2018
ANNUAL
REPORT
AND ACCOUNTS

The
Nottingham

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KEY HIGHLIGHTS

The Society has continued to focus on the development of its strategy of rewarding our members for planning, protecting and saving for their future. We continue to deliver our 'all under one roof' advice and service offering through enthusiastic expert team members. We strive to be easy to deal with and to be known as a force for good in our heartland.

Below are some of the key achievements and financial highlights of 2018:

We strive to support and reward our members to plan for and protect their financial futures

- Group pre-tax profit of £11.8 million
- Total assets of £4.1 billion
- Gross mortgage lending of over £800 million resulting in mortgage book growth of 4%
- Strong retail franchise – total branch balances of £2.4 billion – up 13% in 2018
- The Society welcomed over 25,000 new customers and is now present in 67 locations across 11 counties
- Over 2,750 customers used our whole-of-market mortgage advice services in 2018
- Net Promoter Score of 79%
- Arrears levels remain very low at less than a quarter of industry average
- Strong capital ratios with Tier 1 ratio at 15.3% and leverage ratio of 5.1%

CHAIRMAN'S STATEMENT

John Edwards

Market and economic background

I began my statement last year with some comments regarding the difficult December the UK had just experienced in Brussels regarding the Brexit agreement. 12 months further on, with March 29th almost upon us, it doesn't feel as if 2018 delivered any real progress in terms of the arrangements for our withdrawal from the EU, which are still not finalised.

Against this backdrop of continued uncertainty, the UK economy has begun to show signs of a slowdown with GDP growth in 2018 at a six year low of 1.4% in the ONS' first estimate, a fall from 1.8% in the previous year. Inflation has now fallen below the Bank of England's target of 2%, though employment remains at an all-time high.

Furthermore, these statistics mask a series of significant societal and economic shifts which, when combined with our currently assumed new status outside of the European Union, will undoubtedly deliver continued challenges and uncertainty for the UK over the coming years.

Consumer behaviour is undergoing one of the biggest shifts for over 50 years with high streets up and down the country suffering alongside a large number of established and reputable retailers. The increasing role of online and smartphones is changing the way we live and causing all consumer facing businesses to re-evaluate how they remain relevant for their customers in this emerging world.

Building societies, like all customer led organisations, are facing into these changes. For example, the way we buy and sell houses is beginning to change fundamentally, with shifting expectations around what good looks like for customers. However, the second half of the year has demonstrated that this is not a binary debate about online versus traditional players – in late 2018, a number of national online estate agencies went into administration, leaving thousands of homes unsold, despite the fact that vendors had already paid for the service.

As we progress through 2019, there is no doubt that if economic conditions tighten in the face of uncertain demand, alongside increasing societal changes in shopping and purchase habits, trading conditions will get more challenging.

We saw this beginning to emerge in the second half of 2018. As housing transactions stuttered, competition for mortgage lending increased significantly and some lenders were willing to provide mortgages at less than 1%. In response, we wisely elected to moderate our activity and slow down our lending plans. We do not believe it is sustainable to develop and grow the Society, as we have done so successfully in recent years, if yields on mortgages, which are used to pay our savers and run the Society, are 1% or less. This is a clear demonstration of our mutual ethos of running this Society for the long term benefit of all its members, whilst managing short term turbulence in trading conditions.

Whilst we remain vigilant for any opportunities that may arise as a consequence of these difficult trading conditions, we believe that the next 12-18 months will be characterised as difficult and uncertain. Margins for all societies will fall and housing transactions are likely to be flat at best. We therefore expect a period when our income profile will not be growing in the way that it has done so over the past five years.

However, as we have said previously, we remain confident in our strategy, recognising that in the years ahead it will be more important than ever for our members to plan for, and protect, their financial futures. Our unique proposition and continued investment in digitalisation will make The Nottingham more relevant to all age ranges, irrespective of the short term trading conditions.

Regulation

The Regulators continue to introduce significant changes to how they want firms to operate in the new market conditions. Whilst many of the changes reflect how we believe firms should operate in a modern market place, there is nevertheless always significant work required for societies to demonstrate and document compliance with the new regulatory requirements.

2018, in particular, witnessed a significant agenda, not least the GDPR provisions, which introduced the biggest change in data protection regulation seen for over 25 years. This significant European-wide change was also accompanied by new standards and expectations related to operational resilience, largely linked to the increasing cyber security threat, as data losses across all industries became almost a daily occurrence on the news. The Society welcomes these new provisions and continues to do all it can to protect members' data. This included the transfer of all our data servers from the Society's premises to state of the art, purpose built data centres. Through our developing relationship with Salesforce, the Society also has access to global leading data security techniques and capabilities, which we believe will be increasingly important in the years ahead.

In addition to the above, there were a range of other regulatory initiatives in 2018 covering cash savings, mortgages and the introduction of IFRS 9, a completely revised accounting standard related to providing for future losses on lending – all in all another busy year.

Strategy and progress

We are confident that our unique 'all under one roof' member proposition, which seeks to support and reward our loyal members for planning for and protecting their financial futures, remains aligned with our founding fathers' original purpose, as well as being relevant and valued by existing and prospective members today.

However, as I noted earlier, we fully understand that the way we deliver this proposition needs to reflect the changing expectations of existing and future members. We remain of the belief that there is a role for a strong mutual provider like The Nottingham to combine the best of face-to-face advice and service, with the digital accessibility that is now expected as the norm.

The Board continues to encourage the management team to develop our unique proposition such that it can be equally accessible face-to-face, digitally, or in any combination that a member may wish to use. We accept

that in the short term this will markedly increase the sum that we invest in your Society, but it is absolutely the right decision to best serve our members and customers.

David highlights the progress and achievements of the past 12 months in his Chief Executive review on page 6.

Board

Reflecting the pace of change within the Society and in general, the Board has continued to evolve during the year.

Simon Baum joined us as a Non-Executive Director in June. Simon joins us following a successful career in retail banking where he specialised in credit risk and risk management at a range of firms including Experian, PwC, Alliance & Leicester plc, Santander UK plc and Nationwide Building Society. Simon has already brought his wide and extensive experience to bear to the benefit of the Society as Chair of our Board Risk Committee – I welcome Simon to our Board.

Following almost eight successful years as Chief Operating Officer, Simon Taylor left the Society to pursue new challenges. Simon was an integral part of the executive team that has grown and developed the Society; almost doubling our assets and taking our branch network from 34 branches over four counties to 67 covering 11 counties. We thank him for his contribution and wish him well for the future.

Charles Roe joined us in April as Chief Risk Officer from Grant Thornton LLP where he was a Director in their Regulatory Financial Services practice. Prior to that Charles was at the FSA/FCA where he undertook a number of senior supervisory roles including Head of Department for the Insurance Broking and Mortgage and Building Society sectors. Charles has established himself strongly in his first few months with the Society and we were delighted to appoint him as an Executive Director of the Society in January 2019.

After having served the Society loyally for 13 years, I am sorry to announce that Jane Kibbey, our Senior Independent Director and Vice Chair will be retiring from the Board when her period of office expires at the AGM in April.

Jane has served the Society and Board tirelessly over what has been a significant period of change and success. During her tenure she has, at various points, been a member of all four Board sub-committees; most notably as Chair of the Remuneration Committee from 2015 to 2017. She has consistently championed the voice of the member, ensuring that we have maintained world class service levels over many years and consistently delivered great value to our growing membership.

Since succeeding Keith Whitesides as Senior Independent Director and Vice Chair, Jane has continued to support me with her wise counsel and effervescent enthusiasm for The Nottingham and its mutual values. We all wish Jane our very best wishes for the future and a long and happy retirement, whilst committing to maintain her enthusiasm and focus on delivering value to our members through our unique proposition. Thank you Jane for your support and guidance, you will be missed by all of us.

Supporting our communities

One of the four pillars upon which we base the Society is how we support our communities through our Doing Good Together initiative. I am pleased and proud that we have continued to do this through a wide range of activities all aimed to support one of our charitable themes of homelessness, employability and financial awareness.

Our Grants for Good scheme provided £32,000 to a whole range of groups, supporting over 3,000 people across Nottinghamshire, Leicestershire, Lincolnshire, Norfolk and South Yorkshire – our grant programme has now distributed over £170,000 in the past seven years.

We also continued to commit strongly to our charity partnership in 2018. 250 students at more than 15 schools and colleges have benefited from our support of the great work carried out by Young Enterprise to ignite commercial and entrepreneurial skills in teenagers. 300 students have also benefited from our Money Academy sessions, designed to help with personal money management.

We have sponsored and participated in three Sleep Out events in support of Framework this year – supporting 500 fundraisers to fund the rough sleeper hotline and support the charity's off the street campaign. We have also supported 50 local up and coming athletes through our support of the charity SportsAid, some of whom have gone on to represent Great Britain at a range of international events.

Of course our staff continued to do fantastic things. Volunteering for a whole range of charitable activities in support of our charity partners and a significant amount of fundraising for Macmillan, Help for Heroes, MND, Homestart, Stonebridge City Farm and Second Helpings. As ever, my gratitude and immense respect go to all our team members who selflessly gave their time and financial support to such a wide range of deserving causes.

Summary

Whilst we continue to live in uncertain times, helping our members plan and protect their financial futures remains as relevant as ever.

However, it is clear that the whole building society sector is going through a seismic change in terms of how members expect to receive advice and service. Whilst we have demonstrated consistently in recent years that branches have a core role to play in delivering our proposition, it will be equally important to ensure we can seamlessly deliver excellent service in both the physical branch environment and the digital world.

We have embarked on investing in, and developing, leading technology for our members and expect to need to continue to do so for the foreseeable future as we continue to successfully grow our membership sustainably, both now and in the years ahead.

It is at times like these that our mutual ethos serves us well, enabling us to continue to invest in the long term success of the Society, despite short term market, economic and political uncertainties. This has been made possible by our financial strength and the progress we have achieved in recent years to grow the Society and build our capability. Whilst we expect profitability to reduce in the short term, the Board remains confident that it is in the long term interests of our membership to continue to deliver world class service, great value and invest for the future, rather than pursue short term profit.

I would as always like to thank all of our team members, and our partners and suppliers who have supported us strongly over the past year, and wish them all our very best wishes for 2019.

Finally I would like to thank you, our members, for your continued support and loyalty in 2018.

John Edwards
Chairman

14 March 2019

CHIEF EXECUTIVE'S REVIEW

David Marlow

As highlighted in the Chairman's statement, the Society continues to face changing and uncertain times. Against this backdrop, I am pleased to report that we have continued to make good progress in the development of our 'all under one roof' strategy to support and reward our members to plan for and protect their financial futures.

As we headed into 2018, we undertook to focus on four key pillars of: serving and rewarding our growing membership, delivering operational excellence, strong financial adequacy and developing a culture which continually encourages our people to do the right thing for members and supporting the communities that we operate in.

Serving and rewarding our members

Over recent years we have championed the role of branches in the delivery of our unique proposition and finished 2017 by opening seven new branches in Cambridgeshire, Lincolnshire and Norfolk. I am pleased to report that we have continued to see our members taking advantage of our enlarged network. Savings balances in branches increased in 2018 by 13% and have now reached almost £2.4 billion; up from just over £1 billion in 2013. We have been very pleased with the performance of our seven new branches with balances achieved of almost £100 million and over 5,000 new members welcomed. This is ahead of our expectations. We now have £0.5 billion of balances in our new branches which have opened between 2013 and 2017. We continue to attract new members, with over 25,000 joining us in 2018. This included new LISA customers, as we became only the second provider to offer a Cash Lifetime ISA, giving our members an opportunity to save for their first home and receive up to a £1,000 bonus every year from the Government. We are excited about the opportunity to grow a new section of our membership in 2019, particularly when we offer our LISA account online for the first time through our new innovative savings platform.

Members continued to benefit from our unique member rewards scheme which is designed to reward members, with cashback and discounts for planning and protecting their financial futures – in 2018 members benefited to the tune of just under £0.5 million. Members also continue to increase their use of our unique whole-of-market mortgage advice service through Nottingham Mortgage Service ('NMS'), with a record number benefiting from our advice in 2018. Over the past five years we have helped almost 12,000 customers find the right mortgage for them, from across the market. This is set to grow further as increasing numbers of members remortgage through the service – in fact in 2018, over 30% of our total business was for existing NMS customers taking a new deal.

In December we were excited to launch our concept branch in new premises at Newark. There are a number of new innovations which we expect to be popular with members including individual seated booths for transacting, no more standing at the counter and the introduction of a new community area which provides facilities and technology for community groups to take advantage of. We will be reviewing the results and findings closely before commencing a broader rollout of our new approach to branch advice and service.

Continued excellence in advice and service from our team members has enabled us to continue to deliver world class levels of customer service. We have maintained our Net Promoter Score of 79%, which is some way ahead of the financial service average of 49%. We were also very pleased to note that The Nottingham was announced as one of the firms with the lowest level of complaints across the entire financial services industry, according to official FCA figures, for the first half of 2018.

This message was endorsed to me and my senior colleagues by our members as we embarked on a number of member roadshows across our branch network in 2018. These events are important in confirming that we are consistently meeting our high service standards and to give members the opportunity to let us know what good looks like for them and how we could further improve our service. My thanks go to all our members who take the time to join us on these events and provide their feedback.

Operational excellence

If we are to maintain our current standards and develop our proposition and service so that it remains relevant to existing and prospective new members, we must continue to invest in, and develop, the capability of the Society to ensure that we meet our members needs now and in the future.

In 2018, we have embarked on an extensive programme of digital development to ensure that in the future our members can benefit from an engaging and innovative online offering, which seamlessly integrates with our face-to-face service, ultimately offering the best of both worlds.

In December, we were proud to announce the launch of 'Beehive Money'; our first large scale implementation of our new internet platform capability delivered in partnership with Salesforce – a global leader in digital customer relationship management. All existing online savers have now been moved over to Beehive Money, which offers a speedier, simpler, and more intuitive way to save money online.

In 2019 we aim to move our mortgage intermediary broker application system onto the new platform and, in doing so, radically reduce the time it takes to apply for, and receive, a decision in principle from us. We will also introduce the opportunity for our LISA savings customers to apply for and conduct their account online as well as in branch, and ultimately offer all Society savings customers the opportunity to operate their savings accounts online in addition to in-branch. At present they must choose one or the other.

In addition to launching our new concept branch in Newark, we have also been investing in technology across our branch network to provide quicker access to advice and support. We have installed a high definition video capability across our branch network, which enables us to offer customer interviews in branch with one of our specialists, wherever they may be, across our branch network or at our head office in Nottingham. The dual screen technology, supported by network printing, allows continuous dialogue with one of our advisors whilst also being able to present all

relevant details to customers. Initial customer reaction to this new innovation has been excellent and it has significantly reduced the need to make an appointment with one of our specialist mortgage advisers. This is another example of how we can maximise the utilisation of our branch network as an advice and service hub.

Our performance

As the Chairman highlighted, following a strong first half of the year for lending, changing market conditions led us to temper our plans for the remainder of 2018.

We ended the year by growing our mortgage book by 4% to £3.5 billion; this was supported by gross lending of £834 million and over £600 million of existing customers switching to new terms with us at the end of their current deal. Whilst gross lending was not at the record level of the previous year, our capability to retain customers supported the good overall growth of the mortgage book.

As a mutual, we benefit from the ability to plan for the long term in the best interests of the Society's members. As such we do not need to strive to maximise profit, but continue to operate and develop the Society in a sustainable manner. This is well demonstrated in our financial performance for 2018, where we have grown net interest income, in the year by 4%. However, we have seen the anticipated impact of our investment plans for the Society's future, as we report a profit before tax of £11.8 million, which is down £2.7 million or 19% on 2017. This is despite managing administration expenses to an increase of just £1.7 million (4%) over the period. Overall this has enabled us to reduce our management expense ratio, which has fallen slightly in 2018 to 1.09%. In the coming period, we expect to need to continue to closely manage our mix of investment and administrative expenses, to strike the right balance for our members. We believe that this is the right approach to secure the future capability and sustainability of the Society, as we respond to significant shifts in customer behaviour and expectations.

Quality and strength

As always, the Society has continued to maintain a high level of financial strength underpinned by strong capital, liquidity and high credit risk standards. Our performance in 2018 has sustained our strong capital levels at a leverage ratio of 5.1%, as well as maintaining appropriate levels of high quality liquidity. Despite increased competition, we have maintained our high standard of credit assessment and this is reflected in our market leading credit quality. Under new IFRS 9 provisioning methodology, we have seen a small release of provisions for losses related to our lending this year. This is underpinned by the fact that from over 26,000 mortgage accounts, we only have 42 which are three months or more in arrears, remaining at an almost de minimis level for a book of this size. All evidencing the financial strength of the Society.

Further details of our financial adequacy can be found in the strategic report on page 9.

People and culture

Our culture and values are driven by our vision to reward our members for planning, protecting and saving for their future. We deliver our 'all under one roof' advice and service offering through enthusiastic expert team members. We strive to be easy to deal with and to be known as a force for good in our heartland.

Over the past 18 months we have worked with colleagues to live our values of being accountable and relevant to members as our ultimate owners; that we are respectful, open and work together as one team, whilst supporting our communities. It is their hard work and commitment that has enabled us to make such strong progress in the delivery of our member focused strategy.

Our people strategy and performance management approach are focused on supporting our team members to deliver our vision in line with our values, and in doing so create a positive open culture which is focused on serving our membership fairly. In 2018 we have focused hard on continuing to improve our leadership and communication across our growing operations, as well as engaging and encouraging all team members to speak up and for managers and leaders to listen carefully, to ensure we remain aligned with our stated vision and values. In 2018 our members have benefited from this as more of our colleagues have come forward to highlight areas of opportunities or activities where we could improve our proposition and service.

Outlook

2019 will undoubtedly be a year of uncertainty for us all. We continue to believe that our unique proposition, if delivered brilliantly and continually evolving to match changing expectations, will remain as popular as ever with our growing membership.

We are committed to creating the ideal hybrid of traditional service and advice with digital accessibility and innovation. That will enable us to help our growing membership plan for their financial futures more effectively and efficiently. We aim to do this by continuing to focus on serving and rewarding membership and having strong financial adequacy, whilst being reputable and resilient to all market conditions and supporting the communities in which we serve.

I would once again like to thank all our team members at The Nottingham and my colleagues on the Board for their enduring enthusiasm and commitment to developing our strategy and serving our members.

Finally, I would like to thank our members who continue to support loyally the Society.

David Marlow
Chief Executive

14 March 2019

STRATEGIC REPORT

Daniel Mundy

Business model and Group strategy

The Nottingham is the UK's eighth largest building society with £4.1 billion of assets and a regional presence extending to 67 branches over 11 counties. The Nottingham has the fifth largest building society branch network in the UK.

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

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

The membership model at The Nottingham looks to reward members for doing the right thing for planning and protecting their financial futures by providing access to advice services which may not otherwise be available to them. The Member Rewards programme we have in place supports this.

The Society continues to move forward from its firm foundations, focusing on the four key pillars of growing and rewarding membership; strong financial adequacy; operational excellence; and people, culture and community.

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

Group structure and brands

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

Business performance

The Chief Executive's review includes a summary of factors affecting our performance in 2018 and should be read in conjunction with this report.

This section focuses on the financial performance indicators that underpin our strategic pillars of financial adequacy and growing and rewarding membership. These are key to our business success and reviewed by the Board on a regular basis. The Board is pleased with the overall performance of the Group in the context of its strategic objectives.

Strategic objective	Key Performance Indicator	Achieved	2018 performance	
Strong financial adequacy				
Capital	Protect and build capital on behalf of members for the longer term whilst maintaining an excess over regulatory requirements.	✔	CET1 ratio: Tier 1 ratio: Leverage ratio:	14.7% 15.3% 5.1%
Liquidity	Maintain confidence of members and regulators by ensuring there is sufficient liquidity to meet obligations even in stressed conditions.	✔	LCR: Liquid resources:	219% 20.4%
Resilience	Have a resilient financial plan that delivers optimal financial performance and can withstand identified risks.	✔	PAT ratio: Interest margin: Cost income ratio: Manex ratio: Arrears ratio:	0.24% 1.26% 78.6% 1.09% 0.16%
Growing and rewarding membership				
Customer	Grow sustainable membership built on relationships. Deliver great advice and service.	✔	Net Promoter Score: More than 25,000 new customers Customer satisfaction:	79% 83%

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Underlying profit before tax	**13.6**	**15.6**	**15.0**	**16.8**
FSCS costs	-	(0.2)	-	(0.2)
Losses from derivative financial instruments	(0.7)	(0.2)	(1.2)	(0.3)
Strategic investment costs	(0.6)	(0.7)	(0.6)	(0.6)
Impairment of goodwill	(0.5)	-	-	-
Reported profit before tax	**11.8**	**14.5**	**13.2**	**15.7**

The Board monitors both reported and underlying profit before tax. Reported profit before tax is a commonly used comparative measure of profit. However, it includes a number of items which the Board does not believe fully reflect underlying business performance and therefore underlying profit is also used to measure performance. Underlying profit before tax equates to reported results, adjusted to exclude charges in respect of fair value gains or losses from derivatives and hedge accounting as well as one-off strategic investment costs, which are not ongoing in nature. The comparative periods are disclosed on a similar basis, but also include charges in respect of the Financial Services Compensation Scheme ('FSCS'), which have transferred into underlying profit in 2018. During 2018, the goodwill generated from the acquisition of the lettings business was impaired, and this is also one-off in nature.

2018 Financial review and key performance indicators

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

Underlying profit and profit after tax ratio

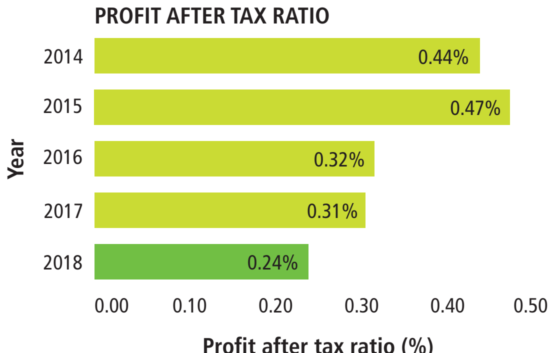
The Group's underlying profit before tax reduced by 13% from £15.6m to £13.6m in 2018. Whilst the Group did well to maintain income at similar levels to the previous year, this has been offset by rising operating costs as we invest for the future.

Strategic investment costs of £0.6m, which are excluded from underlying profit, reflect one-off costs incurred in relation to the restructuring of the Member Services divison and the implementation of the data protection legislation requirements.

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

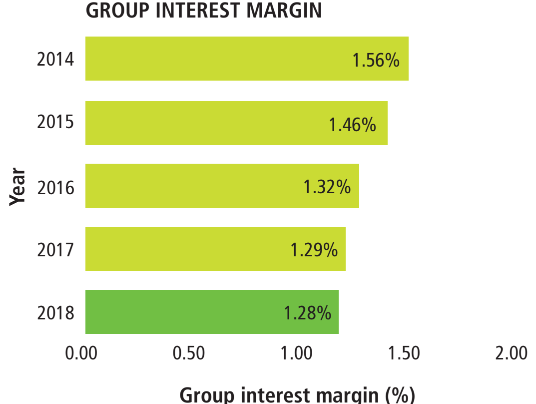
Another year of strong performance from the Group's whole-of-market mortgage advice business has contributed £0.4m of profit to the Group. This, however, has been offset by continued difficult trading conditions in the estate agency division, which has reported a trading loss for the year of £1.3m. A further £0.5m one-off charge has been incurred in the year in relation to the write down of goodwill, which arose on the acquisition of the lettings business and has been excluded from underlying profit. The Board continues to recognise the valued strategic contribution which estate agency makes towards our 'all under one roof' proposition.

As a result of the above, the Group's profit after tax ratio has reduced from 0.31% in 2017 to 0.24% in 2018, which is within the Board's appetite and plan.



Net interest income

Net interest income increased by £1.9m in the year to £50.2m as we delivered a net interest margin of 1.26%, a small reduction of 3 bps against 2017.



Asset yields continue to remain suppressed, driven by the low interest rate environment and access to low cost central bank funding through the Term Funding Scheme (TFS) (closed to new facilities in February 2018) and Funding for Lending Scheme (FLS) facilities. The ring fencing activities that have taken place with some of the larger financial services institutions have also driven surplus liquidity into the mortgage market and there is rising competition from challenger banks.

However, we continue to try and protect our savings members from the low interest rate environment as much as possible. Our average savings rate in 2018 and our average rate payable at the end of the year stood at 1.0%. As a result, our branch savings balances, which increased by 13% in 2018, now stand at £2.4bn, more than double the level of five years ago.

Fee income

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

	2018 £m	2017 £m
Building society	2.9	3.2
Estate agency	2.8	4.3
Mortgage broking	1.8	1.6
Total	**7.5**	**9.1**

The total Group fee income has fallen by 18% in 2018 to £7.5m. The fall in estate agency and mortgage related fees has been partially offset by an increase in mortgage broking fees.

The overall fee income for the Society has fallen marginally against the prior year. Levels of fee income continue to be impacted by intense competition in the mortgage market which has seen mortgage arrangement fees fall or disappear altogether on new mortgage lending. Third party estate planning income, through provision of financial planning and protection products, has continued to perform well and is in line with our expectations and the Society's £0.5m contribution towards rewarding members has also increased against the prior year.

Income from the estate agency business reduced by 35% to £2.8m, driven by the downturn and lack of supply in the housing market which continues to be particularly impacted by the uncertainty following the EU referendum.

The success of the Group's whole-of-market mortgage advice proposition continues with income up by 13% to £1.8m in the year.

Derivatives

The Nottingham uses derivative instruments to manage exposure to changes in interest rates which arise from fixed rate mortgage lending and fixed rate retail savings products. This leads to volatility in results; such volatility would only be realised if we chose to sell the derivatives before they reach maturity. The Nottingham has no need, or intention, to sell these derivatives and so expects the £0.7m negative fair value adjustment to reverse out over the derivatives' remaining lives. As this volatility arises primarily due to timing differences, the Board excludes its impact from underlying performance.

