

In addition to the above, the Group holds other third party liquid assets and self-issued notes off balance sheet that may be capable of financing through third party sale and repurchase agreements.

Repurchase agreements

The Group undertakes securities financing transactions in the form of repurchase agreements (repo) to demonstrate liquidity of the securities held in the Group's Liquid Asset Buffer (LAB). Cash is borrowed in return for pledging securities as collateral and because settlement is on a 'delivery versus payment' basis, the main credit risk arises from intraday changes in the value of the collateral. This is largely mitigated by the Group's collateral management processes.

From a liquidity perspective the main risk is that during a stress, the Group has insufficient repo market capacity to rapidly monetise the LAB. To mitigate this risk, repo market capacity is assessed via a quarterly review process. This is supplemented by the frequent execution of bilateral repos to maintain credit lines and anonymous transactions via a central counterparty clearing house, such as the London Clearing House, using an electronic trading platform.

All LAB repo activity is secured against highly liquid assets and generally transacted for an overnight term. The weighted average duration of repo trades maturing in the period is 2.2 days (2013: 1.7 days).

LAB securities funding transactions currently have no impact on either funding or encumbered asset reporting due to the short term nature of the transactions, meaning they do not impact the income statement. Repo transactions convert UK government bonds (highly liquid securities) into cash, so there is a marginal movement in the liquidity position.

The Group also had a number of non-LAB repo transactions outstanding during the period which all matured before the reporting date.

Managing liquidity and funding risks

The Group's management of liquidity and funding risk aims to ensure that at all times there are sufficient liquid resources, both as to amount and quality, to cover cash flow mismatches and fluctuations in funding, to retain public confidence and to enable it to meet financial obligations as they fall due, even during episodes of stress. This is achieved through management and stress testing of business cash flows, and the setting of appropriate risk limits (which are outlined in further details below), to maintain a prudent funding mix, maturity profile and level of high quality liquid assets. The Group's approach to liquidity and funding risk is managed by the Group's Assets and Liabilities Committee (ALCO) and by the Board as part of the annual review of the Individual Liquidity Adequacy Assessment (ILAA) document.

The Board is responsible for setting risk appetite with respect to levels of liquidity and funding risks. This is articulated through the Board's risk appetite statements. The Board translates this into limits which define the minimum level of liquid resources and the funding mix of the balance sheet. ALCO is responsible for setting more detailed limits within Board limits, including the level and maturity profile of funding, and for monitoring the composition of the Group's balance sheet. Wholesale and retail funding maturities are monitored to ensure there are no excessive concentrations in future maturities. This enhances the ability of the Group to refinance maturing liabilities. The Balance Sheet Risk Committee (BSRC) sets further granular limits and is responsible for monitoring liquidity and funding risks. A consolidated cash flow forecast is maintained on an ongoing basis and reviewed by the Weekly Trading Committee (WTC) which has responsibility for monitoring liquidity metrics.

A Contingency Funding Plan (CFP) has been approved by ALCO and describes metrics which would indicate an emerging market-wide and/or Nationwide-specific stress. It also details procedures and a range of available actions that the Group could take in the event of a liquidity or funding stress, thereby allowing adequate liquidity resources to be maintained. The CFP is reviewed every six months and tested at least annually. The Group also has a Recovery Plan which describes potential actions that could be utilised in a more extreme stress.

Liquidity stress testing

To mitigate liquidity and funding risk generated by its business activities, the Group holds a portfolio of liquid assets as detailed in the 'Treasury assets' section above. A series of liquidity stress tests are performed daily against a number of scenarios, including those prescribed by the Regulator. The internal stress tests are run alongside the calculation of the regulatory individual liquidity requirement (ILG) and they represent the Group's view of liquidity risks and therefore determine the required levels of liquidity to be held.

The Group aims to maintain liquidity resources of at least 100% of the anticipated outflows seen under each of the internal and regulatory-prescribed stress tests. The scenarios include an idiosyncratic stress which incorporates the impact of potential rating agency downgrades, a market-wide stress and a combination of the two. The stress scenarios consider a range of factors and the consequent impact on the Group's cash flows over multiple time horizons. The stress is assumed to be most severe in the first 10 business days. Assumptions used in internal liquidity stress tests are reviewed regularly with changes proposed to ALCO for approval and approved annually by the Board as part of the ILAA process.

The primary period over which internal liquidity stress testing is performed is 30 business days (circa six weeks). Beyond this, it is assumed that additional actions detailed in the CFP would be utilised if required.

Financial risk management (continued)

As at 4 April 2014, potential outflows under the most severe stress test (the combined idiosyncratic and market-wide stress scenario) were modelled at £22.8 billion (2013: £22.3 billion). The risk drivers detailed below are linked to the outflow assumptions. The liquidity assessed as eligible in the stress testing, which includes liquidity and mortgage inflows, as a percentage of stressed outflows equated to 128% (2013: 119%).

The table below details the key assumptions used in modelling the liquidity stress scenarios.

Liquidity risk driver	Modelling assumptions used
Retail funding	Significant unexpected outflows are experienced with no new deposits received.
Wholesale funding	Substantial outflows are seen at contractual maturity as the Group is assumed to become a greater credit risk. This behaviour is driven by credit rating downgrade assumptions.
Off balance sheet	Contractual outflows in relation to asset-backed funding programmes as a result of credit rating downgrades. Outflows are experienced as a result of other off balance sheet commitments such as the mortgage pipeline. Inflows from mortgages or retail and commercial loans are assessed on a behavioural basis and therefore take into account expected overpayments and customers in arrears.
Intra-group	We continue to provide funding to subsidiaries.
Marketable assets	Asset values are reduced in recognition of the stressed conditions assumed.

Significant events in regulatory environment

In December 2010, the Basel Committee on Banking Supervision (BCBS) announced proposals to introduce two new liquidity metrics as part of the implementation of Basel III. These are a short term liquidity stress metric, the Liquidity Coverage Ratio (LCR), and a longer term funding metric, the Net Stable Funding Ratio (NSFR). The LCR is designed to promote short-term resilience of a bank's liquidity risk profile by ensuring it has sufficient high quality liquid assets to survive a significant stress scenario lasting for one month. The NSFR is designed to promote a sustainable funding maturity structure over at least 12 months.

In January 2013, the BCBS announced revised guidelines in respect of the LCR. In June 2013, the CRD IV package (CRR and CRD IV), which includes requirements for the LCR, was published in the Official Journal of the European Union. The LCR will become a European standard from January 2015 with firms required to have a ratio in excess of 60% increasing to 100% by January 2018. In the UK the Financial Policy Committee recommended that the LCR is implemented at 80% from January 2015 rising thereafter to reach 100% from January 2018.

The BCBS also published a consultation paper in January 2014 announcing further refinements to the NSFR which are expected to be broadly positive for the Group. The NSFR is expected to be implemented at a minimum of 100% from January 2018.

Until these measures are translated into UK regulation, some uncertainty will remain over how the UK Individual Liquidity Adequacy Standard regime will transition to the LCR standard. The Group continues to monitor its position relative to the anticipated requirement of both the LCR and NSFR.

Based on current interpretations of regulatory requirements, and guidance including European CRR, as at 4 April 2014 the Group had an LCR ratio of 90.7% and a NSFR ratio of 112.4%. The LCR position represents a surplus to both European and anticipated UK regulatory requirements as at 1 January 2015. The NSFR ratio already exceeds the 100% ratio requirement due for implementation in January 2018.

Significant events in market environment

Central bank liquidity support continues to remain available to solvent financial institutions within the UK banking system. This was reiterated in October 2013 when the Bank of England published developments to their Sterling Monetary Framework with the aim of increasing the availability and flexibility of liquidity insurance provided to solvent financial institutions. This included confirmation that liquidity would be provided at longer maturities, against a wider range of collateral, at lower cost, and with greater predictability of access.

Business and Risk Report continued

Financial risk management (continued)

External credit ratings

The Group received a one-notch long-term credit rating downgrade from Standard and Poor's (S&P) in August 2013 and Fitch in September 2013. These changes aligned the Group's long-term ratings with industry peers and thus did not have a material impact on the Group's funding franchise.

In March 2014 Fitch announced that, in light of evolving bank resolution frameworks, downward revisions of Support Rating Floors would be likely within a standard outlook horizon due to weakening of sovereign support assumptions. The Group's current credit rating is not dependent on the Support Rating Floor; therefore it is unlikely that there will be any significant impact on the Group's long-term credit rating. In April 2014, S&P placed a number of European banks' ratings, including the Group's ratings, on negative outlook to reflect the possible removal of government support by the end of 2015.

The Group's short and long term credit ratings from the major rating agencies as at 27 May 2014 are as follows:

	Long Term	Short Term	Subordinated	Date of last rating action/ confirmation*
Standard & Poor's	A	A-1	BBB	August 2013
Moody's	A2	P-1	Baa1	October 2013
Fitch	A	F1	A-	September 2013

*The outlook for all Moody's and Fitch is Stable; the outlook for S&P is Negative.

The table below sets out the amount of additional collateral the Group would need to provide in the event of a one and two notch downgrade by external credit rating agencies.

	Cumulative adjustment for a one notch downgrade	Cumulative adjustment for a two notch downgrade
	£bn	**£bn**
4 April 2014	**9.0**	**9.0**
4 April 2013	4.8	8.1

The contractually required cash outflow would not necessarily match the actual cash outflow as a result of management actions that could be taken to reduce the impact of the downgrades.

Outlook for financial risk management

The more accommodating stance from the Bank of England, contained within the Sterling Monetary Framework, suggests that the funding environment for solvent UK banks and building societies is likely to endure. Within this framework, the Bank of England made changes designed to increase the availability and flexibility of liquidity insurance provided to solvent financial institutions; for example, by providing liquidity at longer maturities, against a wider range of collateral, at lower cost and with greater predictability of access.

While uncertainties remain over the definition and implementation of the new Basel III liquidity measures, greater clarity is expected over the coming months with it being anticipated that the European Commission will adopt the delegated LCR Act by 30 June 2014. The Group will continue to monitor unfolding events and the implementation of these metrics in the UK.

As regulators implement new resolution tools with the aim of avoiding bail-outs, rating agencies have announced they are reviewing the implications for financial institutions of reduced extraordinary government support. The Group also continues to monitor regulatory initiatives at the European and UK level which aim to introduce a requirement for firms to hold a minimum level of liabilities which can be 'bailed in' to enable recapitalisation of the Group. This may have an impact on the cost of term wholesale funding.

As several of the Group's competitors have announced strategic changes to refocus on the UK retail banking market, the margin earned on the Group's core products may be squeezed through increased competition. The Group therefore continues to monitor this situation and will adapt its strategies accordingly.

Market risk management

Overview

Market risk is the risk that the value of, or net income arising from, the Group's assets and liabilities changes as a result of changes to market indices, specifically interest rates, exchange rates or equity prices. The Board risk appetite statement for market risk is to take only those market risks that are essential to the core business activities. In consequence the Group does not maintain a trading book and it uses risk management strategies designed to provide stability of earnings.

Significant events/environment

Low and flat interest rates have continued to dominate. Base rates remain unchanged and the provision of Forward Guidance from the Bank of England has stabilised forward interest rates. The Funding for Lending Scheme (FLS) has continued to keep funding costs low through much of the year. However, underlying rates in longer term debt securities markets, principally gilts, have begun to rise following the lows seen in 2012/13. The spread between swap rates and gilt yields have remained relatively stable during the year.

There have been no material changes to the Group's policies and practices for the management of market risk. The management of swap spread risk relating to the Group's holdings of swapped government debt has been further enhanced by linking the risk to capital requirements for those holdings. The Market Risk Policy is embedded in the Group's Financial Risk Framework. Market risk measures are reported to the Balance Sheet Risk Committee and highlighted to ALCO where appropriate.

Market risk management

Market risk only arises in the banking book as the Group does not have a trading book. Most of the Group's exposure to market risk arises because of fixed rate mortgages or savings, or through foreign exchange risk on non-sterling financial assets and liabilities held.

The principal market risks that affect the Group are listed below together with the types of risk reporting measures used:

Risk type	Reporting measure
Interest rate risk	Sensitivity/value at risk
Basis risk	Earnings at risk
Swap spread risk	Sensitivity/value at risk
Foreign exchange risk	Value at risk
Product option risk	Sensitivity

In addition stress analysis is used to evaluate the impact of more extreme, but plausible events. These techniques are described below with a review of the exposures during the year.

Sensitivity analysis (PV01 sensitivity)

Sensitivity analysis is used to assess the change in value of, for example, the Group's net interest exposure against a one basis point (0.01%) parallel shift in interest rates (PV01). As is the case with VaR (see below), this analysis is done on a daily basis separately for each currency (but with the main risk arising from sterling exposures) and in aggregate. Sensitivity analysis is also used for swap spread risk and product option risks.

Earnings at risk and net interest income (NII) measurement

Earnings at risk is used to measure basis risk exposures and net interest income metrics are used to monitor exposure to interest rate risks. Both measures apply rate shocks to the rates paid on liabilities and to the rates earned on assets and the impact on interest earnings is calculated. Both risks are described below in more detail.

Value at risk (VaR)

VaR 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. The Group uses a 10-day horizon and a 99 per cent confidence level in its day to day VaR monitoring. VaR is used to monitor interest rate, swap spread and currency risks and is not used to model income. To be consistent with the management view values reported below are on the same basis as those used internally.

VaR is based on historic market behaviour and uses a series of recorded market rates and prices to derive plausible future scenarios. This takes into account inter-relationships between different markets and rates, including interest rates and foreign exchange rates.

The VaR model used by the Group incorporates underlying risk factors based on interest rate and foreign exchange 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 it is a valuable guide to risk, VaR needs to be viewed in the context of the following limitations which may mean that exposure could be higher than modelled:

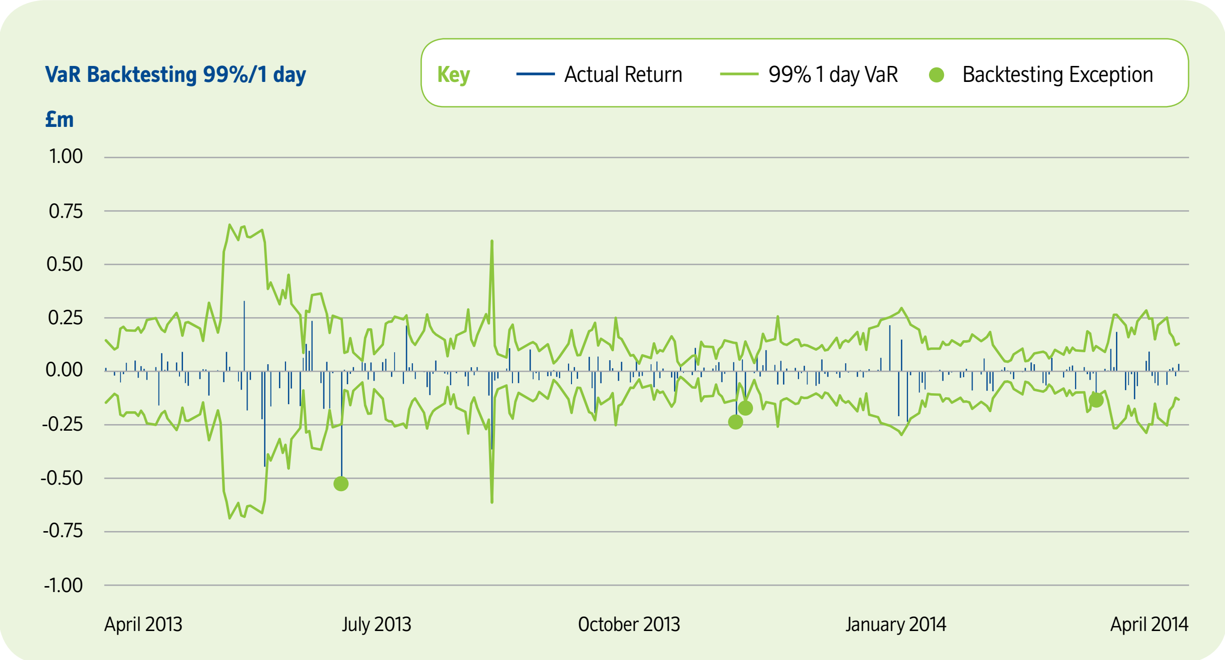
- VaR models often under-predict the likelihood of extreme events and over-predict the benefits of diversification in those extreme events
- the use of a 99% confidence level, by definition, does not take account of changes in value that might occur beyond this level of confidence
- the VaR model uses historical data to predict future events. Exceptional market moves outside of the confidence level at which the model operates will deliver exceptions. For example, in periods of heightened volatility the model is likely to under-predict market risks and in periods of low volatility it is likely to over-predict market risks

Business and Risk Report continued

Market risk management (continued)

- historical data may not adequately allow prediction of circumstances arising due to Government interventions and stimulus packages, which increases the difficulty of evaluating risks
- VaR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

To seek to mitigate the limitations, the Group undertakes backtesting of the VaR model on a regular basis to ensure that the model is appropriate. This process compares actual performance against the estimated VaR numbers. An exception is created when a loss is greater than the daily VaR on any given day. In 2013/14, the backtesting did not highlight any model deficiencies and all of the loss exceptions were due to significant movements in market rates. The chart below shows the results of the backtesting at the daily 99% level. Exceptions are highlighted by the four dots.



The model goes through an annual review process to ensure it continues to be appropriate for risk reporting. Risks not captured in VaR (RNIV) are risks that cannot be captured by a VaR model as movements are outside of the historic range. These include:

- product option risk
- market liquidity risk: although the Group does not have a high ongoing dependency on market liquidity
- fair value Level 3 asset management: the Group only holds a very small portfolio of these assets and whilst historic data is not a reliable predictor of the future the impact is limited
- interest rate movements can also impact credit/debit valuation adjustments (CVA/DVA). These are not captured in the VaR or sensitivity analysis but are monitored.

Stress analysis

To evaluate the potential impact of more extreme, though plausible, events or movements in a set of financial variables the Standard VaR metric is augmented with stress testing.

For example, for interest rate risk exposures standard PV01 sensitivity analysis is supplemented by the production of stressed sensitivity measures. A more severe 200 basis point (2.0%) parallel shift in interest rates is calculated in a similar manner to PV01, this sensitivity analysis is known as PV200. PV200 numbers are generated and monitored daily.

Stressed VaR is used to estimate the potential loss arising from unfavourable market movements in a stressed environment. It is calculated in the same way as VaR and is similarly calibrated over a two year period. The calculation is made on the same 99% 10-day basis but instead uses volatilities and correlations from a 24 month period of significant financial stress. The Group reviews stressed VaR on the GBP portfolio only.

Market risk management (continued)

During the last year the stressed VaR on interest rates was on average 3.2 times the regular VaR. For interest rate risk exposures this difference is dominated by the split between long and short dated positions. During the stressed period volatility of rates in the short end were significantly higher than prevailing volatilities.

Each quarter, the residual interest rate risk and foreign exchange positions are also subjected to a range of stressed scenarios designed to highlight potential losses in extreme market scenarios. The results of these situations are presented to the Balance Sheet Risk Committee as additional insight into scenarios in which the Group may make losses on the residual interest rate and foreign currency positions.

A range of metrics are also regularly produced focusing on the crystallisation of product option risks under stressed events.

Interest rate risk

The main market risk faced by the Group is interest rate risk which primarily arises from the retail and commercial assets and liabilities, reserves, liquidity holdings, and wholesale funding activities. Market movements in interest rates affect the interest rate margin realised from lending and borrowing activities. To reduce the impact of such movements hedging activities are undertaken by Treasury.

For example, interest rate risks generated by lending to and receiving deposits from members are offset against each other internally. The remaining net exposure is managed on a continuous basis, within parameters set by ALCO. This is achieved using a combination of derivatives and on balance sheet instruments (such as loans, deposits and bonds).

Reserves and non-interest bearing current accounts are subject to the volatility of short-term interest rate movements. They are managed to reduce the impact on earnings by converting short term interest margin volatility into a more stable medium term rate. Hedging programmes have also been implemented to manage interest rate risk in relation to core capital deferred shares and the AT1 issuance.

The table below highlights the limited amount to which the Group is exposed as a result of how this risk is managed:

Interest rate risk	**2014**			2013		
	Average	**High**	**Low**	Average	High	Low
	£m	**£m**	**£m**	£m	£m	£m
VaR (99%/10-day) *(Audited)*	**0.6**	**2.2**	**0.1**	0.8	1.8	0.1
Sensitivity analysis (PV01) *(Audited)*	**-**	**0.1**	**(0.1)**	-	0.1	(0.1)
Stress testing (PV200: all currencies)	**(0.2)**	**22.9**	**(20.4)**	7.9	22.3	(16.2)

Basis risk

Where assets and liabilities reprice at the same time but in line with a different interest rate basis, the Group is exposed to basis risk. For example, where assets reprice with reference to Bank of England base rate but liabilities reprice with reference to 3 month Libor, a basis risk exists. Basis risk is managed using a holistic approach incorporating a projection of balance sheet exposure net of derivatives. The risk to earnings from basis risk is calculated over the next year under a stressed rate scenario. Group exposure is limited with mitigating actions being taken by ALCO.

Business and Risk Report continued

Market risk management (continued)

Earnings risk (sensitivity of net interest income (NII))

Earnings risk or net interest income (NII) risk is the risk that the Group's income is adversely affected by a change in the level of interest rates. The sensitivity of Group NII to changes in interest rates is measured monthly using a forecasting model and potential interest rate scenarios. This is calculated for a forward period of 12 months.

Importantly all assets and liabilities maturing within the 12 months are assumed to reinvest in like-for-like products, which ensures that the balance sheet remains static. In addition, the model does not take any corporate strategies or management actions into account.

The table below sets out the sensitivity of future NII to rises and falls in rates:

Potential favourable/(adverse) impact on NII *(Audited)*	**2014**
	£m
+200 basis points shift	**281**
+100 basis points shift	**133**
-25 basis points shift	**(41)**
-50 basis points shift, floored at 1bp	**(102)**

The following should be noted in relation to the above:

- the interest rate sensitivities set out above are illustrative only and are based on simplified scenarios
- the negative shift scenarios are floored at 1bp to prevent rates from turning negative
- the reported sensitivity will vary over time due to a number of factors such as timing of maturing assets and liabilities, market conditions, customer behaviour and strategic changes to the balance sheet mix and should not therefore be considered predictive of future performance.

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

Swap spread risk

The Group is required to hold a substantial liquidity portfolio. These assets are predominantly fixed rate government securities and the Group uses interest rate swaps to hedge the Group against movements in interest rates. However, there remains a residual risk associated with the possible movements in the spread between sovereign debt yields and swap rates. This 'swap spread risk' reflects the fact that the market value of the swapped primary liquidity portfolio can move up and down on a day to day basis. The market value will change as sovereign debt and swap rates vary. In economic terms this risk is only realised if a bond and swap are sold ahead of maturity.

These market value movements are monitored and the risk is controlled via internal limits linked to capital requirements. Exposures are monitored daily and are reported on a monthly basis to ALCO.

Foreign exchange risk

As a UK based business the Group has low levels of foreign exchange risk. Foreign currency exposure is managed through natural offset on the balance sheet or by the use of derivatives to reduce currency exposures to acceptable levels. ALCO sets and monitors limits on the net currency exposure. During the year the risk limits were reduced further to ensure the Group minimises currency risk within operational boundaries. The table below sets out the extent of the residual exposure to foreign exchange risk:

Foreign exchange risk *(Audited)*	**2014**			2013		
	Average	**High**	**Low**	Average	High	Low
	£m	**£m**	**£m**	£m	£m	£m
VaR (99%/10-day)	**0.2**	**0.7**	**-**	0.3	0.8	-

Market risk management (continued)

Product option risks

Potential losses from market risks also arise as a result of customers exercising options embedded in fixed rate products which can result in required changes to hedging. The key product risks are prepayment risk (early redemption or overpayment of fixed rate mortgages), access risk (early withdrawal of fixed rate savings), and attrition risk (higher or lower take up of fixed rate mortgages). These risk exposures are quantified and assessed using a set of bespoke models that predict customer behaviour in response to changes in interest rates. The resulting potential costs are then closely monitored. These stressed risk measures are subject to a set of triggers and are reported to the Balance Sheet Risk Committee and ALCO, along with a set of proposed management actions where necessary to bring the exposures within appetite.

Model validation

Managing market risk effectively is highly dependent on effective models which are mathematical representations of business systems designed to help describe, predict and optimise decisions and scenarios which are used throughout the Group's business.

The risk associated with market risk models is controlled and managed through the model validation policy which requires that all new models are validated by an independent oversight team prior to use. The validation process identifies model strengths and weaknesses, assesses the potential impact of these and suggests appropriate mitigating actions. The review findings are finally presented to the Model Risk Oversight Committee (MROC) which is responsible for approving models as fit for purpose. In addition the first line performs backtesting and sensitivity analysis on models with a set of performance metrics assessed monthly for each model in terms of accuracy and its associated impact on results. All models are also subject to a more thorough periodic review, at least annually, to ensure they remain fit for purpose.

Calculations to determine the capital requirements for interest rate risk are made using the same models as those used for monitoring day to day interest rate risk to ensure consistency with the management view.

Outlook for market risk

Interest rates are expected to remain low but with an increased level of volatility due to market uncertainty around the timing of rate increases. This could increase the likelihood of results beyond the outer edges of those predicted by the VaR model as the market moves out of a benign period. NII is also subject to fluctuations due to volatility in swap rates. The prospect of higher interest rates is likely to be positive for NII.

In June 2013 the European Banking Authority issued a consultation paper on guidelines for managing Interest Rate Risk in the Banking Book (IRRBB). Subsequent to this, the Basel Committee has set up a task force to update regulation and principles for managing IRRBB. The Group is actively taking part in the industry debate on these issues and this will continue in 2014/15.

Market risk could arise due to wider global financial developments, such as the re-emergence of tensions within the Eurozone. For a further discussion of the top risks affecting the Group please see the 'Top and Emerging Risks' section of this report.

Business and Risk Report continued

Pension obligation risks

Overview

The Group sponsors a number of defined benefit schemes, the most significant of which is the Nationwide Pension Fund ('the Fund'), which is closed to new employees. Pension risk arises when the market value of the Fund's assets is considered to be insufficient to meet the liabilities of the Fund, resulting in a deficit in the Fund.

Uncertainty in the estimated size of the liabilities and volatility in future investment returns from the assets may cause volatility in the pension fund deficit. The key risk factors impacting the deficit are set out below. These risks can have a positive or negative impact on the deficit.

- **Changes in long-term interest rates and credit spreads:** decreases in long-term interest rates and/or credit spreads will increase the value placed on the Fund's liabilities. The increase in liabilities will be partially offset by an increase in the value of the Fund's holdings in bonds.
- **Inflation risk:** the majority of the pension benefits are linked to inflation and higher inflation will lead to higher liabilities (although, for most benefits, caps on the level of inflationary increases are in place to protect against extreme inflation). Where assets are correlated with inflation (e.g. index-linked gilts and inflation swaps), the increase in the liabilities may be partly offset by increases in the value of these assets.
- **Longevity risk (life expectancy):** the majority of the pension benefits are paid for the life of the members. Therefore increases in life expectancy above current assumptions will result in an increase in the liabilities.
- **Asset volatility:** the liabilities are calculated using a discount rate set with reference to bond yields. If assets underperform the bond yields, this will cause the position to deteriorate. The Fund holds a significant proportion of growth assets (e.g. listed and private equities, infrastructure and global absolute return funds) which, although expected to outperform bonds in the long term, create volatility and risk in the short term. The allocation to growth assets is monitored by the Fund trustees and the Group to ensure that it remains appropriate given the Fund's long term objectives.
- **Pension legislation:** the Group is also exposed to potential changes in the regulatory environment or legislation, which could increase the liabilities or capital requirements.

Where the deficit deteriorates, this could result in increased employer cash contribution requirements and/or impact the Group's capital position.

Significant events/environment

The continuation of low gilt yields and tight credit spreads has resulted in lower discount rates being applied in the valuation of pension liabilities, resulting in an increase in the estimate of the Fund's liabilities and ongoing volatility in the valuation of these liabilities as yields and rates vary.

The latest triennial valuation of the Fund, with an effective date of 31 March 2013, is currently underway. Contribution requirements, including any deficit recovery plan, are expected to be agreed between the Group and the Trustees of the Fund by mid-2014. The previous triennial funding valuation had an effective date of 31 March 2010 and revealed a trustee funding deficit of £320 million. This was paid off in full during 2010/11 and 2011/12.

Outlook for pension obligation risk

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

Operational risks

Overview

The Group defines operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. Operational risk encompasses transformation risk.

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

Risk category	Definition
Financial reporting and tax	The risk of material error in the external financial reports, non-compliance with tax laws or codes or failure to maintain the integrity of the general ledger.
Fraud	The risk of loss or failure caused by an act of dishonesty, false representation, the failure to disclose information, or by abuse of position.
Group security	The risk of loss of data or damage to assets, including physical and cyber-based attacks, and unauthorised disclosure of information.
Information and financial management	The risk of loss or failure arising from inaccurate, unavailable, incomplete or undefined data; errors in regulatory and/or internal and external critical reporting; ungoverned assumptions and errors in financial planning and/or financial information provided to support material decision making.
Infrastructure and resilience	The risk of failure to provide a robust technological and/or physical infrastructure to support operational activities and the achievement of business objectives.
People	The risk of loss or failure due to the inability to recruit, develop, reward and retain the required people resources.
Transformation	The risk of loss or failure arising from formally managed project activities that seek to deliver change in the Group's capabilities.

Operational risk profile

The Group's operational risk function collects and reports on the operational risk events that have occurred, by count and by value, in order to better understand those exposures that require management attention. For the purposes of reporting, the Group defines an operational risk event or loss as a "financial loss, cost or gain arising from an operational risk incident". There is a regulatory requirement for the Group to collect and report on these operational risk events.

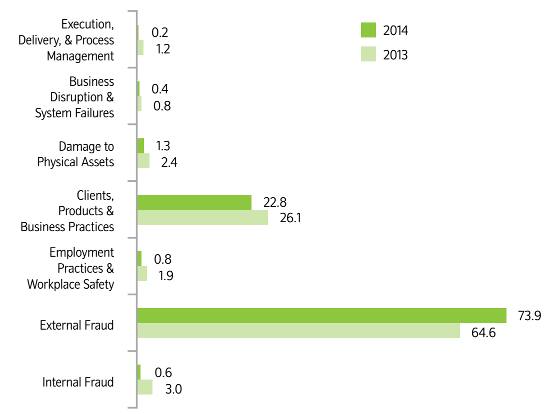
The Group reports operational risk events against both internal risk categories as well as by Basel II categories. The use of Basel II categories allows the Group to compare operational risk event experience with the broader industry. The analysis below presents the Group's operational risk events by Basel II category. Consistent with the Group's historical and industry experience, within this reporting period 96.7% by count, and 97.2% by value, of the Group's operational risk event experience has been recorded against two of the Basel II categories: 'External Fraud' and 'Clients, Products & Business Practices'.

The 'External Fraud' category has been driven by debit and credit card low value, high volume, fraud events whilst the 'Clients, Products & Business Practices' category also reflects PPI claims. As a percentage of total events by count and by value 'External Fraud' events have increased by 9.3% and 5.1% to 73.9% and 30.0% respectively. In comparison, 'Clients, Products & Business Practices' events, by count, have reduced by 3.3%, whilst by value, the Group's experience for this category has increased by 7.8%. Across both of these categories, operational risk event experience remains in line with the industry.

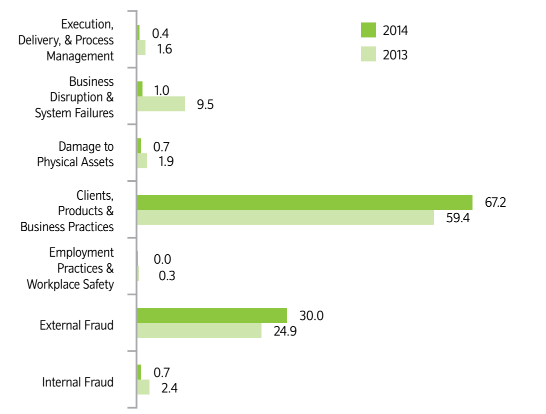
Business and Risk Report continued

Operational risks (continued)

Operational risk events by category
% of total risk events by count



Operational risk events by category
% of total risk events by value



Significant events/environment

The Group continues to invest in new products and services for a growing customer base. The Group's operations are well controlled, which has resulted in a market leading level of customer service delivery.

Following the successful launch of its new core banking platform in December 2012, the Group is close to completing the migration of 5.2 million accounts from the legacy banking platform onto the new SAP banking platform. This delivery will improve operational risk management and IT running costs for the Group and enhance customer experience through the product propositioning now made available to all customers.

The Group continues to make significant investment in transforming its products and delivery channels through the implementation of new systems and organisational structures and meet consumer expectations of digital banking. The operational complexity of these activities may however increase the inherent risk of system failures or process errors, and the Group works diligently to ensure controls are in place to manage this.

In December 2011, the Government endorsed a recommendation made by the Independent Commission on Banking (ICB) to increase competition in the Personal Current Account (PCA) market, by improving the PCA switching service. The 7 Day Account Switching (7DAS) programme reduced end-to-end switching from 18 to 7 days resulting in a net gain of over 37,000 accounts switched to the Group during 2013/14 and implemented a redirection service to ensure direct debits and payments from old accounts will be automatically redirected to new accounts for a 13 month period.

Acknowledging the scale of regulatory change, including increased reporting and stress testing and the current macroeconomic environment, management of operational risk remains a priority and continued improvement in controls is a key focus for management. The Group actively seeks to ensure that it mitigates operational risk through analysis using past experience, and its approach to lessons learnt, where the concepts of continuous improvement and learning from its and others' mistakes are key components to driving operational risk improvement.

Outlook for operational risk

The Group's operational risk profile is informed by risk assessments from the business and by review and challenge by both the second line Operational Risk team and the Operational Risk Committee.

In recognition of the cyber risk facing both the Group and the financial sector in general, the Group continues to focus its efforts on discharging its cyber risk management responsibilities effectively. This ensures that the Group continues to safeguard the organisation and, importantly, its customers.

As the rise of digital banking changes customers' expectations around the availability of banking services, the Group will seek to make digital transactions easier and more available to its customers. With this in mind, the Group will also seek to invest in transforming its products and delivery channels to meet evolving customer and regulatory expectations in this area.

The Operational Risk Framework is subject to regular review, and for 2014/15 some changes to the key risk categories detailed above are being introduced to better align the categories to organisational, governance, and reporting structures.

Customer and compliance risks

Overview

The Group defines 'customer and compliance risk' as the risk that the organisation fails to design and implement operational arrangements, or systems and controls, such that it cannot maintain legal and regulatory compliance, deliver fair customer outcomes or achieve a positive experience for its customers. The definition is further defined into six risk sub-categories:

Risk category	Definition
Firm and culture	The risk that the Group fails to implement operational arrangements, systems and controls that achieve legal and regulatory compliance and embed a corporate culture where fair customer outcomes and the achievement of a positive experience are central to the Group's values and behaviours.
Customer experience	The risk that the Group's customers do not have a positive experience.
Retail conduct	The risk that the Group's products and services (including contracts and terms and conditions) are not designed, developed and operated to deliver fair customer outcomes and compliance.
Wholesale conduct	The risk that the Group's commercial and financial markets activity is inappropriate and/or does not comply with regulatory requirements.
Prudential standards	The risk that the design and operation of the Group's systems and controls fails to maintain compliance with prudential requirements.
Financial crime	The risk that the Group fails to establish effective systems and controls to prevent the risk that it might be used to further financial crime.

Significant events/environment

In recent years, issues associated with non-compliant processes and failures to meet legitimate expectations of customers have proven to be significant source of cost for the industry. The industry will continue to evolve as it responds to the volume and scale of regulation it will experience in the coming years, while also delivering products and services that meet the demands of the Digital Society. The ongoing focus of good consumer outcomes in this environment will remain a key area of risk for the industry.

The Groups's mutual ethos and long standing commitment to 'doing the right thing' means it is well placed to meet these challenges and serve its members safely. The business will continue to deliver, and further develop, systems and controls that protect its members, with carefully designed products delivered by a sales force that is well trained and monitored.

Regulatory change

The pace of regulatory change has increased since April 2013, following the regulatory split between the Prudential Regulatory Authority (PRA) and Financial Conduct Authority (FCA). Like most banks and building societies, the Group has been impacted by two core regulatory changes in 2013/14: the Capital Requirements Regulations combined with the Capital Requirements Directive IV, and the lead-up to the Mortgage Market Review (MMR) implementation. In addition, the Group has continued to support the additional changes from the Retail Distribution review and the implementation of the 7 Day Account Switcher Service.

Internal change

The Group has introduced the customer and compliance risk frameworks, which provide a solid foundation for the organisation to understand potential risks to which it could be exposed and to consider these in the design and distribution of products and associated systems and controls.

Nationwide has expanded its Group Compliance division in 2013/14 and it will expand further in 2014/15, with additional skills and capabilities to meet the needs of the changing environment and the Digital Society. A key change has been the recruitment of a Chief Compliance Officer. This move, along with the inclusion of this role on the Executive Committee, recognises the importance of customer and compliance risk to the organisation.

Customer and compliance risk profile

Nationwide has not been subject to the same level of regulatory censure as its main competitors reflecting its commitment to delivering fair customer outcomes. However, the Group recognises the need to continue to transform and innovate to meet the demands of its members, the regulators and the wider financial services industry.

Business and Risk Report continued

Customer and compliance risks (continued)

Compared to the industry as a whole, far fewer customer complaints about Nationwide to the Financial Ombudsman Service (FOS) have been upheld: only 10% of the complaints to FOS about the Group have been upheld compared to 51% across the industry as a whole. This reflects the Group's approach to resolving complaints against it fairly.

No additional provision has been made this year for PPI. The Group has continued to experience a significant but declining volume of reactive PPI complaints during the financial year, a substantial proportion of which relate to cases where there has been either no sale or no evidence of mis-selling. The Group continues to re-assess the ultimate level of complaints expected and the appropriateness of the provision, which reflects the redress and associated administration that will be payable in relation to claims it expects to uphold. Further costs in relation to invalid claims are recognised in administrative expenses as incurred.

The Group is reviewing its compliance with various regulatory matters, including consumer credit legislation and during the year it made a provision of £69 million in respect of potential customer redress. However, no customer detriment has been identified.

Tax compliance

The statutory reported tax charge for the year is £128 million (2013: £10 million credit). This represents an effective tax rate of 18.9%, which is lower than the statutory rate in the UK of 23% (2013: 24%). 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. Further information is provided in notes 12 and 21.

During the year the Group income statement bore taxes of £345 million (2013: £258 million) including irrecoverable VAT, bank levy, employment and property taxes which are charged to profit before tax as part of administrative expenses and depreciation. With the exception of the bank levy, all of these amounts are recognised in arriving at underlying profit.

The Group complies with all UK tax laws. Nationwide has an open and transparent relationship with HMRC, such that HMRC has accorded the Group a 'low risk' status.

Taxes borne in the year	**2014**	2013
	£m	£m
Corporate income taxes	**87**	33
Bank levy	**17**	16
Taxes on property	**24**	23
Employment taxes	**47**	47
Indirect taxes	**170**	139
Total	**345**	258

In addition, the Group collected and remitted a further £397 million (2013: £454 million) of taxes to the UK and overseas exchequers through deduction of taxes at source on payroll and customer accounts.

Additional taxes collected and remitted	**2014**	2013
	£m	£m
Tax withheld at source (on savings accounts)	**247**	303
Payroll taxes	**141**	134
Indirect taxes (Insurance Premium Tax and VAT)	**9**	17
Total	**397**	454

Customer and compliance risks (continued)

Outlook for customer and compliance risk

The FCA, which is significantly more assertive than its predecessor, will continue to develop the regulatory regime around the concept of culture and conduct risk.

The Group will remain alert to the challenges that it faces in a rapidly changing environment, with further development of its controls and processes and a focus on consumer outcomes and protecting the Group's members, now and in the future:

- the Group will further enhance the customer and compliance risk frameworks, to improve its identification, management and governance of aggregate risks and enhance its understanding of conduct and culture risk
- the Group will constantly review its products and services, to ensure they continue to meet the Group's members' expectations
- the Group will continue to keep pace with the volume of legal and regulatory change, through proactive management of its business strategy and proposition.

This pace of change will continue with the recent transfer of Consumer Credit Regulation to the FCA, and the impending Mortgage Credit Directive; introduction of a new payments regulator; and Senior Managers and Certification Regimes, which will replace the existing Approved Persons Regime (APR).

The PRA and FCA will consult with the industry on the detail in 2014, with the regimes coming into force in 2015, with the intention to capture a wider range of individuals from an accountability and liability perspective than under the existing APR.

There will be increasing prudential requirements being placed on the business, with greater scrutiny on the level of capital required, implementation of the Firm Data Submission (FDS) and a new stress testing regime.

The FCA will continue to develop its regulatory approach in respect of its consumer protection, market integrity and competition objectives, with the focus of supervision being the assessment of whether the firm has the customer at the heart of how the business is being run.

The digitisation of the Group's proposition provides further challenges where legislation and processes are carried forward into the digital age. Increasing standards for conduct could restrict the Group's channels, services or proposition. The Group will design and implement appropriate controls and processes in order to continue to provide the services that its members value against the changing regulatory backdrop.

Business and Risk Report continued

Strategic risks

Strategic risk is split into the following sub-categories:

Risk category	Definition
Business model	The risk associated with failing to adopt an appropriate business model, set appropriate goals and targets in the Corporate Plan, or adapt to external developments.
Reputation	The risk that arises from material adverse publicity resulting in a loss of confidence from key stakeholders sufficient to threaten the strategic objectives of the business.
Strategic initiatives	The risk that the Group enters into strategic initiatives that undermine the business model, or does not enter into appropriate strategic initiatives that would enhance the business model.

Strategic risk focuses on large, longer term risks that could become a material problem for the 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.

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.

A number of the top and emerging risks have the potential to affect more than one risk category and 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.

In particular, the Group faces a challenge to build new digital services that appeal to new members whilst not compromising the traditional services that are valued by longer established customers.

To manage strategic risk, the 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 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.

Risk governance

Enterprise Risk Management Framework

Robust management of the risks inherent in running the Group's business is at the heart of safeguarding its members' interests and delivering a sustainable business model. The Group's day-to-day business activities, whether they are offering a range of product choices, making sound lending decisions or managing its balance sheet effectively all require effective management of risk.

All trading divisions and subsidiaries of the Group manage risks within an Enterprise Risk Management Framework (ERMF). The ERMF is structured around five headings:

Heading	Description
Risk culture	Sets out the values and behaviours present throughout the organisation that shape risk decisions across the Group.
Risk governance and control	Sets the risk categories, the Three Lines of Defence and how these are deployed, the committee governance structure, and standards for documentation and policy.
Risk strategy	Sets out the Board's risk appetite and overall 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	Sets out the standards across the Group, encompassing risk data and systems, the use of models, reporting, and risk-based performance measurement.
Stress testing and planning	Sets out the approach to Group-wide stress testing, scenario analysis, contingency plans, and the interactions with other corporate processes.

The ERMF is an evolving document and undergoes an annual review during March. Changes from the March 2013 review have been incorporated during the financial year and are noted, where relevant, elsewhere in the Business and Risk Report. Further refinements from the March 2014 review will be incorporated during the coming financial year.

The following sections describe the elements of the risk framework in more detail.

Risk culture

Risk culture is defined as "the values, beliefs, knowledge and understanding about risk and the management of risk, advocated by the Board, shared and adopted by employees within the organisation". This 'tone from the top' is supported by appropriate levels of resource with the necessary skills.

The risk culture sets out:

- the Group's approach to maintaining a strong risk culture
- the risk culture statements to which all directors and staff are committed, and
- required ('do') and prohibited ('don't') behaviours.

Risk culture is grouped under four high level objectives:

- shared understanding and attitude: the Group shares a common risk language and is conscientious about managing risk regardless of individual role. Risk policies and limits are complied with and situations where that is not possible are promptly escalated ensuring that it only takes appropriate risks
- clear communication: communication is focused on the risks that are most important and urgent. Both positive and negative news is shared openly, without bias, and communicated using plain language that can be easily understood. Staff are comfortable challenging each other, regardless of seniority
- effective risk teams: the risk teams are respected, influential, well equipped, highly skilled and work in close partnership with the business areas they support
- highest standards: the Group strives to achieve more with less, optimising the returns it earns for members against the risks it takes. The Group is always learning and improving in order to be the best at risk management.

The risk culture objectives drive a series of expected behaviours that require all of the Group's directors, management and staff to be risk aware, communicate and work together effectively. They also complement the internal PRIDE values and support the Group's customer-focused objectives, reinforcing its 'On Your Side' proposition to customers.

The aim of the Group's risk culture is to ensure that all staff work together to recognise, manage and mitigate risk. In the final quarter of the year, a survey is undertaken to assess the effectiveness of the risk culture in the Group, the results of which feed into the objectives for the Risk Management Division for the next financial year. The third annual survey in 2014 showed year-on-year improvements both in the development of the Group's common risk language and the ability to challenge since the introduction of ERMF.

Business and Risk Report continued

Risk governance (continued)

Risk categorisation

Whilst the Group accepts that all of its business activities involve risk, it seeks to protect its membership by managing the risks that arise from its activities appropriately. The principal risks inherent within the business are described in the table below:

Risk category	Definition
Lending	The risk that a borrower or counterparty fails to pay interest or to repay principal on a loan or other financial instrument (e.g. a bond) on time. Lending risk also encompasses extension risk and concentration risk.
Financial	The risk of the Group 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, which may be exposed by changes in market rates, market conditions or the Group's own credit profile.
Operational	The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.
Customer and compliance	The risk that the Group fails to design and implement operational arrangements, systems and controls such that it can maintain legal and regulatory compliance, deliver fair customer outcomes and achieve a positive experience for its customers.
Strategic	The risk of significant loss or damage arising from business decisions that impact the long-term interests of the membership, or from an inability to adapt to external developments.

Under each of these principal risk categories are more specific risk sub-categories describing increasingly granular risk types.

In addition to these principal categories of risk, model risk is managed under a separate framework across all risk categories and business areas where risk models are used. The Group has a dedicated department within Risk Management Division to oversee model risk across the Group. The model risk framework ensures effective governance and oversight of risk models, and that standards are consistently applied.

Risk category	Definition
Model risk	The risk that an adverse outcome (incorrect or unintended decision or financial loss) occurs as a direct result of weaknesses or failures in the design or use of a model. The adverse consequences include financial loss, poor business or strategic decision making, or damage to the Group's reputation.

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 governance committees and by the Chief Risk Officer.

Risk governance (continued)

Three Lines of Defence

The Group continues to adopt the Three Lines of Defence model ensuring clear independence of responsibilities for risk control, oversight and governance in accordance with best practice within the industry with the objective of:

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

In organisational terms, the Three Lines of Defence model 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 by key control functions and, 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 oversight functions, independent from the first line, report either into the Group Risk Director (reporting to the Chief Risk Officer) or the Compliance Oversight Director (reporting to the Chief Compliance Officer). These functions are aligned to the principal risk categories and model risk to oversee the first line management of risk, including concentrations where appropriate. The oversight teams maintain risk management frameworks, set standards, review policies, establish limits that are consistent with risk appetite, monitor and report on compliance with those limits.

Third line assurance is provided by Group Internal Audit, which ultimately reports to the Audit Committee. Information about the role and activities of the Audit Committee can be found in the Corporate Governance section of this report.

First line of defence	Second line of defence	Third line of defence
Every Nationwide employee is responsible for the risks that are a part of their day-to-day job. The first line of defence ensures all key risks within their operations are identified, mitigated and monitored by appropriate internal controls within an overall control environment.	Independent functions within the Risk Management and Compliance Divisions are responsible for providing oversight and challenge of activities conducted in the first line.	Group Internal Audit provides independent assurance over the first and second lines of defence.

Risk governance structure at Group level

The Board Risk Committee and Audit Committee continue to provide oversight and advice to the Board. The Executive Risk Committee continues to ensure a co-ordinated management approach across all risks categories. The remit and scope of risk reporting for each of these committees has been reviewed and revised to align to the new ERMF.

As part of the annual ERMF governance review the composition and chairmanship of the existing risk committees was revisited. A number of changes to the risk committee structure were agreed and implemented at the start of the financial year:

- creation of a first line Operational Risk Committee under the chairmanship of the Chief Operating Officer, replacing the previous Operational Risk Oversight Committee.
- the Group Risk Oversight Committee was renamed the Group Risk and Compliance Committee, reflecting the enhanced focus on compliance matters.

The Chief Risk Officer chairs the Group Risk and Compliance 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. The Chief Compliance Officer is deputy chair of the Group Risk and Compliance Committee and has the same direct access to the Chair of the Board Risk Committee as the Chief Risk Officer.

Beneath the second line Group Risk and Compliance Committee there is a specialist Model Risk Oversight sub-committee.

Beneath the Customer Committee, Operational Risk Committee, Lending Committee and Assets and Liabilities Committee (ALCO) in the first line there are specialist sub-committees, forums and working groups that 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.

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Business and Risk Report continued

Information Flow

Board

Chair: Geoffrey Howe – Chairman

- Ensure maintenance of sound system of internal control and risk management.
- Review the effectiveness of the Group's risk and control processes to support its strategy and objectives.
- Approve the Group's risk appetite, risk management framework, key regulatory documents (i.e. Internal Capital Adequacy Assessment Process and Individual Liquidity Adequacy Assessment) and Contingency Funding Plan.

Board Committees

Board IT Strategy & Transformation Committee

Chair: Mitchel Lenson – Non Executive Director

- Oversight of the Strategic Investments portfolio.
- Oversight of the IT strategy, architecture, delivery roadmap and architectural governance controls.
- Oversight of individual transformation programmes.

Board Risk Committee

Chair: Alan Dickinson – Non Executive Director

- Provide oversight and advice to the Board on current and emerging risk exposures of the Group.
- Review the Group's Risk Appetite andsupporting metrics.
- Review the effectiveness of the Group's ERMF to manage and mitigate risk.

Executive Committees

Executive Risk Committee

Chair: Graham Beale – Chief Executive

- Determine the Group's attitude to risk.
- Exercise responsibility for controlling risk across the Group.
- Monitor and review the risk exposures of the Group.

First Line – Risk Control

Customer Committee

Chair: Mitchel Lenson – Non Executive Director

- Determine the Group's attitude to customer risk.
- Exercise primary responsibility for controlling customer risk across the Group.
- Monitor and review the customer risk profile of the Group.

Divisional risk & control meetings

Chair: Executive/Group Director of respective division

- Review first line operational, customer and compliance risk and control reporting.

Operational Risk Committee

Chair: Tony Prestedge – Chief Operating Officer

- Determine the Group's attitude to operational risk.
- Exercise primary responsibility for controlling operational risk across the Group.
- Monitor and review the operational risk exposures of the Group.

Assets & Liabilities Committee

Chair: Mark Rennison – Group Finance Director

- Determine the Group's attitude to financial risk.
- Manage the financial risk profile of the Group.

Audit Committee

Chair: Roger Perkin – Non Executive Director

- Monitor the integrity of the financial statements of the Group.
- Review the adequacy and effectiveness of internal controls and risk management systems.
- Monitor the effectiveness of the Compliance Oversight function.
- Review the adequacy of Whistleblowing, Fraud and Bribery Prevention procedures.
- Monitor the effectiveness of the internal audit function.

Lending Committee

Chair: Chris Rhodes – Executive Director Group Retail

- Determine the Group's attitude to lending risk.
- Manage the lending risk profile of the Group.

Specialist risk sub-committees and forums beneath provide specialist advice

Second Line – Compliance Committee

Group Risk & Compliance Committee

Chair: Iain Laing – Chief Risk Officer

- Oversight of the design, implementation, embedding and effective operation of the ERMF.
- Monitor performance across all primary risk categories.
- Review and prioritise risk and compliance oversight activity.
- Review control gaps and the adequacy of management response.
- Oversight of the management of compliance with all applicable legal and regulatory requirements.
- Holistic oversight of risk and compliance across the Group.

Third Line – Assurance

Group Internal Audit

Group Internal Audit provides independent, objective assurance regarding the adequacy and effectiveness of systems of risk management and internal controls across the business in order to mitigate key business risks.

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Business and Risk Report continued

Risk governance (continued)

Risk strategy

Board risk appetite

The Board sets high-level risk appetite to enable the Group to:

- identify and define the types and levels of risks it is willing to accept both qualitatively and quantitatively
- describe risks the Group is willing to take, and those it will not take, in pursuit of strategic goals, and
- establish a framework for business decision making.

The high level Board risk appetite agreed for 2013/14 was as follows:

"The Group maintains legal and regulatory compliance, delivers fair customer outcomes, and achieves a positive experience for customers."
"The Group holds sufficient capital and liquidity resources, and sustains this with stable earnings, diverse sources of funding and minimal exposure to market and off-balance sheet risks."
"The Group builds high quality lending portfolios that seek to earn an adequate return."
"The Group ensures controls are effective to minimise serious customer or business disruption."
"The Group ensures that the business model and strategy are focused on securing the long-term needs of its membership."

The Board risk appetite statements are further expanded into qualitative statements that are supported by a focused suite of Board risk metrics, limits and triggers, designed to cover all the Group's risks. Board risk appetite is incorporated into and informs relevant group processes, e.g. the corporate planning process. Board risk appetite is reviewed annually.

Board risk appetite is supported by risk strategies for principal risks that are approved by the Board Risk Committee. The risk strategies set out in detail the key risks posed, how risk is managed, and a more granular view of risk appetite including detailed limits and triggers that are monitored by first line risk committees. Reporting, limits and controls are set in a hierarchy that links the Board's tolerance for risk with on the ground risk taking actions and behaviour throughout the Group. Lower level metrics from first line risk committees are escalated to the Executive Risk Committee and the Board Risk Committee should they fall out of tolerance or breach risk appetite.

Risk governance (continued)

Risk measurement

Risk management approach

The Group has clear risk management objectives and a strategy to deliver them through core risk management processes put in place under ERMF. At a strategic level, the Group's risk management objectives are to:

- identify risks against the Corporate Plan and divisional objectives
- assess risk exposure by impact and likelihood
- respond to risks by evaluating their position against risk appetite and formulating associated management responses, and
- monitor the agreed management action plans and updates.

In the course of risk assessment, controls may be challenged or strengthened and risks mitigated within the context of risk appetite. The approach serves to help executives improve the control and co-ordination of risk taking across the business and to manage the risk profile in the context of corporate objectives.

Each of the Group's 'Top and Emerging Risks' has associated risk metrics which provide insight into the impact and likelihood of the risk occurring. These are monitored within the risk governance structure.

Stress testing and planning

The Group engages in thorough stress testing, scenario analysis and contingency planning, in order to better understand and prepare for low-frequency, high impact events. A range of group wide, multi-risk category 'corporate' stress tests, and operational risk scenario analyses are undertaken to ensure that the financial position and risk profile of the Group provide sufficient resilience to withstand the impact of stressed economic and market conditions (systemic stress) or one-off events (idiosyncratic stress). Stress testing is an integral part of the annual corporate planning process, the adequacy assessment processes for liquidity and capital, and the annual review of Group risk appetite.

The stress testing and scenario analysis programme is overseen by the Board Risk Committee, with corporate stress testing co-ordinated by ALCO, and operational risk scenario analysis activity co-ordinated by the Operational Risk Committee. The Group's ERMF document includes high-level principles and minimum standards that apply to any stress testing or scenario analysis activity undertaken, which are supported by more detailed standards and methodologies at a local level. This includes a common three stage process (planning and preparation, running the stress test, and review and report), and minimum requirements for each stage aimed at ensuring an appropriate choice of scenarios, supported by robust documentation, with stakeholder engagement, challenge and review throughout the design, completion and subsequent reporting of the stress test.

The Group also undertakes reverse stress tests to identify those scenarios which could result in the business model ceasing to be viable as measured by the breaching of regulatory minima on key capital ratios such as Common Equity Tier 1 and solo surplus and eliminating forecast profitability.

Outputs from stress testing activity are used to inform capital and liquidity planning, articulate potential management actions within contingency plans, and further improve the management of the Group's risk profile.

Business and Risk Report continued

EDTF Recommendations

Disclosures in this Report arising from EDTF recommendations

For the 2013/14 Annual Report the Group has aimed to develop its approach to risk reporting to ensure that disclosure is transparent and easily navigable. In particular, the Annual Report seeks to:

- provide the user with insight into the level of risk across the Group's business and portfolios, the material risks and uncertainties that the Group faces and the key areas of management focus, and
- present the Group's Business and Risk Report to allow the user to understand the Group's business model and performance and to find out more about the major risk policies which underlie its risk exposures.

Some of the EDTF's recommended capital adequacy and RWA disclosures can be found in the Group's Pillar 3 Disclosures 2014 (available at nationwide.co.uk).