Management expenses

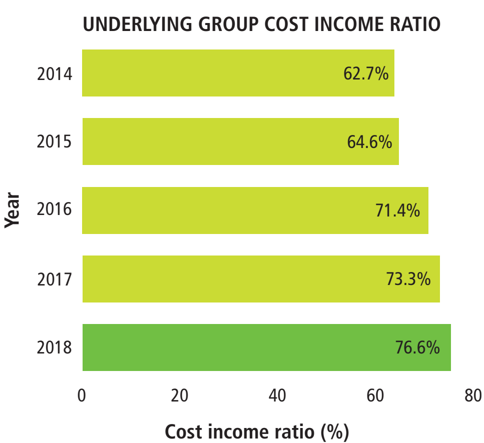
The Group's management expenses, including depreciation and amortisation, have increased by 5% to £43.4m in 2018.

	2018 £m	2017 £m
People related costs	22.6	22.1
Other administrative expenses	16.8	15.5
Strategic investment costs	0.6	0.7
Total administrative expenses	**40.0**	**38.3**
Depreciation and amortisation	3.4	3.0
	43.4	**41.3**

The Society has invested significantly during 2018, particularly in the areas of technology and branch network. The prior year reorganisation and investment in the enlarged branch network has been in operation for a full year, and continues to allow the Group to better deliver its customer and member focused 'all under one roof' offering. The investment in digitalisation will deliver improved accessibility to our services for members and demonstrates that the Society continues to evolve and improve its IT capability and resilience. The first phase of digitalisation was successfully delivered in December 2018, with the launch of our new e-savings system, Beehive Money.

Whilst the continuing investment is placing pressure on non-people related expenditure, as new technological delivery costs are fully embedded into the cost base, the redeployment of internal resource on strategic investment projects has ensured that people related expenditure is broadly flat against 2017. The larger cost base however, is supported by a larger asset base and overall there has been a slight fall in the Group management expense ratio to 1.09% for the year (2017: 1.10%).

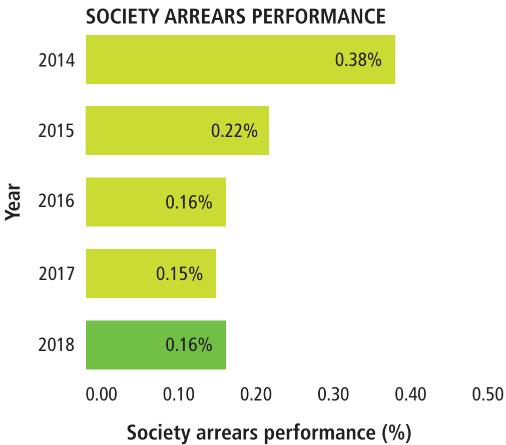
The Group's underlying cost income ratio is defined as total administrative expenses (excluding one-off strategic investment costs) as a percentage of total income (excluding the impact of fair value gains or losses from derivatives and hedge accounting).



The Group's underlying cost income ratio increased to 76.6% from 73.3% as the increased spend slightly outweighed the increase in income. Notwithstanding the increase in the year, the ratio remains within the Board's target range.

Impairment and provisions

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



The Society's arrears ratio has continued to stay at record low levels, with the ratio at the end of 2018 standing at 0.16%. This low level of arrears should be regarded as de minimis for a mortgage book of this size given that only 42 cases out of more than 26,000 mortgage accounts are three months or more in arrears. At the year-end, the Society had only four properties in possession.

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

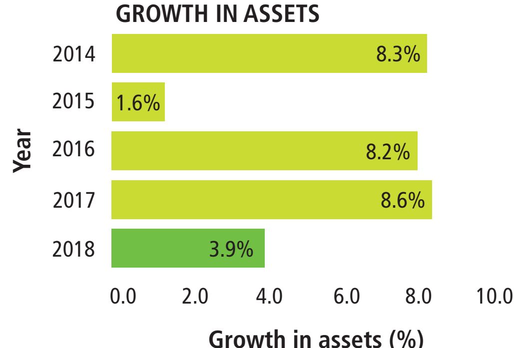
The Society's total overall impairment provisions at 31 December is £1.2m (2017: £3.2m), which equates to 0.03% of the total book. As outlined in note 36, the Society has adopted IFRS 9 for accounting for impairment during 2018, which resulted in a release of £1.7m of provisions before tax on transition from IAS 39 to IFRS 9, which is reflective of only having secured portfolios and limited losses experienced historically.

The Society is holding £0.6m in respect of PPI and customer redress provisions, and has recognised no further charge in the year (2017: £0.6m). This level of customer redress provision held is reflective of the Financial Conduct Authority's (FCA) time barring of PPI claims, effective from August 2019, and the Plevin case ruling, which were both announced in the prior year.

In common with all other UK regulated deposit takers, the Society is required to pay levies under the Financial Services Compensation Scheme (FSCS). Following the settlement of the loans outstanding in relation to the 2008/09 bank failures, no further levy is expected and therefore there is a net release of £0.1m to the income statement. (2017: £0.2m charge). Ongoing costs of the FSCS scheme are recognised in administrative expenses.

Assets

The Group balance sheet increased by 3.9% in the year to £4.1bn and this growth was driven by the 4.0% increase in our mortgage book.



Liquid assets

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

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

The Group's liquidity is made up as follows:

	2018	2017
	£m	£m
Bank of England	254.9	351.1
Multilateral Development Banks	63.9	28.6
UK Gilts & T'Bills	70.3	30.9
Floating rate notes	3.0	16.2
Mortgage backed securities	78.9	33.5
Other	35.9	34.6
Total	**506.9**	**494.9**

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

The Society supplements on-balance sheet liquidity with access to the Bank of England's Sterling Monetary Framework facilities supported by prepositioned collateral. When taking into account both on- and off-balance sheet liquidity, total liquid resources was 20.4% (2017: 25.8%), with prepositioned assets in addition.

The two key measures of liquidity introduced under CRD IV are the Liquidity Coverage Ratio ('LCR') and Net Stable Funding Ratio ('NSFR'). The final requirements for the NSFR are still to be finalised but the Society is currently in excess of the minimum levels required for both measures, with the LCR at the end of year being 219% (2017: 154%).

Mortgages

Gross lending totalled £834m for the year, of which £583m related to prime residential lending and £237m to buy-to-let. This mix is in line with prior years with mortgage lending remaining concentrated in prime high quality mortgage assets. Residential mortgages, excluding buy-to-let, account for 72% of the total lending book.

The Secured Business Lending (SBL) book increased to £71.9m.

	2018	2017
	£m	£m
Residential	3,434.3	3,301.9
SBL	71.9	66.6
Total	**3,506.2**	**3,368.5**

Total mortgage balances increased by 4.0% during the year to £3.5bn. Whilst gross lending fell against the prior year, it still remained strong and the Society saw continued success on customer retention where we retained 74% of customers who reached the end of their fixed or discounted product term in the year.

Residential mortgage lending is focused primarily in the 60% to 80% LTV category but performance continues to be underpinned by the low interest rate environment and levels of House Price Inflation (HPI). The Society's average LTV increased marginally from 56% to 57% during the year.

	2018	2017
	%	%
<60%	35.7	38.7
60% - 80%	43.3	41.6
80% - 90%	16.1	16.6
>90%	4.9	3.1

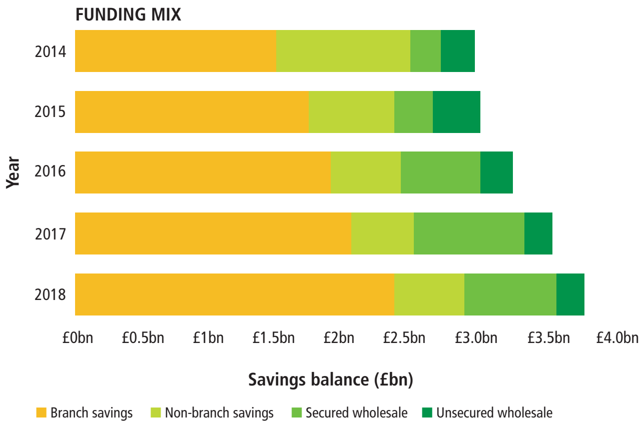
Geographic distribution continues to remain focused in two broad areas, our heartland of the East Midlands/Yorkshire and London/South East.

	2018	2017
	%	%
East Midlands/Yorkshire	31.5	32.4
London & South East	21.9	21.2
North	15.8	16.0
Eastern	9.5	9.2
West Midlands	9.8	10.0
South West	8.2	8.0
Other	3.3	3.2

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

Retail and wholesale funding

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



Retail savings continue to be the cornerstone of our funding requirement, with the remainder obtained from the secured and unsecured wholesale funding markets. The Bank of England's Term Funding Scheme ('TFS') has continued to provide access to secured funding and has supported asset growth during the first half of the year, with £588m (2017: £485m) drawn down under TFS as at 31 December. This is in addition to the £163m remaining under the Funding For Lending ('FLS') scheme (2017: £297m). Both schemes are now closed to further drawdowns and the Society has robust plans in place to replace the funds. The Society also has £101.3m (2017: £146.5m) outstanding as at 31 December borrowed through a secured bilateral funding agreement. Overall this has resulted in a higher proportion of secured wholesale funding than in previous years, however the repayment of FLS balances in the year has resulted in the wholesale funding ratio reducing from 28.6% to 24.2%.

Retail savings have increased by £272m to £2.9bn in 2018. We have continued to see inflows into our branch based retail accounts with branch balances having increased by £266m to £2.4bn by the end of the year, representing an increase of 13%. Branch balances represent over 80% of total retail balances and this provides further support of the Group's combined operating model. It also continues to demonstrate the strength of our growing retail franchise and provides strong evidence that customers have responded positively to our moves to maintain good rates for savers, alongside our 'Member Rewards' proposition.

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

Customer satisfaction

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

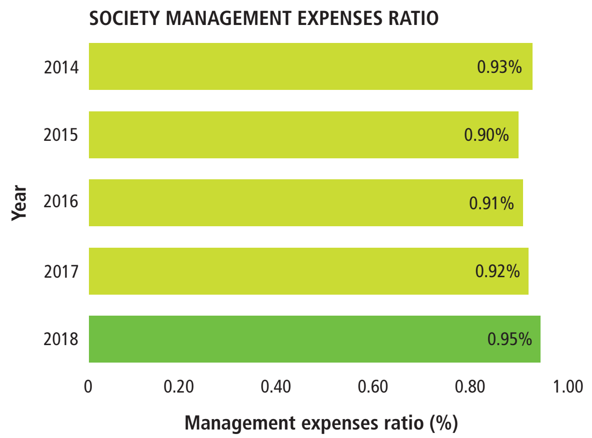
Our customer satisfaction survey is central to assessing how well we are delivering customer service and is based on customers' responses to actual transactions and activity with The Nottingham. In 2018 we have maintained our industry leading levels of satisfaction, with 83% of our customers rating us as excellent, an increase from 82% in 2017.

The Net Promoter Score measures the percentage of customers strongly prepared to recommend The Nottingham to others, less those who are not prepared to recommend The Nottingham, which results in a net percentage of our customers who would recommend our products and services. The Nottingham's Net Promoter Score also remained strong at 79%, and in line with 2017.

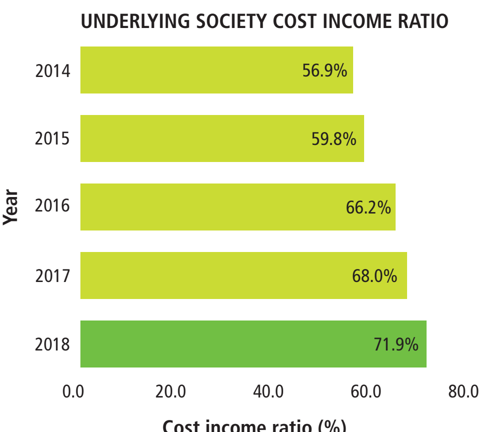
Our customer base continues to grow, with over 25,000 new customers welcomed to the Society during 2018. With strong customer satisfaction scores, an enlarged branch network and the 'Member Rewards' programme in place, we anticipate that this growth will continue.

Society performance

Overall, the Society has delivered a profit before tax of £13.2m for 2018 (2017: £15.7m). A growing asset base and a net interest margin of 1.26% has supported higher net income overall, alongside the benefit of the payment of a £0.3m dividend from its mortgage broking subsidiary entity in the year. This higher income has been offset by additional investment expenditure as previously outlined, resulting in a slight increase of the Society management expense ratio to 0.95% (2017: 0.92%).



The Society's underlying cost income ratio (excluding fair value movement on derivatives and one-off strategic investment costs) has increased to 71.9%, in the main reflecting the slight fall in net interest margin and increase in costs as outlined above.



Capital

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

Common Equity Tier 1 (CET1) capital is the strongest form of capital and comprises the Society's general reserves. Overall CET1 resources have increased by £5.4m in the year. This is driven by the retained profit and other comprehensive income movements of the Society, offset by unfavourable changes in fair value reserves and day 1 IFRS 9 adjustments recognised directly in reserves. The increase in resources has been offset by an increase in risk weighted assets, reflecting the growth in mortgage assets. Overall this resulted in a CET1 ratio of 14.7%.

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

CAPITAL RESOURCES

	2018 Final CRD IV £m	2017 Final CRD IV £m	2018 Transitional CRD IV £m	2017 Transitional CRD IV £m
COMMON EQUITY TIER 1 CAPITAL				
General reserves	219.6	215.5	219.6	215.5
Fair value reserves	(1.0)	-	(1.0)	-
Regulatory adjustments and deductions	(7.0)	(9.3)	(7.0)	(9.3)
TOTAL COMMON EQUITY TIER 1 CAPITAL	**211.6**	**206.2**	**211.6**	**206.2**
ADDITIONAL TIER 1 CAPITAL				
Permanent Interest Bearing Shares	-	-	9.5	11.9
TOTAL ADDITIONAL TIER 1 CAPITAL	**-**	**-**	**9.5**	**11.9**
TIER 2 CAPITAL				
Permanent Interest Bearing Shares	23.8	23.8	14.3	11.9
Collective provision	-	2.9	-	2.9
TOTAL TIER 2 CAPITAL	**23.8**	**26.7**	**14.3**	**14.8**
TOTAL REGULATORY CAPITAL	**235.4**	**232.9**	**235.4**	**232.9**
RISK WEIGHTED ASSETS	**1,442.4**	**1,412.8**	**1,442.4**	**1,412.8**

CAPITAL RATIOS

	2018 Final CRD IV %	2017 Final CRD IV %	2018 Transitional CRD IV %	2017 Transitional CRD IV %
Common Equity Tier 1 ('CET1') ratio	14.7	14.6	14.7	14.6
Total Tier 1 ratio	14.7	14.6	15.3	15.4
Total Capital ratio	16.3	16.5	16.3	16.5
Leverage ratio	5.1	4.9	5.3	5.2

Regulatory adjustments include deductions for intangible assets and investments in qualifying holdings.

At 15.3%, the Society's Tier 1 ratio – which compromises both CET1 and Additional Tier 1 capital – has fallen marginally in the year driven by the increased risk weighted assets and the transitional provisions applied to the Society's Permanent Interest Bearing Shares ('PIBS').

The leverage ratio, which is calculated as Tier 1 capital divided by total balance sheet exposure, has improved slightly in the year to 5.1% under the final rules basis. This is driven by the retained profit of the Society in the year offset by an increase in asset exposures from the enlarged mortgage book.

The leverage ratio, excluding central bank deposits, would be 5.3% under the final rules basis.

The Regulator requires that the Society holds a certain amount of capital against the assets it holds. This is referred to as its Total Capital Requirement. At 31 December 2018, the Society's Total Capital Requirement was set at 9.85% of risk weighted assets or £142.1m.

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

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

Principal risks and uncertainties

In common with other financial institutions, the nature of our business results in a number of inherent risks which are continuously monitored and managed by the Board. These inherent risks, and how the Board manage them, are considered in the risk management report on page 25 to 29.

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

Whilst we are a low-risk, UK-based organisation, we inevitably face challenges that pose risk to the delivery of our strategic objectives. We continue to operate in an uncertain global environment which creates risks and challenges for the mutual building society model. At the time of writing this report, uncertainties around Brexit and the UK's future trading relationship with the EU permeate through all of the key risks faced by the Society. In particular, Brexit has the potential to create further economic uncertainty which will inevitably impact risks relating to the UK housing market (which affect both our estate agency business and the value of the security held against our mortgage lending) and the future path of interest rates (thus impacting our net interest margin). The key risks and uncertainties, and how we mitigate them, are summarised below.

Core mortgage lending yield

The Society is operating in a market where competition for mortgage yields is stronger than ever, while arrears rates are at historic lows. Throughout 2018, the Society has seen a gradual and sustained reduction in the rate of interest it has been able to achieve in all lending segments, including prime residential lending and buy-to-let, and across the loan-to-value scale.

Yield compression has been exacerbated by the recently-introduced regulations on bank ring-fencing. This has restricted lending activities in the larger UK banks such that they are now predominantly only able to lend to retail customers and SME businesses, funded by their excess liquidity.

The Society has clear risk-adjusted return thresholds that it aims to meet. The market may continue to impact some market segments to the extent that they do not achieve these thresholds. In this event, the Society will adjust its growth plans to ensure it continues to deliver a long-term, sustainable return on its lending, whilst delivering good value products to savers relative to market conditions.

Impact of government funding

The market has continued to benefit from the relatively inexpensive funding provided through the Bank of England's Funding for Lending Scheme (FLS) and Term Funding Scheme (TFS). While this has contributed to the reduction in mortgage rates and, in turn, the narrowing of interest margins, these schemes are now closed. As a result, as this is repaid over time, the Society will realign its funding profile for future mortgage lending, by increasing other sources of wholesale funding.

The Society has robust plans in place to replace the funds that it has drawn from the two schemes, however forward-looking risks remain in terms of how the market will adjust to the removal of this stimulus.

Retail lending impairments

The level of retail lending impairments has continued to remain benign with the Society experiencing a very low number of arrears cases. Although arrears are expected to continue to be stable while interest rates remain low, future increases in interest rates may potentially put borrowers under additional financial pressure. Additionally, as mentioned above, a disorderly or unfavourable Brexit could cause economic dislocation resulting in increased unemployment and thus affect our borrowers' ability to repay their loans.

The majority of the Society's mortgage customers are currently on fixed rate products and would therefore not be immediately impacted by changes in interest rates, although many of our borrowers have never experienced significant interest rate rises or periods of economic downturn. Management regularly conducts stress testing on the mortgage book to gauge possible impacts of higher interest rate costs or increased unemployment on our borrowers and, as a result, has confidence that our customers are well placed to manage rising costs.

Housing market

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

The data on house prices for 2018 has been mixed, with increasing variations in growth rates across different UK regions, with some regions exhibiting negative growth. Market data continues to evidence subdued levels of housing activity which has resulted in the demise of some estate agencies both on the high street and online. Therefore, the future path of house prices remains unclear, fuelled by the ongoing EU exit negotiations and global market volatility.

Changes to the regulatory and tax environment in relation to buy-to-let lending have not had a materially negative impact, although we have seen some smaller landlords exiting from the market and selling their properties. Regional analysis of the Society's lending portfolio is undertaken regularly to ensure that changes in house prices are appropriately reflected. The Board remains vigilant to trends in the housing market and actively monitors performance of the estate agency and lending activity. The Society is therefore well positioned to respond effectively to any impact, volatility or downturn in the market.

Cyber risk

Organisations across both financial and non-financial sectors continue to experience high-profile cyber events attracting significant attention from both media and regulators. Cyber risk is the subject of increased regulatory focus, particularly the relationship between cyber security and operational resilience. The increasingly sophisticated cyber-attacks can result in financial crime, services being rendered unavailable or theft of customer data. The Society's exposure to cyber risk is also influenced by an increasing online profile.

Managing cyber risk therefore remains a focus of Society management to safeguard the business and protect its members' data and savings. An approved cyber-security strategy and separate cyber risk policy are in-place, which are reviewed annually by a cross-functional governance committee with responsibility for cyber risk. The Society continues to invest in technology to prevent and detect cyber-attacks, whilst specialists maintain an awareness of prevailing threats and are able to respond proactively to events. Technical expertise is complemented with education and awareness activities to ensure that our employees are equipped to recognise and manage the risks associated with cyber security. The capability to respond and recover from cyber events is kept under continuous review including contingency planning, crisis management and disaster recovery plans.

Third party delivery of key services

The Nottingham works closely with key suppliers who provide services to members on our behalf. The Society closely manages such relationships which are supported by rigorous contractual requirements and strict service delivery standards. All suppliers are monitored to ensure that their services meet the Society's high standards at all times and, where applicable, ensuring that they meet defined financial adequacy requirements. Metrics on service delivery are regularly reviewed at management committees. The Nottingham is committed to ensuring that its trusted suppliers continue to provide the highest level of service to our members and, on the rare occasions where this doesn't happen, the Society acts in the best interests of our customers to ensure good, regulatory compliant customer outcomes are achieved.

Project and Change

To enable the Society to continue to grow, remain innovative and improve existing ways of working, a wide-ranging change agenda is being pursued. The volume of activity and level of financial investment related to this programme of work will remain high for the foreseeable future, with a resultant increase in the amount of change activity taking place across the organisation.

The first of these larger and strategically important projects went live in December 2018, with further significant enhancements following throughout 2019. To help mitigate the risks associated with a change programme of this size, a number of specialist contractors have been recruited with specific skills and expertise. New and enhanced relationships with (and therefore reliance on) third parties have been developed, as the Society looks to expand capability; with different ways of working being embraced in order to maximise opportunities and efficiencies.

The change activity is underpinned by an evolving project risk management framework, which champions clear attribution of responsibilities, regular and transparent status reporting and a high level of oversight and scrutiny by members of the Executive team and the Board.

Daniel Mundy
Finance Director

14 March 2019

Doing Good Together

Our commitment to do the right thing to support the communities of our heartlands remained ever strong in 2018.

Through our Doing Good Together initiative, we continued to focus our community support on the key themes of homelessness, financial education and employability. These themes directly support the premise on which the building society was first founded – helping our members put a roof over their heads and to plan for, and protect, their financial future.

Since we set up Doing Good Together, we have contributed almost £1 million to local communities through fundraising, volunteering and financial donations. In 2018 we are proud to have raised funds for a number of worthy causes, both locally and nationally.

We continued our Grants for Good scheme in 2018 and donated a total of £32,000 to nine community programmes that support our themes, reaching over 3,000 people across Nottinghamshire, Leicestershire, Lincolnshire, Norfolk and South Yorkshire.

Since starting our Grants for Good scheme we have donated a total of £173,000, helping almost 10,000 people.

Our Young Enterprise volunteers have helped 250 students understand what is involved in running a business, while 300 students across our heartland have improved their knowledge of financial planning following a Money Academy session delivered by their local branch.

We continue our partnership with local homelessness charity Framework, and this year we sponsored three 'Sleep Out' events, supporting more than 500 fundraisers and raising greater awareness of homelessness. We also donated £1,000 to cover the cost of 200 calls to the rough-sleeper hotline in support of the charity's Off the Streets campaign. Since the beginning of our partnership we have now donated £85,000, and raised more than £52,000 in fundraising.

We are committed to not only sharing funds, but also the time and talent of our people with the communities we serve. This is why we give every team member two days a year paid leave for volunteering. In 2018 our team members donated over 700 hours of volunteering time to community projects from helping set up the Hoodwinked Robins charity auction event for the Nottinghamshire Hospice to creating a Santa's Grotto at Stonebridge City Farm.

Sports sponsorship

Our sports partnerships and associated community support has also been a prominent feature of 2018. We have sponsored 50 local athletes through the charity SportsAid. These athletes are sponsored by their local branch, with financial support, recognition and personal development opportunities during the critical early stages of their careers with the majority aged between 12 and 18.

Following the success of our partnership with the Lawn Tennis Association, we marked our fourth year as Official Partner of the Nature Valley Open Tennis Tournament in Nottingham in 2018. The international tournament is played on outdoor grass courts at The Nottingham Tennis Centre and is seen by players as a major warm up to Wimbledon.

In the run up to the tournament we held a family tennis day, supported by the coaching team from the Nottingham Tennis Centre, giving local families a chance to try tennis for free.

During 2018, we announced a brand new partnership with the Nottingham Panthers ice hockey club. The Panthers have the highest average attendance of any ice hockey club in the UK and a very loyal and local fan base. Our partnership with the Panthers has enabled us to extend our reach and engage directly with a fan base of over 63,000 people and we are proud to support such a prestigious club.

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

Through our partnership with the club, the TAG rugby scheme has been delivered to over 7,000 pupils in over 100 schools throughout Leicestershire. We also co-sponsor the Junior Tigers club which engages with around 50,000 children each year.

Our people strategy

The Nottingham is absolutely committed to the development and support of our people. We know that our success hinges on our ability to attract, grow and engage enthusiastic and expert team members as well as fostering a culture that encourages our team members, to do the right thing. This year, Human Resources was re-branded to 'People & Development' to reflect our belief that people are at the heart of the business and our knowledge that providing a great workplace experience will ultimately deliver better results for our members. Under the new strategic pillar of People, Culture & Community, our objectives, which we set for 2018, included defining and embedding a culture framework that drives the right behaviours, gathering insightful management information and feedback from our team members to inform our decisions. This creates a performance culture that includes meaningful conversations between leaders and team members and attracting and engaging the best talent and enhancing our leadership capability.

Organisational alignment

This year, we focused on embedding the 'all under one roof' business operating into the retail network. This has enabled the Group to continue to develop our member value proposition. There has also been further reorganisation of the operational and marketing areas, as well as the retail network during 2018 to create a 'Member Services' function. The objective of the new Member Services function is to drive a member-centric strategy and streamline operational processes.

Engagement

Our Doing the Right Thing culture was launched this year: it frames how we think and act in our Society towards our members, team members and our communities. This year was spent communicating and embedding the culture, which is assessed on a bi-annual basis and discussed with our Executive Committee and Board. Our relaunched annual employee survey, 'Your Voice Matters', was issued online in June this year; we had a high response rate, with more that 85% of employees giving us their views and opinions. We have received a richness of data from the exercise and all functions have developed actions plans, as well as a Society-wide plan, to address overall themes. To enable our team members to be updated and drive further engagement, our 'Doing the Right Thing in action' e-newsletter was launched this year. We have also focused on enhancing overall employee health and wellbeing with our monthly initiative, 'Your Health Matters', which provides regular communications to raise awareness.