Type of risk	Recommendation	Disclosure	Annual Report	Other
General	1	The risks to which the business is exposed	Pages 32 to 33, and 153 to 159	
	2	The Group's risk appetite and stress testing	Pages 158 to 159	
	3	Top and emerging risks and the changes during the reporting period	Pages 87 to 88	
	4	Discussion of the future regulatory developments affecting the business model	Pages 33, 88 and 149 to 151	
Risk governance, risk management and business model	5	Group Risk Committee and their activities	Pages 62 to 63 and 156 to 157	
	6	Risk culture, governance and ownership	Pages 153 to 159	
	7	Diagram of risk exposure	Page 86	
	8	Stress testing and underlying assumptions	Page 159	
Capital adequacy and RWAs	9	Pillar 1 capital requirements		Please see the Group's Pillar 3 Disclosures 2014 and Capital Management Report
	10	Reconciliation of accounting balance sheet to regulatory balance sheet		
	11	Flow statement of the movement in regulatory capital since the previous reporting period		
	12	Discussion of targeted level of capital, and plan on how to achieve this		
	13	Analysis of RWAs by risk type		
	14	Capital requirements for each Basel asset class		
	15	Analysis of credit risk for each Basel asset class		
	16	Flow statements reconciling the movements in RWAs for each risk weighted asset type		
	17	Discussion of Basel credit risk model performance		

EDTF Recommendations (continued)

Type of risk	Recommendation	Disclosure	Annual Report	Other
Liquidity	18	Analysis of Group's liquid asset buffer	Pages 127 to 131	
Funding	19	Encumbered and unencumbered assets analysed by balance sheet category	Pages 137 to 138, and 140	
	20	Consolidated total assets, liabilities and off-balance sheet commitments analysed by contractual maturity at the balance sheet date	Pages 134 to 136	
	21	Analysis of the Group's sources of funding and a description of its funding strategy	Pages 128 to 133	
Market risk	22	Relationship between market risk measures for non-trading portfolios and the balance sheet, by business segment	Page 128	
	23	Discussion of significant non-trading market risk factors	Pages 142 to 143	
	24	VaR assumptions, limitations and validation	Pages 141 to 142	
	25	Discussion of stress tests, reverse stress tests and stressed VaR	Pages 142 to 143	
Credit risk	26	Analysis of aggregate credit risk exposures, including details of both personal and wholesale lending	Pages 92 to 94 and 108 to 109	
	27	Discussion of the policies for identifying impaired loans, defining impairments and renegotiated loans, explaining loan forbearance policies	Pages 98 to 103 and 112 to 116*	
	28	Reconciliation of the opening and closing balances of impaired loans and impairment allowances during the period	Page 118	
	29	Analysis of counterparty credit risk arising from derivative transactions	Pages 125 to 126	
	30	Discussion of credit risk mitigation, including collateral held for all sources of credit risk	Pages 93 to 94 and 113 to 114	
Other risks	31	Quantified measures of the management of operational risk	Pages 147 to 151	
	32	Discussion of publically known events	Pages 147 to 151	

*These page numbers represent the policies for identifying impaired loans, defining impairments and renegotiated loans, explaining loan forbearance policies for the residential mortgage and commercial lending books which represent the majority of the Group's loans and advances to customers. Additional disclosures can be found in consumer banking and other lending loan books.

Capital Management Report

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

The Group manages its capital structure to ensure it continues to meet minimum regulatory requirements, as well as meeting the expectations of other key stakeholders. As part of the risk appetite framework, the Group targets a Common Equity Tier 1 (CET1) ratio amongst the best in market compared to major banking peers. Nationwide's strategy is to meet this primarily through retained earnings, supplemented by external capital issuances where appropriate, as well as the strategic management of credit risk.

Capital position

The Group's capital and leverage ratios have increased this year as a result of a strong trading performance and strategic capital management activities including deleveraging. The successful issuances of core capital deferred shares (CCDS) and Additional Tier 1 (AT1) securities also strengthened the Group's capital base and improved its regulatory capital ratios.

Nationwide's capital position at 4 April 2014 is summarised in the table below. All tables in this section show the capital position for 4 April 2014 on a CRD IV 'end point' basis with the exception of total Tier 1 capital and total regulatory capital resources and associated ratios, which include grandfathered legacy Tier 1 and 2 instruments under transitional rules. This reflects the PRA's accelerated implementation of CET1 deductions, so that they apply in full from 1 January 2014, but retaining transitional phasing for grandfathering of capital instruments. Proforma 4 April 2013 CRD IV capital figures are included on the same basis to allow comparability. In addition, the proforma figures reflect the change in treatment of securitisation exposures rated below BB- as described below.

Key capital ratios	**2014 CRD IV**[1]	2013 CRD IV PROFORMA[2]	2013 Basel II
	%	%	%
Capital – CRD IV (end point) unadjusted			
CET1 ratio [3]	**14.5**	9.1	12.3
Leverage ratio [4]	**3.3**	2.2	
PRA adjusted ratios			
PRA Adjusted CET1 ratio [5]	**11.2**		
PRA Adjusted Leverage ratio [5]	**3.2**		

Notes:

1. Capital ratios are reported under CRD IV on an 'end point' basis.
2. On 1 January 2014 CRD IV was introduced. The column headed 4 April 2013 CRD IV shows the 4 April 2013 figures on a proforma basis, had these rules applied then, and reflecting a change in treatment of securitisation exposures rated below BB-. It is provided to assist in understanding the changes in the regulatory capital position during the year.
3. For 4 April 2013, on a Basel II basis Core Tier 1 ratio is reported in this line.
4. The Group reported a leverage ratio of 2.0% in the 2013 Pillar 3 disclosures. The principal reason for the difference between the figure previously reported and the proforma figure now reported of 2.2% is the change in treatment of securitisation exposures rated below BB-.
5. On 20 June 2013 the PRA published CET1 and leverage ratios for major banks and building societies, including Nationwide, on an adjusted basis to reflect 'regulatory headwinds' as estimated by the PRA. They also set minimum targets for these ratios of 7% and 3% respectively.

The introduction of Basel III on 1 January 2014 was implemented through the Capital Requirements Regulation and Directive, together referred to as CRD IV. These new regulations reduced CET1 capital resources, increased capital requirements and made certain existing capital instruments ineligible. As a result, the application of CRD IV reduced the Group's previously reported regulatory capital and capital ratios including the CET1 ratio.

The capital disclosures included in this report are on a Group basis, including all subsidiary entities. For regulatory purposes the Group also reports on an Individual Consolidated basis, which only includes those subsidiaries meeting particular criteria contained within CRD IV. Nationwide's CET1 ratio on this basis at 4 April 2014 is 0.1% lower than the Group basis due to reserves held by entities that sit outside of the Individual Consolidation, with a small impact from the risk weighted assets of these entities. More detail on an Individual Consolidated basis can be found in the Group's 2014 Pillar 3 disclosure.

In December 2013 the Group successfully issued £550 million (£531 million net of issuance costs) of CCDS which qualifies as CET1 capital. In addition the Group issued £1 billion (£992 million net of issuance costs) of Additional Tier 1 capital in March 2014. These successful transactions demonstrate that Nationwide has access to the external market when required to support the Group's capital position and the achievement of its strategic objectives.

As part of its capital management strategy the Group bought back £506 million of its own permanent interest bearing shares (PIBS) in September and October 2013. This transaction removed instruments that are not eligible as capital under end-point CRD IV rules and generated additional CET1 by crystallising gains. Future liability management options and decisions with respect to capital calls will be made at the Group's discretion in light of the then prevailing market, economic and regulatory conditions.

In June 2013 the PRA set an expectation that major UK firms maintain a minimum 7% end-point CET1 ratio and 3% leverage ratio. In calculating these target ratios, the PRA initially applied adjustments to Nationwide's CET1 resources and applied a risk weight floor to prime mortgages thus increasing risk weighted assets by £10.6 billion. The adjustment to capital resources related to the commercial real estate portfolio and this has since been reduced (from £0.4 billion to £0.1 billion).

Since the year end the Group has sold commercial real estate loans which represented gross balances of £694 million at 4 April 2014 and over 90% of its remaining exposure to the German real estate market. The disposal will be recognised in the first quarter of 2014/15 and has a positive impact on the CET1 and leverage ratios on a proforma basis of approximately 0.5% and 0.1% respectively.

After applying the PRA adjustments, the adjusted end point CET1 ratio is 11.2% and the adjusted leverage ratio is 3.2% as at 4 April 2014, meaning that the Group's ratios now exceed the targets of 7% and 3% respectively established by the PRA in June 2013.

Capital Management Report continued

Total regulatory capital

The table below reconciles the general reserves to total regulatory capital and explains the movement in regulatory capital by category.

Capital position	**2014 CRD IV Transitional (Audited)**	2013 CRD IV Transitional PROFORMA[1]	2013 Basel II (Audited)
	£m	£m	£m
General reserve	**7,363**	6,765	6,765
Core capital deferred shares (CCDS)	**531**	-	-
Revaluation reserve (note 1)	**71**	67	-
Regulatory adjustments and deductions:			
■ Foreseeable distributions (note 2)	**(45)**	-	-
■ Prudent valuation adjustment (note 3)	**(5)**	(13)	-
■ Own credit and debit valuation adjustments (note 4)	**(17)**	(37)	-
■ Available for sale reserve (note 5)	**(51)**	(252)	-
■ Defined benefit pension fund adjustment (note 6)	**-**	-	263
■ Intangible assets (note 7)	**(890)**	(821)	(878)
■ Goodwill (note 7)	**(12)**	(16)	(16)
■ Excess of expected losses over impairment (note 8)	**(1,096)**	(1,130)	(429)
■ Securitisation and other positions (note 9)	**-**	(12)	(251)
Total regulatory adjustments and deductions	**(2,116)**	(2,281)	(1,311)
Common Equity Tier 1 capital	**5,849**	4,551	5,454
Additional Tier 1 Capital Securities (AT1)	**992**	-	-
Permanent interest bearing shares (note 10)	**592**	937	1,304
Tax in respect of expected loss excess over impairment (note 8)	**-**	-	136
Total Tier 1 capital	**7,433**	5,488	6,894
Dated subordinated debt (note 10)	**2,073**	2,167	2,281
Revaluation reserve (note 1)	**-**	-	67
Surplus of impairment over expected loss (note 8)	**171**	-	-
Collectively assessed impairment allowances	**27**	91	70
Deductions:			
■ Excess of expected losses over impairment (note 8)	**-**	-	(565)
■ Securitisation and other positions (note 9)	**-**	-	(251)
Total deductions	**-**	-	(816)
Tier 2 capital	**2,271**	2,258	1,602
Total regulatory capital	**9,704**	7,746	8,496

Note:

1. On 1 January 2014 CRD IV was introduced. The column headed 4 April 2013 CRD IV shows the 4 April 2013 figures on a proforma basis, had these rules applied then, and reflecting a change in treatment of securitisation exposures rated below BB-. It is provided to assist in understanding the changes in the regulatory capital position during the year.

Explanatory notes (to table opposite)

(1) Under CRD IV the revaluation reserve is included as CET1 capital.

(2) Foreseeable distributions in respect of CCDS and AT1 securities are deducted from CET1 capital under CRD IV.

(3) A prudent valuation adjustment is applied in respect of fair valued instruments as required under regulatory capital rules.

(4) Own credit and debit valuation adjustments are applied to remove balance sheet gains or losses of fair valued liabilities and derivatives that result from changes in the Group's own credit standing and risk, in accordance with CRD IV rules.

(5) The available for sale reserve is included in regulatory capital under CRD IV.

(6) CRD IV does not permit the pension fund deficit to be added back to regulatory capital, in contrast to Basel II.

(7) Intangible assets and goodwill do not qualify as capital for regulatory purposes.

(8) Under CRD IV the net capital expected loss over accounting provisions is deducted from CET1 capital, gross of tax. Any provisions in excess of expected loss are included in Tier 2 capital. Under Basel II the deduction was split 50%, net of tax, from Core Tier 1 and 50%, gross of tax, from Tier 2 with the Tier 2 tax offset being counted within Tier 1 capital.

(9) Securitisation assets rated below BB- are being risk weighted at 1250% in the 2014 and proforma disclosures. The Group has changed its treatment of these items, which were previously treated as a deduction from capital, from 1 January 2014. The proforma disclosures for 2013 have been prepared reflecting the revised treatment to aid comparability.

(10) 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 Tier 2 instruments required by regulatory rules for instruments with less than five years to maturity. The values are subject to the CRD IV grandfathering cap as at January 2014.

Capital Management Report continued

The new CRD IV regulatory framework replaces the previous set of PRA capital rules, and is supplemented by a number of technical standards published by the European Banking Authority. The PRA published its final rules to implement CRD IV in the UK through Policy Statement PS7/13 and associated Supervisory Statements in December 2013.

Total regulatory capital has increased from £8,496 million to £9,704 million over the year with increases in CET1 capital, total Tier 1 capital and Tier 2 capital despite the fact that CRD IV introduced adjustments which reduce constituents of CET1 and Tier 1 capital, as indicated in the proforma 4 April 2013 CRD IV column. The key movements include:

- reduced Common Equity Tier 1 capital, through changes to the definition, such as the recognition of available for sale (AFS) reserves, the 100% deduction of expected losses from CET1, gross of tax, and the fact that CET1 capital can no longer be adjusted to exclude pension deficits
- the first stage of a phased removal of permanent interest bearing shares (PIBS) and some subordinated debt instruments, which will be phased out over eight years from January 2014.

Compared to the proforma April 2013 CRD IV position, CET1 capital has increased as a result of:

- increases in the general reserve (principally from profit after tax)
- a reduction in the negative AFS reserve due to deleveraging of our asset backed securities (ABS) portfolio and improved market values
- net proceeds from the issue of CCDS.

In addition, total Tier 1 capital has increased compared to the proforma April 2013 CRD IV position as a result of net proceeds from the issue of AT1 capital, offset by the buy back of PIBS.

Taken together these changes account for the increase in total regulatory capital compared to the proforma April 2013 CRD IV position.

Risk weighted assets

The table below sets out the Group's risk weighted assets.

Risk weighted assets	**2014 CRD IV**	2013 CRD IV PROFORMA[1]	2013 Basel II
	£m	£m	£m
Credit risk:			
Retail mortgages	**15,105**	16,953	16,953
Retail unsecured lending	**6,899**	6,485	6,485
Commercial loans	**9,061**	13,643	13,643
Treasury	**4,304**	8,119	2,802
Other	**1,295**	1,635	1,107
Total credit risk	**36,664**	46,835	40,990
Operational risk	**3,762**	3,398	3,398
Market risk	**29**	52	52
Total risk weighted assets	**40,455**	50,285	44,440

Note:

1. On 1 January 2014 CRD IV was introduced. The column headed 4 April 2013 CRD IV shows the 4 April 2013 figures on a proforma basis, had these rules applied then, and reflecting a change in treatment of securitisation exposures rated below BB-. It is provided to assist in understanding the changes in the regulatory capital position during the year.

The CRD IV Pillar 1 capital requirements (risk weights) are calculated using:

- the Retail IRB approach for prime, buy to let and self-certified mortgages (other than those originated by the Derbyshire, Cheshire and Dunfermline building societies) and unsecured lending
- Foundation IRB and the PRA's 'slotting' methodology for treasury and commercial portfolios (other than sovereign exposures)
- the Standardised approach for all other credit risk exposures, including some treasury and commercial exposures that are exempt from using the IRB approach.

The introduction of CRD IV increased risk weighted assets (RWAs) principally through asset value correlation, credit value adjustments and increased weightings for deferred tax assets. In addition, as referred to above in note 9, the Group elected to risk weight securitisation exposures rated below BB- rather than deduct them from capital such that they are included in treasury RWAs; this change was made from 1 January 2014 but has been reflected in the 4 April 2013 CRD IV proforma disclosures to aid comparability. Compared to the April 2013 CRD IV position, RWAs have decreased by £9,830 million. This has been driven by deleveraging of the commercial and treasury ABS portfolios and the transfer of some retail specialised lending portfolios onto the IRB approach.

Key ratios

The table below sets out the key capital ratios:

	2014 CRD IV[1]	2013 CRD IV PROFORMA[2]	2013 Basel II
	%	%	%
Solvency ratios (note 1)			
Common Equity Tier 1 (CET1)	**14.5**	9.1	12.3
Total Tier 1 capital (transitional)	**18.4**	10.9	15.5
Total regulatory capital (transitional)	**24.0**	15.4	19.1
	£m	£m	
Leverage (note 2)			
Exposure	**207,562**	205,919	
Capital (excluding PIBS)	**6,841**	4,551	
Leverage ratio	**3.3%**	2.2%[3]	

Notes:

1. On 1 January 2014 CRD IV was introduced. The column headed 4 April 2013 CRD IV shows the 4 April 2013 figures on a proforma basis, had these rules applied then, and reflecting a change in treatment of securitisation exposures rated below BB-. It is provided to assist in understanding the changes in the regulatory capital position during the year.
2. Capital ratios above are reported under CRD IV on an 'end point' basis with the exception of total Tier 1 and total regulatory capital, which include grandfathered legacy Tier 1 and 2 instruments under transitional rules.
3. The Group reported a leverage ratio of 2.0% in the 2013 Pillar 3 disclosures. The principal reason for the difference between the figure previously reported and the proforma figure now reported of 2.2% is the change in treatment of securitisation exposures rated below BB-.

Explanatory notes

(1) Solvency ratios are calculated as the relevant eligible regulatory capital divided by risk weighted assets, on a Group basis.

(2) The leverage ratio is calculated using the CRR definition of Tier 1 capital, and the draft December 2010 Basel III exposure definition in accordance with PRA guidance. Exposures include on and off balance sheet exposures with some regulatory adjustments applied. Ratios using alternative definitions of the exposure and capital metrics can be found in section 3 of the Group's Pillar 3 disclosure at nationwide.co.uk.

A more detailed review of the Group's capital can be found in sections 3 and 4 of our 2014 Pillar 3 disclosure.

Capital Management Report continued

Regulatory developments

Whilst the CRD IV and PRA's policy statement have been published, many of the technical standards being published by the European Banking Authority have not been finalised and the Basel Committee is still consulting on a number of topics.

The leverage ratio has been introduced as a backstop to risk-based capital requirements. The Basel Committee is using a period to 2017 to test a minimum leverage ratio of 3%, whilst the Financial Policy Committee has commenced its own review into the role of the leverage ratio as part of the UK capital framework. This review is expected to be completed by the end of 2014. Furthermore, there is a requirement in CRD IV for the European Banking Authority to consider the impact of the leverage ratio on different business models.

In October 2013, the Bank of England published a Discussion Paper on a framework for stress testing the UK banking system. This new framework assists the PRA to assess the resilience of major UK banks and building societies under stressed macroeconomic and financial conditions. The stress tests will project how firms would be expected to perform under the scenario where there is a significant decline in HPI and a rise in unemployment and the Bank of England base rate. Results of the stress tests are expected to be published by the regulator towards the end of 2014.

The PRA announced in December 2013 that the total Pillar 2A capital requirement should be met with a minimum level of CET1 and Tier 1 capital from January 2015. We anticipate further changes to be announced during 2014 after the anticipated PRA consultation on the Pillar 2 framework.

Outlook for capital management

The Group monitors regulatory changes at a UK, European and global level and, based on current understanding of the reforms, is confident it is well positioned to maintain its overall capital strength as the regulatory framework continues to evolve. All the above regulatory changes are reflected in the Group's capital management plan based on its understanding of the latest developments. The recent capital issuance demonstrates access to external markets and gives increased strategic flexibility to manage the Group's capital position, providing sufficient headroom against future changes to capital requirements.

Regulatory standards, for example the minimum leverage ratio, could increase the regulatory expectations and requirements set for financial services providers are still undergoing change as national and international regulatory initiatives develop. There is a risk that further increases in capital and leverage requirements have the potential to adversely impact the building society model, constraining growth or forcing retrenchment.

There remains a risk that the Financial Policy Committee (FPC) may apply a countercyclical buffer or sectoral capital requirements, which would increase Nationwide's capital requirement and/or risk weighted assets. The FPC has stated its intention to give at least twelve months' notice of any implementation of a countercyclical buffer, providing firms with time to ensure they can meet increased requirements.


Nationwide

Financial Statements

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Our instant access Loyalty Saver account continues to prove highly popular with our members, as it does exactly what its name suggests and rewards their loyalty.
Total balances in the account now exceed £17 billion.

Independent Auditors' Report

To the members of Nationwide Building Society

Report on the Financial Statements

Our opinion

In our opinion the financial statements, defined below:

- give a true and fair view of the state of the Group's and of the Society's affairs as at 4 April 2014 and of the Group and the Society's profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

This opinion is to be read in the context of what we say in the remainder of this report.

What we have audited

The Group financial statements and Society financial statements (the "financial statements"), which are prepared by Nationwide Building Society comprise:

- the Group and Society balance sheets as at 4 April 2014;
- the Group and Society income statements and statements of comprehensive income for the year then ended;
- the Group and Society statements of movements in members' interests and equity and cash flow statements for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union.

Certain disclosures required by the financial reporting framework have been presented elsewhere in the Annual Report and Accounts, rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

What an audit of financial statements involves

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements 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 and the 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 financial statements.

In addition, we read all the financial and non-financial information in the Annual Report and Accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Overview of our audit approach

Materiality

We set certain thresholds for materiality. These helped us to determine the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements. We also took into account that matters below these thresholds may still be considered material for qualitative reasons.

Based on our professional judgment, we determined materiality for the Group financial statements as a whole to be £40 million. This is approximately 0.76% of "Interest receivable and similar income", which we believe to be one of the principal considerations when assessing the Group's financial performance, and in recent years has provided a more consistent indicator of performance than other benchmarks that we considered. This is also approximately 6% of total profits and losses that make up Group profit before tax.

Although our audit was designed to identify material misstatements, we agreed with the Audit Committee that we would report to them misstatements identified during our audit above £2 million as well as misstatements below that threshold that, in our view, warranted reporting for qualitative reasons.

Overview of the scope of our audit

The Group comprises the Society and a number of subsidiaries and consolidated entities, which are structured within three business groupings being Retail, Commercial and Head Office Functions (including Treasury operations). The financial statements are a consolidation of these entities.

In establishing the overall approach to the audit, we considered the significance of each of these entities to the financial statements. We also separately considered our assessment of risk within each entity, the overall coverage of our procedures across the Group and Society, as well as the risk associated with less significant entities not brought into the normal scope of our audit.

For the Group and Society's individually financially significant entities a full scope audit was performed over their complete financial information. Other entities were selected so that we obtained appropriate coverage across all account balances and performed audit work to cover the areas of focus we identified, and which are set out below. This, together with additional procedures performed at the Head Office level, gave us the evidence we needed for our opinion on the Group and Society financial statements as a whole.

Our audit covered 87% of total Group interest receivable and similar income; 91% of total profits and losses that make up Group profit before tax; and 97% of total Group assets.

Areas of particular audit focus

In preparing the financial statements, the Directors made a number of subjective judgements, for example in respect of significant accounting estimates that involved them making assumptions and considering future events that are inherently uncertain. We primarily focused our work in these areas by assessing the Directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

In our audit, we tested and examined information, using sampling and other auditing techniques, to the extent we considered necessary to provide a reasonable basis for us to draw conclusions. We obtained audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

We considered the following areas to be those that required particular focus in the current year. This is not a complete list of all risks identified by our audit. We discussed these areas of focus with the Audit Committee. Their report on those matters that they consider to be significant issues in relation to the financial statements is set out on pages 59 to 61.

Area of focus	How the scope of our audit addressed the area of focus
Impairment of commercial loans We focused on this area because the Directors made complex and subjective judgements when determining the necessity for and, then estimating the size of any such impairment, primarily on the commercial real estate (CRE) lending portfolio. In particular, we focused on the principal assumptions underlying the calculation of individually calculated impairment for loans and advances including the interest rates used in the discounted cash flow analysis and valuation of the underlying collateral. We also focused on the inputs to, and operation of, the provisioning models used to assess a portfolio of loans on a collective basis and the application of any overlays to the results produced by those models.	We tested the design and operating effectiveness of controls for identifying loan loss impairment, including governance processes such as the existence of the provision advisory forum and other credit review meetings. We critically assessed the criteria for determining whether an impairment event had occurred and whether a loss had been incurred. We tested a sample of performing loans to challenge whether impairment events had occurred but not been properly identified. For loans where impairment is individually calculated, we assessed the supporting evidence and considered the implications of external information to understand the latest developments at the borrower and the basis of measuring the impairment provisions held. We assessed the expected future cash flows and the valuation of collateral held, and challenged management as to whether independent valuations obtained by them were up to date, consistent with the strategy being followed and appropriate for the purpose. Where impairment is calculated collectively, we understood and tested the provisioning models and underlying assumptions used. Where modelling assumptions such as the loss experience and emergence period were based on historic data, we assessed whether historic experience was reflective of the losses incurred in the portfolios based upon the economic environment and the circumstances of the borrowers at the balance sheet date. In testing the models and assumptions, we considered whether all relevant risks were reflected in the modelled provision and, where relevant, challenged whether model overlays appropriately reflected those risks. We also tested the extraction of historic data from underlying systems to be input into the impairment models and that access to the underlying systems was appropriately restricted to protect the integrity of the data within them.

Independent Auditors' Report

To the members of Nationwide Building Society continued

Area of focus	How the scope of our audit addressed the area of focus
Accounting for derivatives and underlying hedged items The Group and the Society enter into derivatives for risk management purposes. However, income statement volatility arises due to accounting ineffectiveness of designated hedges, or because hedge accounting is not achievable. For certain financial instruments the Group and the Society apply fair value hedge accounting. The Group and the Society are exposed to the risk of error from the complex and manual nature of the hedging adjustments; in particular the calculations of hedging effectiveness.	The Group uses a number of complex models to calculate hedge accounting adjustments. We tested the design and operating effectiveness of controls over these models including automated and manual controls over the inputs, hedge designations and de-designations, effectiveness testing and the generation of hedge documentation and amortisation schedules. We assessed the extraction of historic data from underlying systems and the external inputs such as foreign currency and interest rates which feed into the models. We tested access to such models and systems was appropriately restricted to protect the integrity of the data within them. We also independently revalued a sample of financial instruments valued using the models. We considered the Group's management reporting and examined the Group's assessment of significant hedging breaks.
Provisions for customer redress The recognition, measurement and disclosure of provisions in respect of customer redress require significant judgement. We focused on this area because of the inherent uncertainty and difficulty in assessing and measuring potential obligations resulting from ongoing regulatory matters and past sales practices, in particular compliance with consumer credit regulations.	We assessed the controls over the measurement of potential obligations arising from customer redress in relation to past sales of financial products and compliance with consumer credit regulations. For matters identified, we considered whether an obligation exists and the appropriateness of any provision recognised and disclosure based upon the facts available. To do this, we read communication with regulators and made inquiries of the Group's internal legal advisors. We also reviewed reports issued by the Group's external legal advisors. We then assessed the assumptions made and key judgements applied by the Directors. We also considered the impact on the financial statements of possible alternative outcomes. We considered whether the disclosures of the application of judgement in estimating the provisions adequately reflected the uncertainties associated with customer redress.
Management override of controls ISAs (UK & Ireland) state that the risk of management override of controls is a significant risk on audit engagements.	We identified judgemental balances, which could be affected by management bias. We assessed and tested the effectiveness of company-wide controls, the overall control environment, including whether access to financial systems is appropriately restricted and the arrangements for staff to 'whistle-blow' inappropriate actions, and interviewed management and the Group's internal audit function. We also performed our own analytical and substantive procedures on balances in the income statements and balance sheets. We tested key reconciliations including reconciliations of the financial records and underlying source systems. We checked that manual journal entries were appropriately authorised and based on appropriate rationale. We incorporated unpredictability into our approach by testing immaterial balances and varying the approach and timing of our testing.

Going Concern

The Directors have voluntarily complied with Listing Rule 9.8.6(R)(3) of the Financial Conduct Authority and provided a statement in relation to going concern, set out on page 51, required for companies with a premium listing on the London Stock Exchange.

The Directors have requested that we review the statement on going concern as if the parent company were a premium listed company. We have nothing to report having performed our review.

As noted in the Directors' statement, the Directors have concluded that it is appropriate to prepare the financial statements using the going concern basis of accounting. The going concern basis presumes that the Group and Society have adequate resources to remain in operation, and that the Directors intend them to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the Directors' use of the going concern basis is appropriate.

However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Group's and Society's ability to continue as a going concern.

Opinions on other matters prescribed by the Building Societies Act 1986

In our opinion:

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

Opinion on additional disclosures

Directors' Remuneration Report

The Society voluntarily prepares a Directors' Remuneration Report in accordance with the provisions of the Companies Act 2006. The Directors have requested that we audit the part of the Directors' Remuneration Report specified by the Companies Act 2006 to be audited as if the Society were a quoted company.

In our opinion the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

Under the Building Societies Act 1986 we are to report to you if, in our opinion:

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

We have no exceptions to report arising from this responsibility.

Corporate Governance Statement

The Directors have chosen to voluntarily comply with the UK Corporate Governance Code (the "Code") as if the parent company were a premium listed company. On page 51 of the Annual Report and Accounts, as required by the Code Provision C.1.1, the Directors state that they consider the Annual Report and Accounts taken as a whole to be fair, balanced and understandable and provide the information necessary for members to assess the Group and Society's performance, business model and strategy. On pages 59 to 61, as required by C.3.8 of the Code, the Audit Committee has set out the significant issues that it considered in relation to the financial statements, and how they were addressed. Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

- the statement given by the Directors is materially inconsistent with our knowledge of the Group and Society acquired in the course of performing our audit; or
- the section of the Annual Report and Accounts describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We have no exceptions to report arising from this responsibility.

Other information in the Annual Report and Accounts

Under ISAs (UK & Ireland), we are required to report to you if, in our opinion, information in the Annual Report and Accounts is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group and Society acquired in the course of performing our audit; or
- is otherwise misleading.

We have no exceptions to report arising from this responsibility.

Independent Auditors' Report

To the members of Nationwide Building Society continued

Matter on which we have agreed to report by exception

Corporate Governance Statement

The Society prepares a Corporate Governance Statement in accordance with the Disclosure Rules and Transparency Rules of the Financial Conduct Authority and has chosen voluntarily to comply with the Code. The Directors have requested that we review the parts of the Corporate Governance Statement relating to the Society's compliance with the nine provisions of the Code specified for auditor review by the Listing Rules of the Financial Conduct Authority as if the Society were a premium listed company. We have nothing to report having performed our review.

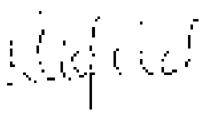
Responsibilities for the financial statements and the audit

Our responsibilities and those of the Directors

As explained more fully in the Directors' Responsibilities Statement set out on pages 49 to 50, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and ISAs (UK & 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.



Richard Oldfield
Senior Statutory Auditor
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
27 May 2014

Income statements

For the year ended 4 April 2014

		Group		Society	
		2014	2013*	**2014**	2013*
	Notes	**£m**	£m	**£m**	£m
Interest receivable and similar income	3	**5,295**	5,395	**5,274**	5,397
Interest expense and similar charges	4	**(2,892)**	(3,414)	**(3,151)**	(3,734)
Net interest income		**2,403**	1,981	**2,123**	1,663
Fee and commission income	5	**489**	558	**479**	548
Fee and commission expense	6	**(135)**	(113)	**(133)**	(113)
Income from investments		**4**	13	**210**	87
Other operating income	7	**134**	46	**120**	48
Losses from derivatives and hedge accounting	8	**(51)**	(165)	**(38)**	(58)
Total income		**2,844**	2,320	**2,761**	2,175
Administrative expenses	9	**(1,611)**	(1,420)	**(1,579)**	(1,382)
Impairment losses on loans and advances to customers	11	**(380)**	(589)	**(371)**	(572)
Impairment losses on investment securities	14	**(3)**	(2)	**(3)**	(2)
Provisions for liabilities and charges	26	**(173)**	(141)	**(173)**	(141)
Profit before tax		**677**	168	**635**	78
Taxation	12	**(128)**	10	**(73)**	67
Profit after tax		**549**	178	**562**	145

*Comparatives have been restated in accordance with IAS 19 (Revised) Employee Benefits. Refer to note 1 for further details.

The notes on pages 183 to 251 form part of these Accounts.

Statements of comprehensive income

For the year ended 4 April 2014

		Group		Society	
		2014	2013*	**2014**	2013*
	Notes	**£m**	£m	**£m**	£m
Profit after tax		**549**	178	**562**	145
Other comprehensive income/(expense):					
Items that will not be reclassified to the income statement					
Remeasurements of retirement benefit obligations:					
Retirement benefit remeasurements before tax	30	**82**	191	**82**	190
Taxation charge	12	**(33)**	(53)	**(33)**	(53)
		49	138	**49**	137
Revaluation of property:					
Revaluation before tax	20	**4**	3	**4**	3
Taxation	12	**1**	-	**1**	-
		5	3	**5**	3
Other items through the general reserve, including effect of corporation tax rate change	12	**(1)**	(2)	**(1)**	(1)
		53	139	**53**	139
Items that may subsequently be reclassified to the income statement					
Available for sale investments:					
Fair value movements taken to members' interests and equity		**185**	258	**187**	239
Amount transferred to income statement		**80**	(115)	**82**	(88)
Taxation	12	**(64)**	(39)	**(62)**	(41)
		201	104	**207**	110
Other comprehensive income		**254**	243	**260**	249
Total comprehensive income		**803**	421	**822**	394

*Comparatives have been restated in accordance with IAS 19 (Revised) Employee Benefits. Refer to note 1 for further details.

The notes on pages 183 to 251 form part of these Accounts.

Balance sheets

At 4 April 2014

		Group		Society	
		2014	2013	**2014**	2013
	Notes	**£m**	£m	**£m**	£m
Assets					
Cash		**5,342**	7,886	**5,342**	7,886
Loans and advances to banks		**2,110**	2,522	**2,064**	2,394
Investment securities – available for sale	14	**10,563**	13,421	**10,563**	13,403
Derivative financial instruments	15	**3,020**	4,212	**2,422**	2,663
Fair value adjustment for portfolio hedged risk		**221**	872	**221**	872
Loans and advances to customers	16	**166,574**	159,587	**139,383**	132,922
Investments in equity shares	17	**29**	28	**29**	28
Investments in Group undertakings	18	**-**	-	**26,372**	25,918
Intangible assets	19	**956**	894	**944**	882
Property, plant and equipment	20	**852**	886	**850**	878
Investment properties		**9**	8	**9**	8
Accrued income and expenses prepaid		**185**	147	**638**	1,170
Deferred tax	21	**33**	154	**21**	135
Current tax assets		**-**	15	**-**	8
Other assets		**32**	86	**31**	151
Total assets		**189,926**	190,718	**188,889**	189,318
Liabilities					
Shares		**130,468**	125,574	**130,468**	125,574
Deposits from banks	22	**1,984**	3,230	**1,002**	1,868
Other deposits	23	**7,135**	6,747	**10,470**	14,476
Due to customers	24	**6,208**	5,960	**6,208**	1,167
Fair value adjustment for portfolio hedged risk		**33**	150	**33**	150
Debt securities in issue	25	**28,557**	33,429	**20,690**	24,340
Derivative financial instruments	15	**2,391**	3,885	**2,913**	4,764
Other liabilities		**269**	251	**5,094**	6,347
Provisions for liabilities and charges	26	**310**	318	**310**	318
Accruals and deferred income	27	**461**	366	**459**	365
Subordinated liabilities	28	**2,269**	2,540	**2,269**	2,540
Subscribed capital	29	**601**	1,304	**601**	1,304
Deferred tax	21	**25**	30	**13**	13
Current tax liabilities		**74**	-	**40**	-
Retirement benefit obligations	30	**235**	354	**235**	353
Total liabilities		**181,020**	184,138	**180,805**	183,579
Members' interests and equity					
Core capital deferred shares	31	**531**	-	**531**	-
Other equity instruments	32	**992**	-	**992**	-
General reserve		**7,363**	6,765	**6,541**	5,930
Revaluation reserve		**71**	67	**71**	67
Available for sale reserve		**(51)**	(252)	**(51)**	(258)
Total members' interests and equity		**8,906**	6,580	**8,084**	5,739
Total members' interests, equity and liabilities		**189,926**	190,718	**188,889**	189,318

The notes on pages 183 to 251 form part of these Accounts.

Approved by the Board of Directors on 27 May 2014.
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 and equity

For the year ended 4 April 2014

	Core capital deferred shares	**Other equity instruments**	**General reserve**	**Revaluation reserve**	**Available for sale reserve**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
At 5 April 2013	-	-	6,765	67	(252)	6,580
Profit for the year	**-**	**-**	**549**	**-**	**-**	**549**
Net movement in available for sale reserve	**-**	**-**	**-**	**-**	**201**	**201**
Net revaluation of property	**-**	**-**	**-**	**5**	**-**	**5**
Reserve transfer	**-**	**-**	**1**	**(1)**	**-**	**-**
Effect of tax rate change on other items through the general reserve	**-**	**-**	**(1)**	**-**	**-**	**(1)**
Net remeasurements of retirement benefit obligations	**-**	**-**	**49**	**-**	**-**	**49**
Total comprehensive income	**-**	**-**	**598**	**4**	**201**	**803**
Issue of core capital deferred shares	**531**	**-**	**-**	**-**	**-**	**531**
Issue of Additional Tier 1 capital	**-**	**992**	**-**	**-**	**-**	**992**
At 4 April 2014	**531**	**992**	**7,363**	**71**	**(51)**	**8,906**

For the year ended 4 April 2013

	Core capital deferred shares	Other equity instruments	General reserve	Revaluation reserve	Available for sale reserve	Total*
	£m	£m	£m	£m	£m	£m
At 5 April 2012	-	-	6,450	65	(356)	6,159
Profit for the year	-	-	178	-	-	178
Net movement in available for sale reserve	-	-	-	-	104	104
Net revaluation of property	-	-	-	3	-	3
Reserve transfer	-	-	1	(1)	-	-
Effect of tax rate change on other items through the general reserve	-	-	(2)	-	-	(2)
Net remeasurements of retirement benefit obligations	-	-	138	-	-	138
Total comprehensive income	-	-	315	2	104	421
At 4 April 2013	-	-	6,765	67	(252)	6,580

*Comparatives have been restated in accordance with IAS 19 (Revised) Employee Benefits. Refer to note 1 for further details.

The notes on pages 183 to 251 form part of these Accounts.

Society statement of movements in members' interests and equity

For the year ended 4 April 2014

	Core capital deferred shares	Other equity instruments	General reserve	Revaluation reserve	Available for sale reserve	Total
	£m	£m	£m	£m	£m	£m
At 5 April 2013	-	-	5,930	67	(258)	5,739
Profit for the year	**-**	**-**	**562**	**-**	**-**	**562**
Net movement in available for sale reserve	**-**	**-**	**-**	**-**	**207**	**207**
Net revaluation of property	**-**	**-**	**-**	**5**	**-**	**5**
Reserve transfer	**-**	**-**	**1**	**(1)**	**-**	**-**
Effect of tax rate change on other items through the general reserve	**-**	**-**	**(1)**	**-**	**-**	**(1)**
Net remeasurements of retirement benefit obligations	**-**	**-**	**49**	**-**	**-**	**49**
Total comprehensive income	**-**	**-**	**611**	**4**	**207**	**822**
Issue of core capital deferred shares	**531**	**-**	**-**	**-**	**-**	**531**
Issue of Additional Tier 1 capital	**-**	**992**	**-**	**-**	**-**	**992**
At 4 April 2014	**531**	**992**	**6,541**	**71**	**(51)**	**8,084**

For the year ended 4 April 2013

	Core capital deferred shares	Other equity instruments	General reserve	Revaluation reserve	Available for sale reserve	Total*
	£m	£m	£m	£m	£m	£m
At 5 April 2012	-	-	5,648	65	(368)	5,345
Profit for the year	-	-	145	-	-	145
Net movement in available for sale reserve	-	-	-	-	110	110
Net revaluation of property	-	-	-	3	-	3
Reserve transfer	-	-	1	(1)	-	-
Effect of tax rate change on other items through the general reserve	-	-	(1)	-	-	(1)
Net remeasurements of retirement benefit obligations	-	-	137	-	-	137
Total comprehensive income	-	-	282	2	110	394
At 4 April 2013	-	-	5,930	67	(258)	5,739

*Comparatives have been restated in accordance with IAS 19 (Revised) Employee Benefits. Refer to note 1 for further details.

The notes on pages 183 to 251 form part of these Accounts.

Cash flow statements

For the year ended 4 April 2014

		Group		Society	
		2014	2013*	**2014**	2013*
	Notes	**£m**	£m	**£m**	£m
Cash flows (used in)/generated from operating activities					
Profit before tax		**677**	168	**635**	78
Adjustments for:					
Non-cash items included in profit before tax	41	**451**	922	**555**	786
Changes in operating assets	41	**(4,705)**	(6,615)	**(5,075)**	(6,239)
Changes in operating liabilities	41	**2,200**	(1,198)	**1,015**	(1,367)
Interest paid on subordinated liabilities		**(129)**	(93)	**(129)**	(93)
Interest paid on subscribed capital		**(60)**	(88)	**(60)**	(88)
Taxation		**(18)**	(27)	**(2)**	7
Net cash flows used in operating activities		**(1,584)**	(6,931)	**(3,061)**	(6,916)
Cash flows generated from/(used in) investing activities					
Purchase of investment securities		**(2,300)**	(3,010)	**(2,300)**	(3,010)
Sale and maturity of investment securities		**4,634**	14,030	**4,603**	13,951
Purchase of property, plant and equipment		**(128)**	(53)	**(128)**	(53)
Sale of property, plant and equipment		**20**	10	**20**	10
Purchase of intangible assets		**(208)**	(295)	**(208)**	(295)
Proceeds from the sale of an investment in equity shares		**-**	12	**-**	12
Dividends received from non-Group entities		**4**	6	**4**	6
Net cash flows generated from investing activities		**2,022**	10,700	**1,991**	10,621
Cash flows (used in)/generated from financing activities					
Issue of core capital deferred shares		**531**	-	**531**	-
Issue of Additional Tier 1 capital		**992**	-	**992**	-
Issue of debt securities		**21,013**	27,535	**21,013**	27,535
Redemption of debt securities in issue		**(25,401)**	(32,492)	**(23,811)**	(32,492)
Maturity of subordinated liabilities		**(153)**	(200)	**(153)**	(200)
Redemption of subscribed capital		**(506)**	(305)	**(506)**	(305)
Issue of subordinated liabilities		**-**	1,068	**-**	1,068
Net cash flows used in financing activities		**(3,524)**	(4,394)	**(1,934)**	(4,394)
Net decrease in cash		**(3,086)**	(625)	**(3,004)**	(689)
Cash and cash equivalents at start of year		**10,075**	10,700	**9,947**	10,636
Cash and cash equivalents at end of year	41	**6,989**	10,075	**6,943**	9,947

*Comparatives have been restated in accordance with IAS 19 (Revised) Employee Benefits. Refer to note 1 for further details.

The notes on pages 183 to 251 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 (IFRSs) and interpretations (IFRICs) issued by the Interpretations Committee, as published by the International Accounting Standards Board (IASB), and 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 accounting policies have been consistently applied.

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates. Further details on critical accounting estimates are given in note 2.

Changes in accounting policy

The following IFRS pronouncements, relevant to the Group, were adopted with effect from 5 April 2013:

- IAS 19 (Revised) Employee Benefits: The revised standard updates the recognition, presentation and disclosures of retirement benefit plans. The most significant impact for the Group is the replacement of the interest cost and expected return on plan assets with a single interest amount calculated by applying the discount rate to the net defined benefit asset or liability.

  The impact of adopting IAS 19 (Revised) on the Group's results for the year ended 4 April 2014 has been a reduction in profit before tax of £31 million with a corresponding increase in other comprehensive income. The changes have been applied retrospectively and comparatives restated accordingly.

  A summary of the line item restatements for the year ended 4 April 2013 is provided below. The adjustments of the Society have been identical in nature and value. There has been no impact on the Group's or Society's total assets, net assets or reserves at 4 April 2014 or 4 April 2013 as a result of the restatement.

  In addition, note 13 (Operating segments) and note 41 (Notes to the cash flow statements) have been impacted by the restatement.

		Previously published	Adjustment	Restated
	Notes	£m	£m	£m
Income statement of the Group for the year ended 4 April 2013				
Interest receivable and similar income	3	5,581	(186)	5,395
Interest expense and similar charges	4	(3,563)	149	(3,414)
Net interest income		2,018	(37)	1,981
Administrative expenses	9	(1,415)	(5)	(1,420)
Profit before tax		210	(42)	168
Taxation	12	-	10	10
Profit after tax		210	(32)	178
Other comprehensive income of the Group for the year ended 4 April 2013				
Remeasurements of retirement benefit obligations:				
- Retirement benefit remeasurements before tax		149	42	191
- Taxation		(43)	(10)	(53)
		106	32	138

Notes to the Accounts continued

1 Statement of accounting policies (continued)

- IFRS 13 Fair Value Measurement: The standard has replaced guidance on fair value measurement in previous IFRS accounting publications with a single standard. The standard, which is required to be applied prospectively, provides guidance on the calculation of the fair value of financial and non-financial assets and liabilities and additionally requires enhanced disclosures. With the exception of the enhanced disclosures, the new standard has not had a material impact for the Group or Society.

  The additional disclosures, which include valuation techniques, inputs used in measuring fair value and significant detail on the fair value hierarchy, have been given in notes 36 to 38. The disclosure requirements of IFRS 13 do not require comparative information to be provided for periods prior to initial application.
- Amendments to IFRS 7 Disclosures – Offsetting Financial Assets and Financial Liabilities: The amendments require disclosure of the effect or potential effects of netting arrangements on an entity's financial position including financial instruments that are subject to an enforceable master netting arrangement or similar agreement. The amendments have been applied retrospectively with the additional disclosures provided in note 39.
- IAS 39 (Amendments) Novation of derivatives and continuation of hedge accounting: The amendment provides relief from discontinuing hedge accounting in the limited situations where a novation has been made to a clearing counterparty as a consequence of laws or regulations. The Group applied the amendment in the current year, although it did not have a material impact on the results or financial position of the Group or Society.

Future accounting developments

The following pronouncements, relevant to the Group, have been adopted by the EU but are not effective at 4 April 2014 and have therefore not been applied in preparing these financial statements:

Pronouncement	Nature of change	Effective date
IFRSs 10 – 12 and amendments to IAS 27 and 28	A package of five new and revised standards addressing the accounting for consolidation, involvements in joint arrangements and disclosure of involvements with other entities. We are continuing to perform an analysis to assess whether there are any previously unconsolidated entities that will be consolidated, or any previously consolidated entities that will be unconsolidated, under the new requirements. Currently no significant impacts have been identified. Enhanced disclosures will be required of interests in other entities, including subsidiaries and unconsolidated structured entities.	Accounting periods (AP) beginning on or after 1 January 2014
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
Recoverable amount disclosures for non-financial assets (Amendments to IAS 36)	The amendment reduces the circumstances in which the recoverable amount of assets or cash generating units is required to be disclosed. The amendment is not expected to have an impact for the Group.	AP beginning on or after 1 January 2014

1 Statement of accounting policies (continued)

The following pronouncements, relevant to the Group, are neither adopted by the EU nor effective at 4 April 2014 and have therefore not been applied in preparing these financial statements:

Pronouncement	Nature of change	Effective date
IFRS 9 Financial Instruments	The new standard replaces IAS 39. Changes include classification and measurement of the Group's financial assets and liabilities, the recognition of impairment, and hedge accounting. The revised classification and measurement approach will lead to the Group's financial assets being re-classified as either amortised cost, fair value through other comprehensive income (OCI), or fair value through the income statement. Financial liabilities will in most cases be accounted for as at present. One exception is that where the Group opts to fair value a financial liability, movement in fair value due to own credit risk would be directly recognised in OCI. The impairment of financial assets under IFRS 9 will be based on expected credit losses rather than incurred credit losses as at present. Hedge accounting proposals will amend existing IAS 39 approaches for micro hedge accounting. Accounting for dynamic risk management (macro hedge accounting) has been decoupled from IFRS 9 and is now subject to separate consultation. A number of the proposals are not expected to be finalised until later in 2014. It is therefore not yet possible to estimate the financial effects of the new standard, although it is expected to have a significant impact for the Group, in line with the wider industry.	AP beginning on or after 1 January 2018 (to be confirmed by the IASB later in 2014)
IFRIC 21 Levies	The interpretation provides guidance on accounting for the liability to pay a government imposed levy. The interpretation will impact the timing of recognition of FSCS and bank levies throughout the financial year, but will not impact the full year results.	AP beginning on or after 1 January 2014
Defined benefit plans: Employee contributions (Amendments to IAS 19)	The amendment clarifies the requirements for attributing employee/ third party contributions that are linked to service to the relevant accounting period. The amendment is not expected to have an impact for the Group.	AP beginning on or after 1 July 2014
Annual improvements to IFRSs 2010 – 2012 cycle	Several small amendments with no significant impact for the Group.	AP beginning on or after 1 July 2014
Annual improvements to IFRSs 2011 – 2013 cycle	Several small amendments with no significant impact for the Group.	AP beginning on or after 1 July 2014
Clarification of Acceptable Methods of Depreciation and Amortisation (Amendments to IAS 16 and IAS 38)	The amendment clarifies that the use of revenue based methods to calculate depreciation and amortisation are not appropriate. The amendment is not expected to have a significant impact for the Group.	AP beginning on or after 1 January 2016

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 16, 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 or Group'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) and anticipated customer behaviour 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.

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.

1 Statement of accounting policies (continued)

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 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 and are carried at cost less accumulated amortisation. 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.

Software costs, including 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). The amortisation periods used are reviewed annually.

Computer software is 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.

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

(c) Other intangible assets

Other intangibles assets, which largely represent core deposit intangibles acquired by the Group, are carried at cost less accumulated amortisation and impairment and 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, 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 loss or gain.

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 re-measurement of 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 same 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.

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

Notes to the Accounts continued

1 Statement of accounting policies (continued)

impairment. Historical cost includes expenditure that is directly attributable to the acquisition of the items, major alterations and refurbishments.

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 and residual values 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 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 remeasurements arise from experience adjustments (the effects of differences between previous actuarial assumptions and what has actually occurred) and changes in actuarial assumptions. Actuarial remeasurements 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.

(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 remeasurement 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.

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. This includes management's best estimate of amounts payable for customer redress.

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 IAS 37. 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 three categories:

(a) Financial assets at fair value through the income statement

This category consists of derivative financial assets. The Group does not hold any other financial assets classified as held for trading.

1 Statement of accounting policies (continued)

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.

The Group has a practice of fair valuing a portion of mortgage commitments on the balance sheet to alleviate an accounting mismatch. The fair value of mortgage commitments is included within other assets. Movements in the fair value are included in losses from derivatives and hedge accounting 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, loans to banks and cash 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.

(c) Available for sale (AFS)

AFS assets are non-derivative financial assets that are not classified into either of the two categories above. The majority of 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 notes 36 and 37. Investments in equities that do not have a quoted market price in an active market and whose value cannot be reliably measured are measured at cost.

Interest on available for sale assets is recognised using the effective interest rate (EIR) 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.

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.

Impairment of financial assets

(a) Assets carried at amortised cost

The Group assesses at each balance sheet date whether, as a result of one or more events that occurred after initial recognition, there is objective evidence that a financial asset or group of financial assets is impaired. Evidence of impairment may include:

i) indications that the borrower or group of borrowers is experiencing significant financial difficulty

ii) default or delinquency in interest or principal payments

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 loans in a hedge relationship, the effective interest rate used for discounting is calculated using the carrying value of the loan including the hedge adjustment. The resultant provisions are deducted from the appropriate asset values in the balance sheet.

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.

Notes to the Accounts continued

1 Statement of accounting policies (continued)

Retail loans

For retail loans cash flows are estimated based on past experience combined with the Group's view of the future considering the following factors:

i) our 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 of collateral
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 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.

Commercial loans

In assessing objective evidence of a loss event for commercial loans, the following key indicators are considered:

i) contractually due payments exceeding 35 days in arrears
ii) high loan to value or low interest cover ratio
iii) other covenant breaches
iv) loss of significant tenants or other decreases in tenant quality
v) the probability of the borrower entering bankruptcy
vi) restructuring of the debt relating to the borrower's financial difficulties ('forbearance')
vii) local economic conditions (for example, where this impacts on the value of underlying collateral).

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 of collateral
iv) the likely dividend available on liquidation or bankruptcy
v) the extent of other creditors' claims ranking ahead of the Group's, and the likelihood of other creditors continuing to support the borrower
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.

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.

Where a loan is renegotiated on different terms such that it is substantially a different loan, the loan is derecognised and a new loan is recognised at its fair value.

For those loans, for which no individual impairment is recognised, a collective impairment assessment is made, taking account of the following factors:

i) size of the loan
ii) arrears status
iii) historical loss experience (adjusted for current market conditions)
iv) the estimated period between impairment occurring and the loss being identified ('emergence period').

(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 debt 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. Impairment losses recognised on AFS equity shares cannot be reversed.

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.

1 Statement of accounting policies (continued)

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.

Derivative financial liabilities are classified as fair value through the income statement. The Group does not hold any other 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.

Fair value of financial assets and liabilities

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

Level 1 – Valuation using quoted market prices

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

Level 2 – Valuation technique using observable inputs

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

Level 3 – Valuation technique using significant unobservable inputs

Financial instruments are classified as Level 3 if their valuation incorporates significant inputs that are not based on observable market data (unobservable inputs). A valuation input is considered observable if it can be directly observed from transactions in an active market, or if there is compelling external evidence demonstrating an executable exit price. An input is deemed significant if it is shown to contribute more than 10% to the valuation of a financial instrument. Unobservable input levels are generally determined based on observable inputs of a similar nature, historical observations or other analytical techniques.

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/losses 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.

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

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, 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 type, 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 credit valuation and debit valuation adjustments are made for counterparty or own credit risk to the extent not already included in the valuation.

Notes to the Accounts continued

1 Statement of accounting policies (continued)

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. 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.

(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. In a micro hedge, the carrying value of the underlying asset or liability ('the hedged item') is adjusted for the hedged risk to offset the fair value movement of the related derivative. In the case of a portfolio hedge, an adjustment is included in the fair value adjustments for portfolio hedged risk category on the balance sheet to offset the fair value movement in 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

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 hedge 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.

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 at a predetermined price (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 (typically, the interest rate risk and credit risk on the asset) 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.

Equity instruments

Issued financial instruments are classified as equity instruments where the contractual arrangement with the holder does not result in the Group having a present obligation to deliver cash, another financial asset or a variable number of equity instruments. Where the Group does have a present obligation, the instrument is classified as a financial liability.

The proceeds of the issuance of equity instruments are included in equity. Costs incurred that are incremental and directly attributable to the issuance are deducted from the proceeds (net of applicable tax).

Distributions to holders of equity instruments are recognised when they become irrevocable and are deducted, net of tax where applicable, from the general reserve.

During the year the Group issued two types of new equity instrument, core capital deferred shares (CCDS) and Additional Tier 1 (AT1) capital. Further details of the instruments are included in notes 31 and 32.

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1 Statement of accounting policies (continued)

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 and loans and advances to banks.

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 amounts in relation to 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.

IFRS disclosures

For ease of reference, certain audited IFRS disclosures are included within the Business and Risk Report as follows:

- Loans and advances and lending risks (pages 89 to 126)
- Financial risk management – including liquidity and funding risk (pages 127 to 140)

These disclosures (where marked as 'audited') are covered by the Independent Auditors' Report on pages 172 to 176.

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 disclosed in the following notes:

Area of significant judgement and estimate	Note
Mortgage effective interest rates (EIR)	3
Savings EIR	4
Impairment provisions on loans and advances	11
Impairment of available for sale assets	14
Provisions for customer redress	26
Retirement benefit obligations (pensions)	30

Notes to the Accounts continued

3 Interest receivable and similar income

	Group		Society	
	2014	2013*	**2014**	2013*
	£m	£m	**£m**	£m
On residential mortgages	**4,825**	4,851	**3,700**	3,677
On other loans:				
Connected undertakings	**-**	-	**1,140**	1,247
Other	**1,039**	1,130	**1,008**	1,080
On investment securities	**396**	1,280	**393**	1,260
On other liquid assets	**38**	49	**37**	48
Net expense on financial instruments hedging assets	**(1,003)**	(1,915)	**(1,004)**	(1,915)
	5,295	5,395	**5,274**	5,397

*Comparatives have been restated in accordance with IAS 19 (Revised) Employee Benefits. Refer to note 1 for further details.

Included within interest receivable and similar income is interest accrued on loans three or more months in arrears: Group £44 million, Society £19 million (2013: Group £43 million, Society £20 million) and the unwind of the discount on impairment provisions: Group £66 million, Society £64 million (2013: Group £46 million, Society £42 million). Further detail is included in note 11.