Talent Development

Key areas of focus this year have been around supporting the organisation to develop and embed leadership behaviours across all business areas through a refreshed performance review process, Your Performance Journey, and a number of development opportunities. Committed to development, we have implemented processes in which people leaders can track skills movement, carve career pathways in our operational functions and work together with people partners to re-energise talent and succession. We were also proud to see a member of the senior management team successfully graduate with the first cohort of the BSA/ Loughborough University MSc Leadership & Management programme during the year.

Talent Acquisition

Acquiring the best talent continues to be key to delivering The Nottingham's vision. For 2018, the focus has been on the strategic sourcing for key vacancies, within head office functions including building the Risk and Legal & Regulatory teams and resourcing the Omni digitalisation channel programme within IT & Change. Another key focus has been working, in collaboration with Talent Development, to develop academies for both internal and external talent within Nottingham Mortgage Servies and Legal & Regulatory. We are planning to deliver new systems allowing a more streamlined approach and time efficiencies with the recruitment process for both managers and candidates in 2019.

Equality, Diversity & Inclusion

We remain committed to the Women in Finance Charter, of which we have been a signatory since its inception in 2016. We continue to comfortably exceed our diversity floor of 30%. We are also investing in our leaders by raising awareness of the value of a diverse and inclusive culture. We have focussed on training our managers, on helping our leaders identify barriers to impartiality and encouraging inclusive leadership. We reported our Gender Pay Gap in 2018 for the first time and in line with our building society and wider financial services sector, we continue on our journey to put in place mechanisms and remove barriers to develop a truly diverse and inclusive team culture.

Environment

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

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

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

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

YOUR BOARD OF DIRECTORS

Non-Executive Directors

John Edwards

Chairman

John joined the Board in February 2012 and was appointed Chairman in May 2014. In his executive career, he held a number of roles at a CEO level in the insurance and investment sector, retiring in 2009 from Lloyds Banking Group where he was CEO of their international financial services division. He was the senior independent Non-Executive Director of the LV Group until September 2015 and is currently a Non-Executive Director of Saga Services Ltd and GreyCastle Life Reinsurance (SAC) Ltd.

Jane Kibbey

BSc, MCIPD

Vice-Chairman & Senior Independent Director

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

Simon Baum

Simon joined the Board in June 2018. Simon has spent over 30 years specialising in risk management within the financial services arena, holding several senior positions at Experian, Alliance & Leicester and Santander, both within the UK and overseas. His previous roles include Director of Mortgage Risk at Santander.

Andrew Neden

MA, FCA

Andrew joined the Board in 2014. He is a Chartered Accountant with over 35 years' experience in financial services in the UK and overseas. After a number of years running KPMG's UK financial sector transaction services team, he was the global Chief Operating Officer for KPMG's financial services business. Current directorships include the Wesleyan Assurance Society and ABC International Bank plc; he chairs the Audit committee for both organisations. He also chairs Aetna Insurance Company Limited.

Kavita Patel

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

Kerry Spooner

LLB (Hons)

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

Executive Directors

David Marlow

ACIB

Chief Executive

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

Daniel Mundy

BA (Hons)

Finance Director

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

Changes to the Board in the year to 31 December 2018

Simon Baum was appointed to the Board as a Non-Executive Director in June 2018.
Simon Taylor resigned from the Board as an Executive Director in November 2018.

Changes to the Board post 31 December 2018 and up to the date of signing the accounts

Charles Roe was appointed to the Board as an Executive director in January 2019.

Board Committees

Risk

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

Audit

Andrew Neden – Chair
Kavita Patel
Kerry Spooner

Nominations

John Edwards – Chair
Jane Kibbey
David Marlow

Remuneration

Kerry Spooner – Chair
John Edwards
Andrew Neden

DIRECTORS' REPORT

The Directors' report should be read in conjunction with the Chairman's statement, Chief Executive's review and Strategic report on pages 4 to 17.

Business objectives and activities

The Nottingham is a strong and successful mutual building society, which builds upon its strong regional foundations, and has a track record of serving members for almost 170 years. At The Nottingham we aim to serve the needs of our members, offering a safe and secure place for their savings, helping them own their own home and supporting them through the complex challenges they face in planning for the future.

Information on the Group's business objectives and activities are provided in the Strategic report on pages 8 to 17.

Business review, future developments and key performance indicators

The Group's business activities and future plans are reviewed in the Strategic report section of the Annual Report and Accounts on pages 8 to 17. Additionally within the Strategic report, we comment upon the financial (and other) key performance indicators used by the Board during the year to assist its control, direction and drive for business results.

Principal risks and uncertainties

The principal risks and uncertainties faced by the Group are outlined on pages 16 and 17, and our approach to managing these risks can be found in the Risk management report on pages 25 to 29.

Financial risk management objectives and policies

As a result of its normal business activities, the Group is exposed to a variety of risks, including credit, market and liquidity. The Group's objective is to minimise the impact of these risks, as well as financial risk, upon its performance. The risk management report on pages 25 to 29 considers this in detail. A further explanation of the financial risks and the controls in place to manage them (including the use of derivatives) is given in note 30 to the Annual Report and Accounts.

Results

Group reported profit before tax for the year was £11.8 million (2017: £14.5 million). The Group profit after tax for the year transferred to general reserves was £9.4 million (2017: £11.5 million). As at 31 December 2018, total Group reserves and equity were £222.8 million (2017: £212.7 million).

Capital

Group gross capital at 31 December 2018 was £247.9 million, (2017: £238.3 million) being 6.55% (2017: 6.55%) of total shares and borrowings. Free capital, as at the same date, amounted to £223.9 million (2017: £218.3 million) and 5.91% (2017: 6.00%) of total shares and borrowings.

The annual business statement on page 104 gives the explanation of these ratios. The Board of directors remains committed to maintaining a strong capital position.

Loans and advances

During 2018, total lending was £834 million (2017: £1,021 million) and the average advance made was £162,162 (2017: £167,205), with the average debt at the end of the year being £133,778 (2017: £129,849). As at 31 December 2018, there were five cases (2017: two cases) of properties being 12 or more months in arrears or in possession. The total amount of balances outstanding in those cases was £398,903, with arrears of £32,769.

No mortgage losses were realised during the year from existing provisions. Provisions for potential mortgage losses total £1.2 million (0.03% of mortgage balances).

The Group offers a number of different forbearance options to customers including reduced payment concessions, payment plans, capitalisations and mortgage term extensions. As at 31 December 2018, the Group had 104 loans (2017: 106) subject to some form of forbearance. Note 30 to the Annual Report and Accounts on page 90 provides further details.

Property, plant and equipment

Freehold premises owned by the Group are shown in the Annual Report and Accounts at cost less depreciation. An estimate of the value of those properties, prepared in late 2018 by the Group's professional services team, indicates that market value is £2.2 million (2017: £1.9 million) higher than book value.

Supplier payment policy

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

As at 31 December 2018, the total amount owed to suppliers was equivalent to 12 days' credit (2017: 3 days).

Charitable and political donations

During the year, the Group made charitable donations of £95,000 (2017: £106,000). No contributions were made for political purposes.

Country-by-country reporting

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

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

Environmental policy

The environmental policy is set out in the corporate responsibility report on pages 18 to 19.

Our people

Our cultural foundation of 'Doing the Right Thing' for our members, team members and communities, while operating within a strong governance framework, encompasses everything that we're about and the way we should strive to get things done. It highlights the importance of leadership, leading the culture and being open and accessible. We also measure our culture on a bi-annual basis to assess our health status as a Society.

Attracting, engaging and growing diverse talent, offering equality of opportunity to all and supporting an inclusive culture is key to our success. Our commitment to Equality, Diversity and Inclusion is highlighted in our 'Doing the Right Thing' culture. This is also reflected in our Dignity at Work and Diversity & Inclusion policies, and is central to our employment practices and the services we offer. We raise team member awareness during the on-boarding process and through annual refresher training and all our training continues to reflect these principles and relevant legislation.

Engagement of, and with, our people is important to us. We launched an updated annual online people survey 'Your Voice Matters' this year and, along with feedback we received from our online exit survey, key themes have emerged that we have taken ownership of and are acting on. We hold sessions with our wider leadership team, where they are given an opportunity to share feedback. We also continue to work in partnership with our employee forum, which has been rebranded to the 'Your Voice Matters' Forum. Our culture framework also encourages speaking up to do the right thing and we are creating platforms to do this.

Supporting our communities together is central to who we are. This theme runs through our Vision, Values and 'Doing the Right Thing' culture and is evidenced by the time and support our team members have given to charities and community projects as part of our Doing Good Together initiative.

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

The directors are responsible for preparing the annual report, annual business statement, directors' report and the annual accounts in accordance with applicable law and regulations. The Building Societies Act 1986 ('the Act') requires the directors to prepare Group and Society annual accounts for each financial year. Under that law they are required to prepare the Group annual accounts in accordance with IFRSs as adopted by the EU and applicable law and have elected to prepare the Society annual accounts on the same basis.

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

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

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

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

Directors' responsibilities for accounting records and internal control

The directors are responsible for ensuring that the Group:

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

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

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

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

Directors' statement pursuant to the disclosures and transparency rules

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

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

Directors' statement pursuant to the UK Corporate Governance Code

As required by the UK Corporate Governance Code, the directors confirm their opinion that the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for members to assess the performance, strategy and business model of the Society. Details of the governance procedures which have been implemented to support this can be found in the Board Audit Committee report on page 34.

Going concern and viability

Going concern

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

The directors have considered the risks and uncertainties discussed on pages 16 to 17 and 25 to 29, and the extent to which they might affect the preparation of the Annual Report and Accounts on a going concern basis.

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

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

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

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

Viability statement

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

The four year corporate plan considers the Group's profitability, cash flows, liquidity and capital requirements as well as other key financial ratios over the period. These ratios are subject to sensitivity analysis and stress testing, which involves varying a number of the main assumptions underlying the forecast both individually and in unison. Where appropriate, this stress testing is carried out to evaluate the potential impact of the Group's principal risks, as outlined on pages 16 to 17 of the Strategic report and the risk management report on page 25, actually occurring. Based on the reviews completed, the Board considers that the Society is viable over the medium term.

Directors

The names of the directors of the Society who served during the year and up to the date of signing the accounts, their roles and membership of Board committees are detailed in the governance section on pages 20 to 21. Other business interests are shown in the annual business statement. None of the directors have any beneficial interest in, or any rights to subscribe for shares in, or debentures of, any connected undertaking of the Society, as at 31 December 2018.

In accordance with the agreement made by the Board and in line with the rules for re-election outlined on page 31, all directors will stand for re-election at the 2019 Annual General Meeting. In addition, Simon Baum and Charles Roe, who joined the Board in June 2018 and January 2019 respectively, will seek election at the 2019 Annual General Meeting. Jane Kibbey will retire at the Annual General Meeting and will therefore not seek re-election. Simon Taylor resigned as a director in November 2018.

Auditor

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

On behalf of the Board of directors,

John Edwards
Chairman

14 March 2019

RISK MANAGEMENT REPORT

For the year ended 31 December 2018

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

The Board is responsible for ensuring that an effective framework is in place to promote and embed a risk-aware culture that identifies, appropriately mitigates and manages the risks, which the Group and Society face in the course of delivering its strategic objectives. This includes both current risks and those associated with the implementation of future strategy.

The Board reviews and approves a risk appetite statement annually.

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

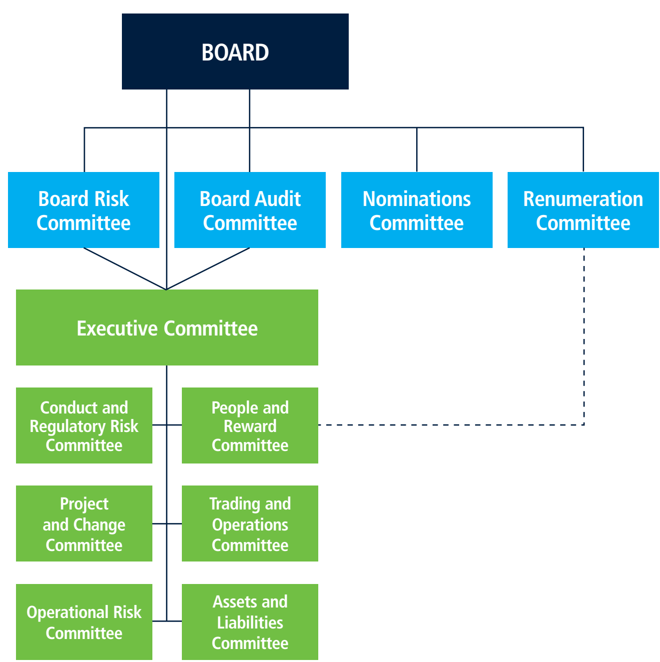
The Board Risk Framework

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

The risk management framework is based on the three lines of defence (described on page 32) and focuses on:

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

Day-to-day risk management is the responsibility of the Executive Committee (see below), which oversees the Society's risk and governance committees, as detailed in the diagram below.



The Operational Risk Committee is supported by the Information Risk Committee and the Health and Safety Committee. The Assets and Liabilities Committee is supported by the Credit Committee, the Prudential Oversight Committee, the Model Governance Committee and the Liquidity and Funding Committee.

In April 2018, the Society appointed Charles Roe as Chief Risk Officer (CRO). The appointment of a CRO is a sign of the increased focus on sound risk management practices within The Nottingham and subsequent to the year-end, Charles was appointed as an Executive Director of the Society. Additionally, during 2018, the Society implemented a new risk management system. The system is used to collate and manage all Society-wide risks and provides management with up-to-date management information on the state of risk management within the Society.

This report has been prepared to reflect the risk management framework and practices present throughout 2018. In the last quarter of 2018, the CRO led a project to further enhance the Society's governance structure. These new arrangements have started to be implemented during the first quarter of 2019 and the main impact will be the formation of a new Executive Risk Committee, which will be chaired by the CRO and will focus on the day-to-day oversight of risk within The Nottingham. The Society's main risk management committees will report into this new body. The implementation of the enhanced committee structure will enable the Executive Committee to focus on the delivery of The Nottingham's strategy and its performance against strategic goals.

Board Risk Committee

As detailed on page 21, the Board Risk Committee comprises all full Board members, both executive and non-executive. It is responsible for:

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

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

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

Executive Committee

The Executive Committee is responsible for acting on behalf of the Board in the organising, managing and protection of the Society's assets to deliver value to members through the provision of savings, mortgages and related services, whilst remaining within the law, regulation and agreed Board risk appetites.

The Committee is responsible for ensuring the management and delivery of four key areas on behalf of Board:

1. Development and oversight of current and future strategy for the Society;
2. Risk management framework;
3. Business planning process; and
4. Oversight of operations and risk management.

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

Strategic risk

When discussing future strategy, the Committee and ultimately the Board takes care to ensure that risks such as system enhancements, long term funding approaches, acquisitions and changes in the external economy are evaluated and that plans are in place to effect any required risk mitigation. The Executive Committee oversees the detailed evaluation of these risks.

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

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

Assets and Liabilities Committee

The Assets and Liabilities Committee (ALCO) is responsible for overseeing The Nottingham's liquidity risk, market and interest rate risk, credit risk and its capital sustainability risk. In addition, ALCO reviews treasury activity for compliance with approved treasury policies and procedures. The ALCO is supported by four sub-committees:

- Credit Committee;
- Prudential Oversight Committee ('POC');
- Model Governance Committee ('MGC'); and
- Liquidity and Funding Committee ('LAF').

The role of the Credit Committee is discussed further in the next section.

The membership of ALCO comprises at least one Executive Director and relevant senior managers.

Market and interest rate risk

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

The economy continues to be dominated by low interest rates and an uncertain economic environment, largely driven by uncertainties over the UK's future relationship with Europe. Current market expectations indicate that this will remain the case for some months to come. The Society actively monitors its position against its basis risk appetite to ensure any future change to interest rates does not adversely affect the Society's interest margin.

The Society's limits for the management of market and interest rate risk are documented in the Market and Interest Rate Risk Appetite Statement, which is developed, defined and recommended by ALCO and its sub committees and considered and approved ultimately by the Board.

Basis risk, which arises from changes in the relationship between different types of interest rates, is included within this risk category as a subset of interest rate risk.

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

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

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

Liquidity risk

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

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

The liquidity policy sets the framework for the day-to-day activities of the Treasury team to ensure that all liquidity management activities are conducted within approved risk appetites. The Society maintains a diverse funding base and ensures compliance with applicable regulatory requirements. Defined control limits determine the overall level of liquidity to be maintained. The base level and composition of the Society's liquidity is subject to PRA guidance and regular stress testing and is also documented as part of its Internal Liquidity Adequacy Assessment Process (ILAAP), as required by the Prudential Regulation Authority ('PRA').

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

The Society also maintains a funding profile in line with a longer term funding measure, the Net Stable Funding Ratio (NSFR), which requires financial institutions to hold sufficient stable funding to cover the duration of their long term assets.

Based on our current and forecast liquidity positions, the liquidity portfolio held by the Society comfortably exceeds the minimum requirements of the LCR. Similarly the funding profile exceeds the requirements under the NSFR.

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

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

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

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

Capital sustainability risk

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

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

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

The Board monitors the current and future level of capital held by the Society in relation to its TCR on a regular basis. The Society's current and future capital levels remain well in excess of the PRA requirements. An analysis of the components of The Nottingham's current capital position can be found in the Strategic report on page pages 14 to 15.

Credit Committee

As discussed in the previous section, the Credit Committee is a sub-committee of ALCO, which is comprised of relevant senior managers. It is responsible for oversight of the Society's retail and wholesale assets, which includes residential and buy-to-let (BTL) mortgages, Secured Business Loans (SBL) and those wholesale assets managed by the Society's Treasury function.

Retail credit risk

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

A Retail Credit Risk Appetite Statement and Policy are developed and proposed by the Credit Committee and considered and approved by the Board. The Society manages the level of credit risk it undertakes by applying various control disciplines, the objectives of which are to maintain asset quality in line with approved risk appetite. The Board ultimately receives monthly information on key risk appetite limits.

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

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

The Society remains committed to promoting home ownership and its risk appetite allows lending to first time buyers, but it restricts the overall level of high loan-to-value lending to ensure the risk is managed sufficiently. Similarly, we continue to follow our long term policy of offering interest-only products, which are covered by strict policies and monitoring procedures.

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

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

The Society continues to be a responsible lender and its approach to lending is based on making sure that customers can afford to meet their mortgage repayments from the outset, through the use of a prudent affordability calculator, as well as our manual underwriting processes. Should customers find themselves in financial difficulty, we respond with appropriate forbearance activities to ensure fair customer outcomes. The purpose of forbearance is to support customers who experience temporary financial difficulties by providing the assistance they require to enable them to regularise their financial arrangements. Only as a matter of last resort does the Society take the property into possession.

Residential, BTL and SBL loans are granted only against the 'bricks and mortar' value (i.e. loans are provided only for the purchase or re-mortgaging of a property and not for working capital or machinery etc.) An SBL policy is used to manage levels of business lending risk with loans manually underwritten. To ensure appropriate management of lending risk, the Society maintains watch lists to monitor those loans which are a possible cause for concern in order that risk mitigating action can be taken as appropriate. Primarily, SBL loans are made available to Small and Medium-sized Enterprises (SMEs) for either owner-occupied or investment property purposes. The regulatory limit for SBL lending is set at 10% and the Society was comfortably within this limit at 2% as at 31 December 2018.

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

Wholesale credit risk

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

The Society's risk of counterparty default is relatively low due to the high proportion of total liquidity held in UK Sovereign debt securities and the Bank of England reserve account. The composition of the treasury loans can be found on page 86.

The Society's liquidity policy sets out the amounts, products and counterparties under which Treasury liquid assets can be held. Credit worthiness of counterparties is assessed using a number of factors including minimum acceptable credit ratings approved by the Board Risk Committee, together with lending limits. The policy also allows for investments in multi-lateral development banks, and also in Residential Mortgage Backed Securities subject to criteria set by the Board Risk Committee. The Board does not permit any lending directly to sovereign states, other than the UK, and all lending is in sterling.

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

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

Conduct and Regulatory Risk Committee

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

The Conduct and Regulatory Risk Committee (CRRC) is responsible for overseeing how The Nottingham conducts its business, ensuring that all customer-impacting activities are conducted in a clear, transparent and fair manner, delivering fair outcomes for customers.

The Committee is chaired by the Director of Member Services supported by relevant senior managers.

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

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

Operational Risk Committee

The Operational Risk Committee (ORC) is responsible for actively overseeing the management of operational risk across The Nottingham. It is also responsible for ensuring that the Society maintains sufficient operational resilience to ensure the ongoing delivery of key services to customers.

The Committee is chaired by the Director of Member Services supported by relevant senior managers.

The Committee is supported by two sub-committees:

- Information Risk Committee; and
- Health and Safety Committee.

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

To ensure the effective monitoring and reporting of risk, The Nottingham maintains a number of risk registers, including a Group risk register, functional risk registers and project risk registers. These risk registers help management assess the probability and impact of the risks identified, and the effectiveness of mitigating controls. As part of the Committee's responsibilities, it ensures that the Society has appropriate business continuity plans in place, which are tested on a periodic basis.

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

Information Risk Committee

Due to the importance of protecting the Society against the risk of loss of customer data through events such as a cyber-attack, the Operational Risk Committee is supported by the Information Risk Committee. The Committee is chaired by the Head of IT & Change.

The Nottingham mitigates cyber risk by:

- having a Board approved Cyber Security Strategy that is annually reviewed;
- having a specialist governance committee with responsibility for cyber risk;
- keeping aware of prevailing threats and acting proactively to minimise exposure;
- continued investment in technology to prevent and detect cyber-attacks;
- education and awareness initiatives to ensure that our staff are equipped to manage cyber-attacks and consider the risks associated with cyber security during the course of day-to-day activities;
- developing the capability to respond and recover from cyber events, e.g., contingency measures, crisis management and disaster recovery plans;
- collaborating with relevant authorities; and
- ensuring relevant cyber risk insurance policies are in place.

Project and Change Committee

The Project and Change Committee ultimately supports the Board in ensuring the optimum use of resources when delivering The Nottingham's programme of projects. It performs this role through the approval and prioritisation of all requests to initiate or materially change a project and ensures their status is monitored. The Committee is chaired by the Head of IT & Change, supported by relevant senior managers.

The Nottingham's change activity is underpinned by an evolving project risk management framework, which champions clear attribution of responsibilities, regular and transparent status reporting and a high level of oversight and scrutiny by members of the Executive team and the Board. All significant projects must be approved by the Executive Committee and the Board.

Risk Oversight

The risk management framework is supported by a series of control documents and risk reporting and is overseen by both the second and third lines of defence working through the committee structure detailed above.

This framework enables the Board and senior management to maintain effective oversight of the level of risk within The Nottingham and to ensure that appropriate controls and mitigating activities are in place.

On behalf of the Board of directors,

Simon Baum
Chairman of the Board Risk Committee

14 March 2019

CORPORATE GOVERNANCE REPORT

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

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

This report sets out how the Board has operated in 2018 and complied with the provisions of the Code. The Board is committed to complying with best practice in corporate governance. In 2018, the Board did not comply with the Code provision that all directors should be subject to annual election. The Board was concerned that in extreme circumstances that requirement could have implications for the financial stability of the Society which would not be in the best interests of members.

However, the Board have reviewed the position and, at the annual general meeting in 2019, all directors will be submitted for election/re-election in line with the Code.

During 2018, the Board has reviewed and considered the requirements of the revised Code (July 2018), which is effective from 1 January 2019, and agreed its approach, in preparation for its implementation.

Leadership

The Board

As at 31 December 2018, the Board consisted of six Non-Executive Directors (including the Chairman), all of whom are considered to be independent in character and judgement, and two Executive Directors, providing a complementary balance of skills and expertise.

The Board held eight meetings and two strategy review meetings during 2018.

In addition the Non-Executive Directors meet regularly, without the Executive Directors present, and consider all aspects of Board responsibilities, governance and performance.

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

Division of responsibilities

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

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

The Chairman

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

Non-Executive Directors

Independent Non-Executive Directors play a vital role in challenging and helping develop strategy, whilst providing independent judgement, knowledge and experience.

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

One of the independent Non-Executive Directors is appointed as the senior independent director, to provide a sounding board for the Chairman and to serve as an intermediary for the other directors as necessary. The senior independent director is identified on page 20.

Effectiveness

Composition of the Board

The names of the directors together with brief biographical details are set out on pages 20 and 21.

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

The four committees meet regularly and current membership of these committees is shown on page 21.

The table below shows the attendance of each director at the relevant Board and Board committee meetings. The number to the left is the number of meetings actually attended; the number to the right is the number of meetings the director was eligible to attend during 2018.

Director	Board	Risk	Nominations	Remuneration	Audit
S. Baum	6/6	3/3	-	-	-
J. Edwards	8/8	4/4	3/3	6/6	-
J. Kibbey	8/8	4/4	3/3	-	1/1
D. Marlow	8/8	4/4	3/3	-	-
D. Mundy	8/8	4/4	-	-	-
A. Neden	8/8	4/4	-	6/6	6/6
K. Patel	8/8	4/4	-	-	6/6
K Spooner	8/8	4/4	-	6/6	6/6
S. Taylor	6/6	3/3	-	-	-

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

In addition to the four Board committees identified above, the Board has an Executive Committee to support the Board in managing the day-to-day operations of the Group. The Executive Committee meets twice monthly and its membership is made up of both Executive Directors and senior leaders. The Executive Committee is responsible for acting on behalf of the Board in organising, managing and protecting the Society's assets to deliver value to members, whilst ensuring the Society operates within the law, regulation and clear, agreed Board risk appetites. It is responsible, therefore, for ensuring the management and delivery of four key areas on behalf of the Board: Strategy; Risk Management; Business Planning; and Operational Oversight. The Risk Management Report on page 25 covers this Committee in further detail.

Appointments to the Board

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

The Committee meets at least twice a year. Additional meetings may be convened if necessary.