Interest receivable on residential mortgages includes adjustments to reflect the changes in the Group's effective interest rate assumptions, including a charge of £20 million (2013: £18 million) in respect of an update of early redemption charges and a credit of £12 million (2013: £2 million) which resulted from an update to the effective interest rate assumptions applicable to the recognition of mortgage fee income.

The lower amounts recorded in the financial year for interest receivable on investment securities and net expense on financial instruments hedging assets are driven primarily by a significant number of disposals of investment securities during the prior year as part of an exercise to deleverage legacy treasury assets. These disposals generated a net loss of £45 million (2013: £139 million net gain).

Critical accounting estimates and judgements

The Group uses the effective interest rate (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 the deal period to which they relate.

A one year change in the expected lives assumption would change the value of the loans by £11 million. A 10% change in the anticipated level of future early redemption charges would change the value of the loans by £4 million.

4 Interest expense and similar charges

	Group		Society	
	2014	2013*	**2014**	2013*
	£m	£m	**£m**	£m
On shares held by individuals	**2,250**	2,741	**2,250**	2,741
On subscribed capital	**59**	89	**59**	89
On deposits and other borrowings:				
Subordinated liabilities	**129**	96	**129**	96
Connected undertakings	**-**	-	**268**	347
Other	**167**	210	**96**	96
On debt securities in issue	**814**	944	**636**	738
Foreign exchange differences	**28**	-	**3**	21
Net income on financial instruments hedging liabilities	**(570)**	(689)	**(305)**	(417)
Interest on net defined benefit pension liability (note 30)	**15**	23	**15**	23
	2,892	3,414	**3,151**	3,734

*Comparatives have been restated in accordance with IAS 19 (Revised) Employee Benefits. Refer to note 1 for further details.

Interest expense is net of a £38 million credit (2013: £60 million) which resulted from an update of the Group's effective interest rate assumptions in relation to savings accounts which offer an initial bonus.

Critical accounting estimates and judgements

The Group's effective interest rate (EIR) adjustment for savings bonus interest allocates the cost of bonus interest across the estimated life of the savings balance and is therefore dependent on management's estimates of savings balance profiles, in particular the level of balances retained beyond the end of the bonus period. A one year extension to the estimated life would result in an additional £25 million of bonus interest expense being deferred in to future accounting periods.

5 Fee and commission income

	Group		Society	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Mortgage related fees	**31**	34	**23**	25
Banking and savings fees	**254**	242	**254**	242
General insurance fees	**120**	160	**120**	159
Other insurance fees	**47**	43	**47**	43
Other fees and commissions	**37**	79	**35**	79
	489	558	**479**	548

Notes to the Accounts continued

6 Fee and commission expense

	Group		Society	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Mortgage related fees	**2**	-	**-**	-
Banking and savings fees	**118**	107	**118**	107
Other fees and commissions	**15**	6	**15**	6
	135	113	**133**	113

7 Other operating income

	Group		Society	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Net gain on redemption of subscribed capital	**125**	43	**125**	43
Rental income	**5**	5	**5**	4
Profit from sale of property, plant and equipment	**4**	-	**4**	-
Other (expense)/income	**-**	(2)	**(14)**	1
	134	46	**120**	48

Other operating income for the year ended 4 April 2014 includes a £125 million (2013: £43 million) net gain from the redemption of subscribed capital and redemption related fees.

The £14 million other expense in the Society relates to the acquisition of a portfolio of commercial loans with a fair value of £178 million from its subsidiary company, Derbyshire Home Loans Limited. The loans were acquired at their carrying value of £192 million. The transfer had no impact on the Group's profit or reserves.

8 Losses from derivatives and hedge accounting

	Group		Society	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Derivatives designated as fair value hedges	**913**	503	**1,248**	249
Fair value movement attributable to hedged risk	**(979)**	(616)	**(1,298)**	(382)
Losses from fair value hedge accounting (note i)	**(66)**	(113)	**(50)**	(133)
Derivatives economically hedging mortgage commitments	**33**	(64)	**33**	(64)
Fair value movement attributable to mortgage commitments (note ii)	**(32)**	78	**(32)**	78
Net gain from mortgage pipeline (note ii)	**1**	14	**1**	14
Fair value gains/(losses) from other derivatives (note iii)	**14**	(66)	**11**	61
	(51)	(165)	**(38)**	(58)

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 and in following months leads to the amortisation of existing balance sheet positions.

(ii) The Group elects to fair value its mortgage commitments in order to reduce the accounting mismatch caused when derivatives are used to hedge mortgage commitments.

(iii) Other derivatives are those used for economic hedging but which are not in an IAS 39 hedge accounting relationship because hedge accounting is not currently achievable.

Although the Group only uses derivatives for the hedging of risks, income statement volatility can still arise due to hedge accounting ineffectiveness or because hedge accounting is not achievable. Management recognise that this arises from the application of accounting rules which do not reflect the economic reality of the business and as such this volatility will continue period on period but will always trend back to zero over time.

A loss of £51 million (2013: loss of £165 million) has been recognised in the year for derivatives and hedge accounting. Included within this result was the impact of the following:

- Losses of £66 million (2013: losses of £113 million) on hedge relationships. The 2014 charge includes losses of £65 million (2013: £84 million gain) on micro hedges, resulting from relatively large sterling and euro interest rate increases in the first half of the year, coupled with bond maturities and disposals. The 2013 charge includes losses of £203 million principally arising from the amortisation of balances relating to past ineffectiveness on fixed rate mortgages.
- A £5 million gain (2013: loss of £74 million) on cross currency interest rate swaps which economically hedge non-sterling wholesale funding, but where hedge accounting is not currently achievable.

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 market risks are continually managed.

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Notes to the Accounts continued

9 Administrative expenses

	Group		Society	
	2014	2013*	**2014**	2013*
	£m	£m	**£m**	£m
Employee costs:				
Wages and salaries	**439**	413	**430**	403
Bonuses	**63**	67	**63**	67
Social security costs	**48**	47	**47**	46
Pension costs (note 30)	**86**	77	**84**	76
	636	604	**624**	592
Other administrative expenses	**676**	584	**657**	558
Bank levy (note 26)	**17**	16	**17**	16
	1,329	1,204	**1,298**	1,166
Depreciation, amortisation and impairment	**282**	216	**281**	216
	1,611	1,420	**1,579**	1,382
Other administrative expenses include:				
Property operating lease rental	**32**	31	**32**	31
Other property costs	**76**	77	**75**	77
Postage and communications	**67**	66	**66**	66
Computer costs	**121**	104	**121**	104
Marketing and advertising	**22**	28	**22**	28
Money transmission and other bank costs	**45**	42	**44**	41
Legal, professional and consultancy	**65**	52	**64**	50
Training, education and other staff related costs	**127**	76	**124**	74
Other	**121**	108	**109**	87
	676	584	**657**	558

*Comparatives have been restated in accordance with IAS 19 (Revised) Employee Benefits. Refer to note 1 for further details.

Administrative expenses include £75 million (2013: £16 million) of transformation costs, including a charge of £18 million relating to severance provisions (2013: £7 million release) and a charge of £9 million (2013: £1 million) relating to onerous lease and other property related provisions. Transformation costs are driven primarily by ongoing integration of the activities of the Derbyshire, Cheshire and Dunfermline brands, as well as strategic changes to the Group's IT service delivery model.

The bonus charges within the employee costs in the above table include deferred bonuses for the Group and Society of £3 million (2013: £1 million).

Deferred bonuses are paid to directors and senior executives as part of the Medium Term Bonus Scheme based upon a three year performance period. In accordance with Prudential Regulation Authority (PRA) requirements, one third of the medium term bonus 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 the scheme measures declines substantially over the one year deferral period. Deferred bonuses are awarded in cash.

9 Administrative expenses (continued)

The deferred bonuses are expected to be charged to the income statement in the following years:

	Group and Society			
	Actual	**Actual**	Expected	Expected
	2012/13	**2013/14**	2014/15	2015/16
	£m	**£m**	£m	£m
Bonus plan cycle:				
2010-2013	1	**-**	-	-
2011-2014	-	**3**	-	-
2012-2015	-	**-**	3	-
2013-2016	-	**-**	-	3
Income statement charge for deferred bonuses	1	**3**	3	3

The bonus scheme for future periods has been revised as explained in the Directors' Remuneration Report.

Directors' emoluments are shown as part of the Directors' Remuneration Report 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	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Audit fees for the Group and Society statutory audit	**1.8**	1.8	**1.8**	1.8
Fees payable for other services:				
Audit of subsidiaries pursuant to legislation	**0.3**	0.3	**-**	-
Audit-related assurance services	**0.5**	0.5	**0.5**	0.5
Total audit and audit-related assurance services	**2.6**	2.6	**2.3**	2.3
Other assurance services	**1.0**	0.8	**1.0**	0.8
All other services	**1.0**	1.7	**1.0**	1.7
	4.6	5.1	**4.3**	4.8

The Group's 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.

Fees in relation to 'other assurance services' and 'all other services' above relate primarily to work undertaken in relation to the Group's capital and funding issuance programmes and regulatory projects.

Notes to the Accounts continued

10 Employees

	Group		Society	
	2014	2013	**2014**	2013
The average number of persons employed during the year was:				
Full time	**13,150**	12,720	**13,111**	12,679
Part time	**4,118**	4,299	**4,110**	4,294
	17,268	17,019	**17,221**	16,973
Society:				
Central administration	**8,896**	8,676	**8,896**	8,676
Branches	**8,325**	8,297	**8,325**	8,297
Subsidiaries	**47**	46	**-**	-
	17,268	17,019	**17,221**	16,973

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:

2014 Group	**Prime residential**	**Specialist residential**	**Consumer banking**	**Commercial lending**	**Other lending**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
At 5 April 2013	32	133	87	958	14	1,224
Charge for the year	**-**	**-**	**60**	**309**	**11**	**380**
Amounts written off during the year	**(15)**	**(52)**	**(3)**	**(215)**	**(9)**	**(294)**
Amounts recovered during the year	**1**	**4**	**33**	**10**	**-**	**48**
Disposal	**-**	**-**	**-**	**-**	**(4)**	**(4)**
Unwind of discount	**-**	**(1)**	**(4)**	**(61)**	**-**	**(66)**
At 4 April 2014	**18**	**84**	**173**	**1,001**	**12**	**1,288**

The £4 million disposal within other lending relates to the sale of a subsidiary undertaking containing a student loan portfolio.

The increase in impairment provisions on consumer banking is driven by a change in the accounting treatment for charged off accounts. Previously these had been written off in full with subsequent recoveries taken to profit when received. Balances on charged off accounts are now held on the balance sheet, together with relevant provisions, where at least partial recovery is still expected.

11 Impairment provisions on loans and advances to customers (continued)

2013 Group	Prime residential	Specialist residential	Consumer banking	Commercial lending	Other lending	Total
	£m	£m	£m	£m	£m	£m
At 5 April 2012	40	162	80	547	14	843
(Credit)/charge for the year	(6)	22	79	493	1	589
Amounts written off during the year	(9)	(87)	(100)	(130)	(3)	(329)
Amounts recovered during the year	1	4	30	2	2	39
Transfer from credit loss fair value adjustment	7	35	-	86	-	128
Unwind of discount	(1)	(3)	(2)	(40)	-	(46)
At 4 April 2013	32	133	87	958	14	1,224

The Group impairment provision of £1,288 million at 4 April 2014 (2013: £1,224 million) comprises individual provisions of £959 million (2013: £871 million) and collective provisions of £329 million (2013: £353 million).

Excess credit loss fair value adjustments relating to loans acquired from the Derbyshire, Cheshire and Dunfermline building societies were released to interest receivable in 2013. The remaining credit fair value adjustment is shown as part of the Group's impairment provision, rather than being presented as a separate deduction from the carrying value of the loans.

2014 Society	**Prime residential**	**Consumer banking**	**Commercial lending**	**Other lending**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**
At 5 April 2013	32	87	894	-	1,013
Charge for the year	**-**	**60**	**300**	**3**	**363**
Amounts written off during the year	**(15)**	**(3)**	**(200)**	**-**	**(218)**
Amounts recovered during the year	**1**	**33**	**9**	**-**	**43**
Transfer	**-**	**-**	**58**	**-**	**58**
Unwind of discount	**-**	**(4)**	**(60)**	**-**	**(64)**
At 4 April 2014	**18**	**173**	**1,001**	**3**	**1,195**

The £58 million transfer shown within the Society's commercial lending relates to a portfolio of commercial loans which were acquired by the Society from its subsidiary company, Derbyshire Home Loans Limited.

2013 Society	Prime residential	Consumer banking	Commercial lending	Other lending	Total
	£m	£m	£m	£m	£m
At 5 April 2012	40	80	541	-	661
(Credit)/charge for the year	(6)	79	494	-	567
Amounts written off during the year	(9)	(100)	(121)	-	(230)
Amounts recovered during the year	1	30	2	-	33
Transfer from credit loss fair value adjustment	7	-	17	-	24
Unwind of discount	(1)	(2)	(39)	-	(42)
At 4 April 2013	32	87	894	-	1,013

Notes to the Accounts continued

11 Impairment provisions on loans and advances to customers (continued)

The Society impairment provision of £1,195 million at 4 April 2014 (2013: £1,013 million) comprises individual provisions of £924 million (2013: £754 million) and collective provisions of £271 million (2013: £259 million).

The Society's impairment loss on loans and advances to customers in the income statement of £371 million (2013: £572 million) includes an £8 million provision relating to the Society's loan to a subsidiary undertaking, driven by the impairment of corporate loans held within the subsidiary (2013: £5 million provision relating to loans to two subsidiary undertakings). The Group figures above include the impairment of the underlying corporate loans within other lending.

Critical accounting estimates and judgements

In accordance with the accounting policy described in note 1, impairment is measured as the difference between an asset's carrying amount and the present value of management's estimate of future cash flows.

Key assumptions included in the measurement of 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 in relation to retail loans and advances differ from those estimated by 10%, the impairment provision would change by an estimated £26 million. For residential mortgages the estimate of future house price index (HPI) movements is also a key assumption in estimating the eventual loss. No account has been taken of projected future HPI increases in establishing provisions. Where actual future HPI is 5% higher or lower than the current assumption of zero, the ultimate provisions required will differ by an estimated £11 million.

In calculating the provisions for commercial loans, estimates of discounted cash flows are made on the basis of the planned strategy for each loan. These estimates include assumptions for underlying property values and future expected cash flows for rental income and any maintenance, redevelopment or refurbishment expenditure on the properties. Commercial property values are driven by estimates of current and expected future rental incomes and by property yields, which are updated based upon industry wide data available for different property sectors. To the extent that actual cash flows differ from those estimated by 10% on impaired loans, the impairment provision on commercial loans would change by an estimated £233 million.

12 Taxation

A current year tax charge of £161 million (2013: £41 million) has been offset by adjustments in relation to prior periods of £18 million (2013: £44 million) and the impact of the change in the corporation tax rate on deferred tax of £15 million (2013: £7 million) to result in the tax charge of £128 million (2013: credit of £10 million) as shown below:

	Group		Society	
	2014	2013*	**2014**	2013*
	£m	£m	**£m**	£m
Current tax:				
UK corporation tax	**87**	33	**31**	3
Corporation tax – adjustment in respect of prior years	**(3)**	(29)	**-**	(31)
Total current tax	**84**	4	**31**	(28)
Deferred tax (note 21):				
Current year	**74**	8	**69**	(15)
Adjustment in respect of prior years	**(15)**	(15)	**(14)**	(18)
Effect of corporation tax rate change	**(15)**	(7)	**(13)**	(6)
Total deferred taxation	**44**	(14)	**42**	(39)
Tax charge/(credit)	**128**	(10)	**73**	(67)

*Comparatives have been restated in accordance with IAS 19 (Revised) Employee Benefits. Refer to note 1 for further details.

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	
	2014	2013*	**2014**	2013*
	£m	£m	**£m**	£m
Profit before tax	**677**	168	**635**	78
Tax calculated at a tax rate of 23% (2013: 24%)	**156**	40	**146**	19
Adjustments in respect of prior years	**(18)**	(44)	**(14)**	(49)
Effect of different tax rates in other countries	**(3)**	(4)	**-**	-
Expenses not deductible for tax purposes/(income not taxable):				
Building depreciation	**2**	2	**2**	1
Non-taxable dividends received	**-**	-	**(47)**	(18)
Bank levy	**4**	4	**4**	4
Other	**2**	-	**(5)**	(17)
Previously unrecognised losses	**-**	(1)	**-**	(1)
Effect of corporation tax rate change	**(15)**	(7)	**(13)**	(6)
	128	(10)	**73**	(67)

*Comparatives have been restated in accordance with IAS 19 (Revised) Employee Benefits. Refer to note 1 for further details.

Notes to the Accounts continued

12 Taxation (continued)

The tax on items through other comprehensive income is as follows:

	Group		Society	
	2014	2013*	**2014**	2013*
	£m	£m	**£m**	£m
Available for sale investments	**64**	40	**62**	41
Revaluation of property	**(1)**	-	**(1)**	-
Gain on retirement benefit obligations	**33**	53	**33**	53
Other items through the general reserve, including effect of corporation tax rate change	**1**	2	**1**	1
	97	95	**95**	95

*Comparatives have been restated in accordance with IAS 19 (Revised) Employee Benefits. Refer to note 1 for further details.

The Group tax charge through the available for sale reserve of £64 million (2013: £40 million) is made up of a charge of £61 million (2013: £36 million) through deferred tax, a charge of £2 million (2013: £4 million credit) through current tax and a reclassification to the general reserve of £1 million (2013: £nil).

13 Operating segments

For management reporting purposes, the Group is organised into the following business streams:

- Retail
- Commercial
- Head office functions.

These business streams 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, including commercial real estate lending, lending to housing associations and Project Finance lending.

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, compliance, 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 Project Finance lending is set to reflect the lower average historic cost of wholesale funding which was available when these loans were 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, based upon regulatory capital metrics.

Notes to the Accounts continued

13 Operating segments (continued)

Segmental results are as follows:

2014	Notes	Retail	Commercial	Head office functions	Total
		£m	£m	£m	£m
Net income/(expense) from external customers		2,853	683	(1,133)	2,403
(Charge)/revenue from other segments		(216)	(564)	780	-
Net interest income		2,637	119	(353)	2,403
Other income	i	353	17	122	492
Total revenue		2,990	136	(231)	2,895
Administrative expenses	ii	(1,417)	(59)	(43)	(1,519)
Impairment and other provisions	iii	(129)	(309)	(14)	(452)
Underlying profit/(loss) before tax		1,444	(232)	(288)	924
FSCS levies		(104)	-	-	(104)
Transformation costs		(40)	-	(35)	(75)
Bank levy		-	-	(17)	(17)
Losses from derivatives and hedge accounting		-	-	(51)	(51)
Profit/(loss) before tax		1,300	(232)	(391)	677
Taxation					(128)
Profit after tax					549
Total assets	iv	149,259	17,163	23,504	189,926
Total liabilities		135,925	1,039	44,056	181,020

13 Operating segments (continued)

Comparative results presented below have been restated in order to align presentation with 4 April 2014, updating the funding costs to reflect a change in capital allocation methodology.

In addition, the comparative results are restated for the impact of IAS 19 (Revised) Employee Benefits as explained in note 1.

2013		Retail	Commercial	Head office functions	Total
	Notes	£m	£m	£m	£m
Net income/(expense) from external customers		2,284	794	(1,097)	1,981
(Charge)/revenue from other segments		(343)	(720)	1,063	-
Net interest income		1,941	74	(34)	1,981
Other income	i	433	18	53	504
Total revenue		2,374	92	19	2,485
Administrative expenses	ii	(1,309)	(46)	(33)	(1,388)
Impairment and other provisions	iii	(166)	(493)	(5)	(664)
Underlying profit/(loss) before tax		899	(447)	(19)	433
FSCS levies		(68)	-	-	(68)
Transformation costs		(3)	-	(13)	(16)
Bank levy		-	-	(16)	(16)
Losses from derivatives and hedge accounting		-	-	(165)	(165)
Profit/(loss) before tax		828	(447)	(213)	168
Taxation					10
Profit after tax					178
Total assets	iv	138,810	20,371	31,537	190,718
Total liabilities		131,184	526	52,428	184,138

Notes:

(i) Other income excludes losses from derivatives and hedge accounting which are shown separately.

(ii) Administrative expenses exclude transformation 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 acquisition of The Mortgage Works (UK) plc.

Notes to the Accounts continued

14 Investment securities – available for sale

	Group		Society	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Government and supranational investment securities	**6,994**	8,984	**6,994**	8,984
Other debt investment securities	**3,569**	4,437	**3,569**	4,419
	10,563	13,421	**10,563**	13,403

The decrease in the value of investment securities during the year ended 4 April 2014 was due primarily to the sale of UK gilts, non-domestic government bonds and asset backed securities.

Investment securities include items with a carrying value of £231 million (2013: £116 million) which have been pledged as collateral under UK payment schemes. In addition, at 4 April 2013, £231 million of investment securities had been sold under sale and repurchase agreements (see note 22 for details of the associated liabilities). These assets were not derecognised as the Group retained substantially all the risks and rewards of ownership. The Group was unable to use, sell or pledge the transferred assets for the duration of the transaction and remained exposed to any associated interest rate risk or credit risk of the assets.

At 4 April 2013, certain notes with a carrying value of £1,250 million issued by Silverstone Master Issuer plc to the Society under the asset backed funding programmes (note 16) had also been sold under sale and repurchase agreements. In accordance with accounting standards these notes were not recognised by the Society.

The proceeds and accrued interest of sale and repurchase agreements of £nil (2013: £1,207 million) are included within deposits from banks (note 22).

At 4 April 2014 the Group holds collateral under reverse total return swaps with a fair value of £175 million (2013: £188 million). In line with accounting standards, the collateral is not recognised in the accounts and therefore is not reflected in the table above. The Group is permitted to sell or re-pledge the collateral in the absence of default by the owner. No amounts have been sold or re-pledged at 4 April 2014 (2013: £nil). The related proceeds of £149 million (2013: £149 million) are included in loans and advances to banks.

Impairment losses on investment securities of £3 million were recognised in the year ended 4 April 2014 (2013: £2 million). Further information on treasury credit risk is included in the Business and Risk Report.

Critical accounting estimates and judgements

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 the Risk Management Division.

A watch list is used to categorise any available for sale assets showing signs of deterioration. Although not currently impaired, in stressed market conditions impairments in a range of £10 million to £30 million would be possible for these assets. This estimate is based upon reviewing a range of cash flow outcomes for the underlying assets.

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15 Derivative financial instruments

All of the Group's derivative financial instruments are held for risk mitigation purposes, although not all of these derivatives are designated as hedging instruments as defined by IAS 39. Interest rate swaps are used in hedge accounting relationships to remove the interest rate risk on fixed rate assets and liabilities. The table below provides an analysis of the notional amount and fair value of derivatives by instrument type:

	2014			2013		
	Contract/ notional amount	**Fair value**		Contract/ notional amount	Fair value	
	£m	**Assets £m**	**Liabilities £m**	£m	Assets £m	Liabilities £m
a) Society						
Interest rate swaps	**94,223**	**1,233**	**2,511**	108,845	1,859	4,463
Cross currency interest rate swaps	**16,376**	**506**	**347**	16,321	266	251
Caps, collars and floors	**264**	**-**	**-**	469	-	1
Forward foreign exchange	**7,413**	**13**	**42**	7,016	152	22
Forward rate agreements	**2,731**	**-**	**-**	5,490	-	-
Swaptions	**329**	**-**	**12**	344	2	27
Interest rate futures	**2,150**	**-**	**-**	1,304	-	-
Equity index swaps	**2,577**	**670**	**1**	2,682	384	-
	126,063	**2,422**	**2,913**	142,471	2,663	4,764
b) Subsidiaries						
Interest rate swaps	**9,401**	**1,011**	**-**	11,342	1,390	-
Cross currency interest rate swaps	**11,946**	**591**	**479**	13,648	1,186	152
	21,347	**1,602**	**479**	24,990	2,576	152
Intra Group derivative elimination	**(30,656)**	**(1,004)**	**(1,001)**	(31,679)	(1,027)	(1,031)
Group	**116,754**	**3,020**	**2,391**	135,782	4,212	3,885

Contract/notional amount indicates the amount on which payment flows are derived at the balance sheet date and does not represent amounts at risk.

Notes to the Accounts continued

15 Derivative financial instruments (continued)

The table below provides an analysis of the fair value of derivatives, split between those designated in effective hedging relationships at the balance sheet date and those which, whilst being economic hedges, are not subject to hedge accounting at the balance sheet date:

Fair value	**2014**		2013	
	Assets £m	**Liabilities £m**	Assets £m	Liabilities £m
a) Society				
Designated as hedges at the balance sheet date	**432**	**1,360**	1,127	3,670
Not designated as hedges at the balance sheet date	**1,990**	**1,553**	1,536	1,094
	2,422	**2,913**	2,663	4,764
b) Subsidiaries				
Designated as hedges at the balance sheet date	**1,011**	**-**	1,390	-
Not designated as hedges at the balance sheet date	**591**	**479**	1,186	152
	1,602	**479**	2,576	152
Intra Group derivative elimination	**(1,004)**	**(1,001)**	(1,027)	(1,031)
Group	**3,020**	**2,391**	4,212	3,885

Group	**2014**			2013		
	Contract/ notional amount	**Fair value**		Contract/ notional amount	Fair value	
	£m	**Assets £m**	**Liabilities £m**	£m	Assets £m	Liabilities £m
Derivatives have remaining maturities as follows:						
In not more than one year	**40,790**	**167**	**199**	62,626	660	201
In more than one year	**75,964**	**2,853**	**2,192**	73,156	3,552	3,684
	116,754	**3,020**	**2,391**	135,782	4,212	3,885

Society	**2014**			2013		
	Contract/ notional amount	**Fair value**		Contract/ notional amount	Fair value	
	£m	**Assets £m**	**Liabilities £m**	£m	Assets £m	Liabilities £m
Derivatives have remaining maturities as follows:						
In not more than one year	**42,664**	**276**	**195**	59,929	253	214
In more than one year	**83,399**	**2,146**	**2,718**	82,542	2,410	4,550
	126,063	**2,422**	**2,913**	142,471	2,663	4,764

16 Loans and advances to customers

	Group		Society	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Prime residential mortgages	**119,301**	110,587	**118,130**	108,955
Specialist residential mortgages	**26,257**	24,806	**954**	1,014
Consumer banking	**3,689**	3,401	**3,689**	3,401
Commercial lending	**16,283**	18,958	**15,632**	18,056
Other lending	**164**	422	**98**	83
	165,694	158,174	**138,503**	131,509
Fair value adjustment for micro hedged risk*	**880**	1,413	**880**	1,413
	166,574	159,587	**139,383**	132,922

*The fair value adjustment for micro hedged risk relates to commercial lending.

Loans and advances to customers in the table above are shown net of impairment provisions held against them.

Maturity analysis

Loans and advances to customers have remaining contractual maturities as follows:

	Group		Society	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Repayable on demand	**2,143**	1,921	**2,089**	1,856
Other loans and advances by residual maturity repayable:				
In not more than three months	**3,458**	3,334	**3,363**	3,271
In more than three months but not more than one year	**5,702**	5,712	**5,621**	5,627
In more than one year but not more than five years	**26,767**	26,502	**25,495**	25,231
In more than five years	**128,912**	121,929	**103,130**	96,537
	166,982	159,398	**139,698**	132,522
Impairment provision on loans and advances (note 11)	**(1,288)**	(1,224)	**(1,195)**	(1,013)
Fair value adjustment for micro hedged risk	**880**	1,413	**880**	1,413
	166,574	159,587	**139,383**	132,922

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, 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 or utilised as whole mortgage loan pools for the Bank of England's (BoE) Funding for Lending Scheme (FLS). The programmes have enabled the Group to obtain secured funding or to create additional collateral which could be used to source additional funding.

Notes to the Accounts continued

16 Loans and advances to customers (continued)

Mortgages pledged and the nominal values of the notes in issue are as follows:

Group and Society	**2014**				
	Mortgages pledged	**Notes in issue**			
		Held by third parties	**Held by the Group**		**Total notes in issue**
			Drawn	**Undrawn**	
	£m	**£m**	**£m**	**£m**	**£m**
Covered bond programme	**20,211**	**9,457**	**-**	**4,500**	**13,957**
Securitisation programme	**24,303**	**6,906**	**-**	**12,291**	**19,197**
Whole mortgage loan pools	**13,762**	**-**	**11,681**	**2,081**	**13,762**
	58,276	**16,363**	**11,681**	**18,872**	**46,916**

Group and Society	2013				
	Mortgages pledged	Notes in issue			
		Held by third parties	Held by the Group		Total notes in issue
			Drawn	Undrawn	
	£m	£m	£m	£m	£m
Covered bond programme	21,856	11,376	-	4,500	15,876
Securitisation programme	24,994	7,606	1,250	12,291	21,147
Whole mortgage loan pools	4,891	-	3,490	1,401	4,891
	51,741	18,982	4,740	18,192	41,914

The securitisation programme notes are issued by Silverstone Master Issuer plc and are not included in the accounts of the Society. Silverstone Master Issuer plc is fully consolidated into the accounts of the Group.

The whole mortgage loan pools are pre-positioned at the BoE under the FLS. No loans are issued when pre-positioning the mortgage loan pools at the BoE. Instead, the whole loan pool is pledged to the BoE and drawings are made directly against the eligible collateral, subject to a haircut. Therefore, values shown under notes in issue are the whole mortgage loan pool notional balances.

Mortgages pledged include £2.9 billion (2013: £3.6 billion) in the covered bond and securitisation programmes that are in excess of the amount contractually required to support notes in issue.

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. The Group and Society continue to be exposed to the liquidity risk, interest rate risk and credit risk of the mortgages. 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 25).

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, and
- whole mortgage loan pools securing amounts drawn under the FLS. At 4 April 2014 the Group had outstanding FLS drawings of £8.5 billion (2013: £2.5 billion).

Notes in issue, held by the Group and undrawn are debt securities issued by the programmes to the Society and mortgage loan pools that have been pledged to the BoE FLS but not utilised. The majority of these 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 ended 4 April 2014 £0.03 billion and €2.0 billion (total £1.4 billion sterling equivalent) of notes matured. There were no new issuances in the year.

16 Loans and advances to customers (continued)

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 have been used to purchase a share of the beneficial interest in the mortgages pledged for the benefit of the note holders. The remaining beneficial interest in the pledged mortgages of £6.4 billion (2013: £4.0 billion) stays with the Society and incorporates its required minimum seller share in accordance with the rules 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 2014 £1.25 billion and $0.55 billion (total £1.6 billion sterling equivalent) of notes were redeemed early or matured. There were no new issuances in the year.

The following table sets out the carrying value and fair value of the transferred assets and liabilities for the Silverstone Master Trust.

	Carrying value			Fair value		
	Transferred assets	**Associated liabilities**	**Total**	**Transferred assets**	**Associated liabilities**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
At 4 April 2014	**24,303**	**(19,197)**	**5,106**	**24,188**	**(19,368)**	**4,820**
At 4 April 2013	24,994	(21,147)	3,847	23,875	(21,750)	2,125

The Society holds cash deposited by the covered bond programme of £1.8 billion (2013: £2.0 billion) and by the Silverstone programme of £3.3 billion (2013: £1.8 billion).

17 Investments in equity shares

	Group		Society	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
At 5 April	28	29	28	29
Disposals	**-**	(10)	**-**	(10)
Increase in fair value	**1**	9	**1**	9
At 4 April	**29**	28	**29**	28

Investments in equity shares include investments of £28 million (2013: £27 million) carried at fair value. £7 million (2013: £7 million) of the Group's investments in equity shares relate to participation in industry wide banking and credit card service operations.

During the year ended 4 April 2013 the Group sold £10 million of equity investments relating to participation in an industry wide credit card service operation.

Notes to the Accounts continued

18 Investments in Group undertakings

	Shares	**Loans**	**Total**
	£m	**£m**	**£m**
At 5 April 2013	361	25,557	25,918
Additions	**-**	**3,580**	**3,580**
Impairment	**-**	**(8)**	**(8)**
Disposals, redemptions and repayments	**(37)**	**(3,081)**	**(3,118)**
At 4 April 2014	**324**	**26,048**	**26,372**

	Shares	Loans	Total
	£m	£m	£m
At 5 April 2012	388	24,569	24,957
Additions	-	5,796	5,796
Impairment	-	(5)	(5)
Disposals, redemptions and repayments	(27)	(4,803)	(4,830)
At 4 April 2013	361	25,557	25,918

During the year ended 4 April 2014 the Society received dividend payments of £206 million (2013: £74 million) and £37 million (2013: £27 million) relating to capital reductions from subsidiary undertakings.

The impairment charge for the year ended 4 April 2014 includes £8 million relating to a subsidiary that holds a corporate loan portfolio. The £8 million impairment is included in impairment loss on loans and advances to customers in the income statement.

Audited accounts are prepared for all the Group's principal subsidiaries. The interests of the Society in its principal subsidiary undertakings, as at 4 April 2014 are set out below:

100% held subsidiary undertakings	**Nature of business**
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 therefore 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.

Nationwide International Limited is no longer considered a principal subsidiary undertaking following the transfer of the subsidiary's deposit taking business to the Society during the year.

18 Investments in Group undertakings (continued)

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 2014 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

For smaller subsidiaries the Group has adopted the audit exemptions under Section 479A of the Companies Act 2006 which became available in the Department for Business Innovation & Skills (BIS) regulations published in September 2012. In order to fulfil the requirements of these regulations the Society guarantees all outstanding liabilities of the exempted subsidiary undertakings in respect of the year ended 4 April 2014.

The Group has adopted the audit exemption for the following subsidiary undertakings for the year ended 4 April 2014:

Unaudited subsidiary undertakings	
Confederation Mortgage Services Limited	Nationwide International Limited
Dunfermline BS Nominees Limited	Nationwide Investments (No 1) Limited
First Nationwide	Nationwide Trust Limited
Jubilee Mortgages Limited	NBS Fleet Services Limited
Monument (Sutton) Limited	Staffordshire Leasing Limited
Nationwide Anglia Property Services Limited	The Derbyshire (Premises) Limited

All of the above unaudited subsidiary undertakings are limited liability companies, with the exception of First Nationwide which is an unlimited company. All of the above subsidiaries are registered in England and Wales and operate in the UK, with the exception of Nationwide International Limited, which is registered and operates in the Isle of Man.

Notes to the Accounts continued

19 Intangible assets

2014 Group	Computer software		Total computer software	Other intangible assets	Goodwill	Total
	Externally acquired	Internally developed				
	£m	£m	£m	£m	£m	£m
Cost						
At 5 April 2013	424	663	1,087	42	16	1,145
Additions	**78**	**135**	**213**	**-**	**-**	**213**
Disposals	**(31)**	**(12)**	**(43)**	**-**	**(4)**	**(47)**
At 4 April 2014	**471**	**786**	**1,257**	**42**	**12**	**1,311**
Accumulated amortisation and impairment						
At 5 April 2013	121	102	223	28	-	251
Amortisation charge	**35**	**101**	**136**	**4**	**4**	**144**
Impairment in the year	**-**	**7**	**7**	**-**	**-**	**7**
Disposals	**(31)**	**(12)**	**(43)**	**-**	**(4)**	**(47)**
At 4 April 2014	**125**	**198**	**323**	**32**	**-**	**355**
Net book value						
At 4 April 2014	**346**	**588**	**934**	**10**	**12**	**956**

19 Intangible assets (continued)

2013 Group	Computer software		Total computer software	Other intangible assets	Goodwill	Total
	Externally acquired	Internally developed				
	£m	£m	£m	£m	£m	£m
Cost						
At 5 April 2012	387	448	835	42	16	893
Additions	75	227	302	-	-	302
Disposals	(38)	(12)	(50)	-	-	(50)
At 4 April 2013	424	663	1,087	42	16	1,145
Accumulated amortisation and impairment						
At 5 April 2012	136	52	188	24	-	212
Amortisation charge	23	59	82	4	-	86
Impairment in the year	-	3	3	-	-	3
Disposals	(38)	(12)	(50)	-	-	(50)
At 4 April 2013	121	102	223	28	-	251
Net book value						
At 4 April 2013	303	561	864	14	16	894

Intangible assets at 4 April 2014 include £138 million (2013: £155 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. To the extent that these new systems platforms are not yet ready for use by the business, no amortisation has been charged against these assets.

Software costs capitalised during the year ended 4 April 2014 relate mainly to new systems platforms and are being amortised over estimated useful lives predominantly of either 5 years or, for some systems platforms, 10 years.

In the year ended 4 April 2014, £4 million (2013: £12 million) of borrowing costs have been capitalised using a capitalisation rate of 1.92% (2013: 2.39%).

An impairment loss of £7 million (2013: £nil) was recognised in the year to 4 April 2014 in respect of development work on internal systems which have now been superseded.

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.

Notes to the Accounts continued

20 Property, plant and equipment

2014 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**
Cost or valuation							
At 5 April 2013	231	186	48	465	131	878	1,474
Additions	**1**	**-**	**-**	**1**	**22**	**86**	**109**
Revaluation	**4**	**-**	**-**	**4**	**-**	**-**	**4**
Disposals	**(13)**	**-**	**(10)**	**(23)**	**(12)**	**(69)**	**(104)**
At 4 April 2014	**223**	**186**	**38**	**447**	**141**	**895**	**1,483**
Accumulated depreciation and impairment							
At 5 April 2013	-	76	34	110	72	406	588
Depreciation charge	**-**	**4**	**1**	**5**	**16**	**110**	**131**
Disposals	**-**	**-**	**(10)**	**(10)**	**(12)**	**(66)**	**(88)**
At 4 April 2014	**-**	**80**	**25**	**105**	**76**	**450**	**631**
Net book value							
At 4 April 2014	**223**	**106**	**13**	**342**	**65**	**445**	**852**

2013 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
Cost or valuation							
At 5 April 2012	232	186	48	466	120	968	1,554
Additions	1	-	-	1	26	48	75
Revaluation	3	-	-	3	-	-	3
Disposals	(5)	-	-	(5)	(15)	(138)	(158)
At 4 April 2013	231	186	48	465	131	878	1,474
Accumulated depreciation and impairment							
At 5 April 2012	-	71	33	104	68	437	609
Depreciation charge	-	2	1	3	17	103	123
Impairment in the year	-	3	-	3	1	-	4
Disposals	-	-	-	-	(14)	(134)	(148)
At 4 April 2013	-	76	34	110	72	406	588
Net book value							
At 4 April 2013	231	110	14	355	59	472	886

Group property, plant and equipment at 4 April 2014 includes £2 million (2013: £8 million) of land and buildings held by subsidiary undertakings.

Property, plant and equipment includes £76 million (2013: £81 million) of assets in the course of construction.

In the year ended 4 April 2013 an impairment charge of £4 million was made which related primarily to a former technology centre.

21 Deferred tax

Deferred tax is provided in full on temporary differences under the liability method at the standard UK corporation tax rate at the balance sheet date.

The Finance Act 2013 introduced legislation to reduce the main rate of corporation tax from 23% to 21% from 1 April 2014 and from 21% to 20% from 1 April 2015.

The movements on the deferred tax account are as follows:

	Group		Society	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
At 5 April	124	201	122	178
Income statement (charge)/credit	**(59)**	7	**(55)**	33
Income statement effect of corporation tax rate change	**15**	7	**13**	6
Reclassification to current tax	**21**	-	**21**	-
Available for sale investments	**2**	4	**-**	-
Property revaluation	**(1)**	1	**(1)**	-
Retirement benefit obligations	**(19)**	(46)	**(19)**	(46)
Tax losses utilised	**(62)**	(36)	**(62)**	(36)
Effect of corporation tax rate change in other comprehensive income	**(15)**	(14)	**(13)**	(13)
Taxation on items through other comprehensive income	**(95)**	(91)	**(95)**	(95)
Taxation on items taken directly to members' interests and equity	**2**	-	**2**	-
At 4 April	**8**	124	**8**	122

Deferred tax assets and liabilities are attributable to the following items:

	Group		Society	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Deferred tax assets				
Accelerated depreciation	**(55)**	(63)	**(55)**	(63)
Property revaluation	**1**	3	**-**	-
Tax losses carried forward	**-**	87	**-**	87
Retirement benefit obligations	**49**	81	**49**	81
Provisions for loan impairment	**8**	11	**4**	6
Other provisions	**30**	35	**23**	24
	33	154	**21**	135
Deferred tax liabilities				
Accelerated tax depreciation	**-**	(1)	**-**	-
Property revaluation	**(12)**	(12)	**(12)**	(12)
Other provisions	**(13)**	(17)	**(1)**	(1)
	(25)	(30)	**(13)**	(13)
Net deferred tax asset	**8**	124	**8**	122

Notes to the Accounts continued

21 Deferred tax (continued)

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 deferred tax charge/(credit) in the income statement (see note 12) comprises the following temporary differences:

	Group		Society	
	2014	2013*	**2014**	2013*
	£m	£m	**£m**	£m
Accelerated tax depreciation	**(4)**	12	**(3)**	12
Retirement benefit obligations	**8**	(6)	**8**	(6)
Provisions for loan impairment	**2**	6	**2**	2
Tax losses carried forward	**48**	(44)	**48**	(45)
Effect of corporation tax rate change	**(15)**	(7)	**(13)**	(6)
Other	**5**	25	**-**	4
	44	(14)	**42**	(39)

*Comparatives have been restated in accordance with IAS 19 (Revised) Employee Benefits. Refer to note 1 for further details.

22 Deposits from banks

	Group		Society	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Deposits from banks are repayable from the balance sheet date in the ordinary course of business as follows:				
Accrued interest	**1**	6	**1**	6
Repayable on demand	**1,468**	1,688	**486**	346
Other amounts owed to banks with residual maturity repayable:				
In not more than three months	**421**	242	**421**	242
In more than three months but not more than one year	**73**	250	**73**	250
In more than one year but not more than five years	**21**	1,001	**21**	1,001
In more than five years	**-**	43	**-**	23
	1,984	3,230	**1,002**	1,868

For the Group and Society, deposits from banks at 4 April 2013 included £1,207 million in respect of sale and repurchase agreements. The corresponding carrying value of assets of £231 million sold under sale and repurchase agreements was included within investment securities – available for sale (see note 14).

23 Other deposits

	Group		Society	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Other deposits are repayable from the balance sheet date in the ordinary course of business as follows:				
Accrued interest	**4**	5	**4**	14
Repayable on demand	**481**	362	**3,807**	4,137
Other deposits with residual maturity repayable:				
In not more than three months	**2,358**	2,045	**2,367**	2,685
In more than three months but not more than one year	**1,197**	1,345	**1,197**	4,566
In more than one year but not more than five years	**3,095**	2,990	**3,095**	3,074
	7,135	6,747	**10,470**	14,476

The Society's other deposits for the year ended 4 April 2014 include £3,335 million (2013: £8,089 million) of deposits from subsidiary undertakings.

Other deposits comprise wholesale deposits placed with the 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 £3,222 million (2013: £2,985 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 within losses from derivatives and hedge accounting. A loss of £305 million (2013: £160 million) was recognised by the Group and Society during the year ended 4 April 2014. This impact is largely offset by changes in the fair value of associated derivatives which are also recognised in the income statement.

The minimum amount on an undiscounted basis that the Group and Society are contractually required to pay at maturity for the PEBs is £2,732 million (2013: £2,794 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 £86 million (2013: £80 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 £1,115 million (2013: £1,140 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.

Notes to the Accounts continued

24 Due to customers

	Group		Society	
	2014	2013	**2014**	2013
	£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	**27**	43	**27**	4
Repayable on demand	**3,586**	3,812	**3,586**	865
Other amounts due to customers with residual maturity repayable:				
In not more than three months	**756**	803	**756**	70
In more than three months but not more than one year	**1,803**	1,183	**1,803**	198
In more than one year but not more than five years	**36**	119	**36**	30
	6,208	5,960	**6,208**	1,167

The 2013 comparative amounts due to customers in the Group include savings deposit balances held in the Group's offshore subsidiary Nationwide International Limited. During 2014 the business of this offshore subsidiary, including the related deposit balances, was transferred into the Society.

Amounts classified as due to customers do not confer membership rights.

25 Debt securities in issue

	Group		Society	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Certificates of deposit and commercial paper	**6,123**	7,849	**6,123**	7,849
Fixed and floating rate notes	**14,121**	16,120	**14,121**	15,926
Other debt securities	**7,213**	7,898	**276**	268
	27,457	31,867	**20,520**	24,043
Fair value adjustment for micro hedged risk	**1,100**	1,562	**170**	297
	28,557	33,429	**20,690**	24,340
Debt securities in issue are repayable from the balance sheet date in the ordinary course of business as follows:				
Accrued interest	**94**	99	**122**	132
Residual maturity repayable:				
In not more than one year	**11,775**	10,091	**8,454**	9,663
In more than one year	**15,588**	21,677	**11,944**	14,248
	27,457	31,867	**20,520**	24,043
Fair value adjustment for micro hedged risk	**1,100**	1,562	**170**	297
	28,557	33,429	**20,690**	24,340

Debt securities in issue in the Group and Society include £16,363 million (2013: £18,982 million) secured on certain loans and advances to customers. Further information is given in note 16.

26 Provisions for liabilities and charges

Group	Bank levy	FSCS	Customer redress	Other provisions	Total
	£m	£m	£m	£m	£m
At 5 April 2013	8	133	142	35	318
Provisions utilised	**(19)**	**(95)**	**(87)**	**(13)**	**(214)**
Charge for the year	**17**	**104**	**72**	**27**	**220**
Release for the year	**-**	**-**	**(3)**	**(11)**	**(14)**
Net income statement charge	**17**	**104**	**69**	**16**	**206**
At 4 April 2014	**6**	**142**	**124**	**38**	**310**
At 5 April 2012	5	111	105	74	295
Provisions utilised	(13)	(46)	(36)	(31)	(126)
Charge for the year	16	68	73	8	165
Release for the year	-	-	-	(16)	(16)
Net income statement charge/(release)	16	68	73	(8)	149
At 4 April 2013	8	133	142	35	318

The income statement charge for provisions for liabilities and charges of £173 million (2013: £141 million) includes the FSCS charge of £104 million (2013: £68 million) and the customer redress charge of £69 million (2013: £73 million).

The net income statement charge for bank levy of £17 million (2013: £16 million) and other provisions of £16 million (2013: £8 million release) are included within administrative expenses in the income statement.

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 currently total approximately £17 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. The charge recognised by the Group for interest is £57 million (2013: £26 million), which comprises £44 million for the 2014/15 scheme year and a £13 million adjustment to the 2013/14 scheme year reflecting fluctuating gilt rates by reference to which the interest is calculated.

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 remaining shortfall will total approximately £70 million. In line with the intentions of the FSCS on timing of resultant levies, the Group has recognised £35 million of this amount within the 2013/14 charge with the remaining £35 million expected during the next financial year.

The Group has also recognised £12 million in respect of the shortfall resulting from the failure of the Dunfermline Building Society. The FSCS has confirmed that this levy will be made during September 2014. Potential further shortfalls in relation to Dunfermline Building Society in future years remain uncertain in terms of both quantification and timing.

The amount provided by the Group of £142 million (2013: £133 million) comprises £91 million of interest and capital due relating to the 2014/15 scheme year and £51 million of interest due relating to the 2013/14 scheme year.

Customer redress

The Group holds a provision for customer redress which reflects management's best estimate of the cost of complaints related to past sales of financial products, including PPI.

The Group has continued to experience a significant but declining volume of reactive PPI complaints during the financial year, a substantial proportion of which relate to cases where there has been either no sale or no evidence of mis-selling. The Group continues to re-assess the ultimate level of complaints expected and the appropriateness of the provision, which reflects the redress and associated administration that will be payable in relation to claims we expect to uphold. Further costs in relation to invalid claims are recognised in administrative expenses as incurred.

In line with much of the industry, the Group is reviewing its compliance with various regulatory matters, including consumer credit legislation, and has made a provision of £69 million in respect of potential customer redress.

Notes to the Accounts continued

26 Provisions for liabilities and charges (continued)

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 a present obligation and it is probable that the expenditure will be made. All components of the net charge for other provisions in the years ended 4 April 2013 and 4 April 2014 are included within administrative expenses.

Critical accounting estimates and judgements

Customer redress provisions

The customer redress provision of £124 million at 4 April 2014 includes balances related to past sales of financial products, including PPI, together with an estimate of the potential costs of remediation in respect of a number of issues which are still under enquiry.

The amount of the provision related to past sales of PPI is calculated based upon management's best estimate of complaint volumes, 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, average redress payments and complaint handling costs.

Other amounts that are provided as an estimate of the potential costs of remediation are subject to ongoing review of various regulatory matters, including consumer credit regulations.

If the total amount of customer redress that is payable increases by 10% from the current estimate, provisions would increase by £10 million.

27 Accruals and deferred income

Accruals and deferred income for the Group and Society include £37 million (2013: £40 million) of interest accrued on subordinated liabilities, £7 million (2013: £13 million) of interest accrued on subscribed capital and £42 million (2013: £64 million) of deferred income in relation to PEBs.

Income received in relation to 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	
	2014	2013
	£m	£m
At 5 April	64	89
Releases	**(22)**	(25)
At 4 April	**42**	64

28 Subordinated liabilities

	Group and Society	
	2014	2013
	£m	£m
5.25% Subordinated notes due 2014 ($225m)	**-**	148
5% Subordinated notes due 2015 ($400m)	**241**	264
8.625% Subordinated notes due 2018 (£)	**125**	125
6.73% Subordinated loan due 2019 (£)	**-**	15
6.75% Subordinated loan due 2020 (€750m)	**620**	635
5.25% Subordinated loan due 2020 (£)	**150**	150
6.5% Callable reset subordinated notes due 2022 (£)	**30**	30
4.125% Subordinated loan due 2023 (€1,250m)	**1,032**	1,059
	2,198	2,426
Fair value adjustment for micro hedged risk	**85**	130
Unamortised premiums and issue costs	**(14)**	(16)
	2,269	2,540

All of the Society's subordinated liabilities are unsecured. The Society may, with the prior consent of the Prudential Regulation Authority (PRA), redeem some of the subordinated notes early at par (100%), unless stated, as follows:

- All or some of the 8.625% notes due in 2018 at any time at the higher of par (100%) or a price equating to a yield equal to the 8.75% 2017 benchmark gilt on a semi-annual basis, by giving not less than 30 days' and not more than 60 days' notice.
- Notice of the early redemption of the 6.73% subordinated loan due in 2019 was given on 3 April 2014. At 4 April 2014 this item was held in a clearing account awaiting settlement.
- All of the 5.25% subordinated note due 2020 may be redeemed on 23 November 2015 by giving not less than 15 days' or more than 30 days' notice. If the notes are not called the rate reverts to 3 month Libor plus 1.54%.
- All or some of the 6.5% notes due 2022 may be redeemed on 1 September 2017 by giving not less than 30 days' or more than 60 days' notice. If the notes are not called the rate reverts to the 5 year gilt plus 3%.
- All or some of the 4.125% notes due 2023 may be redeemed on 20 March 2018 by giving not less than 30 days' or more than 60 days' notice. If the notes are not called the rate reverts to the 5 year swap rate plus 3.3%.

The 5.25% subordinated notes due in 2014 all matured in January 2014.

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, AT1 and CCDS) of the Society.

The interest rate risk arising from the issuance of fixed rate subordinated liabilities has been mitigated through the use of interest rate swaps.

Notes to the Accounts continued

29 Subscribed capital

	Group and Society	
	2014	2013
	£m	£m
Floating rate permanent interest bearing shares	**3**	3
6.875% Permanent interest bearing shares	**10**	30
7.971% Permanent interest bearing shares	**200**	200
7.25% Permanent interest bearing shares	**33**	60
6.25% Permanent interest bearing shares	**44**	125
5.769% Permanent interest bearing shares	**84**	400
7.859% Permanent interest bearing shares	**38**	100
Floating rate permanent interest bearing shares	**10**	10
6% Permanent interest bearing shares	**140**	140
	562	1,068
Fair value adjustment for micro hedged risk	**64**	270
Unamortised premiums and issue costs	**(25)**	(34)
	601	1,304

All permanent interest bearing shares (PIBS) are unsecured and denominated in sterling. The PIBS are only repayable with the prior consent of the PRA as follows:

- The 7.971% PIBS are repayable, at the option of the Society, in whole on 13 March 2015 and every fifth anniversary thereafter.
- The 7.25% PIBS are repayable, at the option of the Society, in whole on 5 December 2021 and every fifth anniversary thereafter.
- The 6.25% PIBS are repayable, at the option of the Society, in whole on 22 October 2024 and every fifth anniversary thereafter.
- The 5.769% PIBS are repayable, at the option of the Society, in whole on 6 February 2026 and every fifth anniversary thereafter.
- The 7.859% PIBS are repayable, at the option of the Society, in whole on 13 March 2030 and every 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 6.875% 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.
- 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.
- 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.

In September 2013, the Group, with the consent of the PRA, redeemed £485 million of PIBS. In October 2013, the Group, with the consent of the PRA, redeemed a further £21 million of PIBS. The redemptions resulted in a net gain of £125 million in other operating income (see note 7).

PIBS rank pari passu with each other and the AT1 instruments recently issued by the Group. They are deferred shares of the Society and rank behind the claims against the Society of all subordinated noteholders, depositors, creditors and investing members (other than the holders of CCDS) 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.

30 Retirement benefit obligations

	Group	
	2014	2013
	£m	£m
Present value of funded obligations	**3,843**	3,813
Present value of unfunded obligations	**12**	12
	3,855	3,825
Fair value of fund assets	**(3,620)**	(3,471)
	235	354

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 employees have been able to join a defined contribution arrangement.

Employees are entitled to annual pensions on retirement at age 65 of one sixtieth of career average earnings (revalued to retirement) for each year of service after 1 April 2011. Benefits accrued prior to 1 April 2011 varied with the majority being one fifty fourth of final salary for each year of service. Benefits are also payable on death and following other events such as withdrawing from active service. No other post-retirement benefits are provided to these employees.

The Fund is administered by a board of trustees which is legally separate from the Group. The Trustees are composed of representatives of both the employer and employees, plus an independent trustee. The Trustees are required by law to act in the interest of all relevant beneficiaries and are responsible for the investment policy with regard to the assets plus the day to day administration of the benefits.

Approximately 33% of the defined benefit obligations are attributable to current employees, 34% to former employees and 33% to current pensioners and dependants. The duration of the obligation is approximately 21 years reflecting the split of the obligation between current employees (26 years), deferred members (24 years) and current pensioners (14 years).

The amounts recognised in the income statement are as follows:

	Group	
	2014	2013*
	£m	£m
Defined benefit current service cost	**56**	56
Defined contribution cost	**26**	19
Past service cost	**4**	4
Curtailment gains	**(4)**	(6)
Administrative expenses	**4**	4
Included in employee costs (note 9)	**86**	77
Interest on net defined benefit liability (note 4)	**15**	23
	101	100

*Comparatives have been restated in accordance with IAS 19 (Revised) Employee Benefits. Refer to note 1 for further details.

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Notes to the Accounts continued

30 Retirement benefit obligations (continued)

Changes in the present value of net defined benefit liability (including unfunded obligations) are as follows:

	Group	
	2014	2013*
	£m	£m
At 5 April	354	517
Current service cost	**56**	56
Past service	**4**	5
Curtailment gains	**(4)**	(6)
Interest on net defined benefit liability	**15**	23
Return on assets less/(greater) than discount rate	**43**	(261)
Contributions by employer	**(112)**	(54)
Administrative expenses	**4**	4
Actuarial (gains)/losses on defined benefit obligations	**(125)**	70
At 4 April	**235**	354

*Comparatives have been restated in accordance with IAS 19 (Revised) Employee Benefits. Refer to note 1 for further details.

Changes in the present value of defined benefit obligations (including unfunded obligations) are as follows:

	Group	
	2014	2013*
	£m	£m
At 5 April	3,825	3,606
Current service cost	**56**	56
Past service	**4**	5
Curtailment gains	**(4)**	(6)
Interest expense on obligation	**181**	171
Employee contributions	**-**	1
Experience gains on plan assumptions	**(63)**	(5)
Changes in demographic assumptions	**(171)**	-
Changes in financial assumptions	**109**	75
Benefits paid	**(82)**	(78)
At 4 April	**3,855**	3,825

*Comparatives have been restated in accordance with IAS 19 (Revised) Employee Benefits. Refer to note 1 for further details.

The experience gains on plan assumptions of £63 million (2013: £5 million) arose from using updated membership data from the triennial actuarial valuation which is currently in progress.

The changes in demographic assumptions of £171 million gain (2013: £nil) arose from using updated assumptions relating to commutation terms, withdrawal rates, post retirement mortality and the proportion of scheme members who are married.