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

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

Commitment

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

Development

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

Information and support

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

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

Evaluation

Executive directors are evaluated using the performance management framework for all employees. The Executive Directors are appraised by the Chief Executive. The Chief Executive is appraised by the Chairman. The performance of Non-Executive Directors is reviewed annually by the Chairman. The senior independent director conducts interviews with each director in order to appraise the performance of the Chairman, the results of which are discussed with the Chairman.

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

Re-election

In 2019, all directors will be submitted for election at the annual general meeting (the 'AGM') in accordance with the Code.

Non-Executive Directors can serve up to a maximum of three three-year terms, subject to annual re-election. Any extension must be approved annually, subject to rigorous review, and be explained giving due consideration to the continuing independence and objectivity of the Non-Executive Director.

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

Accountability and audit

Financial and business reporting

The Directors' report on pages 22 to 24 details the responsibilities of the directors in preparing the Group's accounts.

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

The Board has responsibility to present a fair, balanced and understandable assessment of the Group's performance and financial position, business model and strategy, consideration of which is contained within the Chief Executive's review on pages 6 to 7, the Strategic report on pages 8 to 17 and within the report and accounts taken as a whole.

Viability statement

In accordance with the requirements of the Code, the Board has assessed the prospects of the Society over a period longer than the 12 months required by the going concern provision. The viability statement is considered on page 24 within the Directors' report.

Risk management and internal control

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

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

To assist in monitoring the risk management framework, the Assets and Liabilities, , Conduct & Regulatory Risk, Operational Risk, Trading & Operations, Project and Change and People and Reward Committees report into the Executive Committee, who in turn reports into the Board Risk Committee. The Board Risk Committee meets at least four times a year.

The Board has carried out a robust assessment of the principal risks facing the Group, including those that would threaten the business model, future performance, solvency and liquidity. These principal risks are detailed on pages 16 to 17 of the Strategic report and further information on risk management is given in the report commencing on page 25.

In accordance with the Code, the Society's Board is committed to maintaining a sound system of internal controls to safeguard both its own assets and those of its members and there is an annual review of risk management and internal control systems. Over recent years, the Board invested in its governance and risk management and formalised the lines of risk identification and acceptance. These governance improvements have been further enhanced during 2018 with the strengthening of the second line oversight function.

1st Line:
Focus: Control
Day-to-day management and control of risk by the business. Results reported to management and Board Risk Committee

2nd Line:
Focus: Oversight
Maintenance of coherent risk frameworks with regular validation and challenge of first line controls. Results reported to management and Board Risk Committee

3rd Line:
Focus: Assurance
Independent assurance of effectiveness of risk control and risk oversight. Results reported to management and Board Audit Committee.

The operation of these three lines of defence is embodied in the terms of reference of the Society's risk committees (Executive, Assets and Liabilities, Conduct & Regulatory, Operational Risk, Trading and Operations and Project and Change) who are informed by sub-committees (Information Risk, Credit, Prudential Oversight, Model Governance, Liquidity and Funding and Health & Safety). The Board Risk Committee has a range of policies and procedures that relate to the identification, assessment, monitoring and control of all the main areas of risk that the Group faces.

The information received and considered by the risk committees provided reasonable assurance that during 2018 there were no material breaches of control or regulatory standards and that the Society maintained an adequate system of internal control. Where weaknesses in controls are identified by the three lines of defence, the Board monitors the steps taken to remedy the issues and to ensure that the Society responds to changing external threats and economic circumstances and to the changing regulatory environment.

Remuneration

Policy and procedures

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

The Remuneration Committee's work and the Society's compliance with the Code principles relating to remuneration is covered in the directors' remuneration report on pages 36 to 41.

Membership

The Committee consists of Non-Executive Directors only and met on six occasions during the year. Additional meetings may be convened if necessary.

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

Relations with members

Dialogue with members

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

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

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

Constructive use of the AGM

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

All postal and proxy votes are counted using independent scrutineers.

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

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

On behalf of the Board of directors,

John Edwards
Chairman

14 March 2019

BOARD AUDIT COMMITTEE REPORT

Board Audit Committee

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

- to monitor the integrity of the financial statements of the Society and any formal announcements relating to the Society's financial performance;
- to review the Society's internal controls and risk management systems working with the Board Risk Committee;
- to monitor and review the effectiveness of the Society's internal audit function, agree and review progress of the annual Internal Audit Plan;
- prior to the members vote at the Annual General Meeting, make recommendations to the Board for appointment, re-appointment and removal of the external auditors;
- to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;
- to develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and to report to the Board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken; and
- to investigate any other relevant matter at the request of the Board.

Membership and attendance

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

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

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

Meeting frequency and reporting

The Committee met six times during 2018 and the main activities during the year were:

- reviewed the results and draft annual report and accounts for the year ending 31 December 2017;
- reviewed the going concern assumptions and all key issues and areas of judgement relating to the financial statement reporting;
- considered reports by the external auditor on its audit and review of the financial statement reporting;
- reviewed the year-end and interim financial statements and draft press releases, with consideration of the fair, balanced and understandable requirements of the UK Corporate Governance Code;
- considered the internal audit strategy for 2018;
- received and reviewed reports from internal audit;
- reviewed and approved the Society's risk-based internal audit plan for the next year;
- reviewed the adequacy and effectiveness of the Society's arrangements for handling matters raised through the whistleblowing policy;
- approved the whistleblowing policy;
- reviewed the adequacy and effectiveness of the Society's internal financial controls, internal control and risk management systems; and
- carried out a review of the Committee's own effectiveness.

Significant issues in relation to the financial statements

The Committee considers a wide range of issues in relation to the financial statements, which relate mainly to judgements and estimates which management have to make during the preparation of the statements. During 2018, the significant issues considered by the Committee included:

- **Implementation of IFRS 9 'financial instruments'**
  The Committee evaluated the model and governance outputs from the implementation project to review and challenge the approach, estimates and assumptions in developing the requirements of the new accounting standard for financial instruments, which was effective from 1 January 2018.
- **Loan loss provisioning – residential & SBL mortgages**
  The Society reviews the IFRS 9 model outputs to estimate the level of impairment required in the residential and commercial book, which uses historical default and loss experience as well as applying judgement. The Committee reviewed and challenged the approach to calculating the provisions and confirmed that the assumptions made are appropriate. The Committee is satisfied with the approach adopted to calculate the provision for impairment and the overall level of provision recognised.
- **Accounting for intercompany balances under IFRS 9**
  The Society considered the classification and measurement basis of its intercompany balances under IFRS 9 and resulting fair value adjustments on adoption of the new accounting standard.
- **Carrying value of consolidated goodwill**
  The Society purchased the Harrison Murray estate agency business in 2013 and the Committee considered the approach to supporting the carrying value of the consolidated goodwill recognised at a Group level.
- **Effective Interest Rate ('EIR') methodology**
  The Society recognises interest income using a constant level of interest over the expected behavioural life of the loan. The Committee reviewed the basis of the EIR calculations, as well as the results from the testing performed by the external auditor, and concluded it was appropriate.
- **Other provisions**
  The Committee reviewed and challenged the estimates and assumptions made by management when calculating the level of provisions at the reporting period and concluded it was appropriate.

- **Calculation of the defined benefit pension plan position**
  The Society has a defined benefit pension scheme which was closed to new entrants in 1997 and closed to future service accrual from 31 January 2009. The Committee reviewed the methodologies and acceptable ranges from which assumptions had been selected in calculating the latest estimate of the scheme's assets and liabilities. This review was supported by a report provided by the Society's pension advisors. Noting that the assumptions adopted by management were consistent with this report, the Committee is satisfied with the position reported in the accounts.
- **Going concern assumption**
  The Committee evaluated whether the going concern basis of accounting was appropriate by considering forecast profitability, liquidity position, funding availability and regulatory capital positions. The review also took into account the detailed stress testing scenarios completed as part of the annual liquidity and capital adequacy assessments.
- **Fair, balanced and understandable**
  The Committee reviewed the integrity of the financial statements and any formal announcements. The content of the annual report and accounts was reviewed and the Committee advised the Board that, in its view, and taken as a whole, it is fair, balanced and understandable and provides the information necessary for members to assess the Society's performance, business model and strategy. The Committee therefore recommended that the Board approve the Annual Report and Accounts.
- **Viability statement**
  The Committee reviewed the requirements of the UK Corporate Governance Code to provide the medium term viability statement in the Annual Report and Accounts and agreed the definition of the medium term period.
- **New accounting standards**
  Regular updates on financial reporting developments were presented to the Committee during the year to enable it to provide effective oversight of the financial reporting within the interim and full year accounts, including the implementation of IFRS 9, IFRS 15 and IFRS 16.
- **External audit findings**
  The external auditor did not highlight any material control weaknesses arising from their review of key financial reporting processes and systems.

Internal controls

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

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

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

Further details on the risk management framework are provided in the corporate governance report on pages 30 to 33.

Independence and effectiveness of external auditor

In 2014, the Society tendered its external audit relationship in line with best practice and Ernst & Young LLP were engaged during 2015 and have therefore been in post for four years at 31 December 2018.

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

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

The Committee considered the performance of Ernst & Young LLP as external auditor for 2018, and is satisfied with their objectivity, independence and effectiveness and therefore recommended that they be re-appointed at the AGM for the current year.

Oversight and effectiveness of internal audit

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

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

Audit committee performance and effectiveness

As outlined in the corporate governance report on page 31, the Board and each of the committees formally evaluate their own performance and effectiveness annually. The Committee therefore considers itself to be effective.

On behalf of the Board of directors,

Andrew Neden
Chairman of the Board Audit Committee

14 March 2019

DIRECTORS' REMUNERATION REPORT

For the year ended 31 December 2018

Statement by the Chair of the Remuneration Committee

On behalf of the Committee, I am pleased to present the annual directors' remuneration report, which sets out the remuneration policy and details of the directors' remuneration in the year to 31 December 2018.

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

- The Remuneration Policy which sets out the Society's remuneration policy for directors; and
- The Annual Remuneration Report which outlines how the policy was implemented in 2018.

There were no changes to the Remuneration Committee membership in 2018. Members of the Remuneration Committee during the period were:

Kerry Spooner	Non-Executive Director and Chair of the Committee
John Edwards	Chairman of the Board
Andrew Neden	Non-Executive Director and Chair of the Audit Committee

2018 performance and awards

The Chairman's statement, Chief Executive's review and Strategic report on pages 4 to 17 describe 2018 as a year of continued strong strategic progress in a very competitive and uncertain environment. The Nottingham is now the eighth largest building society with total assets of £4.1 billion. The year has seen good trading performance with regard to mortgage lending and increased assets in the year. The 'Member Rewards' programme continues to engage membership. There has also been continued growth in the area of branch savings balances, which now stand at £2.4 billion. We have also ensured that sufficient profit has been generated to cover our regulatory capital requirements and continue to invest in the Society whilst maintaining competitive levels of return for our savers.

In the 2018 performance year, there has been continued focus on sustainability for The Nottingham and its members. The overall asset size has grown by 3.9%, total savings balances by 11% and the branch network now stands at 67 locations across 11 counties.

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

The Directors Annual Bonus Plan - the Directors received 40% of the total bonus payment for 2018 following the end of the performance year with 60% being deferred for three years and subject to malus[1] and clawback rules in line with Regulatory best practice.

The 2015 -2017 LTI payments made to directors during 2018 reflect the significant progress made over the period with regard to the key measures of cost income ratio, profit after tax ratio against the comparator peer group and delivery of strategic objectives. This represents settlement of the final LTI scheme and all future variable pay will be through the Directors' Annual Bonus Plan only.

In November 2018, Simon Taylor, the Group's Chief Operating Officer, left the business after almost eight years with the Society. This follows a wider restructure of the Board and Executive Committee construct as outlined by the Chairman on page 5.

During 2018, at the Remuneration Committee's request, a review of the fixed and variable pay arrangements for the Executive Directors and senior leadership was undertaken. The review had the objectives of determining appropriate levels of total reward and variable pay in line with a mutual ethos and current market data as well as delivering a simple reward structure for the Society. External advisers were appointed to support the review with job evaluation, reward benchmarking and providing best practice advice on the make-up and structure of remuneration in financial services outside of London and in the mutual building society sector in particular. The recommendations of the review were considered and accepted by the Committee in December 2018 and planning for implementation in the 2019 performance period is underway.

Remuneration Committee

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

The Committee met six times in 2018 and is made up of a minimum of three Non-Executive Directors, as detailed on page 21. The Chief Executive, Head of People & Development, General Counsel and Company Secretary attend the meetings.

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

The Remuneration Committee's activities in 2018 also included:

- reviewing regulatory updates and assessing the impact on The Nottingham;
- reviewing of the Remuneration Policy for 2018 and recommendation to the Board for approval;
- reviewing and approving the Remuneration Policy Statement ensuring its compliance with the Remuneration Code;
- oversight of the activities undertaken by the Executive Committee and People & Reward Committee in relation to reward;

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

- agreeing the appointment, salary and benefits for the new Chief Risk Officer, Charles Roe, who joined the Society in April 2018 and was appointed as an Executive Director in January 2019;
- consideration of the annual pay review and bonus scheme approval and payments for all employees;
- reviewing and approving of executive variable pay for the 2018 financial year;
- set the direction and principles for all variable pay schemes for 2019; and
- agreeing the remuneration aspects required to support an operational restructure within the Society.

Remuneration policy

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

The policy is there to ensure that:

- Remuneration should be sufficient to attract, reward, retain and motivate high quality leaders and employees to run The Nottingham successfully, delivering value for our members whilst avoiding paying more than is necessary for this purpose in line with our mutual ethos;

and

- Remuneration is structured to strike the right balance between fixed and variable pay. Variable pay schemes are designed to incentivise and reward appropriate behaviour and performance, aligned with The Nottingham's position on risk; rewards are only attributed to the delivery of success and achievement of objectives.

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

Recruitment policy for Executive Directors

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

Service contracts

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

Payment for loss of office of Executive Directors

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

Other directorships

None of the Executive Directors currently hold any paid external directorships. David Marlow is a member of the FCA Small Business Practitioners Panel for which he receives a fee of £10,000 per annum.

Executive Director's total remuneration

Executive Directors' emoluments comprise a basic salary, variable pay, pension entitlement and other taxable benefits as outlined on pages 38 to 39.

The total remuneration received by Executive Directors is detailed on page 40. The information has been audited and shows remuneration for the years ending 31 December 2017 and 31 December 2018 as required under the Building Societies (Accounts and Related Provisions) Regulations 1998.

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

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

Non-Executive Directors

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

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

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

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

Remuneration Code Staff (Material Risk Takers)

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

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

Executive Directors

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

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

Executive Directors (continued)

Variable pay Legacy Long Term Incentive (LTI) *(now fully paid out in 2018)*	Linked to the delivery of the Society and personal objectives. Used to reward Executive Directors within the context of achieving the Society's goals and objectives and designed to incentivise individuals to produce successful, sustainable business results. Payments under the variable pay schemes are not pensionable.	Payment for the final LTI scheme was made in July 2018 following the year-end when all comparator societies' annual accounts were available. The scheme required achievement of Society and individual performance threshold criteria. This remaining scheme was only applicable to D Marlow and S Taylor. D Mundy was not eligible for this scheme, as he was not employed at the start of the scheme.	Payments under the remaining schemes were determined using a balanced scorecard and required achievement of: • Group cost income ratio targets; • Successful implementation of strategic initiatives; • The Society's profit after tax ratio relative to a comparator group of societies; and • Customer satisfaction targets for the period.	On target of 20.2% and maximum of 30% of eligible basic salary as at 31 December 2015 to reflect the previous reward structre.
Pension or pension allowance	A part of fixed remuneration to attract and retain executives of appropriate calibre and experience.	Executive Directors are invited to join the Society's defined contribution pension plan, or, as an alternative be provided with an equivalent cash allowance.	Not applicable	Contribution of 15% of base salary or paid as cash allowance.
Benefits	A part of fixed remuneration to attract and retain executives of appropriate calibre and experience.	The benefits received by Executive Directors are private medical insurance and a car allowance.	Not applicable	Set at a level considered appropriate for each Executive Director by the Committee in line with market practice.

Annual report on remuneration

Executive Director remuneration

Audited Society	2018 David Marlow £000	2018 Daniel Mundy £000	2018 Ashraf Piranie £000	2018 Simon Taylor £000	2018 Total £000	2017 David Marlow £000	2017 Daniel Mundy £000	2017 Ashraf Piranie £000	2017 Simon Taylor £000	2017 Total £000
Fixed remuneration										
Salary[1]	306	236	-	493	**1,035**	296	161	96	223	**776**
Benefits[2]	10	9	-	8	**27**	10	55	2	9	**76**
Variable remuneration										
Annual bonus[3]	37	28	-	-	**65**	43	21	-	31	**95**
Long term incentive plans[4]	58	-	-	43	**101**	60	-	-	47	**107**
	411	273	-	544	**1,228**	409	237	98	310	**1,054**
Pension contribution	46	35	-	32	**113**	44	24	5	33	**106**
	457	**308**	**-**	**576**	**1,341**	**453**	**261**	**103**	**343**	**1,160**

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

[1] Simon Taylor left the Society on 30 November 2018. His 2018 salary includes £232,000 for contractual payment in lieu of notice and an ex-gratia payment of £80,000 made in lieu of the 2018 annual bonus, holiday pay and in recognition of his commitment and service to the Society.
The 2017 salary of Ashraf Piranie includes £60,000 for an ex-gratia payment made in lieu of notice, holiday pay and in recognition of his commitment and service to the Society.

[2] The 2017 benefits of Daniel Mundy include £48,000 for payments agreed under his contract of employment to enable his relocation to the East Midlands area.

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

[4] Legacy LTI Scheme now fully paid out.

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

Executive Directors	Performance Year	Due 2019 £000	Due 2020 £000	Due 2021 £000	Due 2022 £000	Total Deferred £000
David Marlow	2015	53	-	-	-	53
	2016	-	47	-	-	47
	2017	-	-	64	-	64
	2018	-	-	-	56	56
		53	**47**	**64**	**56**	**220**
Daniel Mundy	2017	-	-	32	-	32
	2018	-	-	-	42	42
		-	-	**32**	**42**	**74**
Simon Taylor	2015	38	-	-	-	38
	2016	-	33	-	-	33
	2017	-	-	47	-	47
	2018	-	-	-	-	-
		38	**33**	**47**	**-**	**118**
		91	**80**	**143**	**98**	**412**

Simon Taylor will receive outstanding deferred elements to be paid when due, in line with the terms of the annual bonus scheme. This is subject to achievement of the threshold criteria and Remuneration Committee approval.

Daniel Mundy joined the Society and was appointed to the Board as Finance Director on 19 April 2017. He did not participate in the Legacy Long Term Incentive (LTI) scheme.

Ashraf Piranie resigned from the Board as Deputy CEO and Finance Director on 23 February 2017.

Annual report on remuneration (continued)

Non-Executive Director remuneration

Audited Society		2018 £000	2017 £000
Simon Baum	(appointed 18 June 2018)	35	-
John Edwards (Chairman)		71	68
Jane Kibbey (Vice-Chairman from 29 March 2017)		45	44
Andrew Neden		50	47
Kavita Patel		39	37
Kerry Spooner		47	40
Guy Thomas		-	23
Keith Whitesides (Vice-Chairman until retirement)		-	10
TOTAL EMOLUMENTS FOR SERVICES AS DIRECTORS		**287**	**269**

On behalf of the Board of directors,

Kerry Spooner
Chair of the Remuneration Committee

14 March 2019

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

Opinion

In our opinion, the financial statements:

- Give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's and the Society's affairs as at 31 December 2018 and of the Group's and the Society's income and expenditure for the year then ended; and
- Have been prepared in accordance with the requirements of the Building Societies Act 1986, and, as regards the Group financial statements, Article 4 of the IAS Regulation.

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

Group	Society
Consolidated statement of financial position as at 31 December 2018	Statement of financial position as at 31 December 2018
Consolidated income statement for the year ended 31 December 2018	Income statement for the year ended 31 December 2018
Consolidated statement of comprehensive income for the year ended 31 December 2018	Statement of comprehensive income for the year ended 31 December 2018
Consolidated statement of changes in members' interests for the year ended 31 December 2018	Statement of changes in members' interests for the year ended 31 December 2018
Consolidated cash flow statement for the year ended 31 December 2018	Cash flow statement for the year ended 31 December 2018
Related notes 1 to 36 to the accounts, including a summary of principle accounting policies	Related notes 1 to 36 to the accounts, including a summary of principle accounting policies

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

Basis for opinion

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

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

Conclusions relating to principal risks, going concern and viability statement

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

- the disclosures in the annual report set out on pages 16 to 17 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation set out on page 24 in the annual report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity;
- the directors' statement set out on pages 23 and 24 in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements;
- whether the directors' statement in relation to going concern required under the Listing Rules in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit; or
- the directors' explanation set out on pages 23 and 24 in the annual report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Overview of our audit approach

Key audit matters	• Revenue recognition in relation to effective interest rate (EIR) accounting; • Valuation of loan impairment; • Valuation of goodwill.
Audit scope	• We performed an audit of the complete financial information of the Group and Society. • Our Group audit scope included all of the Society's subsidiaries. Our audit did not involve any component teams.
Materiality	• Overall Group materiality of £1.07m which equates to 5% of the Group's 2018 adjusted profit before tax.

GOVERNANCE

Key audit matters

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

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Revenue recognition in relation to effective interest rate (EIR) accounting		
Refer to the Audit Committee report (page 34) and Accounting policies (pages 53 to 54) of the Consolidated financial statements. Effective interest rate accounting is a judgemental area driven by customer payment behaviours and management's assumptions. Changes in these assumptions could have a material impact on income recognition and could be subject to manipulation and therefore we classify this as a key audit matter.	We assessed the design effectiveness of internal controls operated by the Group over the EIR process. Our audit approach did not seek to rely on the controls identified. We tested the completeness and accuracy of data on a sample basis, from the Society's source system to the EIR models. We challenged assumptions regarding the expected lives of loans by comparing them to recent actual redemption behaviours, and compared assumptions about future changes in interest rates to current market data. We performed sensitivity analysis over the EIR models to assess the significance of individual assumptions. We verified the logic and accuracy of the EIR calculation across products and agreed the total EIR balance to the general ledger. We performed testing of journals recorded throughout the year and at the year-end using an approach based on risk of management override of controls. In each case we substantiated journals recorded to supporting evidence.	We concluded to the Audit Committee that the effective interest rate adjustments made to the Group's loan portfolios were materially correct at 31 December 2018. We gained assurance of the completeness and accuracy of data used within EIR models. We found that key assumptions in relation to behavioural lives of assets and prepayment rates were materially consistent with the underlying data and observed characteristics of the Society's portfolios and market trends. We found that the models were operating effectively in the calculation of EIR adjustments and that the results were accurately reflected in the general ledger. We found no significant errors or evidence of management override of controls from testing of journal entries.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Valuation of loan impairment		
Refer to Audit Committee report (page 34); Accounting policies (page 56) and Note 15 of the Consolidated financial statements. Valuation of loan impairment is an area of estimation that requires management judgement. Whilst the vast majority of the Society's portfolio is high quality with low arrears rates, impairment estimates applied are inherently a subjective area and involve a number of assumptions. Such assumptions include exposure at default, the definition of a significant increase in credit risk, the probability of default rate, loss given default and multiple economic scenarios. Following the adoption of IFRS 9, opening balances were restated and new impairment models were implemented by the Society. Given the amount of estimation involved and the value of the loan impairment provisions compared to audit materiality, we have classified this as a key audit matter.	We assessed the design effectiveness of internal controls operated by the Group over the loan impairment process. Our audit approach did not seek to rely on the controls identified. We tested the completeness and accuracy of data on a sample basis over key data inputs to loan impairment models to source documentation. We engaged modelling specialists to test the design and implementation of the IFRS 9 impairment models. This included assessment of key variables including probabilities of default and loss given default. We utilised a specialist Economist team to test the multiple economic scenarios for appropriateness. We validated the output of the model through to the relevant account balances included within the financial statements and tested that the loan impairment disclosures are accurate. We challenged management over the appropriateness of overlays outside the model process. We performed testing of journals recorded throughout the year and at the year-end using an approach based on risk of management override of controls. In each case we substantiated journals recorded to supporting evidence.	We concluded to the Audit Committee that the provision levels held by the Group in relation to mortgages loan impairment were conservative when compared to a reasonable range using historical data and industry benchmarks. We gained assurance of the completeness and accuracy of data used within the loan impairment models. We found that the models were operating effectively in the calculation of loan impairment balances and that the results were accurately reflected in the general ledger. We found no significant errors or evidence of management override of controls from testing of journal entries.
Valuation of goodwill		
Refer to Audit Committee report (page 34); Accounting policies (page 58) and Note 18 of the Consolidated financial statements. The valuation of goodwill is assessed by management through an annual impairment assessment. The nature of this assessment is judgemental and involves future projections of future cash flows that are inherently uncertain. There are a number of assumptions used in the goodwill impairment assessment which could materially impact the outcome, including growth rates and the selection of an appropriate discount rate. Given the carrying value of goodwill compared to audit materiality, we classified this as a key audit matter.	We assessed the design effectiveness of the key controls in operation over the goodwill impairment assessment. Our audit approach did not seek to rely on the controls identified. We examined management's impairment assessment to assess compliance with IAS 36 *Impairment of assets*. We challenged the forecasts and assumptions used within the assessment with reference to recent actual performance on the locations previously acquired in business combinations.	We concurred with management's assessment that the carrying value of goodwill required an impairment adjustment of £0.5 million at 31 December 2018. We concluded that the discount rate used of 12.5% was reasonable. We found that key assumptions in the impairment model in relation to income and costs of the acquired locations were reasonable and in line with the overall Society's updated business plan for these locations.

Our application of materiality

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

Materiality

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

We determined materiality for the Group to be £1.07 million (2017: £1.6 million), which is 5% of the Group's 2018 profit before tax adjusted to account for the increased interest expense that the Society pays compared to a profit-oriented bank and this equates to 0.45% of total reserves (2017: 0.75% of total reserves attributable to members of the Society).