30 Retirement benefit obligations (continued)

The £109 million loss (2013: £75 million loss) from changes in financial assumptions arose primarily due to a decrease in the discount rate, which increased the value of the obligation. This was partly offset by decreases in assumptions for future salary increases and inflation.

The curtailment gains represent the reduction in the defined benefit obligation arising from pensions increasing in line with plan rules instead of salary increases, in respect of members made redundant during the year.

Changes in the fair value of plan assets for the pension funds are as follows:

	Group	
	2014	2013
	£m	£m
At 5 April	3,471	3,089
Interest income on assets	**166**	148
Return on assets (less)/greater than discount rate	**(43)**	261
Administrative expenses	**(4)**	(4)
Contributions by employer	**112**	54
Employee contributions	**-**	1
Benefits paid	**(82)**	(78)
At 4 April	**3,620**	3,471

Contributions paid by the Group in the year included additional deficit contributions of £60 million (2013: £nil).

Notes to the Accounts continued

30 Retirement benefit obligations (continued)

The major categories of plan assets for the pension funds, stated at fair value, are as follows:

	Group	
	2014	2013
	£m	£m
Listed equities (quoted)	**1,375**	1,516
Government bonds (quoted)	**1,305**	893
Corporate bonds (quoted)	**404**	448
Infrastructure (unquoted)	**227**	229
Property (quoted)	**67**	104
Property (unquoted)	**105**	100
Private equity investments (unquoted)	**192**	164
Cash	**229**	104
Liability relating to repurchase agreement	**(300)**	(110)
Other assets and liabilities	**16**	23
	3,620	3,471

None of the funds' assets are invested in the Group's own financial instruments or property (2013: £nil).

Assets described as quoted are based on unadjusted prices quoted in an active market and represent Level 1 assets as defined by IFRS 13. £524 million (2013: £493 million) of plan assets have been valued using inputs which are not based on observable market data and represent Level 3 assets as defined by IFRS 13. Level 3 assets include private equity investments, infrastructure and certain property investments.

The Fund's liabilities are partly hedged by matching assets, primarily index linked government bonds and fixed rate government and corporate bonds. In addition, sale and repurchase agreements and the use of derivatives also provide partial hedging of the Fund's liabilities.

Government bonds include securities with a carrying value of £307 million (2013: £114 million) which have been sold under sale and repurchase agreements. The assets have not been derecognised as the Fund has retained substantially all the risks and rewards of ownership. The proceeds of the sale and repurchase agreement of £300 million (2013: £110 million) are included as a liability in the above table.

30 Retirement benefit obligations (continued)

The principal actuarial assumptions used were as follows:

	Group	
	2014	2013
	%	%
Discount rate	**4.50**	4.80
Future salary increases	**3.30**	4.40
Future pension increases (maximum 5%)	**3.05**	3.10
Retail price index (RPI) inflation	**3.30**	3.40
Consumer price index (CPI) inflation	**2.30**	2.40

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:

	2014	2013
Retire at 4 April 2014		
Males	**28.4**	28.5
Females	**30.1**	30.9
Retire at 4 April 2034		
Males	**30.0**	30.5
Females	**31.7**	31.6

The Group estimates that its regular contributions to the defined benefit pension funds during the year ended 4 April 2015 will be £46 million.

Critical accounting estimates and judgements

The key assumptions used to calculate the pension obligation are discount rate, future salary increases and pension increases, inflation and mortality. If different assumptions were used, this could have a material effect on the reported obligation. The sensitivity of the results to these assumptions are as follows:

Change in key assumptions at 4 April 2014	**Increase/(decrease) in deficit from assumption change**
	£m
0.1% increase in discount rate	**(83)**
0.1% increase in inflation assumption	**71**
One year increase in life expectancy at age 60	**93**

The above sensitivities apply to changing individual assumptions in isolation; in practice relationships are likely to be related, especially between the discount rate and inflation. Furthermore, a change in market yields could impact asset values (in particular bonds) in the opposite direction to the obligations. The sensitivity to the inflation assumption change includes the resultant changes to the future salary increases and future pension increases assumptions.

Notes to the Accounts continued

31 Core capital deferred shares

Group and Society				
	Number of shares	**CCDS**	**Share premium**	**Total**
		£m	**£m**	**£m**
At 5 April 2013	-	-	-	-
Issuance	**5,500,000**	**6**	**544**	**550**
Issue costs (net of tax)	**-**	**-**	**(19)**	**(19)**
At 4 April 2014	**5,500,000**	**6**	**525**	**531**

In December 2013, the Society issued 5,500,000 of new £1 core capital deferred shares (CCDS) at £100 per share. The gross proceeds of the issuance were £550 million (£531 million net of issuance costs).

CCDS are a new form of Common Equity Tier 1 (CET1) capital which have been developed to enable the Group to raise capital from the capital markets. Previously issued Tier 1 capital instruments, PIBS, no longer meet the capital requirements of CRD IV and are being gradually phased out under the grandfathering regime.

CCDS rank pari passu to each other and are junior to claims against the Society of all depositors, creditors and investing members. Each holder of CCDS has one vote, regardless of the number of CCDS held.

In the event of a winding up or dissolution of the Society and if there was surplus available, the amount that the investor would receive for each CCDS held is limited to the average principal amount in issue, which is currently £100 per share.

There is a cap placed on the amount of distributions that can be paid to holders of CCDS in any financial year. The cap is currently set at £15.24 per share and is adjusted annually in line with CPI.

The Directors have declared an unconditional final distribution of £5.50 per share in respect of the financial year ended 4 April 2014, amounting in aggregate to £30 million. The distribution will be recognised in the statement of movements in members' interests and equity in the financial year ended 4 April 2015.

32 Other equity instruments

Group and Society	
	Total
	£m
At 5 April 2013	-
Issuance	**1,000**
Issue costs (net of tax)	**(8)**
At 4 April 2014	**992**

In March 2014, the Society issued £1,000 million (£992 million net of issuance costs) of new Additional Tier 1 (AT1) capital.

AT1 instruments rank pari passu to each other and to PIBS. They are junior to claims against the Society of all depositors, creditors and investing members, other than the holders of CCDS.

32 Other equity instruments (continued)

AT1 instruments pay a fully discretionary, non-cumulative fixed coupon at an initial rate of 6.875% per annum. The rate will reset on 20 June 2019 and every five years thereafter to the five year mid swap rate plus 4.88%. Coupons are paid semi-annually in June and December. The first coupon payment of £19 million, covering the period to 19 June 2014, is expected to be paid on 20 June 2014 and will be recognised in the statement of movements in members' interests and equity in the financial year ended 4 April 2015.

AT1 instruments have no maturity date. They are repayable at the option of the Society on 20 June 2019 and on every fifth anniversary thereafter. AT1 is only repayable with the consent of the PRA.

If the fully-loaded CET1 ratio for the Society, on either a consolidated or unconsolidated basis, falls below 7% the AT1 instruments convert to CCDS instruments at the rate of one CCDS share for every £80 of AT1 holding.

33 Capital and leasing commitments

Capital commitments	**Group and Society**	
	2014	2013
	£m	£m
Capital expenditure contracted for but not provided for in the Accounts:		
Intangibles	**41**	38
Property, plant and equipment	**30**	42
	71	80

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.

Future minimum payments under operating leases relating to land and buildings were as follows:

Leasing commitments at 4 April	**Group**	
	2014	2013
	£m	£m
Amounts falling due:		
Within one year	**31**	31
Between one and five years	**102**	100
After five years	**208**	169
	341	300

£2 million of the leasing commitments arise in a subsidiary of the Group (2013: £2 million).

Notes to the Accounts continued

33 Capital and leasing commitments (continued)

At the balance sheet date, future minimum lease payments receivable under non-cancellable operating leases were as follows:

Leasing payments receivable as lessor at 4 April	**Group and Society**	
	2014	2013
	£m	£m
Amounts falling due:		
Within one year	**5**	6
Between one and five years	**14**	14
After five years	**34**	18
	53	38
At the balance sheet date, future minimum sublease payments receivable under non-cancellable subleases	**17**	16

34 Contingent liabilities

The Group does not expect the ultimate resolution of any threatened or actual legal proceedings to have a significant adverse impact on the financial position of the Group.

35 Classification and measurement

Given the dominant position of the Society within the Group structure, the disclosures in notes 35 to 39 are on a consolidated basis covering the activities of both the Group and the Society.

The following tables summarise the classification of carrying amounts of the Group's financial assets and liabilities.

2014 Group	Available for sale	Loans and receivables	Fair value through the income statement	Liabilities at amortised cost	Total
	£m	£m	£m	£m	£m
Financial assets					
Cash	-	5,342	-	-	5,342
Loans and advances to banks	-	2,110	-	-	2,110
Investment securities	10,563	-	-	-	10,563
Derivative financial instruments	-	-	3,020	-	3,020
Fair value adjustment for portfolio hedged risk	-	221	-	-	221
Loans and advances to customers	-	166,574	-	-	166,574
Investments in equity shares	29	-	-	-	29
Total financial assets	10,592	174,247	3,020	-	187,859
Other non-financial assets					2,067
Total assets					189,926
Financial liabilities					
Shares	-	-	-	130,468	130,468
Deposits from banks	-	-	-	1,984	1,984
Other deposits	-	-	3,222	3,913	7,135
Due to customers	-	-	-	6,208	6,208
Fair value adjustment for portfolio hedged risk	-	-	-	33	33
Debt securities in issue	-	-	-	28,557	28,557
Derivative financial instruments	-	-	2,391	-	2,391
Subordinated liabilities	-	-	-	2,269	2,269
Subscribed capital	-	-	-	601	601
Total financial liabilities	-	-	5,613	174,033	179,646
Other non-financial liabilities					1,374
Total liabilities					181,020

Notes to the Accounts continued

35 Classification and measurement (continued)

2013 Group	Available for sale	Loans and receivables	Fair value through the income statement	Liabilities at amortised cost	Total
	£m	£m	£m	£m	£m
Financial assets					
Cash	-	7,886	-	-	7,886
Loans and advances to banks	-	2,522	-	-	2,522
Investment securities	13,421	-	-	-	13,421
Derivative financial instruments	-	-	4,212	-	4,212
Fair value adjustment for portfolio hedged risk	-	872	-	-	872
Loans and advances to customers	-	159,587	-	-	159,587
Investments in equity shares	28	-	-	-	28
Other financial assets	-	-	8	-	8
Total financial assets	13,449	170,867	4,220	-	188,536
Other non-financial assets					2,182
Total assets					190,718
Financial liabilities					
Shares	-	-	-	125,574	125,574
Deposits from banks	-	-	-	3,230	3,230
Other deposits	-	-	2,985	3,762	6,747
Due to customers	-	-	-	5,960	5,960
Fair value adjustment for portfolio hedged risk	-	-	-	150	150
Debt securities in issue	-	-	-	33,429	33,429
Derivative financial instruments	-	-	3,885	-	3,885
Subordinated liabilities	-	-	-	2,540	2,540
Subscribed capital	-	-	-	1,304	1,304
Total financial liabilities	-	-	6,870	175,949	182,819
Other non-financial liabilities					1,319
Total liabilities					184,138

The other financial assets amount represents the fair value movement in mortgage commitments entered into where a loan has not yet been made.

Further information on the fair value of financial assets and liabilities is included in notes 36 to 38.

36 Fair value hierarchy of financial assets and liabilities held at fair value

The following tables show the Group's financial assets and liabilities that are held at fair value by fair value hierarchy, balance sheet classification and product type:

4 April 2014	Fair values based on			
	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
Financial assets				
Government and supranational investments	6,994	-	-	6,994
Other debt investment securities	-	3,498	71	3,569
Total investment securities – AFS	6,994	3,498	71	10,563
Investments in equity shares – AFS	-	-	28	28
Interest rate swaps	-	1,718	-	1,718
Cross currency interest rate swaps	-	619	-	619
Forward foreign exchange	-	13	-	13
Equity index swaps	-	-	670	670
Total derivative financial instruments	-	2,350	670	3,020
Total financial assets	6,994	5,848	769	13,611
Financial liabilities				
Interest rate swaps	-	(1,985)	-	(1,985)
Cross currency interest rate swaps	-	(351)	-	(351)
Forward foreign exchange	-	(42)	-	(42)
Swaptions	-	(12)	-	(12)
Equity index swaps	-	-	(1)	(1)
Total derivative financial instruments	-	(2,390)	(1)	(2,391)
Other deposits – PEBs	-	-	(3,222)	(3,222)
Total financial liabilities	-	(2,390)	(3,223)	(5,613)

Notes to the Accounts continued

36 Fair value hierarchy of financial assets and liabilities held at fair value (continued)

4 April 2013	Fair values based on			
	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
Financial assets				
Government and supranational investments	8,641	343	-	8,984
Other debt investment securities	-	4,377	60	4,437
Total investment securities – AFS	8,641	4,720	60	13,421
Investments in equity shares – AFS	-	-	28	28
Interest rate swaps	-	2,524	-	2,524
Cross currency interest rate swaps	-	1,150	-	1,150
Forward foreign exchange	-	152	-	152
Swaptions	-	2	-	2
Equity index swaps	-	-	384	384
Total derivative financial instruments	-	3,828	384	4,212
Other financial assets	-	8	-	8
Total financial assets	8,641	8,556	472	17,669
Financial liabilities				
Interest rate swaps	-	(3,735)	(10)	(3,745)
Cross currency interest rate swaps	-	(90)	-	(90)
Caps, collars and floors	-	(1)	-	(1)
Forward foreign exchange	-	(22)	-	(22)
Swaptions	-	(27)	-	(27)
Total derivative financial instruments	-	(3,875)	(10)	(3,885)
Other deposits – PEBs	-	-	(2,985)	(2,985)
Total financial liabilities	-	(3,875)	(2,995)	(6,870)

The Group's Level 1 portfolio comprises highly rated government securities for which traded prices are readily available. During the year ended 4 April 2014, the Group has reduced this portfolio in response to the changing regulatory environment created by the Funding for Lending Scheme (FLS).

Asset valuations for Level 2 AFS investment securities 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. Other financial assets represent fair value movements in mortgage commitments entered into where a loan has not yet been made. During the year ended 4 April 2014, the Group's Level 2 portfolio has decreased, primarily due to deleveraging of legacy treasury assets.

More detail on the Level 3 portfolio is provided in note 37.

Transfers between fair value hierarchies

Instruments move between fair value hierarchies primarily due to increases or decreases in market activity or changes to the significance of unobservable inputs to valuation. There were no significant transfers between Level 1 and Level 2 portfolios during the year.

37 Fair value of financial assets and liabilities held at fair value – Level 3 portfolio

The main constituents of the Level 3 portfolio are as follows:

Investment securities – AFS

The Group's £71 million Level 3 AFS investment securities at 4 April 2014 comprise mainly £59 million of collateralised debt obligations (CDOs), including CDOs with a fair value of £13 million that are subject to impairment. Substantially all of these securities are priced from internal models based on observable and unobservable performance assumptions.

Investments in equity shares

The Level 3 investments in equity shares of £28 million at 4 April 2014 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.

The tables below set out movements in the Level 3 portfolio, including transfers in and out of Level 3.

During the period one US CDO investment was transferred from Level 2 to Level 3 and one US asset backed security was transferred from Level 3 to Level 2 due to changes in the availability of observable market prices.

Movements in Level 3 portfolio	**Investment securities - AFS**	**Investments in equity shares**	**Net derivative financial instruments**	**Other deposits - PEBs**
	£m	**£m**	**£m**	**£m**
At 5 April 2013	60	28	374	(2,985)
(Losses)/gains recognised in the income statement:				
Net interest expense	**-**	**-**	**(39)**	**-**
Gains/(losses) from derivatives and hedge accounting	**-**	**-**	**295**	**(305)**
Net impairment losses on investment securities	**2**	**-**	**-**	**-**
Gain recognised in other comprehensive income – fair value movement taken to members' interests and equity	**5**	**-**	**-**	**-**
Settlements	**(6)**	**-**	**39**	**68**
Transfers into Level 3 portfolio	**11**	**-**	**-**	**-**
Transfers out of Level 3 portfolio	**(1)**	**-**	**-**	**-**
At 4 April 2014	**71**	**28**	**669**	**(3,222)**

Notes to the Accounts continued

37 Fair value of financial assets and liabilities held at fair value – Level 3 portfolio (continued)

Movements in Level 3 portfolio	Investment securities - AFS	Investments in equity shares	Net derivative financial instruments	Other deposits - PEBs
	£m	£m	£m	£m
At 5 April 2012	76	20	197	(2,890)
(Losses)/gains recognised in the income statement:				
Net interest expense	-	-	(52)	-
Gains/(losses) from derivatives and hedge accounting	-	-	174	(160)
Net impairment losses on investment securities	(23)	-	-	-
Gain recognised in other comprehensive income – fair value movement taken to members' interests and equity	3	8	-	-
Settlements	-	-	55	65
Transfers into Level 3 portfolio	4	-	-	-
At 4 April 2013	60	28	374	(2,985)

37 Fair value of financial assets and liabilities held at fair value – Level 3 portfolio (continued)

Level 3 portfolio sensitivity analysis of valuations using unobservable inputs

The fair value of financial instruments is, in certain circumstances, measured using valuation techniques based on market prices that are not observable in an active market or significant unobservable market inputs.

Reasonable alternative assumptions can be applied for sensitivity analysis, taking account of the nature of valuation techniques used, as well as the availability and reliability of observable proxy and historic data. The following table shows the sensitivity of these fair values to reasonable alternative assumptions (as set out in the table of significant unobservable inputs) and the resultant impact of such changes in fair value on the income statement or members' interests and equity:

At 4 April 2014	**Fair value**	**Favourable changes**		**Unfavourable changes**	
		Income statement	**Members' interests and equity**	**Income statement**	**Members' interests and equity**
	£m	**£m**	**£m**	**£m**	**£m**
Investment securities – AFS:					
Collateralised debt obligations	**71**	**4**	**7**	**(5)**	**(9)**
Investments in equity shares	**28**	**-**	**1**	**-**	**(2)**
Net derivative financial instruments (note i)	**669**	**-**	**-**	**-**	**-**
Other deposits – PEBs (note i)	**(3,222)**	**-**	**-**	**-**	**-**
Total	**(2,454)**	**4**	**8**	**(5)**	**(11)**

At 4 April 2013	Fair value	Favourable changes		Unfavourable changes	
		Income statement	Members' interests and equity	Income statement	Members' interests and equity
	£m	£m	£m	£m	£m
Investment securities – AFS:					
Collateralised debt obligations	60	5	10	(2)	(9)
Investments in equity shares	28	-	-	-	(7)
Net derivative financial instruments (note i)	374	-	-	-	-
Other deposits – PEBs (note i)	(2,985)	-	-	-	-
Total	(2,523)	5	10	(2)	(16)

Notes:

(i) Changes in fair values of the equity index swaps included in net derivative financial instruments will be largely offset by the change in fair value of the PEBs deposits. Any resultant impact is deemed by the Group to be insignificant so these sensitivities have therefore been excluded from the table above.

Notes to the Accounts continued

37 Fair value of financial assets and liabilities held at fair value – Level 3 portfolio (continued)

Alternative assumptions are considered for each product and varied according to the quality of the data and variability of the underlying market. For investment securities – AFS, 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. Scenarios for investments in equity shares reflect prices seen in these holdings in the preceding 12 months.

The following table discloses the significant unobservable inputs underlying the above alternative assumptions for assets and liabilities recognised at fair value and classified as Level 3 along with the range of values for those significant unobservable inputs. Where sensitivities are described the inverse relationship will also generally apply.

At 4 April 2014	Total assets £m	Total liabilities £m	Valuation technique	Significant unobservable inputs	Range		Weighted average (note i)	Units (note ii)
					Min	Max		
Investments securities – AFS: Collateralised debt obligations	59		Discounted cash flows	Conditional prepayment rate	13.11	21.45	16.94	%
				Loss given default	48.10	56.58	51.98	%
				Probability of default	12.07	20.00	14.81	%
				Credit spread	125	375	250	Bps
	12		Mark to market	Price	65.00	80.00	75.00	Points
	71							
Investments in equity shares	28		Mark to market	Price	97.00	110.50	106.00	Points
Net derivative financial instruments (note iii)	669							
Other deposits – PEBs (note iii)		(3,222)						

Notes:

(i) Weighted average represents the input values used in calculating the fair values for the above financial instruments.

(ii) The units used to disclose ranges for significant unobservable inputs are percentages, points and basis points (bps). Points are a percentage of par; for example 100 points equals 100% of par. One basis point (bps) equals 0.01% for example, 125 basis points (bps) equals 1.25%.

(iii) Changes in fair values of the equity index swaps included in net derivative financial instruments will be largely offset by the change in fair value of the PEBs deposits. Any resultant impact is deemed by the Group to be insignificant so these sensitivities have therefore been excluded from the table above.

37 Fair value of financial assets and liabilities held at fair value – Level 3 portfolio (continued)

Some of the significant unobservable inputs used in fair value measurement are interdependent. Where this is the case, a description of those interrelationships is included below.

Conditional prepayment rate

For asset backed securities where the borrower is able to prepay all or part of a loan before the contractual repayment date, the conditional prepayment rate will affect the fair value by altering the timing of future projected cash flows. The effect of a significant increase in conditional prepayment rate on fair value could be favourable or unfavourable, depending on the specific terms of the instrument. Conditional prepayment rates are typically inversely correlated to credit spread. For example, securities with high borrower credit spread typically experience lower prepayment rates, and also tend to experience higher default rates.

Loss given default

Loss given default represents the expected loss upon liquidation of the collateral as a percentage of the balance outstanding. In general, lower recovery and lower projected cash flows will translate to a significant increase in the loss given default, resulting in a reduction in fair value that is unfavourable for the holder of the securitised product.

Probability of default

The probability of default represents an annualised rate of default of the loan principal by the borrower. A significant increase in a probability of default in isolation will typically result in a movement in fair value that is unfavourable.

Probability of default and conditional prepayment rates are typically inversely correlated; lower defaults on loans typically will mean higher credit quality and therefore more prepayments.

Credit spread

The more perceived credit risk there is, the higher the yield that will be demanded for the instrument. This is reflected in the credit spread which typically represents the difference in yield between an instrument and a benchmark security or reference rate. The credit spread for an instrument forms part of the yield used in a discounted cash flow calculation. In general a significant increase in credit spread in isolation will result in a movement in fair value that is unfavourable for the holder of a cash instrument. For a derivative instrument, a significant increase in credit spread in isolation can result in a movement in fair value that is favourable or unfavourable depending on the specific terms of the instrument.

Price

Prices for securities that are marked to market, where the market is illiquid and supporting price information is scarce, are typically subject to significant uncertainty. An increase in the price will directly cause an increase in fair value and vice versa.

Notes to the Accounts continued

38 Fair value of financial assets and liabilities measured at amortised cost

The following table summarises the carrying value and fair value of financial assets and liabilities measured at amortised cost on the Group's balance sheet:

At 4 April 2014	Carrying value	Fair values based on			Total fair value
		Level 1	Level 2	Level 3	
	£m	£m	£m	£m	£m
Financial assets					
Loans and advances to banks	2,110	2,110	-	-	2,110
Loans and advances to customers:					
Residential mortgages	145,558	-	-	141,660	141,660
Consumer banking	3,689	-	-	3,551	3,551
Commercial lending	17,163	-	-	15,675	15,675
Other lending	164	-	-	164	164
Investments in equity shares	1	-	-	1	1
	168,685	2,110	-	161,051	163,161
Financial liabilities					
Shares	130,468	-	130,491	-	130,491
Deposits from banks	1,984	-	1,985	-	1,985
Other deposits	3,913	-	3,915	-	3,915
Due to customers	6,208	-	-	6,210	6,210
Debt securities in issue	28,557	-	29,168	-	29,168
Subordinated liabilities	2,269	-	2,434	-	2,434
Subscribed capital	601	-	583	-	583
	174,000	-	168,576	6,210	174,786

38 Fair value of financial assets and liabilities measured at amortised cost (continued)

At 4 April 2013	Carrying value	Fair values based on			Total fair value
		Level 1	Level 2	Level 3	
	£m	£m	£m	£m	£m
Financial assets					
Loans and advances to banks	2,522	2,522	-	-	2,522
Loans and advances to customers:					
Residential mortgages	135,393	-	-	130,871	130,871
Consumer banking	3,401	-	-	3,413	3,413
Commercial lending	20,371	-	-	20,752	20,752
Other lending	422	-	-	422	422
	162,109	2,522	-	155,458	157,980
Financial liabilities					
Shares	125,574	-	125,316	-	125,316
Deposits from banks	3,230	-	3,232	-	3,232
Other deposits	3,762	-	4,141	-	4,141
Due to customers	5,960	-	-	5,958	5,958
Debt securities in issue	33,429	-	34,003	-	34,003
Subordinated liabilities	2,540	-	2,566	-	2,566
Subscribed capital	1,304	-	1,012	-	1,012
	175,799	-	170,270	5,958	176,228

Loans and advances to customers

In adopting the requirements of IFRS 13, the Group has reviewed and modified its approach to the fair value disclosures for financial assets and liabilities measured at amortised cost on the balance sheet in line with the guidance in the standard to reflect a hypothetical exit price as indicated by the standard, valued on an asset by asset basis, with no liquidity discount.

The change in relationship between carrying value and fair value compared to last year is principally due to the change in valuation methodology. IFRS 13 is not retrospective in application and the Group has not restated the position at 4 April 2013. Whilst figures for the year have not been restated, it is estimated that if this methodology had been applied at 4 April 2013, the reported fair value would have been lower than reported and broadly consistent with the relationship between carrying value and fair value at 4 April 2014.

In arriving at the fair value of loans and advances to customers, the Group uses consistent modelling techniques across the different loan books, taking into account expected future cash flows and future lifetime expected losses, based on historic trends and discount rates appropriate to the loans. Variable rate loans are modelled on estimated future cash flows, discounted at current market interest rates. Variable rate retail mortgages are discounted at the currently available market standard variable interest rate (SVR) which, for example, in the case of our residential BMR mortgage book generates a reduction in fair value as those mortgages are priced below the SVR. For variable rate commercial loans, separate market interest rates are utilised to discount the Group's commercial real estate, registered social landlord and Project Finance lending portfolios.

For fixed rate loans, discount rates have been based on the expected funding and capital cost applicable to the book. When calculating fair values on fixed rate loans, no adjustment has been made to reflect interest rate risk management through internal natural hedges or external hedging via derivatives.

Notes to the Accounts continued

38 Fair value of financial assets and liabilities measured at amortised cost (continued)

Shares, deposits and borrowings

The estimated fair value of shares and deposits with no stated maturity, (including non-interest bearing deposits) is the amount repayable on demand. The estimated fair value of fixed interest rate shares, deposits and other borrowings without quoted market prices represents the discounted amount of estimated future cash flows based on expectations of future interest rates, customer withdrawals and interest capitalisation. For variable interest rate deposits, estimated future cash flows are discounted using current market interest rates for new debt with similar remaining maturity. For fixed rate shares and deposits, the estimated future cash flows are discounted based on market offer rates currently available for equivalent deposits.

Debt securities in issue

The estimated fair values of longer dated liabilities are calculated based on quoted market prices where available or using similar instruments as a proxy for those liabilities that are not of sufficient size or liquidity to have an active market quote. For those notes for which 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.

39 Offsetting financial assets and financial liabilities

The Group has financial assets and liabilities for which there is a legally enforceable right to set off the recognised amounts, and which may be settled net. However the netting arrangements do not result in an offset of balance sheet assets and liabilities for accounting purposes as the right to set off is not unconditional in all circumstances. Therefore, in accordance with IAS 32 Financial Instruments: Presentation, there are no financial assets or liabilities which are offset with the net amount presented on the balance sheet. All financial assets and liabilities are presented on a gross basis on the balance sheet.

In accordance with IFRS 7 Financial Instruments: Disclosures, the following table shows the impact on derivative financial instruments, total return swaps, reverse repurchase agreements and repurchase agreements relating to transactions where:

- There is an enforceable master netting arrangement or similar agreement in place but the offset criteria are otherwise not satisfied, and
- Financial collateral is paid and received.

Master netting arrangements consist of agreements such as an ISDA Master Agreement, global master repurchase agreements and global master securities lending agreements, whereby outstanding transactions with the same counterparty can be offset and settled net following a default or other predetermined event.

Financial collateral on derivative financial instruments consists of cash and securities settled, typically daily or weekly, to mitigate the mark to market exposures. Financial collateral on total return swaps, repurchase agreements and reverse repurchase agreements typically comprises highly liquid securities which are legally transferred and can be liquidated in the event of counterparty default.