Standing basis	• Profit before tax – £12.8m
Adjustments	• Plus mutuality interest expense – £8.6m
Materiality	• Totals £21.4m • Materiality of £1.07m (5% of materiality basis)

Performance materiality

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

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 75% (2017: 75%) of our planning materiality, namely £0.8 million (2017: £1.2 million). We have set performance materiality at this percentage based upon our recent experience of auditing the Group, from which we concluded that there is a lower expectation of undetected misstatement due to the effective control environment and only minor audit differences resulting from our work. As a result, we determined that the higher of our permissible thresholds for our performance materiality was appropriate.

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

Reporting threshold

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

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.06 million (2017: £0.08 million), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

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

Other information

The other information comprises the information included in the annual report set out on pages 4 to 47, including Chairman's statement set out on pages 4 to 5, Chief Executive's statement set out on pages 6 to 7, Strategic report set out on pages 8 to 17, Corporate responsibility report set out on pages 18 to 19, Directors' report as set out on pages 22 to 24, Risk management report as set out on pages 25 to 29, Corporate governance report as set out on pages 30 to 33, and the Board Audit Committee report as set out on pages 34 to 35, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

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

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

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

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

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

- **Fair, balanced and understandable set out on page 23** – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the group's performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or

- **Audit committee reporting set out on pages 34 to 35** – the section describing the work of the audit committee does not appropriately address matters communicated by us to the audit committee; or
- **Directors' statement of compliance with the UK Corporate Governance Code set out on page 24** – the parts of the directors' statement required under the Listing Rules relating to the Society's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

Opinion on other matters prescribed by the Building Societies Act 1986

In our opinion:

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

Matters on which we are required to report by exception

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

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

Other voluntary reporting matters

Directors' remuneration report

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

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 23, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor's responsibilities for the audit of the financial statements

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

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

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

Our approach was as follows:

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

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

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

Other matters we are required to address

Following the recommendation of the audit committee we were appointed by the Society at its annual general meeting on 24 March 2015 to audit the financial statements of the Society for the period ending 31 December 2015 and subsequent financial periods. Our total uninterrupted period of engagement is four years, covering periods from our appointment through to the period ending 31 December 2018.

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

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

Use of our report

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

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

14 March 2019

Notes:

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

INCOME STATEMENTS
for the year ended 31 December 2018

	Notes	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Interest receivable and similar income	3	85.4	82.2	86.8	83.5
Interest payable and similar charges	4	(35.2)	(33.9)	(36.6)	(35.1)
NET INTEREST INCOME		**50.2**	**48.3**	**50.2**	**48.4**
Fees and commissions receivable		7.5	9.1	2.9	3.2
Fees and commissions payable		(1.4)	(1.6)	(1.4)	(1.6)
Other income		-	-	0.3	0.3
Net losses from derivative financial instruments	5	(0.7)	(0.2)	(1.2)	(0.3)
TOTAL NET INCOME		**55.6**	**55.6**	**50.8**	**50.0**
Administrative expenses	6	(40.0)	(38.3)	(34.4)	(31.6)
Depreciation and amortisation	17,18	(3.4)	(3.0)	(3.3)	(2.9)
Finance cost	27	(0.3)	(0.3)	(0.3)	(0.3)
Impairment release – loans and advances	15	0.3	1.3	0.3	1.3
Impairment charge - goodwill	18	(0.5)	-	-	-
Provisions for liabilities - FSCS levy and other	26	0.1	(0.8)	0.1	(0.8)
PROFIT BEFORE TAX		**11.8**	**14.5**	**13.2**	**15.7**
Tax expense	8	(2.4)	(3.0)	(2.5)	(3.1)
PROFIT AFTER TAX FOR THE FINANCIAL YEAR		**9.4**	**11.5**	**10.7**	**12.6**

Profit for the financial year arises from continuing operations.

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

The notes on pages 53 to 103 form part of these accounts.

STATEMENTS OF COMPREHENSIVE INCOME
for the year ended 31 December 2018

	Notes	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Profit for the financial year		9.4	11.5	10.7	12.6
Items that will not be re-classified to the income statement					
Remeasurements of defined benefit obligation	27	0.4	2.1	0.4	2.1
Tax on items that will not be re-classified	8	(0.1)	(0.4)	(0.1)	(0.4)
Items that may subsequently be re-classified to the income statement					
Available-for-sale reserve					
Valuation losses taken to reserves	12	-	(0.4)	-	(0.4)
Tax on items that may subsequently be re-classified	8	-	0.1	-	0.1
FVOCI reserve					
Valuation losses taken to reserves	12	(1.2)	-	(1.2)	-
Tax on items that may subsequently be re-classified	8	0.2	-	0.2	-
Other comprehensive (expense)/income for the period net of income tax		**(0.7)**	**1.4**	**(0.7)**	**1.4**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**8.7**	**12.9**	**10.0**	**14.0**

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

The notes on pages 53 to 103 form part of these accounts.

ACCOUNTS

STATEMENTS OF FINANCIAL POSITION
as at 31 December 2018

	Notes	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
ASSETS					
Cash in hand and balances with the Bank of England	9	256.3	352.6	256.3	352.6
Loans and advances to credit institutions	10	34.5	33.1	19.0	24.6
Debt securities	12	216.1	109.2	216.1	109.2
Derivative financial instruments	13	8.2	7.3	7.8	7.3
Loans and advances to customers	14	3,502.9	3,368.8	3,502.9	3,368.8
Amounts due from subsidiary undertakings	16	-	-	21.2	28.7
Other assets		10.2	5.9	10.0	5.5
Property, plant and equipment	17	13.8	14.6	12.8	13.6
Intangible assets	18	10.2	7.2	6.2	2.7
Deferred tax assets	19	1.4	1.7	1.4	1.7
TOTAL ASSETS		**4,053.6**	**3,900.4**	**4,053.7**	**3,914.7**
LIABILITIES					
Shares	20	2,869.2	2,595.4	2,869.2	2,595.4
Amounts owed to credit institutions	21	685.0	703.7	685.0	703.7
Amounts owed to other customers	22	126.2	185.1	126.2	185.1
Amounts owed to subsidiary undertakings	23	-	-	106.1	158.5
Debt securities in issue	24	106.8	153.5	5.5	7.0
Derivative financial instruments	13	5.9	9.9	5.9	9.8
Other liabilities and accruals	25	6.2	4.9	5.8	4.3
Current tax liabilities		1.0	1.6	1.0	1.6
Provisions for liabilities	26	0.6	1.1	0.6	1.1
Retirement benefit obligations	27	4.8	6.9	4.8	6.9
Subscribed capital	28	25.1	25.6	25.1	25.6
TOTAL LIABILITIES		**3,830.8**	**3,687.7**	**3,835.2**	**3,699.0**
RESERVES					
General reserves		223.8	212.7	219.5	215.7
Fair value reserves	29	(1.0)	-	(1.0)	-
Total reserves attributable to members of the Society		**222.8**	**212.7**	**218.5**	**215.7**
TOTAL RESERVES AND LIABILITIES		**4,053.6**	**3,900.4**	**4,053.7**	**3,914.7**

The notes on pages 53 to 103 form part of these accounts.

These accounts were approved by the Board of directors on 14 March 2019 and signed on its behalf:

John Edwards
Chairman

David Marlow
Chief Executive

Daniel Mundy
Finance Director

STATEMENTS OF CHANGES IN MEMBERS' INTERESTS

for the year ended 31 December 2018

	Notes	General reserves £m	FVOCI reserve £m	Available-for-sale reserves £m	Total £m
GROUP 2018					
Balance as at 1 January 2018		212.7	-	-	212.7
Change on initial recognition of IFRS 9	36	1.4	-	-	1.4
Profit for the year		9.4	-	-	9.4
Other comprehensive income for the period (net of tax)					
Net losses from changes in fair value		-	(1.0)	-	(1.0)
Remeasurement of defined benefit obligation		0.3	-	-	0.3
Total other comprehensive income/(expense)		0.3	(1.0)	-	(0.7)
Total comprehensive income/(expense) for the period		9.7	(1.0)	-	8.7
BALANCE AS AT 31 DECEMBER 2018		**223.8**	**(1.0)**	**-**	**222.8**
GROUP 2017					
Balance as at 1 January 2017		199.5	-	0.3	199.8
Profit for the year		11.5	-	-	11.5
Other comprehensive income for the period (net of tax)					
Net losses from changes in fair value		-	-	(0.3)	(0.3)
Remeasurement of defined benefit obligation		1.7	-	-	1.7
Total other comprehensive income/(expense)		1.7	-	(0.3)	1.4
Total comprehensive income/(expense) for the period		13.2	-	(0.3)	12.9
BALANCE AS AT 31 DECEMBER 2017		**212.7**	**-**	**-**	**212.7**

	Notes	General reserves £m	FVOCI reserve £m	Available-for-sale reserves £m	Total £m
SOCIETY 2018					
Balance as at 1 January 2018		215.7	-	-	215.7
Change on initial recognition under IFRS 9	36	(7.2)	-	-	(7.2)
Profit for the year		10.7	-	-	10.7
Other comprehensive income for the period (net of tax)					
Net losses from changes in fair value		-	(1.0)	-	(1.0)
Remeasurement of defined benefit obligation		0.3	-	-	0.3
Total other comprehensive income/(expense)		0.3	(1.0)	-	(0.7)
Total comprehensive income/(expense) for the period		11.0	(1.0)	-	10.0
BALANCE AS AT 31 DECEMBER 2018		**219.5**	**(1.0)**	**-**	**218.5**
SOCIETY 2017					
Balance as at 1 January 2017		201.4	-	0.3	201.7
Profit for the year		12.6	-	-	12.6
Other comprehensive income for the period (net of tax)					
Net losses from changes in fair value		-	-	(0.3)	(0.3)
Remeasurement of defined benefit obligation		1.7	-	-	1.7
Total other comprehensive income/(expense)		1.7	-	(0.3)	1.4
Total comprehensive income/(expense) for the period		14.3	-	(0.3)	14.0
BALANCE AS AT 31 DECEMBER 2017		**215.7**	**-**	**-**	**215.7**

The notes on pages 53 to 103 form part of these accounts.

CASH FLOW STATEMENTS
for the year ended 31 December 2018

	Notes	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
CASH FLOWS FROM OPERATING ACTIVITIES					
Profit before tax		11.8	14.5	13.2	15.7
Depreciation and amortisation		3.4	3.0	3.3	2.9
Interest on subscribed capital		2.0	2.0	2.0	2.0
Net gains on disposal and amortisation of debt securities		0.6	0.7	0.6	0.7
Increase/(decrease) in impairment		0.2	1.3	(0.3)	1.3
		18.0	**21.5**	**18.8**	**22.6**
CHANGES IN OPERATING ASSETS AND LIABILITIES					
(Increase)/decrease in prepayments, accrued income and other assets		(5.2)	(3.9)	(49.9)	45.7
(Decrease) in accruals, deferred income and other liabilities		(3.4)	(9.9)	(11.8)	(9.9)
(Increase) in loans and advances to customers		(132.1)	(337.5)	(132.1)	(337.5)
Increase in shares		273.8	138.0	273.8	138.0
(Decrease)/increase in amounts owed to other credit institutions and other customers		(77.6)	115.5	(77.6)	115.5
Decrease in loans and advances to credit institutions		0.7	10.4	0.7	10.5
(Decrease)/increase in debt securities in issue		(46.7)	54.8	(1.5)	1.0
(Decrease) in retirement benefit obligation		(2.1)	(0.6)	(2.1)	(0.6)
Taxation paid		(2.9)	(2.6)	(2.9)	(2.6)
NET CASH GENERATED BY/(USED IN) OPERATING ACTIVITIES		**22.5**	**(14.3)**	**15.4**	**(17.3)**
CASH FLOWS FROM INVESTING ACTIVITIES					
Purchase of debt securities		(135.7)	(50.9)	(135.7)	(50.9)
Disposal of debt securities		27.0	38.0	27.0	38.0
Purchase of property, plant and equipment		(1.4)	(3.8)	(1.3)	(3.8)
Purchase of intangible assets		(4.7)	(0.6)	(4.7)	(0.6)
NET CASH (USED IN)/GENERATED BY INVESTING ACTIVITIES		**(114.8)**	**(17.3)**	**(114.7)**	**(17.3)**
CASH FLOWS FROM FINANCING ACTIVITIES					
Interest paid on subscribed capital		(1.9)	(1.9)	(1.9)	(1.9)
NET DECREASE IN CASH AND CASH EQUIVALENTS		**(94.2)**	**(33.5)**	**(101.2)**	**(36.5)**
Cash and cash equivalents at 1 January		360.3	393.8	351.8	388.3
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	**11**	**266.1**	**360.3**	**250.6**	**351.8**

The notes on pages 53 to 103 form part of these accounts.

1. ACCOUNTING POLICIES

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

Basis of preparation

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

The accounts have been prepared on the going concern basis as outlined in the Directors' report on page 24.

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

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

Changes in accounting policy

With effect from 1 January 2018, the Group applies, for the first time, IFRS 9 'Financial Instruments' and IFRS 15 'Revenue from Contracts with Customers'. The Group has therefore changed its accounting policies and made retrospective adjustments, where required, as a result of adopting these new standards. The impacts of IFRS 9 on the Group have been disclosed in note 36 to the Annual Report & Accounts.

To reflect the differences between IFRS 9 and IAS 39, IFRS 7 'Financial Instruments: Disclosures' has also been updated and the Group has adopted it alongside IFRS 9 for the year commencing 1 January 2018. The main changes include additional and more detailed disclosures for hedge accounting as set out in notes 13 and 30.

There is no impact to the financial statements of the Group as a result of adopting IFRS 15 and therefore no separate note and change to accounting policy has been presented.

There has been no restatement of comparative periods as a result of adopting the new standards.

Future accounting developments

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

IFRS 16 'Leases' – effective from 1 January 2019. The adoption of this new accounting standard will result in almost all existing operating lease commitments being recognised on the balance sheet, as the distinction between operating and finance leases is removed. Under the new standard, an asset (the right to use the leased item) and a financial liability to pay rentals are recognised. The financial impact of implementing this accounting standard is estimated to be the recognition of assets and corresponding liabilities of £5.0m - £6.0m, driven predominately by the Group's branch network property lease obligations.

Basis of consolidation

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

Subsidiaries are fully consolidated from the date on which control is transferred to the Group and de-consolidated from the date that control ceases. The Group accounts consolidate the assets, liabilities and results of the Society and all of its subsidiaries, eliminating intercompany balances and transactions. All entities have accounting periods ending on 31 December. The results of subsidiary undertakings acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date that ownership ceases.

Special purpose funding vehicles

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

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

Business combinations between mutual organisations

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

Business combinations

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

Interest income and expense

Under both IFRS 9 and IAS 39, interest income and interest expense for all interest-bearing financial instruments are recognised in 'interest receivable and similar income' or 'interest payable and similar charges'.

1. ACCOUNTING POLICIES (CONTINUED)

The effective interest rate ('EIR') method is applied for all financial assets or liabilities recorded at amortised cost, FVOCI, interest rate derivatives for which hedge accounting is applied and the related amortisation/recycling effect of hedge accounting. The effective interest rate is the rate that discounts the expected future cash flows, over the expected life of the financial instrument, to the net carrying amount of the financial asset or liability. This may include fees and commissions if they are an integral part of the effective interest rate of a financial instrument.

Under IFRS 9 interest income on financial assets is calculated by applying the EIR to the gross carrying amount of the financial asset, unless considered credit impaired. When a financial asset becomes credit impaired, and therefore considered as Stage 3, interest income is calculated by applying the EIR to the net amortised cost of the financial asset. If the financial asset cures and is no longer credit impaired, interest income is reverted to being calculated on a gross basis.

Interest income and expense also includes interest on derivatives measured at FVPL, where hedge accounting is not applied, using the contractual interest rate.

Fees and commissions

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

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

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

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

Cash and cash equivalents

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

Derivative financial instruments and hedge accounting

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

The Group has elected to continue to apply the hedge accounting requirements of IAS 39 on adoption of IFRS 9. The Group has not provided comparative information for periods before the date of initial application of IFRS 9 for the new disclosures introduced by IFRS 9 as a consequential amendment to IFRS 7, as permitted by the standard.

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

If derivatives are not designated as hedges, then changes in their fair values are recognised immediately in the income statement in the period in which they arise.

Fair value hedges

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

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

Financial assets (IAS 39 applicable to 31 December 2017)

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

Loans and receivables

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

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

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

1. ACCOUNTING POLICIES (CONTINUED)

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

Available-for-sale assets

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

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

Impairment of financial assets not carried at fair value through profit and loss (IAS 39 applicable to 31 December 2017)

Assets carried at amortised cost

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

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

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

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

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

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

Available-for-sale assets

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

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

Financial assets (IFRS 9 applicable from 1 January 2018)

Classification and Measurement

Financial assets comprise cash, loans and advances to credit institutions, debt securities, derivative financial instruments and loans and advances to customers. The Group classifies non-derivative financial assets as either amortised cost or FVOCI depending on the business model for managing the assets and the contractual cash flow characteristics. The Group determines its business model at the level that best reflects how it manages groups of assets to achieve its business objective. In making this assessment it considers how the performance of the business model is evaluated and reported within the group, how the risks of the business model are managed and the expected frequency, value and timing of sales of assets. The contractual terms of the financial assets are assessed to determine whether their cashflows represent solely payments of principal and interest or expose the Group to other risks. Management determines the classification of financial assets under IFRS 9 at the earlier of 1 January 2018 or initial recognition. No non-derivative assets have been classified as fair value through profit or loss.

Amortised cost

Financial assets whose business model is to hold for collection of contractual cash flows where those cash flows represent solely payments of principal and interest ('SPPI') are measured at amortised cost. Interest income from these financial assets is included in net interest income using the effective interest rate method. Any gain or loss arising on derecognition is recognised directly in profit or loss. The carrying value of these assets is adjusted by any expected credit loss allowance recognised. The Society classifies the following financial instruments as amortised cost:

- cash in hand and balances with the Bank of England;
- loans and advances to credit institutions; and
- loans and advances to customers.

1. ACCOUNTING POLICIES (CONTINUED)

Loans and advances to customers

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

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

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

Fair value through other comprehensive income ('FVOCI')
The Society recognises its debt securities as FVOCI assets. The business model for these financial assets is to hold for collection of contractual cash flows and for selling the financial assets, where the assets' cash flows represent solely payments of principal and interest and are measured at FVOCI. Movements in the carrying amount are taken through Other Comprehensive Income ('OCI'). When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from reserves to the income statement. Interest income from these financial assets is included in net interest income using the effective interest rate method. The expected credit loss for these assets does not reduce the carrying amount in the statement of financial position, which remains at fair value. Instead, an amount equal to the allowance that would arise if the assets were at amortised cost, is recognised in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss.

Fair value through profit or loss ('FVPL')
Assets that do not meet the criteria for amortised cost or FVOCI are measured at FVPL. Interest income from these financial assets is included in net interest income. The Society recognises its derivative financial instruments and some of its balances with subsidiary entities as FVPL assets.

Impairment of financial assets not carried at fair value through profit or loss (IFRS 9 applicable from 1 January 2018)

Under IFRS 9, the Group assesses on a forward-looking basis the expected credit losses ('ECL') associated with its financial assets carried at amortised cost and FVOCI and with the exposure arising from loan commitments. The allowance is based on the ECLs associated with the probability of default in the next 12 months unless there has been a significant increase in credit risk since origination and the measurement of ECL reflects:

- An unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes;
- The time value of money; and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

IFRS 9 outlines a 'three-stage' model for impairment based on changes in credit quality since initial recognition as summarised below:

- **Stage 1**: A financial instrument that is not credit-impaired on initial recognition and has its credit risk continuously monitored by the Group. ECL is measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months.
- **Stage 2**: If a significant increase in credit risk ('SICR') since initial recognition is identified, the financial asset is moved to 'Stage 2' but is not yet deemed to be credit impaired. The definition of a significant increase in credit risk is detailed below. ECL for stage 2 assets are measured based on expected credit losses on a lifetime basis.
- **Stage 3**: If the financial asset is credit-impaired, it is moved to 'Stage 3'. The definition of credit-impaired and default is outlined below. ECL for stage 3 assets is also measured on expected credit losses on a lifetime basis.

Forward-looking information is taken into account in the measurement of ECL with its use of economic assumptions such as inflation, unemployment rates, house price indices and Gross Domestic Product.

The Group has no purchased or originated credit impaired assets and has not applied any simplified approaches.

Significant increase in credit risk ('SICR')

The Group considers a financial instrument to have experienced a significant increase in credit risk when one of more of the following criteria has been met:

Financial instrument	Definition of significant increase in credit risk
Loans and advances to customers – Retail	• Over 30 days past due on contractual repayments; • Lifetime probability of default doubled since origination; • Lifetime probability of default greater than 1%; or • In forbearance.
Loans and advances to customers - SBL	• Over 30 days past due on contractual repayments; • On management watch list; • Lifetime probability of default doubled since origination; or • In forbearance.
Wholesale liquidity instruments	• Any arrears or receipt of adverse information

1. ACCOUNTING POLICIES (CONTINUED)

Definition of default and credit-impaired

The Group defines a financial asset as in default, which is fully aligned with the definition of credit-impaired, when it is more than 90 days past due on contractual repayments.

It is the Society's policy to consider a financial instrument as 'cured' and therefore reclassified out of Stage 3 when none of the default criteria have been present for at least six consecutive months. The decision whether to classify an asset as Stage 2 or Stage 1 once cured depends on the updated position, at the time of the cure, and whether there has been a significant increase in credit risk compared to initial recognition.

Loans and advances to customers

Forward-looking information incorporated in the ECL models

The assessment of SICR and the calculation of ECL both incorporate forward-looking information. Forecasts of these economic variables are provided by a reputable third party on a quarterly basis and provide the best estimate view of the economy over the next five years. After five years, to project the economic variables out for the full remaining lifetime, a mean reversion approach is used, i.e. long-run averages.

In addition to the base economic scenario forecast, other possible scenarios along with scenario weightings are obtained, of which management have applied three scenarios in the model calculations.

ECL models

The ECL models are driven by three key components:

- **Probability of Default ('PD')**: The PD model takes attributes of the mortgage accounts on the portfolio (for example, origination vintage and time on book) and adjusts for the impacts of a range of independently sourced forward-looking macroeconomic scenarios to produce a vector detailing the likelihood of an account defaulting in a given month within the expected behavioural lifetime. The model outputs are scaled against a number of internal risk grades which are determined using the Society's behavioural scoring models. These behavioural scoring models contain a combination of internal and externally derived data to rank the mortgage accounts by risk and pool the accounts into groups of comparable expected performance.
- **Exposure at Default ('EAD')**: The EAD model predicts the loan exposure of each mortgage account at a future default date. The model takes into account balance amortisation and accrued interest from missed payments given expected changes in the repayment terms of the mortgage; for example interest rates may move in a manner consistent with the macroeconomic scenarios. The calculation produces a vector to represent 'expected' EAD at each potential point of default along the vector from the reporting date up to the expected behavioural lifetime; and
- **Loss Given Default ('LGD')**: The LGD model calculates the likely loss on asset disposal that the Society would suffer if a default were to occur in any given month over the expected behavioural lifetime of the mortgage account. LGD takes into account the EAD in comparison to the value expected to be recovered through the sale of an asset, given the macroeconomic scenario specific trend in property price indices. The expectation of loss is then scaled to reflect the likelihood of a mortgage account reaching default, progressing on to sale of the asset.

Forbearance strategies and renegotiated loans

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

The main options offered by the Society include:

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

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

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

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

Modifications

The Society may on occasion modify the contractual terms of loans provided to customers. When this is solely for commercial reasons and considered part of the ordinary course of business, there is no impact on the impairment approach. Generally, forbearance at the Society, whether retail or SBL lending, does not result in the terms of the loan being modified so significantly that it becomes substantially a different financial asset, and therefore, the original loan remains and does not result in derecognition.

Write off of financial assets

The Group's accounting policy for the write off of credit exposures remains the same under IFRS 9 as it was under IAS 39. Financial assets are written off either partially or in their entirety only when the Group has stopped pursuing the recovery. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the loss allowance, which is then applied to the gross carrying amount. Any subsequent recoveries are credited to the income statement on settlement receipt.

1. ACCOUNTING POLICIES (CONTINUED)

Cash in hand and balances with the Bank of England, Loans and advances to credit institutions and Debt securities

The Group reviews the external credit ratings of its liquid assets at each reporting date. Those assets, which are of investment grade or higher, are considered to have low credit risk and therefore are assumed to have not had a significant increase in credit risk since initial recognition. This includes the Society's debt security portfolio. The Society's policy to allow only high quality, senior secured exposures to Residential Mortgage Backed Securities ('RMBS') ensures continued Society receipt of contractual cash flows in stressed scenarios. For all other wholesale liquidity balances, a simple model calculates the ECL allowance, based on externally provided 12 month PD rates for individual counterparties.

Derecognition of financial assets and liabilities

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

Financial liabilities

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

Fair value of financial assets and liabilities

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

Level 1 – Valuation using quoted market process

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

Level 2 – Valuation technique using observable inputs

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

Level 3 – Valuation technique using significant unobservable inputs

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

Subscribed capital

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

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

Intangible assets

Computer Software

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

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

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

Goodwill

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

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

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

1. ACCOUNTING POLICIES (CONTINUED)

Other intangibles

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

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

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

Property, plant and equipment

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

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

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

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

Employee benefits

Long term incentive schemes

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

Pensions

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

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

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

Leases

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

Taxation

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

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

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

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

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

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

1. ACCOUNTING POLICIES (CONTINUED)

Provisions and contingent liabilities

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

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

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

Accounting estimates and judgements

In the course of preparing the financial statements, no judgements have been made in the process of applying the Group's accounting policies, other than those involving estimations, which have had a significant effect on the amounts recognised in the financial statements. The Group's significant estimates, including judgements involving estimations, are shown below.

Impairment losses on loans and advances to customers

The Group reviews its mortgage advances portfolio at least on a quarterly basis to assess impairment. In determining whether an impairment loss should be recorded, the Group is required to exercise a degree of judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values and the assessment of significant increase in credit risk. The Society's ECL calculations under IFRS 9 are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies, which individually are not possible to isolate. Note 1 on pages 55 to 56 outlines the accounting policies and key definitions for IFRS 9.

Key elements of the ECL models that are considered accounting judgements, including estimation, include:

- The internal credit grading model, which assigns PDs to individual accounts;
- The criteria for assessing if there has been a significant increase in credit risk;
- Determination of associations between macroeconomic scenarios, economic inputs and the effect on PDs, EADs and LGDs; and
- Selection of forward-looking macroeconomic scenarios and their probability weightings to derive economic inputs to the ECL models.

Applying a 100% weighting to the Society's pessimistic economic scenario results in further impairment losses of £0.5 million as at 31 December 2018.

Expected mortgage life

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

A 10% increase in the life profile of mortgage assets would result in an increase in the value of loans on the statement of financial position by approximately £1.4 million.

Employee benefits

The Group operates a defined benefit pension scheme. Significant judgements (on such areas as future interest and inflation rates and mortality rates) have to be exercised in estimating the value of the assets and liabilities of the scheme, and hence of its net deficit. The assumptions are outlined in note 27 to the accounts. Of these assumptions, the main determinant of the liability is the discount rate. A variation of 0.1% in the discount rate will change liabilities by approximately £1.0 million.

Goodwill

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

2. SEGMENTAL REPORTING

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

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

The Group reports through three operating segments:

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

2018	Retail financial services £m	Estate Agency £m	Mortgage Broking £m	Consolidation adjustments £m	Total £m
Net interest income	50.2	-	-	-	50.2
Fees and commission receivable	2.9	2.8	1.8	-	7.5
Fees and commission payable	(1.4)	-	-	-	(1.4)
Other income	0.3	-	-	(0.3)	-
TOTAL INCOME	**52.0**	**2.8**	**1.8**	**(0.3)**	**56.3**
Administrative expenses	(34.0)	(4.0)	(1.4)	-	(39.4)
Depreciation and amortisation	(3.3)	(0.1)	-	-	(3.4)
Finance cost	(0.3)	-	-	-	(0.3)
Impairment losses on loans and advances	0.3	-	-	-	0.3
Provisions for liabilities – FSCS and other	0.1	-	-	-	0.1
UNDERLYING PROFIT/(LOSS)	**14.8**	**(1.3)**	**0.4**	**(0.3)**	**13.6**
Net losses from derivative financial instruments	(0.7)	-	-	-	(0.7)
Strategic investment costs	(0.6)	-	-	-	(0.6)
Impairment losses – goodwill	-	(0.5)	-	-	(0.5)
PROFIT/(LOSS) BEFORE TAX	**13.5**	**(1.8)**	**0.4**	**(0.3)**	**11.8**
Tax expense	(2.5)	0.2	(0.1)	-	(2.4)
PROFIT/(LOSS) AFTER TAX	**11.0**	**(1.6)**	**0.3**	**(0.3)**	**9.4**
Total assets	4,048.8	1.6	0.4	2.8	4,053.6
Total liabilities	3,830.2	1.5	0.3	(1.2)	3,830.8
Capital expenditure	6.1	-	-	-	6.1

2. SEGMENTAL REPORTING (CONTINUED)

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

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

There are no further reportable segments or activities which are not presented above or in the primary statements on pages 48 to 52.

3. INTEREST RECEIVABLE AND SIMILAR INCOME

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
On loans fully secured on residential property	84.6	89.2	84.6	89.2
On other loans	2.8	2.4	2.8	2.4
On amounts due from group undertakings	-	-	1.0	1.1
On liquid assets	1.7	1.1	1.7	1.1
On instruments held at amortised cost	89.1	92.7	90.1	93.8
On debt securities	1.3	0.7	1.3	0.7
On derivative hedging of financial assets	(5.6)	(11.2)	(4.9)	(11.0)
On instruments calculated on an EIR basis	84.8	82.2	86.5	83.5
On derivatives not in a hedge accounting relationship	0.6	-	0.3	-
	85.4	**82.2**	**86.8**	**83.5**

Interest on debt securities includes £1.1 million (2017: £0.6 million) arising from fixed income investment securities.

Included within interest income is £0.2 million (2017: £0.2 million) in respect of interest income accrued on impaired loans two or more months in arrears.

4. INTEREST PAYABLE AND SIMILAR CHARGES

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
On shares held by individuals	25.9	25.1	25.9	25.1
On amounts due to group undertakings	-	-	3.1	2.6
On deposits and other borrowings	8.1	7.4	6.4	6.0
On subscribed capital	2.0	2.0	2.0	2.0
On derivative hedging of financial liabilities	(0.8)	(0.6)	(0.8)	(0.6)
	35.2	**33.9**	**36.6**	**35.1**

5. NET LOSSES FROM DERIVATIVE FINANCIAL INSTRUMENTS

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Derivatives in designated fair value hedge relationships	4.6	12.9	4.6	12.9
Adjustments to hedged items in fair value hedge accounting relationships	(5.2)	(12.9)	(5.2)	(12.9)
Derivatives not in designated fair value hedge relationships	(0.1)	(0.2)	(0.6)	(0.3)
	(0.7)	**(0.2)**	**(1.2)**	**(0.3)**

The net loss from derivative financial instruments of £0.7 million (2017: £0.2 million) represents the net fair value movement on derivative instruments that are matching risk exposure on an economic basis. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting is not achievable on certain items. The movement is primarily due to timing differences in income recognition between derivative instruments and the hedged assets or liabilities. This gain or loss will trend to zero over time and this is taken into account by the Board when considering the Group's underlying performance.

Further information regarding the Group and Society's derivative financial instruments and fair value hedge accounting is presented in notes 13 and 30 of these financial statements.

6. ADMINISTRATIVE EXPENSES

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Wages and salaries	19.4	19.4	16.7	15.1
Social security costs	2.2	1.8	2.0	1.5
Other pension costs	1.0	0.9	0.9	0.8
Total staff costs	**22.6**	**22.1**	**19.6**	**17.4**
Premises and facilities	3.2	3.0	2.7	2.7
IT	4.3	3.6	4.3	3.5
Marketing and advertising	1.5	2.1	1.2	1.8
Operating lease rentals	1.2	0.9	0.9	0.6
Other administrative costs	7.2	6.6	5.7	5.6
	40.0	**38.3**	**34.4**	**31.6**

Included in wages and salaries is £0.4m (2017: £nil) of restructuring costs. A further £0.2m of strategic investment costs are included in other administrative costs.

	Group 2018 £000	Group 2017 £000	Society 2018 £000	Society 2017 £000
Other administrative costs include:				
Remuneration of auditors and associates (excluding VAT)				
Audit of these financial statements	246	119	246	119
Audit of subsidiary undertakings	45	44	-	-
Audit of associated pension schemes	11	10	11	10
Other assurance services	42	33	34	33

7. EMPLOYEES

	Group 2018 Number	Group 2017 Number	Society 2018 Number	Society 2017 Number
The average number of persons employed during the year was:				
Full time	527	512	456	406
Part time	192	195	171	119
	719	**707**	**627**	**525**
Building Society				
Central Administration	267	268	267	268
Branches	360	257	360	257
Subsidiaries	92	182	-	-
	719	**707**	**627**	**525**

The average number of employees on a full time equivalent basis in the Society was 574 (2017: 498) and all of these are employed within the United Kingdom.

8. TAX EXPENSE

		Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Current tax		2.3	2.9	2.4	3.0
Adjustments for prior years		-	-	-	-
TOTAL CURRENT TAX		**2.3**	**2.9**	**2.4**	**3.0**
Deferred tax	19	0.1	0.1	0.1	0.1
Adjustments for prior years		-	-	-	-
TOTAL DEFERRED TAX		**0.1**	**0.1**	**0.1**	**0.1**
		2.4	**3.0**	**2.5**	**3.1**

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

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Profit before taxation	11.8	14.5	13.2	15.7
Expected tax at 19% (2017: 19.25%)	2.2	2.8	2.5	3.0
Expenses not deductible for corporation tax	0.3	0.1	0.1	0.1
Income not taxable	(0.2)	-	(0.1)	-
Effective securitisation	0.1	-	-	-
Adjustment for prior years	-	0.1	-	-
	2.4	**3.0**	**2.5**	**3.1**

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Tax recognised directly in other comprehensive income				
Tax on FVOCI assets	(0.2)	-	(0.2)	-
Tax on available-for-sale assets	-	(0.1)	-	(0.1)
Deferred tax on pension scheme	0.1	0.4	0.1	0.4
TAX (CREDIT)/CHARGE FOR THE YEAR	**(0.1)**	**0.3**	**(0.1)**	**0.3**

Factors affecting future tax charges

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

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

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

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Cash in hand	1.5	1.5	1.5	1.5
Balances with the Bank of England	254.8	351.1	254.8	351.1
	256.3	**352.6**	**256.3**	**352.6**

Balances with the Bank of England includes cash ratio deposits of £5.7 million (2017: £3.3 million) which are not readily available for use in the Group's day-to-day operations and therefore are excluded from cash and cash equivalents.

10. LOANS AND ADVANCES TO CREDIT INSTITUTIONS

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Repayable on call and short notice	15.5	11.0	-	2.5
Other loans and advances to credit institutions	19.0	22.1	19.0	22.1
	34.5	**33.1**	**19.0**	**24.6**

As at 31 December 2018 £17.9 million (2017: £22.1 million) of cash has been deposited by the Group and Society as collateral against derivative contracts.

11. CASH AND CASH EQUIVALENTS

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Cash in hand and balances with the Bank of England	250.6	349.3	250.6	349.3
Loans and advances to credit institutions	15.5	11.0	-	2.5
	266.1	**360.3**	**250.6**	**351.8**

12. DEBT SECURITIES

Group and Society	Notes	2018 IFRS 9 FVOCI £m	2017 IAS 39 Available-for-sale £m
Debt securities			
Gilts		20.5	30.9
Treasury bills		49.9	-
Fixed rate notes		48.8	28.6
Floating rate notes		18.0	16.2
Mortgage backed securities		78.9	33.5
		216.1	**109.2**
Movements on debt securities during the year may be analysed as follows:			
As at 1 January		109.2	97.4
Additions		135.0	50.2
Disposals and maturities		(27.1)	(38.1)
Net losses from changes in fair value recognised in other comprehensive income	29	(1.0)	(0.3)
		216.1	**109.2**

Of this total £198.1 million (2017: £93 million) is attributable to fixed income debt securities.

13. DERIVATIVE FINANCIAL INSTRUMENTS

Group	2018 Contract/ notional amount £m	2018 Fair value of assets £m	2018 Fair value of liabilities £m	2017 Contract/ notional amount £m	2017 Fair value of assets £m	2017 Fair value of liabilities £m
Derivatives not in hedge accounting relationship						
Interest rate swaps	456.7	0.4	(1.0)	185.0	0.2	(0.5)
Derivatives designated as fair value hedges						
Interest rate swaps	1,907.0	7.8	(4.9)	2,013.8	7.1	(9.4)
	2,363.7	**8.2**	**(5.9)**	**2,198.8**	**7.3**	**(9.9)**

Society	2018 Contract/ notional amount £m	2018 Fair value of assets £m	2018 Fair value of liabilities £m	2017 Contract/ notional amount £m	2017 Fair value of assets £m	2017 Fair value of liabilities £m
Derivatives not in a hedge accounting relationship						
Interest rate swaps	343.4	-	(1.0)	185.0	0.2	(0.4)
Derivatives designated as fair value hedges						
Interest rate swaps	1,907.0	7.8	(4.9)	1,857.9	7.1	(9.4)
	2,250.4	**7.8**	**(5.9)**	**2,042.9**	**7.3**	**(9.8)**

Further information regarding the Group's hedge accounting and fair value hedges is presented in note 30 'Financial Instruments' on page 96.

14. LOANS AND ADVANCES TO CUSTOMERS

Group and Society	Notes	2018 IFRS 9 £m	2017 IAS 39 £m
Loans fully secured on residential property		3,434.3	3,301.9
Other loans fully secured on land		71.9	66.6
		3,506.2	3,368.5
Provision for impairment losses on loans and advances	15	(1.2)	(3.2)
		3,505.0	3,365.3
Fair value adjustment for hedged risk		(2.1)	3.5
		3,502.9	**3,368.8**

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

Bank of England funding

The table below summarises the mortgages pledged and encumbered assets.

	Mortgages pledged		Drawn	
	2018 £m	2017 £m	2018 £m	2017 £m
Bank of England funding				
Other whole mortgage schemes (including Funding for Lending)	613.8	1,025.4	409.7	604.0
Term Funding Scheme	836.1	709.6	817.6	680.0
	1,449.9	**1,735.0**	**1,227.3**	**1,284.0**

ACCOUNTS

14. LOANS AND ADVANCES TO CUSTOMERS (CONTINUED)

Other secured funding

As at 31 December 2018, loans and advances to customers also includes £106.8 million (2017: £158.7 million) for both the Group and Society which have been used in secured funding arrangements, resulting in the beneficial interest of these loans being transferred to Arrow Mortgage Finance No.1 Limited, a special purpose vehicle consolidated into the Group Accounts. The carrying value of these loans at the date the beneficial interest was transferred was £166.7 million (2017: £166.7 million). All of the loans pledged are retained within the Society's Statement of Financial Position as the Society retains substantially all the risk and rewards relating to the loans. These loans secure £101.3 million (2017: £146.5 million) of funding for the Group (note 24).

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

Impairment provisions have been deducted from the appropriate asset values on the Statement of Financial Position. The gross carrying amounts and impairment provisions, on an IFRS 9 basis, are presented in detail below.

Group and Society	Loans fully secured on residential property 31 Dec 2018 £m	Other loans fully secured on land 31 Dec 2018 £m	Total 31 Dec 2018 £m	Loans fully secured on residential property 1 Jan 2018 £m	Other loans fully secured on land 1 Jan 2018 £m	Total 1 Jan 2018 £m
Gross carrying amount						
Stage 1	3,170.3	30.0	3,200.3	2,982.3	31.0	3,013.3
Stage 2	258.3	40.3	298.6	314.3	34.4	348.7
Stage 3	5.7	1.6	7.3	5.3	1.2	6.5
	3,434.3	**71.9**	**3,506.2**	**3,301.9**	**66.6**	**3,368.5**

Group and Society	Loans fully secured on residential property 31 Dec 2018 £m	Other loans fully secured on land 31 Dec 2018 £m	Total 31 Dec 2018 £m	Loans fully secured on residential property 1 Jan 2018 £m	Other loans fully secured on land 1 Jan 2018 £m	Total 1 Jan 2018 £m
Expected Credit Loss allowance						
Stage 1	0.1	0.1	0.2	0.2	0.1	0.3
Stage 2	0.1	0.5	0.6	0.4	0.4	0.8
Stage 3	-	0.4	0.4	-	0.4	0.4
	0.2	**1.0**	**1.2**	**0.6**	**0.9**	**1.5**

The movement in the period since adoption of IFRS 9 on 1 January 2018 is immaterial and therefore no movement reconciliation tables have been presented.

The ECL allowance recognised against the Society's loan commitment balance at 31 December 2018 is immaterial to the financial statements and therefore has not been separately disclosed.

Forward-looking information incorporated in the ECL models

The assessment of SICR and the calculation of ECL both incorporate forward-looking information. The key economic variables impacting credit risk and expected credit loss for the portfolios have been determined by management, as outlined below, but expert judgement is also applied in the process. Forecasts of these economic variables are provided by a reputable third party on a quarterly basis and provide the best estimate view of the economy over the next five years. After five years, to project the economic variables out for the full remaining lifetime, a mean reversion approach is used, i.e. long-run averages.

In addition to the base economic scenario forecast, other possible scenarios along with scenario weightings are obtained, of which management have applied three scenarios in the model calculations, weighted 30% upside, 43% base and 27% downside.

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

The summary below outlines the most significant forward-looking assumptions on adoption of IFRS 9 and as at 31 December 2018, over the five year planning period and their low and high points across the optimistic, base and pessimistic scenarios.

		31 Dec 2018	1 Jan 2018
Inflation	Base Low to high	2.2% (0.5)% – 3.4%	2.9% (0.5)% - 3.8%
Unemployment rate	Base Low to high	4.2% 3.4% - 8.5%	4.3% 4.1% - 8.6%
House price index	Base Low to high	3.3% (12.0)% - 6.9%	4.8% (14.2)% - 9.0%
Gross Domestic Product	Base Low to high	1.4% (3.2)% - 3.7%	1.3% (3.6)% - 3.6%

Applying a 100% weighting to the pessimistic economic scenario would result in further impairment losses of £0.5 million as at 31 December 2018 (1 January 2018: £0.6 million).

The impairment provision position under IAS 39 for the prior year is presented below:

Group and Society	2017 IAS 39 Loans fully secured on residential property £m	2017 IAS 39 Other loans fully secured on land £m	2017 IAS 39 Total £m
As at 1 January			
Collective impairment	1.1	1.8	2.9
Individual impairment	0.4	1.2	1.6
	1.5	**3.0**	**4.5**
Income statement			
Charge/(release) for the year			
Collective impairment	0.4	(1.5)	(1.1)
Individual impairment	(0.2)	-	(0.2)
	0.2	**(1.5)**	**(1.3)**
Amount utilised in the year			
Individual impairment	-	-	-
As at 31 December			
Collective impairment	1.5	0.3	1.8
Individual impairment	0.2	1.2	1.4
	1.7	**1.5**	**3.2**

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

A reconciliation between the closing IAS 39 position as at 31 December 2017 and the opening IFRS 9 position as at 1 January 2018 is presented in note 36.

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

Group and Society	2018 IFRS 9 Loans fully secured on residential property £m	2018 IFRS 9 Other loans fully secured on land £m	2018 IFRS 9 Total £m	2017 IAS 39 Loans fully secured on residential property £m	2017 IAS 39 Other loans fully secured on land £m	2017 IAS 39 Total £m
Release/(charge) of provision for impairment	0.2	0.1	0.3	(0.2)	1.5	1.3
Recoveries of debts previously written off	-	-	-	-	-	-
	0.2	**0.1**	**0.3**	**(0.2)**	**1.5**	**1.3**

ACCOUNTS

16. AMOUNTS DUE FROM SUBSIDIARY UNDERTAKINGS

Society	Notes	2018 Shares £m	2018 Amount due £m	2017 Shares £m	2017 Amount due £m
As at 1 January under IAS 39		-	28.7	-	21.7
Change in measurement basis on initial recognition of IFRS 9	36	-	(8.6)	-	-
As at 1 January under IFRS 9		-	20.1	-	21.7
Additions/(repayments)		-	1.1	-	7.0
		-	**21.2**	-	**28.7**

As at 31 December 2017, £8.7m of amounts due from subsidiary undertakings were measured at amortised cost under IAS 39. Following the adoption of IFRS 9, from 1 January 2018, there has been a change in the classification and measurement of these balances and these are now measured at fair value through profit or loss ('FVPL'). This has resulted in the recognition of a transition adjustment of £8.6m (note 36).

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

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

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

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

The amounts due from Arrow Mortgage Finance No. 1 Ltd have a contractual maturity of two years and are expected to be repaid within this period in line with the secured funding term.

All other intercompany balances have no fixed date of repayment and are recognised at fair value through profit or loss. The directors have reviewed the recoverability of outstanding balances with subsidiary undertakings and therefore the fair value as at 31 December 2018 and no change in fair value is deemed necessary.

Details of the balances outstanding with subsidiary undertakings are disclosed in the related party transactions note 33.

17. PROPERTY, PLANT AND EQUIPMENT

	Group			Society		
2018	Land and buildings £m	Equipment, fixtures, fittings £m	Total £m	Land and buildings £m	Equipment, fixtures, fittings £m	Total £m
Cost						
As at 1 January 2018	16.4	23.9	40.3	14.4	23.3	37.7
Additions	0.1	1.3	1.4	0.1	1.2	1.3
Disposals	-	-	-	-	-	-
As at 31 December 2018	**16.5**	**25.2**	**41.7**	**14.5**	**24.5**	**39.0**
Depreciation						
As at 1 January 2018	8.9	16.8	25.7	7.8	16.3	24.1
Charge for the year	0.4	1.8	2.2	0.3	1.8	2.1
On disposals	-	-	-	-	-	-
As at 31 December 2018	**9.3**	**18.6**	**27.9**	**8.1**	**18.1**	**26.2**
Net Book Value						
As at 31 December 2018	**7.2**	**6.6**	**13.8**	**6.4**	**6.4**	**12.8**

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

17. PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
The net book value of land and buildings comprises:				
Freehold	6.7	6.9	5.9	6.1
Short Leasehold	0.5	0.6	0.5	0.5
	7.2	**7.5**	**6.4**	**6.6**
The net book value of land and buildings occupied for own use:				
Building Society	6.0	6.2	6.0	6.2
Subsidiaries	0.8	0.9	-	-
Non - Group	0.4	0.4	0.4	0.4
	7.2	**7.5**	**6.4**	**6.6**

18. INTANGIBLE ASSETS

Group 2018	Goodwill £m	Purchased Software £m	Developed Software £m	Other Intangibles £m	Total £m
Cost					
As at 1 January 2018	4.5	7.5	13.1	0.7	25.8
Additions	-	0.4	4.3	-	4.7
As at 31 December 2018	**4.5**	**7.9**	**17.4**	**0.7**	**30.5**
Amortisation and impairment					
As at 1 January 2018	-	7.1	10.8	0.7	18.6
Charge for the year	-	0.2	1.0	-	1.2
Impairment in the year	0.5	-	-	-	0.5
As at 31 December 2018	**0.5**	**7.3**	**11.8**	**0.7**	**20.3**
Net Book Value					
As at 31 December 2018	**4.0**	**0.6**	**5.6**	**-**	**10.2**

18. INTANGIBLE ASSETS (CONTINUED)

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

The goodwill relates to the 2013 acquisition of 100% of the ordinary share capital of Harrison Murray Ltd (£4.0m) and 100% of the lettings trade and assets of Harrison Murray Commercial Ltd (£0.5m). In accordance with the requirements of IAS 36, the Group completed an impairment review of the carrying value for goodwill as at 31 December 2018 to ensure that the carrying value is stated at no more than its recoverable amount. As a result of this review, the goodwill relating to the lettings trade and assets was written down in value by £0.5 million.

The discounted cash flow calculation used to complete the impairment review is based on the most recent corporate plan for the next four years, which takes into account the risks inherent in the business areas. The cash flows are extrapolated for subsequent years based on a long term growth rate of 3.0%, and discounted at a rate of 12.5%.

Society	2018 Purchased Software £m	2018 Developed Software £m	2018 Total £m	2017 Purchased Software £m	2017 Developed Software £m	2017 Total £m
Cost						
As at 1 January	7.4	13.1	20.5	7.2	12.7	19.9
Additions	0.4	4.3	4.7	0.2	0.4	0.6
As at 31 December	**7.8**	**17.4**	**25.2**	**7.4**	**13.1**	**20.5**
Amortisation						
As at 1 January	7.0	10.8	17.8	6.8	10.0	16.8
Charge for the year	0.2	1.0	1.2	0.2	0.8	1.0
As at 31 December	**7.2**	**11.8**	**19.0**	**7.0**	**10.8**	**17.8**
Net Book Value						
As at 31 December	**0.6**	**5.6**	**6.2**	**0.4**	**2.3**	**2.7**

19. DEFERRED TAX

	Notes	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
As at 1 January		1.7	2.1	1.7	2.1
Charge on initial recognition of IFRS 9	36	(0.3)	-	(0.3)	-
Charge to the income statement		(0.1)	(0.1)	(0.1)	(0.1)
Recognised directly in other comprehensive income		0.1	(0.3)	0.1	(0.3)
		1.4	**1.7**	**1.4**	**1.7**

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

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Pensions and other post tax retirement benefits	(0.1)	(0.1)	(0.1)	(0.1)
Intangible assets	0.1	-	0.1	-
Other provisions	(0.1)	-	(0.1)	-
	(0.1)	**(0.1)**	**(0.1)**	**(0.1)**

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

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Deferred tax assets				
Pensions and other post-retirement benefits	1.1	1.2	1.1	1.2
Property, plant and equipment	0.4	0.4	0.4	0.4
Fair value reserves	0.2	-	0.2	-
Transfer of engagements – fair value adjustments	0.1	0.2	0.1	0.2
	1.8	**1.8**	**1.8**	**1.8**
Deferred tax liabilities				
IFRS transitional adjustments	0.3	-	0.3	-
Intangibles	0.1	0.1	0.1	0.1
	0.4	**0.1**	**0.4**	**0.1**
Net deferred tax asset	**1.4**	**1.7**	**1.4**	**1.7**

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

20. SHARES

Group and Society	2018 £m	2017 £m
Held by individuals	2,869.2	2,595.4
	2,869.2	**2,595.4**

21. AMOUNTS OWED TO CREDIT INSTITUTIONS

Group and Society	2018 £m	2017 £m
Amounts owed to credit institutions	685.0	703.7
	685.0	**703.7**

Amounts owed to credit institutions include £9.8 million (2017: £103.7 million) secured against certain loans and advances to credit institutions and loans and advances to customers.

22. AMOUNTS OWED TO OTHER CUSTOMERS

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Demand accounts				
Retail customers	1.0	1.5	1.0	1.5
Other	3.4	3.6	3.4	3.6
	4.4	**5.1**	**4.4**	**5.1**
Term deposits				
Local Authorities	94.4	97.0	94.4	97.0
Pension Funds/ Insurers	10.0	15.0	10.0	15.0
Other	17.4	68.0	17.4	68.0
	121.8	**180.0**	**121.8**	**180.0**
	126.2	**185.1**	**126.2**	**185.1**

23. AMOUNTS OWED TO SUBSIDIARY UNDERTAKINGS

Society	2018 £m	2017 £m
At 1 January	158.5	101.6
Advance	-	98.3
Repayment	(52.4)	(41.4)
	106.1	**158.5**

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

ACCOUNTS

24. DEBT SECURITIES IN ISSUE

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Senior secured debt	101.3	146.5	-	-
Certificates of deposit	5.5	7.0	5.5	7.0
	106.8	**153.5**	**5.5**	**7.0**

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

25. OTHER LIABILITIES AND ACCRUALS

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Trade creditors	0.8	0.1	0.8	0.1
Accruals and deferred income	3.7	3.1	3.5	2.7
Other creditors	1.7	1.7	1.5	1.5
	6.2	**4.9**	**5.8**	**4.3**

26. PROVISIONS FOR LIABILITIES

Group and Society	2018 FSCS £m	2018 Customer redress & other provisions £m	2018 Total £m	2017 FSCS £m	2017 Customer redress & other provisions £m	2017 Total £m
At 1 January	0.2	0.9	1.1	0.4	0.5	0.9
(Credit)/charge for the year	(0.1)	-	(0.1)	0.2	0.6	0.8
Provisions utilised	(0.1)	(0.3)	(0.4)	(0.4)	(0.2)	(0.6)
	-	**0.6**	**0.6**	**0.2**	**0.9**	**1.1**

FSCS levy

Following the settlement of the loans outstanding from the 2008/09 banking failures, there are no further liabilities outstanding. Ongoing costs of the FSCS scheme are recognised in administrative expenses.