The net amounts after offsetting under IFRS 7 presented below show the exposure to counterparty credit risk for derivative contracts after netting benefits and collateral, and are not intended to represent the Group's actual exposure to credit risk. This is due to a variety of credit mitigation strategies which are employed in addition to netting and collateral arrangements.

39 Offsetting financial assets and financial liabilities (continued)

2014	**Gross and net amounts reported on the balance sheet**	**Master netting arrangements**	**Financial collateral**	**Net amounts after offsetting under IFRS 7**
	£m	**£m**	**£m**	**£m**
Financial assets				
Derivative financial instruments	**3,020**	**(1,440)**	**(1,356)**	**224**
Total return swaps	**149**	**-**	**(149)**	**-**
Total financial assets	**3,169**	**(1,440)**	**(1,505)**	**224**
Financial liabilities				
Derivative financial liabilities	**2,391**	**(1,440)**	**(873)**	**78**
Total financial liabilities	**2,391**	**(1,440)**	**(873)**	**78**

2013	Gross and net amounts reported on the balance sheet	Master netting arrangements	Financial collateral	Net amounts after offsetting under IFRS 7
	£m	£m	£m	£m
Financial assets				
Derivative financial instruments	4,212	(2,208)	(1,631)	373
Total return swaps	149	-	(149)	-
Total financial assets	4,361	(2,208)	(1,780)	373
Financial liabilities				
Derivative financial liabilities	3,885	(2,208)	(1,559)	118
Repurchase agreements	1,207	-	(1,207)	-
Total financial liabilities	5,092	(2,208)	(2,766)	118

The fair value of the financial collateral is the same as the values shown in the table above, except for the total return swaps collateral which has a fair value of £175 million (2013: £188 million) and at 4 April 2013, the repurchase agreements collateral which had a fair value of £1,486 million.

Notes to the Accounts continued

40 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 18.

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:

	2014	2013
	£'000	£'000
Short term employee benefits	**5,708**	5,963
Other long term benefits	**1,736**	1,455
Contractual/other settlements	**407**	1,373
Total key management personnel compensation for the year	**7,851**	8,791

40 Related party transactions (continued)

Transactions with related parties

A number of transactions are entered into with related parties in the normal course of business. These include loans, deposits and the payment and recharge of administrative expenses.

The outstanding balances for related party transactions at the year end, and the associated income and expenses for the year are as follows:

	Society subsidiaries		Key management personnel	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Loans payable to the Society				
Loans outstanding at 5 April	25,557	24,569	0.8	0.6
Loans issued during the year	**3,580**	5,796	**0.3**	0.5
Loans impaired	**(8)**	(5)	**-**	-
Loan repayments during the year	**(3,081)**	(4,803)	**(0.3)**	(0.3)
Loans outstanding at 4 April	**26,048**	25,557	**0.8**	0.8
Deposits payable by the Society				
Deposits outstanding at 5 April	8,089	6,790	4.4	3.6
Deposits issued during the year	**1,199**	1,605	**9.8**	10.2
Deposit repayments during the year	**(5,953)**	(306)	**(8.1)**	(9.4)
Deposits outstanding at 4 April	**3,335**	8,089	**6.1**	4.4
Net interest income				
Interest receivable	**1,140**	1,247	**-**	-
Interest expense	**268**	347	**0.1**	-
Other income and expenses				
Dividends payable to the Society	**206**	74	**-**	-
Fees and expenses paid to the Society	**12**	16	**-**	-
Other balance sheet items				
Accrued income and expenses prepaid due to the Society	**458**	1,030	**-**	-
Other liabilities payable by the Society	**4,849**	6,113	**-**	-

Transactions with key management personnel

Transactions with key management personnel are on the same terms and conditions applicable to other employees within the Group.

In addition to the loans and deposits disclosed in the above table, one non executive director acquired 836 core capital deferred shares during the year. At 4 April 2014 the value of this holding was £103,467.

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 17 July 2014 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 subsidiary undertakings.

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

41 Notes to the cash flow statements

	Group		Society	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Non-cash items included in profit before tax				
Net increase in impairment provisions	**64**	381	**182**	352
Net (decrease)/increase in provisions for liabilities and charges	**(8)**	23	**(8)**	23
Impairment losses on investment securities	**3**	2	**3**	2
Depreciation, amortisation and impairment	**282**	216	**281**	216
Profit on sale of property, plant and equipment	**(4)**	-	**(4)**	-
Interest on subordinated liabilities	**129**	96	**129**	96
Interest on subscribed capital	**59**	89	**59**	89
Losses from derivatives and hedge accounting	**51**	165	**38**	58
Gain on the redemption of subscribed capital	**(125)**	(43)	**(125)**	(43)
Gain on the sale of investments in equity shares	**-**	(7)	**-**	(7)
	451	922	**555**	786
Changes in operating assets				
Loans and advances to banks	**(130)**	7	**(130)**	7
Investment securities	**524**	(1,116)	**537**	(1,098)
Derivative financial instruments and fair value adjustment for portfolio hedged risk	**1,792**	257	**854**	170
Deferred tax assets	**121**	75	**114**	57
Loans and advances to customers	**(7,051)**	(5,799)	**(6,643)**	(4,506)
Other operating assets	**39**	(39)	**193**	(869)
	(4,705)	(6,615)	**(5,075)**	(6,239)
Changes in operating liabilities				
Shares	**4,894**	(43)	**4,894**	(43)
Deposits from banks, customers and others	**(610)**	(165)	**169**	147
Derivative financial instruments and fair value adjustment for portfolio hedged risk	**(1,611)**	(530)	**(1,968)**	(127)
Debt securities in issue	**(484)**	(468)	**(852)**	562
Deferred tax liabilities	**(5)**	2	**-**	(1)
Retirement benefit obligations	**(119)**	(163)	**(118)**	(163)
Other operating liabilities	**135**	169	**(1,110)**	(1,742)
	2,200	(1,198)	**1,015**	(1,367)
Cash and cash equivalents				
Cash	**5,342**	7,886	**5,342**	7,886
Loans and advances to banks repayable in 3 months or less	**1,647**	2,189	**1,601**	2,061
	6,989	10,075	**6,943**	9,947

41 Notes to the cash flow statements (continued)

The Group is required to maintain balances with the Bank of England which, at 4 April 2014, amounted to £315 million (2013: £185 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.

42 Post balance sheet event

Included within loans and advances to customers at 4 April 2014 are commercial real estate loans with gross balances of £694 million (€841 million) which the Group has sold since the year end. Net sales proceeds are in line with the carrying value of the assets.

43 Capital management

The Group is subject to the capital requirements imposed by its regulator the Prudential Regulation Authority (PRA). Regulatory capital comprises the Group's general reserve, revaluation reserve, core capital deferred shares, other equity instruments, 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 PRA. Further unaudited details about the Group's capital position can be found in the Capital Management Report.

44 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 1SN

Other Information

Poor numeracy is a major problem that holds many British people back in life. That's why we have committed to help 200,000 young people improve their numeracy by 2017. In primary schools, Nationwide volunteers offer one to one coaching. At our MoneyLive facility in Birmingham's Safeside centre, teenagers can tour a full size virtual village to learn about personal and financial safety.

Annual Business Statement

For the year ended 4 April 2014

1 Statutory percentages

	2014	Statutory limit
	%	%
Lending limit	**10.16**	25.0
Funding limit	**19.60**	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, and

iii) the principal value of, and interest accrued under, bills of exchange, instruments or agreements creating or acknowledging indebtedness and accepted, made, issued or entered into by the Society or any such undertaking, less any amounts qualifying as own funds.

Y = the principal value of, and interest accrued on, shares in the Society held by individuals otherwise than as bare trustees (or, in Scotland, simple trustees) for bodies corporate or for persons who include bodies corporate.

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

	2014	2013*
	%	%
As a percentage of shares and borrowings:		
■ Gross capital	**6.8**	6.0
■ Free capital	**5.9**	5.1
■ Liquid assets	**10.3**	13.6
Profit for the financial year as a percentage of mean total assets	**0.29**	0.09
Management expenses as a percentage of mean total assets	**0.85**	0.73

* Comparatives have been restated in accordance with IAS 19 (Revised) Employee Benefits. Refer to note 1 for further details.

The above percentages have been prepared from the Society's consolidated accounts and in particular:

- 'Shares and borrowings' represents 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, CCDS, Additional Tier 1 capital, subscribed capital and subordinated liabilities
- 'Free capital' represents the aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment and intangible fixed assets
- 'Liquid assets' represent the total of cash, loans and advances to banks and investment securities
- 'Mean total assets' represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year
- 'Management expenses' represent administrative expenses including depreciation, amortisation and impairment of property, plant and equipment and intangible fixed assets.

Annual Business Statement continued

For the year ended 4 April 2014

3 Information relating to directors
At 4 April 2014

Directors			
Name and date of birth	**Occupation**	**Date of appointment**	**Other directorships**
G M T Howe MA (Cantab) Chairman 3 September 1949	Lawyer	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	
T P Prestedge 12 February 1970	Chief Operating Officer	28 August 2007	Nationwide Anglia Property Services Limited Dunfermline BS Nominees Limited Monument (Sutton) Limited The Derbyshire (Premises) 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 NBS Fleet Services Limited Staffordshire Leasing Limited Arkose Funding Limited
C S Rhodes BSc (Hons), ACA 17 March 1963	Group Retail 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 National Numeracy (Trustee) Visa Europe Limited Visa Europe Services Inc.
A P Dickinson MBA, BSc (Hons), FSS, FCIB, FCIBS 12 June 1950	Non Executive Director	15 June 2010	Kennington Oval Limited Carpetright plc Motability (Governor) Willis Limited Brown Shipley & Co Ltd (Chairman)
M K Jary MA (Oxon), MBA, FRAS 15 June 1963	Management Consultant	1 January 2009	Duchy Originals Limited (Chairman) OC&C Peleus Advisors LLP (Designated Member) OC&C Strategy Consultants LLP (Designated Member) OC&C Strategy Consultants International (Netherlands) (Partner) PCF Social Enterprises Limited (Chairman) The Michael Jary Charitable Trust (Chairman) Fairtrade Foundation (Chairman)

3 Information relating to directors (continued)
At 4 April 2014

Directors

Name and date of birth	Occupation	Date of appointment	Other directorships
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 Bower Bequest Trustee Company Limited Tullett Prebon plc Resolution Ltd Sova Friends Life Group plc Friends Life Group Holdings Limited
Ms R Clifton CBE MA (Cantab), FRSA 30 January 1958	Non Executive Director	1 July 2012	Populus Limited WWF – UK (Fellow) Henley Festival Ltd The British United Provident Association Ltd The Conservation Volunteers TCV Trading 1 Limited TCV Trading 2 Limited BCTV BrandCap Ltd Rita Clifton Limited ASOS plc
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 Standard Life Charitable Trust
M A Lenson MBA, BA (Hons), ACIB, FSI 17 September 1954	Company Director	18 July 2011	Eclipse Film Partners No.39 LLP (Designated Member) The Invicta Film Partnership No.37 LLP (Designated Member) Elysian Fuels 1 LLP (Designated Member) Elysian Fuels 2 LLP (Designated Member) MVA Consultant Services Limited

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. Four executive directors have contracts on this basis; they are G J Beale, M M Rennison, T P Prestedge 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.

50% of awards to directors from the 2013/14 Annual and 2011-14 Medium Term Performance Pay Plans will be linked to the value of the Society's Core Capital Deferred Shares, details of which have been provided in the Report of the Directors on Remuneration.

Indicators for global systemically important banks (G-SIB)

At 31 December 2013

The Basel Committee on Banking Supervision requires disclosure of the 12 indicators used in the assessment methodology for global systemically important banks which have been provided to the PRA. Nationwide meets the threshold for this disclosure requirement as its Basel III leverage ratio exposure measure exceeds €200 billion. The indicators are included within five categories covering cross-jurisdictional activity, size, interconnectedness, substitutability/financial institution infrastructure and complexity.

Nationwide's disclosures are as shown below:

Category	Individual Indicator	Indicator value 31 December 2013 £m
Cross-jurisdictional activity	Cross-jurisdictional claims	6,590
	Cross-jurisdictional liabilities	6,589
Size	Total exposures	211,136
Interconnectedness	Intra-financial system assets	2,458
	Intra-financial system liabilities	6,376
	Securities outstanding	31,257
Substitutability/financial institution infrastructure	Assets under custody	-
	Payments activity	1,324,777
	Underwritten transactions in debt and equity markets	-
Complexity	Notional amount of OTC derivatives	112,400
	Level 3 assets	82
	Trading and AFS securities	2,850

Cross-jurisdictional activity captures a bank's global footprint. Cross-border claims and liabilities indicate a bank's activities outside of its home jurisdiction.

Size is captured through total exposures, which includes on and off-balance sheet items, derivatives and securities financing transactions.

Interconnectedness measures the inter-linkages of financing activities in relation to other financial institutions and reflects loans and deposits from and to other financial institutions, as well as holdings of securities issued by other financial institutions and securities issued by Nationwide.

Substitutability/financial institution infrastructure indicators provide an understanding of a bank's role in a particular business line or as a service provider of infrastructure that supports financial markets. For Nationwide, this includes only payments activity, reporting the gross value of all cash payments sent in the period.

Complexity measures the business, structural and operational complexity of a financial institution. These indicators include the notional amount of over the counter (OTC) derivatives transactions, the fair value of assets categorised as Level 3 in the fair value hierarchy, and the value of those available for sale securities that are more likely to incur discounts if sold in a stressed situation.

Glossary

Additional Tier 1 (AT1) capital	Capital that meets certain criteria set out in CRD IV. In particular, the criteria require that upon the occurrence of a trigger event, the AT1 capital instrument converts to Common Equity Tier 1 capital or the principal is written down on a permanent or temporary basis.
Additional Tier 1 (AT1) securities	Securities that pay a fixed annual coupon at the discretion of the Group. In the event of insolvency, AT1 securities rank the same as PIBS securities holders but behind the claims of all subordinated debt holders, creditors and investing members of the Group, but ahead of CCDS investors. These securities are eligible as Tier 1 capital.
Arrears	Amounts that are unpaid at their contractual date. A customer is in arrears when they are behind in fulfilling their obligations such that an outstanding loan payment is overdue. Such a customer can also be said to be in a state of delinquency. When a customer is in arrears, the entire outstanding balance is said to be delinquent, meaning that delinquent balances are the total outstanding loans on which payments are overdue.
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.
Available for sale (AFS)	Financial assets that are not classified as loans and receivables, held to maturity investments or financial assets at fair value through the income statement.
Bank levy	A levy that applies to certain UK financial institutions (including Nationwide) and the UK operations of foreign banks since 1 January 2011. The levy is based on a percentage of the chargeable equity and liabilities of the institution at the balance sheet date.
Base mortgage rate (BMR)	The Society's base mortgage rate, currently at 2% above the Bank of England base rate. This is available to customers where their current product began before the introduction of SMR during 2009.
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 III	The Basel Committee rules text, issued in December 2010, which presents the details of strengthened global regulatory standards on bank capital adequacy and liquidity. This has been implemented via the CRD IV legislation.
Basel III leverage ratio exposure	The denominator used in the Basel III leverage ratio. Exposure is measured as the sum of the on-balance sheet exposures, derivative exposures, securities financing transaction exposures and off-balance sheet items.
Basis point (bp)	One hundredth of a per cent (0.01 per cent). 100 basis points is one per cent. Used in quoting movements in interest rates and yields on securities.
BIPRU	The prudential sourcebook for banks, building societies and investment firms.
Buy to let mortgages	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 Common Equity Tier 1 ratio, Tier 1 ratio and total capital ratio.
Capital requirements	The amount of capital that the Group is required to hold based upon the risks to which the business is exposed.
Capital Requirements Directive (CRD)	The supervisory framework in the European Commission which reflects the Basel II and Basel III rules on capital measurement and capital standards.
Capital Requirements Directive IV (CRD IV)	European legislation to implement Basel III, which includes the Capital Requirements Regulation (CRR) and Capital Requirements Directive (CRD).
Capital Requirements Regulation (CRR)	European regulation that is directly applicable to European Union member states defining prudential requirements for capital, liquidity and the credit risk for credit institutions and investment firms.

Glossary continued

Capital resources	Capital held, allowable under regulatory rules, less certain regulatory adjustments and deductions that are required to be made.
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.
Charge off	The point at which the customer relationship for non-active accounts is transferred to being one of recovery only, due to significant level of arrears or through placement with a debt collection agency or litigation.
Collateral	Security pledged for repayment of a loan.
Collateralised debt obligations (CDO)	Securities issued by a third party which reference ABS and/or certain other related assets purchased by the issuer. The Group has not established any programmes creating CDOs but has invested in instruments issued by other banking groups.
Collateralised loan obligations (CLO)	Securities 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.
Commercial real estate (CRE)	Includes office buildings, industrial property, medical centres, hotels, retail stores, shopping centres, multifamily housing buildings, warehouses, garages and industrial properties.
Common Equity Tier 1 capital	The highest quality form of capital as defined in CRD IV, comprising accumulated reserves and qualifying instruments after regulatory deductions.
Common Equity Tier 1 (CET1) ratio	Common Equity Tier 1 capital expressed as a percentage of risk weighted assets.
Consumer banking	Comprises credit card, unsecured personal lending and the Group's FlexAccount (current account) products.
Consumer Credit Act (CCA)	The legislation on how firms should market and manage credit for the protection of consumers.
Contingency funding plan (CFP)	A document recording the Group's plan in a range of liquidity and economic factor scenarios, which could have an impact on the Group over multiple time horizons.
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 capital deferred shares (CCDS)	A form of CET 1 capital which has been developed to enable the Society to raise capital from the capital markets. Holders of CCDS receive periodic distributions from the Society. Distributions are discretionary and capped in any financial year. In the event of insolvency, CCDS holders rank behind the claims of AT1 securities holders, PIBS securities holders, all subordinated debt holders, depositors, creditors and investing members of the Group.
Core liquidity ratio	The proportion of total assets that are readily convertible.
Core Tier 1 capital	The highest quality form of capital as defined by the PRA, comprising accumulated reserves and qualifying instruments after regulatory deductions. This class of capital is replaced by Common Equity Tier One Capital under CRD IV.
Core Tier 1 capital ratio	Core Tier 1 capital as a percentage of risk weighted assets.
Cost income ratio (CIR)	A ratio that represents the proportion of administrative expenses to total income.
Covered bonds	Debt securities backed by a portfolio of mortgages that are segregated from the issuer's other assets to be 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 spread	The premium over the benchmark or risk-free rate required by the market to accept a lower credit quality.
Credit valuation adjustment (CVA)	The difference between the risk-free value of a portfolio of trades and the market value which takes into account the counterparty's risk of default. The CVA therefore represents an estimate of the change to fair value that a market participant would make to incorporate inherent credit risk.
Currency swap	An arrangement in which two parties exchange specific principal amounts of different currencies at inception and subsequent 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.
Customer deposits	Money deposited by personal account holders. Such funds are recorded as liabilities in the balance sheet within shares or due to customers.
Customer redress	Compensation for loss as a result of past sales or other consequence (including technical breaches) of financial products.
Debit valuation adjustment (DVA)	The difference between the risk-free value of a portfolio of trades and the market value which takes into account the Group's risk of default. The DVA therefore, represents an estimate of the adjustment to fair value that a market participant would make to incorporate the credit risk of the Group.
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 the CRD IV legislation. 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 bases 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 bases 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 pension 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 Group 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.

Glossary continued

Effective interest rate method (EIR)	The method used to measure the carrying value of a financial asset or liability. EIR allocates associated 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.
Encumbered assets	Assets on the balance sheet which have been pledged as collateral against an existing liability.
End point	Full implementation of CRD IV with no transitional provisions.
Enterprise Risk Management Framework (ERMF)	A framework that seeks to provide the context and guidance for cohesive risk management activity across the Group.
European Banking Authority (EBA)	An independent EU authority which works to ensure effective and consistent prudential regulation and supervision across the European banking sector.
Expected loss (EL)	A calculation to estimate the potential losses on current exposures due to potential defaults. 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)	An estimation of the amount of exposure that will be 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 Conduct Authority (FCA)	The statutory body responsible for conduct of business regulation and supervision of UK authorised firms from 1 April 2013. The FCA also has responsibility for the prudential regulation of firms that do not fall within the PRA's scope.
Financial Ombudsman Service (FOS)	An independent service in the UK for settling disputes between businesses providing financial services and their customers.
Financial Policy Committee (FPC)	A committee based at the Bank of England, charged with identifying, monitoring and taking action to reduce or remove systemic risks with a view to protect and enhance the resilience of the UK financial system. It is also responsible for supporting the economic policy of the UK Government.
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.
Fitch	Rating agency, Fitch Ratings Limited.
Forbearance	Forbearance takes place when a concession is made on the contractual terms of a loan to a customer as a result of financial difficulties.
Foreign exchange risk	The risk that movements in exchange rates adversely affect the value of assets, liabilities, income or costs incurred in foreign currency.
Foundation IRB approach	A method of calculating credit risk capital requirements using internal PD models but with PRA 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.
Funding for Lending Scheme (FLS)	A scheme launched by the Bank of England in July 2012 to incentivise banks and building societies to lend to UK households and non-financial companies through reduced funding costs, the benefits of which are passed on to UK borrowers in the form of cheaper and more easily available loans.
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, CCDS, Additional Tier 1 capital, subscribed capital and subordinated liabilities.
Gross lending	New lending advanced to customers during the period.
House price index (HPI)	An index monitoring changes in house prices both monthly and annually, providing a comprehensive view of the property market.
Help to buy shared equity scheme	A Government scheme which helps house purchasers obtain a mortgage with a 5% deposit. The property is part financed (up to 20% and a minimum of 10%) by an equity loan from the Homes and Communities Agency.
Impaired loans	Loans which are three or more months in arrears, or which have individual provisions raised against them.
Impairment provisions	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 on loans	The reduction in the value of a loan that arises following an impairment review which determines that the recoverable amount is less than the loan's carrying value.
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 PRA on a firm's required quantity of liquidity resources and funding profile.
Individually/collectively assessed impairments	Assets are assessed individually for impairment where there is objective evidence that an impairment loss has occurred. Where a portfolio comprises assets with similar characteristics, collective impairment assessment takes place using appropriate statistical techniques. 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 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)	An 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 PRA permission.
International Accounting Standards Board (IASB)	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.
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	A measurement of the performance of the prime 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.

Glossary continued

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. most investment grade and liquid bonds, asset backed securities, certain CDOs, 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. private equity investments, derivatives including an equity element, deposits including an equity element, some CDOs and certain asset backed securities and bonds.
Leverage ratio	A supplementary measure of risk adjusted capital requirements, defined as the ratio of Additional Tier 1 capital to total exposures.
Libor (London Interbank Offered Rate)	A benchmark interest rate at which banks can borrow funds from other banks in the London interbank market.
Liquid asset buffer (LAB)	A surplus level of adequate, high quality, unencumbered assets that must be held in order to meet the BIPRU requirements for liquidity resources.
Liquidity and funding risk	Liquidity risk is the risk that the Group is unable to meet or settle its financial obligations as they fall due or maintain public and stakeholder confidence. Funding risk is the risk that the Group is unable to realise assets or otherwise raise funds on reasonable terms and/or within reasonable timescales.
Liquidity coverage ratio (LCR)	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 deposit ratio	Represents loans and advances to customers divided by the aggregate of shares, other deposits and amounts due to customers.
Loan to value ratio (LTV)	A ratio which expresses the amount of exposure as a percentage of the value of property on which it is secured. The Group calculates LTV on an indexed basis such that the value of the property is updated on a regular basis to reflect changes in the market using either the house price or commercial real estate indices.
Loans past due/past due loans	Loans where a counterparty has failed to make a payment when contractually due.
Loss given default (LGD)	An estimate of the difference between exposure at default (EAD) and the net amount of the expected recovery expressed as a percentage of EAD.
Loyalty saver	A distinctive set of products which pay enhanced rates as membership length increases.
Main current account	The primary or sole current account used by the customer.
Market risk	The risk that the value of, or net income arising from, the Group's assets and liabilities are impacted as a result of balance sheet or market rate changes.
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.
Moody’s	Rating agency, Moody’s Investors Service Limited.
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).
Mortgage market review (MMR)	A report published by the FCA, requiring all mortgage lenders to enhance responsible lending controls for mortgages by 26 April 2014, to ensure that all mortgages are affordable, and to minimise the risk of detrimental outcomes for customers.
Near prime	Loans to borrowers with marginally weakened credit histories such as a County Court Judgement (CCJ) or default of 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, 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).
Non-performing loans	Loans which are in arrears, including impaired loans with individually assessed impairments.
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.
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.
Pension risk	The risk that the Group's funding obligations for a number of defined benefit pension schemes expose the Group to longevity risk and various market risks including interest rate risk, inflation risk and equity risk in relation to those schemes.
Performing loans	Loans which are neither past due nor impaired.
Permanent interest bearing shares (PIBS)	Unsecured, deferred shares of the Society that, in the event of insolvency, rank equally with the claims of AT1 securities, behind the claims of all subordinated debt holders, depositors, creditors and investing members of the Group, and ahead of the claims of CCDS investors. PIBS are also known as subscribed capital.
Prime residential mortgages	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 that are not quoted on a public exchange.
Probability of default (PD)	An estimate of 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 provisions to the corresponding portfolio of loans and advances to which they relate.
Prudential Regulation Authority (PRA)	The statutory body responsible for the prudential supervision of banks, building societies, insurers and a small number of significant investment firms in the UK from 1 April 2013. The PRA is a subsidiary of the Bank of England.
Regulatory capital	Capital allowable under regulatory rules, less certain required regulatory adjustments and deductions.
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 estimated present value of 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.

Glossary continued

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 funding	Funding obtained from individuals rather than institutions.
Retail IRB approach	An 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 PRA permission.
Retail loans	Loans to individuals rather than institutions, including residential mortgage lending and consumer banking.
Risk appetite	The level and type of risk that the Group is willing to assume in pursuit of its strategic goals.
Risk weighted assets (RWA)	The value of assets, after adjustment under the 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.
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.
Solo surplus	Total capital on an individual consolidated basis less capital requirements. Individual consolidation is a consolidation basis for regulatory purposes which only includes those subsidiaries meeting particular criteria contained within CRD IV.
Solvency risk	The risk that the Group fails to maintain sufficient capital to absorb losses throughout a full economic cycle or to maintain the confidence of current and prospective investors, members, the Board, and regulators.
Sovereign exposures	Exposures to governments, ministries, departments of governments, embassies, consulates and exposures on account of cash balances and deposits with central banks.
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).
Specialist residential lending	Consists of buy to let, self-certified and other non-standard mortgages.
Standard & Poor's (S&P)	Rating agency, Standard & Poor's Credit Market Services Europe Ltd.
Standard mortgage rate (SMR)	The rate mortgage customers revert to since 2009, once any contractual fixed or variable period ends.
Standardised approach	The basic method used to calculate credit risk capital requirements. In this approach the risk weights used in the capital calculation are determined by PRA supervisory parameters. The Standardised approach is less risk-sensitive than IRB.
Stress testing	A process which involves identifying possible future adverse events or changes in economic conditions that could have unfavourable effects on the Group (either financial or non-financial), assessing the Group's ability to withstand such changes, and identifying management actions to mitigate the impact.
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 Additional Tier 1 securities (AT1), permanent interest bearing shares (PIBS) and core capital deferred shares (CCDS).

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).
Swap rate	The fixed interest rate in a fixed to floating interest rate swap.
Tier 1 capital	A measure of the Group's financial strength prior to the introduction of the CRD IV legislation. The Group's general reserves, CCDS and AT1 qualify as Tier 1 capital.
Tier 1 capital ratio	Tier 1 capital as a percentage of risk weighted assets.
Tier 2 capital	A further measure of the Group's financial capital that meets the Tier 2 requirements set out in the CRR, comprising qualifying subordinated debt and other securities and eligible impairment allowances after 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 to transform the way activities are performed.
Unaudited	Financial information that has not been subjected to the audit procedures undertaken by the Group's external auditor.
Underlying profit	A measure which aims to present 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.
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, the Group uses a 10 day horizon and a 99% confidence level.
Wholesale funding	Funding received from larger business, financial institutions and sovereign entities.
Wholesale funding ratio	Wholesale funding as a percentage of total funding.
Wholesale lending	Lending to larger businesses, financial institutions and sovereign entities.
Write off	The point where it is determined that an asset is irrecoverable, or it is no longer considered economically viable to try and recover the asset or final settlement is reached and the shortfall written off. In the event of write off, the customer balance is removed from the balance sheet and the impairment provision held against the asset is released.

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