Customer redress and other related provisions

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

Contingent liabilities

As a deposit taker, the Society continues to have obligations to the FSCS, as well as other contractual obligations to third party suppliers, which may create a financial obligation in future accounting periods.

27. RETIREMENT BENEFIT OBLIGATIONS

a) Defined benefit obligations

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

The pension cost is assessed following the advice of a qualified independent actuary using the projected unit method. The latest funding review of the scheme was as at 31 March 2017. This review showed that the market value of the scheme assets as at 31 March 2017 was £50.3 million and that the actuarial value of those assets represented 88% of the benefits that had accrued to members after allowing for expected future increase in salaries.

An updated actuarial valuation at 31 December 2018 was carried out on a market value basis by a qualified independent actuary, as follows:

Group and Society	2018 %	2017 %
The principal actuarial assumptions used were as follows:		
Discount rate	2.9	2.5
Rate of increase in salaries	3.3	3.4
Rate of increase in pensions	3.6	3.6
Inflation	3.3	3.4

The assumptions applied follow the requirements of IAS 19, which are different to the technical valuation approach. This requires the discount rate to be benchmarked against AA corporate rated bonds, which as at 31 December 2018 were lower than the rate of inflation.

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

Group and Society	2018 Male Years	2018 Female Years	2017 Male Years	2017 Female Years
Expected life at retirement for a new pensioner	24.7	26.8	24.8	26.8
Expected life at retirement in 20 years' time	26.5	28.7	26.4	28.5

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

Group and Society	Change in assumption	2018 £m	2017 £m
Principal actuarial assumption			
Discount rate	+/- 0.25%	(2.4)	(2.6)
Rate of increase in salaries	+/- 0.25%	0.1	0.1
Rate of increase in pensions	+/- 0.25%	0.7	0.8
Mortality age adjustment	+/- 0.25%	0.5	0.6
Inflation	+/- 0.25%	1.0	1.1

27. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

Group and Society	2018 £m	2017 £m
Fair value of scheme assets:		
As at 1 January	53.5	50.4
Interest on pension scheme assets	1.3	1.3
Contributions by employer	2.1	0.7
Benefits paid	(2.6)	(2.1)
Expenses paid by trustees	-	-
(Loss)/gain on asset returns	(4.4)	3.2
As at 31 December	**49.9**	**53.5**
Present value of defined benefit obligations:		
As at 1 January	(58.3)	(59.8)
Past service cost	(0.2)	-
Interest on pension scheme liabilities	(1.4)	(1.6)
Benefits paid	2.6	2.1
Experience (loss) on liabilities	(0.2)	-
Gain on changes in financial assumptions	3.4	1.0
As at 31 December	**(54.1)**	**(58.3)**
Deficit in scheme at 31 December	**(4.2)**	**(4.8)**
Impact of asset ceiling	**(0.6)**	**(2.1)**
LIABILITY IN THE STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER	**(4.8)**	**(6.9)**

In recognising the net surplus or deficit of the pension scheme, the funded status of the scheme is adjusted to reflect the funding requirement agreed by the sponsor alongside the rights of any return of surplus, with the recognition of an asset ceiling liability. The actual return on plan assets was a loss of £3.1 million (2017: £4.5 million gain).

Following the recent legal case ruling, the Society has recognised a past service cost of £0.2 million (2017: £nil) in the year, to reflect the estimate of liabilities for GMP equalisation.

The major categories of plan assets are as follows:

Group and Society	2018 £m	2017 £m
Equities	22.5	23.2
Bonds	17.8	17.0
Liability driven investments	8.4	11.7
Cash	0.1	0.1
Secured pensioners	1.1	1.5
Fair value of scheme assets	**49.9**	**53.5**

The amounts recognised in finance income are:

	2018 £m	20176 £m
Interest cost	(1.4)	(1.6)
Interest on pension scheme assets	1.3	1.3
	(0.1)	**(0.3)**

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

Group and Society	2018 £m	2017 £m
Opening defined benefit obligation at 1 January	(6.9)	(9.4)
Amount recognised in the income statement	(0.3)	(0.3)
Employer contributions	2.0	0.7
Remeasurement gains	0.4	2.1
CLOSING DEFINED BENEFIT OBLIGATION AS AT 31 DECEMBER	**(4.8)**	**(6.9)**

27. RETIREMENT BENEFIT OBLIGATIONS (CONTINUED)

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

Group and Society	2018 £m	2017 £m
Actual return less expected return on plan assets	(4.4)	3.2
Experience loss arising on scheme liabilities	(0.2)	-
Changes in assumptions underlying the present value of the scheme liabilities	3.4	1.0
Change in impact of asset ceiling	1.6	(2.1)
REMEASUREMENT OF DEFINED BENEFIT OBLIGATION	**0.4**	**2.1**

The average duration of the defined benefit obligation as at 31 December 2018 is 17 years (2017: 17 years). This number can be analysed as follows:

Group and Society	2018 Years	2017 Years
Active members	21	21
Deferred members	21	21
Retired members	13	13

During the year, the Group made additional contributions of £2.1 million (2017: £0.7 million) as part of its funding plan. The Group and Society have committed to contribute £1.5 million in 2019 under the agreed funding plan.

b) Defined contribution obligations

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

The pension charge for the period represents contributions payable by the Group and Society to the schemes and amounted for the Group to £0.9 million (2017: £0.8 million) and for the Society £0.8 million (2017: £0.7 million). There were no outstanding or prepaid contributions at either the beginning or end of the year.

28. SUBSCRIBED CAPITAL

Group and Society	2018 £m	2017 £m
7.875% sterling permanent interest bearing shares	23.9	23.9
Fair value adjustment for hedged risk	1.2	1.7
	25.1	**25.6**

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

29. FAIR VALUE RESERVES

Group and Society	2018 FVOCI £m	2017 Available-for-sale £m
At 1 January	-	0.3
Transfer from available-for-sale on adoption of IFRS 9	-	-
Net loss from changes in fair value	(1.0)	(0.3)
	(1.0)	**-**

ACCOUNTS

30. FINANCIAL INSTRUMENTS

Classification & Measurement

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

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

The ALCO, supported by the CC and LAF, monitors statement of financial position risks (including the use of derivative financial instruments), funding and liquidity in line with the Group's prudent policy statements and ensures that the management of credit risk is consistent with the credit risk appetite statement.

Key performance indicators are provided to the Executive Committee and Board monthly by the ALCO and its sub committees.

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

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

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

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

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

The fair values of these hedges as at 31 December 2018 are shown in note 13.

30. FINANCIAL INSTRUMENTS (CONTINUED)

Classification & Measurement (continued)

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

Financial instrument	Terms and conditions	Accounting policy: IFRS 9	Accounting policy: IAS 39
Loans and advances to credit institutions	Fixed or LIBOR linked interest rate Fixed term Short to medium term maturity	Amortised cost Accounted for at settlement date	Amortised cost Accounted for at settlement date
Debt securities	Fixed or LIBOR linked interest rate Fixed term Short to medium term maturity	Fair value through other comprehensive income Accounted for at settlement date	Fair value through other comprehensive income Accounted for at settlement date
Loans and advances to customers	Secured on residential property or land Standard maximum contractual term of 25 years Fixed or variable rate interest	Amortised cost Accounted for at settlement date	Amortised cost Accounted for at settlement date
Shares	Variable term Fixed or variable interest rates	Amortised cost Accounted for at settlement date	Amortised cost Accounted for at settlement date
Amounts owed to credit institutions	Fixed or LIBOR linked interest rate Fixed term Short to medium term maturity	Amortised cost Accounted for at settlement date	Amortised cost Accounted for at settlement date
Amounts owed to other customers	Fixed or LIBOR linked interest rate Fixed term Short to medium term maturity	Amortised cost Accounted for at settlement date	Amortised cost Accounted for at settlement date
Debt securities in issue	Fixed or LIBOR linked interest rate Fixed term Short to medium term maturity	Amortised cost Accounted for at settlement date	Amortised cost Accounted for at settlement date
Subscribed capital	Fixed interest rate Issued for indeterminate period Only repayable upon winding up of the Society	Amortised cost Accounted for at settlement date	Amortised cost Accounted for at settlement date
Derivative financial instruments	Fixed interest received/paid converted to variable interest paid/received Based on notional value of the derivative	Fair value through profit and loss Accounted for at trade date	Fair value through profit and loss Accounted for at trade date

30. FINANCIAL INSTRUMENTS (CONTINUED)

Classification & Measurement (continued)

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

Carrying values by category (IFRS 9)	Held at amortised cost	Held at fair value			
Group As at 31 December 2018	Financial assets and liabilities at amortised cost £m	Fair value through other comprehensive income £m	Derivatives designated as fair value hedges £m	Unmatched derivatives £m	Total £m
Financial assets					
Cash in hand and balances with the Bank of England	256.3	-	-	-	256.3
Loans and advances to credit institutions	34.5	-	-	-	34.5
Debt securities	-	216.1	-	-	216.1
Derivative financial instruments	-	-	7.8	0.4	8.2
Loans and advances to customers	3,502.9	-	-	-	3,502.9
Other assets	35.6	-	-	-	35.6
	3,829.3	**216.1**	**7.8**	**0.4**	**4,053.6**
Financial liabilities					
Shares	2,869.2	-	-	-	2,869.2
Amounts owed to credit institutions	685.0	-	-	-	685.0
Amounts owed to other customers	126.2	-	-	-	126.2
Debt securities in issue	106.8	-	-	-	106.8
Derivative financial instruments	-	-	4.9	1.0	5.9
Subscribed capital	25.1	-	-	-	25.1
Other liabilities	12.6	-	-	-	12.6
	3,824.9	**-**	**4.9**	**1.0**	**3,830.8**

30. FINANCIAL INSTRUMENTS (CONTINUED)

Classification & Measurement (continued)

Carrying values by category (IAS 39)	Held at amortised cost		Held at fair value			
Group As at 31 December 2017	Loans and receivables £m	Financial assets and liabilities at amortised cost £m	Available-for-sale £m	Derivatives designated as fair value hedges £m	Unmatched derivatives £m	Total £m
Financial assets						
Cash in hand and balances with the Bank of England	-	352.6	-	-	-	352.6
Loans and advances to credit institutions	33.1	-	-	-	-	33.1
Debt securities	-	-	109.2	-	-	109.2
Derivative financial instruments	-	-	-	7.1	0.2	7.3
Loans and advances to customers	3,368.8	-	-	-	-	3,368.8
Other assets	-	29.4	-	-	-	29.4
	3,401.9	**382.0**	**109.2**	**7.1**	**0.2**	**3,900.4**
Financial liabilities						
Shares	-	2,595.4	-	-	-	2,595.4
Amounts owed to credit institutions	-	703.7	-	-	-	703.7
Amounts owed to other customers	-	185.1	-	-	-	185.1
Debt securities in issue	-	153.5	-	-	-	153.5
Derivative financial instruments	-	-	-	9.4	0.5	9.9
Subscribed capital	-	25.6	-	-	-	25.6
Other liabilities	-	14.5	-	-	-	14.5
	-	**3,677.8**	**-**	**9.4**	**0.5**	**3,687.7**

30. FINANCIAL INSTRUMENTS (CONTINUED)

Fair values of financial assets and liabilities carried at amortised cost

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

Group		2018 Book value £m	2018 Fair value £m	2017 Book value £m	2017 Fair value £m
Financial assets					
Cash in hand and Balances with the Bank of Engand	a	256.3	256.3	352.6	352.6
Loans and advances to credit institutions	b	34.5	34.5	33.1	33.1
Loans and advances to customers	c	3,502.9	3,507.6	3,368.8	3,375.9
Financial liabilities					
Shares	d	2,869.2	2,876.5	2,595.4	2,600.6
Amounts owed to credit institutions	d	685.0	685.0	703.7	704.0
Amounts owed to other customers	d	126.2	126.2	185.1	185.2
Debt securities in issue	e	106.8	106.8	153.5	153.5
Subscribed capital	f	23.9	29.0	23.9	30.6

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

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

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

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

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

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

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

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

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

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

30. FINANCIAL INSTRUMENTS (CONTINUED)

Fair values of financial assets and liabilities carried at fair value

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

Group	Notes	2018 Level 1 £m	2018 Level 2 £m	2018 Total £m	2017 Level 1 £m	2017 Level 2 £m	2017 Total £m
Financial assets							
FVOCI - Debt securities	12	216.1	-	216.1	-	-	-
Available-for-sale – Debt securities	12	-	-	-	109.2	-	109.2
Derivative financial instruments – Interest rate swaps	13	-	8.2	8.2	-	7.3	7.3
		216.1	**8.2**	**224.3**	**109.2**	**7.3**	**116.5**
Financial liabilities							
Derivative financial instruments – Interest rate swaps	13	-	(5.9)	(5.9)	-	(9.9)	(9.9)
		-	**(5.9)**	**(5.9)**	**-**	**(9.9)**	**(9.9)**

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

Valuation techniques

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

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

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

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

Debt securities

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

Interest rate swaps

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

Transfers between fair value hierarchies

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

30. FINANCIAL INSTRUMENTS (CONTINUED)

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

Credit risk

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

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

Group and Society	2018 £m	2017 £m
Credit risk exposure		
Cash in hand and Balances with the Bank of England	256.3	352.6
Loans and advances to credit institutions	34.5	33.1
Debt securities	217.3	109.2
Derivative financial instruments	8.2	7.3
Loans and advances to customers	3,502.9	3,365.3
Total statement of financial position exposure	**4,019.2**	**3,867.5**
Off balance sheet exposure – mortgage commitments	79.2	190.6
	4,098.4	**4,058.1**

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

The Executive Committee, supported by ALCO and CC, is responsible for approving treasury counterparties for both derivatives and investment purposes within the Board's risk appetite. Limits are placed on the amount of risk accepted in relation to one counterparty, or group of counter-parties, and to industry sectors. This is monitored weekly by the Society's Treasury risk team and reviewed monthly by the ALCO and CC.

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

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

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

Group	2018 £m	2018 %	2017 £m	2017 %
Industry sector				
Banks	116.8	23.0	84.3	17.0
Building Societies	1.0	0.2	-	-
Multilateral Development Banks	63.9	12.6	28.6	5.8
Central Government	325.2	64.2	382.0	77.2
	506.9		**494.9**	

Group	2018 £m	AAA %	AA %	A %	Other %	2017 £m
Geographic region						
United Kingdom	440.0	17.9	77.9	4.0	0.2	450.2
Multilateral Development banks	63.9	100.0	-	-	-	28.6
Canada	-	-	-	-	-	12.6
Australia	3.0	-	100.0	-	-	3.5
	506.9					**494.9**

30. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk (continued)

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

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

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

All of the Group's treasury assets are classified as Stage 1 for ECL calculation purposes under IFRS 9 and there are no impairment charges against any of the Group's treasury assets as at 31 December.

b) Loans and advances to customers

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

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

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

For existing customers who have been added to the lending portfolio, management use behavioural scorecards to review the ongoing creditworthiness of customers by determining the likelihood of them defaulting over a rolling 12 month period together with the amount of loss if they do default. The continual assessment of customer risk of default is used to assess the customer's suitability for further lending as well as feed into strategic decision making processes, such as the corporate plan. Models used within the customer rating process are monitored in line with industry best practice and to provide insight into changes observed within the mortgage portfolios.

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

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

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

The maximum credit risk exposure is disclosed in the table on page 86.

Loans and advances to customers are predominantly made up of retail loans fully secured against UK residential property (£3,434.3 million), split between residential and buy-to-let loans with the remaining £71.9 million being secured on commercial property.

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

30. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk (continued)

b) Loans and advances to customers (continued)

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

Group and Society	2018 %	2017 %
Geographical analysis		
Eastern	9.5	9.2
East Midlands	19.0	19.6
London	7.7	7.4
North East	5.1	5.2
North West	10.7	10.8
South East	14.2	13.8
South West	8.2	8.0
Wales	3.0	2.8
West Midlands	9.8	10.0
Yorkshire & Humberside	12.5	12.7
Other	0.3	0.5
	100.0	**100.0**

Retail loans (Loans fully secured on residential properties)

Loans fully secured on residential property are split between residential and buy-to-let. The average LTV is the mean LTV for the portfolio. Each individual LTV is calculated by comparing the value of the mortgage loan to the value of collateral held adjusted by a house price index. The simple average LTV of residential mortgages is 56% (2017: 55%). All residential loans above 80% LTV are insured against loss.

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

Group and Society	2018 Residential %	2018 Buy-to-let %	2017 Residential %	2017 Buy-to-let %
Loan to Value analysis				
< 60%	32.5	44.6	34.8	51.0
60% - 80%	39.1	55.3	39.2	48.8
80% - 90%	21.7	0.1	21.2	0.1
> 90%	6.7	-	4.8	0.1
	100.0	**100.0**	**100.0**	**100.0**
Average loan to value of loans	56.4	58.8	55.1	57.9
Average loan to value of new business	74.5	66.4	78.6	67.2

The quality of the Group's retail mortgage book is reflected in the number and value of accounts in arrears. By volume 0.2% (2017: 0.2%) of loans are three months or more in arrears and by value it is 0.1% (2017: 0.1%).

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

30. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk (continued)

b) Loans and advances to customers (continued)

Retail loans (continued)

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

Group and Society	2018 IFRS 9 Indexed £m	2018 IFRS 9 Unindexed £m	2017 IAS 39 Indexed £m	2017 IAS 39 Unindexed £m
Value of collateral held:				
Neither past due or impaired	-	-	6,067.3	5,079.3
Past due but not impaired	-	-	31.8	23.7
Impaired	-	-	1.3	1.2
Stage 1: 12 month expected credit losses	5,832.6	4,998.7	-	-
Stage 2: Lifetime expected credit losses	408.6	357.3	-	-
Stage 3: Lifetime expected credit losses	13.2	9.4	-	-
	6,254.4	**5,365.4**	**6,100.4**	**5,104.2**

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

With collateral capped to the amount of outstanding debt, the value of collateral held against loans in stages 2 and 3 under IFRS 9 and which are in arrears, is £17.4 million as at 31 December 2018. Under IAS 39, the value of collateral held against loans 'past due but not impaired' as at 31 December 2017 was £12.4 million.

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

The table below provides information on retail gross loans and Expected Credit Loss stages split by the number of days past due ('DPD'):

Group and Society	31 December 2018 Gross loans £m	31 December 2018 Expected Credit Loss £m	1 January 2018 Gross loans £m	1 January 2018 Expected Credit Loss £m
Stage 1: 12 month expected credit losses				
< 30 days past due	3,170.3	0.1	2,982.3	0.2
Stage 2: Lifetime expected credit losses				
< 30 days past due	245.0	0.1	310.7	0.4
> 30 days past due	13.3	-	3.6	-
Stage 3: Lifetime expected credit losses				
< 90 days past due	2.9	-	1.6	-
> 90 days past due	2.8	-	3.7	-
	3,434.3	**0.2**	**3,301.9**	**0.6**

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30. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk (continued)

b) Loans and advances to customers (continued)

Forbearance

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

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

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

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

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

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

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

The table below details the number of forbearance cases within the retail loans category:

Group and Society	2018 Number	2017 Number
Type of forbearance		
Interest only concessions	3	6
Reduced payment concessions	1	2
Payment plans	24	27
Capitalisations	58	61
Mortgage term extensions	59	63
Less: cases with more than one form of forbearance	(50)	(54)
	95	**105**

These cases are covered by an IFRS 9 ECL allowance of £3,000 (2017 provision under IAS 39 equivalent: £10,000). In total, £2.2 million (2017: £2.3 million) of loans are subject to forbearance.

30. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk (continued)

b) Loans and advances to customers (continued)

Secured Business Loans (Other loans fully secured on land)

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

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

Group and Society	2018 £m	2018 %	2017 £m	2017 %
Owner occupied	32.8	45.6	31.1	46.5
Investment property	39.1	54.4	35.5	53.5
	71.9	**100.0**	**66.6**	**100.0**

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

Group and Society	2018 %	2017 %
Loan to Value analysis		
< 60%	36.0	32.5
60% - 80%	49.2	49.4
80% - 90%	14.5	17.8
> 90%	0.3	0.3
	100.0	**100.0**
Average loan to value of loans	50.7	60.4
Average loan to value of new business	52.0	54.0

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

Group and Society	2018 IFRS 9 Indexed £m	2018 IFRS 9 Unindexed £m	2017 IAS 39 Indexed £m	2017 IAS 39 Unindexed £m
Value of collateral held:				
Neither past due or impaired	-	-	133.7	140.0
Past due but not impaired	-	-	2.0	2.1
Impaired	-	-	2.6	4.4
Stage 1: 12 month expected credit losses	69.3	67.6	-	-
Stage 2: Lifetime expected credit losses	82.5	91.0	-	-
Stage 3: Lifetime expected credit losses	2.5	3.6	-	-
	154.3	**162.2**	**138.3**	**146.5**

Collateral reflects the latest valuation completed. If a property has had a desktop valuation since the latest full valuation, the collateral reflects the desktop valuation (70% of the SBL book has had a desktop valuation (2017: 81%)).

30. FINANCIAL INSTRUMENTS (CONTINUED)

Credit risk (continued)

b) Loans and advances to customers (continued)

Secured Business Loans (continued)

The table below provides information on SBL gross loans and Expected Credit Loss stages split by the number of days past due ('DPD'):

Group and Society	31 December 2018 Gross loans £m	31 December 2018 Expected Credit Loss £m	1 January 2018 Gross loans £m	1 January 2018 Expected Credit Loss £m
Stage 1: 12 month expected credit losses				
< 30 days past due	30.0	0.1	31.0	0.1
Stage 2: Lifetime expected credit losses				
< 30 days past due	39.1	0.5	34.0	0.4
> 30 days past due	1.2	-	0.4	-
Stage 3: Lifetime expected credit losses				
< 90 days past due	1.3	0.3	1.1	0.4
> 90 days past due	0.3	0.1	0.1	-
	71.9	**1.0**	**66.6**	**0.9**

In terms of SBL risk, the single largest borrower represents less than 1.5% (2017: 1.6%) of the SBL mortgage book.

Forbearance

The Group has various forbearance options to support customers who may find themselves in financial difficulty. These include 'interest only' concessions, re-negotiation of contractual payment, payment plans and capitalisations.

'Interest only' concessions are offered to customers in financial difficulty on a temporary basis with formal periodic review. The concession allows the customer to reduce monthly payments to cover interest only, and if made, the arrears status will not increase.

Re-negotiation of contractual payments is provided to reduce the monthly payment to a level affordable by the customer. The agreement remains within the Society's lending policy, for example within the maximum mortgage term.

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

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

The table below shows those loans subject to forbearance within the SBL loans category:

Group and Society	2018 Number	2017 Number
Type of forbearance		
Interest only concessions	1	1
Re-negotiation of contractual payment	5	2
Active payment plan	3	6
	9	**9**

These cases are covered by an IFRS 9 ECL allowance of £0.1 million (2017 provision equivalent: £0.3 million). In total, £1.8 million (2017: £2.1 million) of loans are subject to forbearance.

30. FINANCIAL INSTRUMENTS (CONTINUED)

Liquidity risk

Liquidity risk is the risk that the Society will not have sufficient financial resources available to meet its obligations as they fall due, under either normal business conditions or a stressed environment. It is the Society's policy that a significant amount of its total assets are carried in the form of cash and other readily realisable assets in order to:

i) meet day-to-day business needs;
ii) meet any unexpected cash needs;
iii) maintain public confidence; and
iv) ensure maturity mismatches are provided for.

Monitoring of liquidity, in line with the Society's prudent policy framework, is performed daily. Compliance with these policies is reported to the ALCO and LAF monthly and through to the Board Risk Committee.

The Society's liquidity policy is designed to ensure the Society has sufficient liquid resources to withstand a range of stressed scenarios. A series of liquidity stress tests have been developed as part of the Internal Liquidity Adequacy Assessment process ('ILAAP'). They include scenarios that fulfil the specific requirements of the PRA (the idiosyncratic, market-wide and combination stress tests) and scenarios identified by the Society which are specific to its business model. The stress tests are performed monthly and reported to ALCO and LAF to confirm that liquidity policy remains appropriate.

The Society's liquid resources comprise high quality liquid assets, including a Bank of England reserves account, Gilts, time deposits and investment grade fixed and floating rate notes issued by highly rated financial institutions, supplemented by unencumbered mortgage assets. At the end of the year the ratio of liquid assets to shares and deposits was 13.4% compared to 13.6% at the end of 2017. When also taking into account the off balance sheet liquid resources, the ratio of liquid resources to shares and deposits was 20.4% (2017: 25.8%).

The Society maintains a contingency funding plan, as part of its Recovery and Resolution Plan process, to ensure that it has so far as possible, sufficient liquid financial resources to meet liabilities as they fall due under each of the scenarios.

The table below analyses the Group's assets and liabilities into relevant maturity groupings, based on the remaining period to contractual maturity at the statement of financial position date. This is not representative of the Group's management of liquidity. Loans and advances to customers rarely run their full course. The actual repayment profile is likely to be significantly different from that shown in the analysis. For example most mortgages have a contractual maturity of around 25 years but are generally repaid much sooner. The average life of a mortgage at the Group, currently in product, is 3.4 years (2017: 3.3 years). Conversely, retail deposits repayable on demand generally remain on the balance sheet much longer.

Group Residual maturity as at 31 December 2018	On demand **£m**	Not more than three months **£m**	More than three months but not more than one year **£m**	More than one year but not more than five years **£m**	More than five years **£m**	Total **£m**
Financial assets						
Liquid assets						
Cash in hand and balances with the Bank of England	250.6	-	5.7	-	-	256.3
Loans and advances to credit institutions	15.5	19.0	-	-	-	34.5
Debt securities	-	40.2	30.1	145.8	-	216.1
Total liquid assets	266.1	59.2	35.8	145.8	-	506.9
Derivative financial instruments	0.1	-	1.1	6.7	0.3	8.2
Loans and advances to customers	1.5	28.5	83.4	490.9	2,898.6	3,502.9
Other assets	-	0.3	9.7	1.1	24.5	35.6
	267.7	**88.0**	**130.0**	**644.5**	**2,923.4**	**4,053.6**
Financial liabilities and reserves						
Shares	650.0	1,152.6	551.5	514.4	0.7	2,869.2
Amounts owed to credit institutions	2.1	79.2	14.6	589.1	-	685.0
Amounts owed to other customers	4.4	86.9	34.9	-	-	126.2
Debt securities in issue	-	-	5.5	101.3	-	106.8
Derivative financial instruments	-	-	0.7	5.1	0.1	5.9
Subscribed capital	-	0.1	-	-	25.0	25.1
Reserves	-	-	-	-	222.8	222.8
Other liabilities	1.7	3.3	1.6	1.2	4.8	12.6
	658.2	**1,322.1**	**608.8**	**1,211.1**	**253.4**	**4,053.6**
NET LIQUIDITY GAP	**(390.5)**	**(1,234.1)**	**(478.8)**	**(566.6)**	**2,670.0**	**-**

30. FINANCIAL INSTRUMENTS (CONTINUED)

Liquidity risk (continued)

Group Residual maturity as at 31 December 2017	On demand £m	Not more than three months £m	More than three months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Total £m
Financial assets						
Liquid assets						
Cash in hand and balances with the Bank of England	349.3	-	3.3	-	-	352.6
Loans and advances to credit institutions	11.0	22.1	-	-	-	33.1
Debt securities	-	12.7	18.7	74.8	3.0	109.2
Total liquid assets	360.3	34.8	22.0	74.8	3.0	494.9
Derivative financial instruments	-	0.1	0.2	7.0	-	7.3
Loans and advances to customers	0.6	27.4	84.5	483.7	2,772.6	3,368.8
Other assets	-	1.8	5.0	0.9	21.7	29.4
	360.9	**64.1**	**111.7**	**566.4**	**2,797.3**	**3,900.4**
Financial liabilities and reserves						
Shares	484.0	1,207.9	515.8	387.6	0.1	2,595.4
Amounts owed to credit institutions	-	144.9	63.5	495.3	-	703.7
Amounts owed to other customers	6.1	106.3	70.7	2.0	-	185.1
Debt securities in issue	-	2.0	5.0	146.5	-	153.5
Derivative financial instruments	-	0.2	0.9	8.8	-	9.9
Subscribed capital	-	-	-	-	25.6	25.6
Reserves	-	-	-	-	212.7	212.7
Other liabilities	0.8	2.6	3.2	1.1	6.8	14.5
	490.9	**1,463.9**	**659.1**	**1,041.3**	**245.2**	**3,900.4**
NET LIQUIDITY GAP	**(130.0)**	**(1,399.8)**	**(547.4)**	**(474.9)**	**2,552.1**	**-**

There is no material difference between the maturity profile for the Group and that for the Society. As at 31 December 2018, £1,245.2 million (2017: £1,305.7 million) of the Group's assets were encumbered.

30. FINANCIAL INSTRUMENTS (CONTINUED)

Liquidity risk (continued)

The following is an analysis of gross contractual cash flows payable under financial liabilities:

Group 31 December 2018	Repayable on demand £m	Not more than three months £m	More than three months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Total £m
Shares	687.4	1,173.6	551.5	514.4	0.7	2,927.6
Amounts owed to credit institutions	2.3	81.2	14.6	589.1	-	687.2
Amounts owed to other customers	4.4	87.0	35.1	-	-	126.5
Debt securities in issue	-	5.0	9.2	8.7	83.9	106.8
Derivative financial instruments	-	0.3	2.9	39.2	-	42.4
Subscribed capital	-	0.5	1.5	7.9	23.9	33.8
TOTAL LIABILITIES	**694.1**	**1,347.6**	**614.8**	**1,159.3**	**108.5**	**3,924.3**
Group 31 December 2017						
Shares	511.6	1,226.2	515.8	387.6	0.1	2,641.3
Amounts owed to credit institutions	0.1	143.9	64.8	495.5	-	704.3
Amounts owed to other customers	6.1	106.4	71.1	2.0	-	185.6
Debt securities in issue	-	8.7	10.0	15.9	119.0	153.6
Derivative financial instruments	-	0.7	1.8	28.3	0.4	31.2
Subscribed capital	-	0.5	1.5	7.9	23.9	33.8
TOTAL LIABILITIES	**517.8**	**1,486.4**	**665.0**	**937.2**	**143.4**	**3,749.8**

The analysis of gross contractual cash flows differs from the analysis of residual maturity due to the inclusion of interest accrued at current rates, for the average period until maturity on the amounts outstanding at the statement of financial position date.

30. FINANCIAL INSTRUMENTS (CONTINUED)

Market and interest rate risk

Market risk is the risk of changes to the Society's financial condition caused by market interest rates. The Society is exposed to market risk in the form of changes (or potential changes) in the general level of interest rates, changes in the relationship between short and long-term interest rates and divergence of interest rates for different balance sheet elements (basis risk).

The Society has adopted the 'Extended' approach to interest rate risk, as defined by the PRA, which aims to undertake the hedging of individual transactions within an overall strategy for structural hedging, based on a detailed analysis of the statement of financial position.

The management of interest rate risk is based on a full statement of financial position gap analysis. The statement of financial position is subjected to a stress test of a 2% rise in interest rates on a weekly basis and the results are reported through to the monthly ALCO meeting. In addition management review interest rate basis risk. Both sets of results are measured against the risk appetite for market risk which is currently set at a maximum of 4.0% of capital. These are in turn reviewed monthly by the ALCO and LAF and reported through to the Board Risk Committee.

The table below summarises the Group's exposure to interest rate risk.

Group and Society	2018 £m	2017 £m
Changes in market value from a 2% parallel upward shift in interest rates	3.5	(6.7)

There is no material difference between the interest rate risk profile for the Group and that for the Society.

The Group is not exposed to foreign currency risk.

The Society does not have any financial assets or liabilities that are offset with the net amount presented in the statement of financial position as IAS32 'Financial Instruments – Presentation' requires both an enforceable right to set off and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously. Neither of these conditions are met by the Society.

All financial assets and liabilities are presented on a gross basis in the statement of financial position.

The Society centrally clears its derivatives instruments, which requires it to enter into Credit Support Annexes (CSA's) and which typically provide for the exchange of collateral on a daily basis to mitigate net mark to market credit exposure.

The following table shows the impact on derivative financial instruments and repurchase agreements after collateral:

Group and Society	2018 Gross Amounts £m	2018 Financial collateral* £m	2018 Net amounts £m	2017 Gross Amounts £m	2017 Financial collateral* £m	2017 Net amounts £m
Financial assets						
Derivative financial instruments	8.2	(8.2)	-	7.3	(7.3)	-
TOTAL FINANCIAL ASSETS	**8.2**	**(8.2)**	**-**	**7.3**	**(7.3)**	**-**
Financial liabilities						
Derivative financial instruments	5.9	(5.9)	-	9.9	(9.9)	-
Repurchase agreements	59.8	(59.8)	-	183.7	(183.7)	-
TOTAL FINANCIAL LIABILITIES	**65.7**	**(65.7)**	**-**	**193.6**	**(193.6)**	**-**

* Financial collateral disclosed is limited to the amount of the related financial asset and liability.

30. FINANCIAL INSTRUMENTS (CONTINUED)

Market and interest rate risk (continued)

Fair value hedges

The Group holds a portfolio of fixed rate mortgages and savings products as well as fixed rate PIBS and therefore is exposed to changes in fair value due to movements in market interest rates. The Group manages this risk exposure by entering into pay fixed/ receive floating interest rate swaps for its loans to customers and pay floating/receive fixed interest rate swaps to hedge its fixed rate liabilities.

Only the interest rate risk element is hedged and therefore other risks, such as credit risk, are managed but not hedged by the Group. The interest rate risk component is determined as the change in the fair value of the long term fixed rate mortgages arising solely from changes in 3 month LIBOR (the benchmark rate of interest). Such changes are usually the largest component of the overall change in fair value. This strategy is designated as a fair value hedge and its effectiveness is assessed by comparing changes in the fair value of the loans attributable to changes in the benchmark rate of interest with changes in the fair value of the loans attributable to changes in the benchmark rate of interest with changes in the fair value of the interest rate swaps. The Group establishes the hedging ratio by matching the notional of the derivatives with the principal of the portfolio being hedged. Possible sources of ineffectiveness are as follows:

- differences between the expected and actual volumes of prepayments, as the Group hedges to the expected repayment date taking into account expected prepayments based on past experience;
- difference in the discounting between the hedged item and the hedging instrument, as cash collateralised interest rate swaps are discounted using the relevant reference rate discount curves, which are not applied to the fixed rate mortgages; and
- hedging derivatives with a non-zero fair value at the date of initial designation as a hedging instrument.

The exposure from this portfolio frequently changes due to new loans originated, contractual repayments and early prepayments made by customers in each period. As a result, the Group adopts a dynamic hedging strategy (sometimes referred to as a 'macro' or 'portfolio' hedge) to hedge the exposure profile by closing and entering into new swap agreements at each month-end. The Group uses the portfolio fair value hedge of interest rate risk to recognise fair value changes related to changes in interest rate risk in the relevant portfolio, and therefore reduce the profit or loss volatility that would otherwise arise from changes in fair value of the interest rate swaps alone.

The following table details the hedging instruments included in the derivative financial instruments line of the Group's consolidated statement of financial position:

Group and Society	2018 Contract/notional amount £m	2018 Fair value of assets £m	2018 Fair value of liabilities £m	2018 Changes in fair value used for calculating hedge ineffectiveness £m
Derivatives designated as fair value hedges for interest rate risk (note 13)				
Fixed rate mortgages	1,887.0	6.7	(4.9)	5.1
Fixed rate savings	10.0	-	-	-
Subscribed capital	10.0	1.1	-	(0.5)
	1,907.0	**7.8**	**(4.9)**	**4.6**

The following table details the hedge exposures covered by the Group's hedging strategies:

Group and Society	2018 Carrying amount of hedged item: Assets £m	Liabilities £m	2018 Accummulated amount of fair value adjustments on the hedged item: Assets £m	Liabilities £m	2018 Balance sheet line item	2018 Change in fair value of hedged item for ineffectiveness assessment £m
Hedged items in fair value hedges for interest rate risk (note 13)						
Fixed rate mortgages	1,904.7	-	-	(2.1)	Loans & advances to customers	(5.7)
Fixed rate savings	-	8.4	-	-	Shares	-
Subscribed capital	-	10.0	-	(1.2)	Subscribed capital	0.5
	1,904.7	**18.4**	**-**	**(3.3)**		**(5.2)**

ACCOUNTS

30. FINANCIAL INSTRUMENTS (CONTINUED)

Market and interest rate risk (continued)

Fair value hedges (continued)

The following table contains information regarding the effectiveness of the hedging relationships designated by the Group, as well as the impacts on profit or loss.

Group and Society	2018 Hedge ineffectiveness recognised in income statement £m	2018 Income statement line item that includes reclassified amount
Fair value hedges		
Interest rate swaps		
Fixed rate mortgages	(0.6)	Net losses from derivative financial instruments
Fixed rate savings	-	Net losses from derivative financial instruments
Subscribed capital	-	Net losses from derivative financial instruments
	(0.6)	

31. CAPITAL STRUCTURE

The Society's policy is to maintain a strong capital base to maintain member, creditor and market confidence and to sustain future development of the business. The formal Internal Capital Adequacy Assessment Process ('ICAAP') assists the Society with its management of capital. Through its quarterly business plan update the Board monitors the Society's capital position to assess whether adequate capital is held to mitigate the risks it faces in the course of its business activities. The Society's actual and expected capital position is reviewed against stated risk appetite which aims to maintain capital at a specific level above its Total Capital Requirement ('TCR').

The Board manages the Society's capital and risk exposures to maintain capital in line with regulatory requirements which includes monitoring of:

- **Lending and Business Decisions** – The Society uses application scorecards to help it assess whether mortgage applications fit within its appetite for credit risk. Once loan funds have been advanced behavioural scorecards are used to review the ongoing risk profile of both the portfolio's and individual customers. In addition, for residential and buy-to-let mortgages property values are updated on a quarterly basis.
- **Pricing** – Pricing models are utilised for all mortgage product launches. The models include expected loss estimates and capital utilisation enabling the calculation of a risk adjusted return on capital.
- **Concentration risk** – The design of retail products takes into account the overall mix of products to ensure that exposure to market risk remains within permitted parameters.
- **Counterparty risk** – Wholesale lending is only carried out with approved counterparties in line with the Society's lending criteria and is subject to a range of limits. The limits are monitored daily to ensure the Society remains within risk appetite.

This is subjected to regular stress tests to ensure the Society maintains sufficient capital for future possible events.

The Group's capital requirements are set and monitored by the PRA. During 2018, the Society has complied with the requirements included within the EU Capital Requirements Directive IV (Basel III). Further details of these requirements and their impact on the Society are provided in the Strategic report on pages 14 to 15.

There were no reported breaches of capital requirements during the year. There have been no material changes in the Society's management of capital during the year.

Under Basel III Pillar 3, the Society is required to publish further information regarding its capital position and exposures. The Society's Pillar 3 disclosures are available on our website **www.thenottingham.com**.

32. FINANCIAL COMMITMENTS

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Capital commitments				
Capital expenditure contracted for but not provided for in the accounts	-	0.1	-	0.1
Leasing commitments				
The total of future minimum lease payments under non-cancellable operating leases are payable as follows:				
Land and buildings:				
Commitments due:				
Less than one year	0.9	0.9	0.6	0.7
Between one year and five years	2.7	2.6	2.1	2.1
In more than five years	2.0	2.5	1.7	2.2
	5.6	**6.0**	**4.4**	**5.0**
Other:				
Commitments due:				
Less than one year	0.3	0.2	0.3	0.2
Between one year and five years	0.6	0.3	0.6	0.3
	6.5	**6.5**	**5.3**	**5.5**

33. RELATED PARTY TRANSACTIONS

Transaction with Group companies

Details of the Society's shares in group undertakings are given in note 16.

During the normal course of business the following transactions were undertaken during the year:

Society	2018 Nottingham Mortgage Services £m	2018 Nottingham Property Services £m	2018 Harrison Murray £m	2017 Nottingham Mortgage Services £m	2017 Nottingham Property Services £m	2017 Harrison Murray £m
Management charges paid	-	0.2	0.2	0.1	0.1	0.1
People related recharges	-	0.2	0.3	-	-	-
Fixed occupancy related recharges	-	0.2	0.3	-	-	-

In 2018, the Society changed its approach to cost recharges as part of its 'all under one roof' strategy. This has resulted in additional intercompany recharge transactions in the year.

During the year, Nottingham Building Society has received £0.1 million (2017: £0.1 million) in fees for providing cash manager and mortgage servicer fees to Arrow Mortgage Finance No.1 Limited.

Movement on the intercompany balances are disclosed in note 16.

At the end of the year the following balances were outstanding between the Society and its subsidiaries:

	2018 Amount owed to subsidiaries £m	2018 Amount owed by subsidiaries £m	2017 Amount owed to subsidiaries £m	2017 Amount owed by subsidiaries £m
Arrow Mortgage Finance No. 1 Limited	(106.1)	20.1	(158.5)	20.1
Estate Agency	-	1.0	-	8.5
Mortgage Broking	-	0.1	-	0.1
	(106.1)	**21.2**	**(158.5)**	**28.7**

Interest accrues on the balances outstanding with Arrow Mortgage Finance at LIBOR plus a margin. The repayment of the loans will follow the collection of the principal and interest of the underlying mortgage assets, used as security and has a contractual maturity within two years.

No interest is charged on balances between the other Group companies.

33. RELATED PARTY TRANSACTIONS (CONTINUED)

Transactions with key management personnel

Transactions with key management personnel are on the same terms and conditions applicable to members and other employees within the Group. The directors are considered to be the only key management personnel as defined by IAS 24, which includes Non-Executive Directors.

Compensation for key management personnel for the year totalled £1.3 million (2017: £1.4 million) and a breakdown is disclosed on page 40 in the Directors' remuneration report.

In addition, the following transactions were undertaken through the normal course of business:

Group and Society	2018 Number of key management personnel and their close family members Number	2018 Amounts in respect of key management personnel and their close family members £000	2017 Number of key management personnel and their close family members Number	2017 Amounts in respect of key management personnel and their close family members £000
Loans and advances				
Net movements in the year	-	(14)	-	(14)
Balances outstanding 31 December	2	154	2	168
Share accounts				
Net movement in the year	1	26	(3)	(149)
Balances outstanding 31 December	9	81	8	55
Interest receivable on loans & advances		4		5
Interest payable on share accounts		-		1

Directors' loans and transactions

As at 31 December 2018 there was one (2017: one) outstanding secured mortgage loan made in the ordinary course of business at a normal commercial rate to directors and their connected persons. A register is maintained at the head office of the Society which shows details of all loans, transactions and arrangements with directors and their connected persons. A statement of the appropriate details contained in the register, for the financial year ended 31 December 2018, will be available for inspection at the head office for a period of 15 days up to and including the annual general meeting.

34. NOTES TO THE CASH FLOW STATEMENTS

Group and Society	Notes	2018 £m	2017 £m
Changes in liabilities arising from financing activities			
Subscribed capital at 1 January		23.9	23.9
Accrued interest		1.9	1.9
Interest paid		(1.9)	(1.9)
Subscribed capital at 31 December	28	**23.9**	**23.9**

35. REGISTERED OFFICE

Nottingham Building Society is a building society, incorporated and domiciled in the United Kingdom. The address of its registered office is: Nottingham House, 3 Fulforth Street, Nottingham, NG1 3DL.

36. CHANGES TO ACCOUNTING POLICIES

This note explains the impact on the financial statements as a result of adopting the new accounting standard IFRS 9 'Financial Instruments' and also discloses the new accounting policies, that have been applied with effect from 1 January 2018, where they differ to those applied in prior periods.

IFRS 9 replaces the provisions of IAS 39 that relate to the recognition, classification and measurement of financial assets and financial liabilities, derecognition of financial instruments, impairment of financial assets and hedge accounting. The Group has not adopted the hedge accounting module of the standard and has elected to continue to apply the hedge accounting requirements of IAS 39 on adoption of IFRS 9.

As permitted by the transitional provisions of IFRS 9, the standard was adopted without restating comparative information and therefore any adjustments to the carrying value of financial instruments at the date of transition were recognised in the opening retained earnings of the reported period.

The adoption of IFRS 9 has resulted in changes in the Society's accounting policies for recognition, classification and measurement of financial assets and liabilities and impairment of financial assets.

a) IFRS 9 'Financial Instruments' – Impact on the financial statements

The adoption of IFRS 9 'Financial Instruments' has had the following overall impact on the financial statements of the Group and Society:

Balance sheet	Notes	Group 31 December 2017 As originally presented IAS 39 £m	Group IFRS 9 adjustment £m	Group 1 January 2018 Restated IFRS 9 £m	Society 31 December 2017 As originally presented IAS 39 £m	Society IFRS 9 adjustment £m	Society 1 January 2018 Restated IFRS 9 £m
Assets							
Cash in hand and balances with the Bank of England		352.6	-	352.6	352.6	-	352.6
Loans and advances to credit institutions		33.1	-	33.1	24.6	-	24.6
Debt securities		109.2	-	109.2	109.2	-	109.2
Derivative financial instruments		7.3	-	7.3	7.3	-	7.3
Loans and advances to customers	**(c)**	3,368.8	1.7	3,370.5	3,368.8	1.7	3,370.5
Amounts owed by subsidiary undertakings	**(b)**	-	-	-	28.7	(8.6)	20.1
Other assets		5.9	-	5.9	5.5	-	5.5
Property, plant and equipment		14.6	-	14.6	13.6	-	13.6
Intangible assets		7.2	-	7.2	2.7	-	2.7
Deferred tax assets	**(c)**	1.7	(0.3)	1.4	1.7	(0.3)	1.4
TOTAL ASSETS		**3,900.4**	**1.4**	**3,901.8**	**3,914.7**	**(7.2)**	**3,907.5**
Liabilities							
Shares		2,595.4	-	2,595.4	2,595.4	-	2,595.4
Amounts owed to credit institutions		703.7	-	703.7	703.7	-	703.7
Amounts owed to other customers		185.1	-	185.1	185.1	-	185.1
Amounts owed to subsidiary undertakings		-	-	-	158.5	-	158.5
Debt securities in issue		153.5	-	153.5	7.0	-	7.0
Derivative financial instruments		9.9	-	9.9	9.8	-	9.8
Other liabilities and accruals		4.9	-	4.9	4.3	-	4.3
Current tax liabilities		1.6	-	1.6	1.6	-	1.6
Provisions for liabilities		1.1	-	1.1	1.1	-	1.1
Retirement benefit obligations		6.9	-	6.9	6.9	-	6.9
Subscribed capital		25.6	-	25.6	25.6	-	25.6
TOTAL LIABILITIES		**3,687.7**	**-**	**3,687.7**	**3,699.0**	**-**	**3,699.0**
Reserves							
General reserves	**(b) (c)**	212.7	1.4	214.1	215.7	(7.2)	208.5
Fair value reserves		-	-	-	-	-	-
Total reserves attributable to members of the Society		212.7	1.4	214.1	215.7	(7.2)	208.5
TOTAL RESERVES AND LIABILITIES		**3,900.4**	**1.4**	**3,901.8**	**3,914.7**	**(7.2)**	**3,907.5**

36. CHANGES TO ACCOUNTING POLICIES (CONTINUED)

a) IFRS 9 'Financial Instruments' – Impact on the financial statements (continued)

The total impact on the Group's retained earnings as at 1 January 2018 is as follows:

	Notes	Group £m	Society £m
Closing retained earnings 31 December – IAS 39		212.7	215.7
Change in measurement basis of intercompany balances	(b)	-	(8.6)
Decrease in provision for loans and advances to customers	(c)	1.7	1.7
Reduction in deferred tax asset relating to impairment provisions	(c)	(0.3)	(0.3)
		1.4	(7.2)
Opening retained earnings 1 January – IFRS 9		**214.1**	**208.5**

b) Classification & Measurement

On 1 January 2018 (the date of initial application of IFRS 9), the Society has assessed which business models apply to the financial assets held by the Group and has classified its financial instruments into the appropriate IFRS 9 categories.

IFRS 9 introduces changes in the classification and measurement of financial instruments, based on the cash flow attributes of the financial asset and the business model that underly the assets. Financial assets may be classified as amortised cost; fair value through other comprehensive income ('FVOCI'); or fair value through profit or loss ('FVPL') as outlined in the accounting policies on page 55.

The Group has assessed the business model applicable to its financial assets, and has allocated the instruments to the appropriate categories as outlined on page 81.

Some of the Society's balances with its subsidiary undertakings are now measured at FVPL as they fail the SPPI test due to there being no fixed date of repayment and no interest charged on the balances. This has resulted in an adjustment to the financial statements of £8.6 million on adoption of IFRS 9.

There is no overall impact to the financial statements as result of adoption of the 'classification & measurement' module of IFRS 9 on a Group basis and the transfer of the closing available-for-sale reserve balance to the opening FVOCI reserve has no impact on the financial statements.

IFRS 9 has not altered the classification and measurement of financial liabilities for the Society.

c) Impairment

From 1 January 2018, the Group assesses on a forward-looking basis the expected credit losses ('ECL') associated with its financial assets carried at amortised cost and FVOCI and with the exposure arising from loan commitments. The allowance is based on the ECLs associated with the probability of default in the next 12 months unless there has been a significant increase in credit risk since origination.

The accounting policies and key judgements and assumptions adopted by the Group in meeting the requirements of the standard to calculate ECLs are outlined on page 57.

The Group has no purchased or originated credit impaired assets and has not applied any simplified approaches.

36. CHANGES TO ACCOUNTING POLICIES (CONTINUED)

c) Impairment (continued)

Loans and advances to customers

The following table reconciles the prior period's closing impairment allowance measured in accordance with the IAS 39 incurred loss model to the new impairment allowance measured in accordance with the IFRS 9 expected loss model as at 1 January 2018.

	Loans fully secured on residential property £m	Other loans fully secured on land £m	Total £m
Closing impairment provision 31 December – IAS 39	1.7	1.5	3.2
Adjustment on transition to IFRS 9	(1.1)	(0.6)	(1.7)
	0.6	**0.9**	**1.5**

The Society has reported a net release on the adoption of IFRS 9. The Society has only secured portfolios with low average LTV ratios and limited losses experienced historically. The release recognised is also reflective of the creation of a less-subjective, forward-looking scenario model that utilises externally provided forecast economic data.

The gross carrying amounts and impairment provisions as at 1 January 2018, on adoption of IFRS 9, as well as the key forward-looking economic judgements are presented in detail in note 15.

Cash in hand and balances with the Bank of England, Loans and advances to credit institutions and Debt securities

The Society's debt security portfolio is all of 'investment grade' or higher and the Society has therefore assessed that the credit risk on its debt security exposures has not increased significantly since initial recognition. Therefore, whilst the Group's liquidity portfolio held at amortised cost and FVOCI are subject to the impairment requirements of IFRS 9, the recognition of a loss allowance on transition as a result of applying the expected credit risk model was immaterial, with no adjustment being recognised in the financial statements on 1 January 2018 or 31 December 2018.

ANNUAL BUSINESS STATEMENT
for the year ended 31 December 2018

1. Statutory percentages	2018 %	Statutory limit %
Lending limit		
Proportion of business assets not in the form of loans fully secured on residential property	2.54	25
Funding limit		
Proportion of shares and borrowings not in the form of shares held by individuals	24.24	50

The percentages are calculated in accordance with, and the statutory limits are those prescribed by, sections 6 and 7 of the Building Societies Act 1986 and are based on the Group statement of financial position.

Business assets are the total assets of the Society and its subsidiary undertakings as shown in the Group statement of financial position plus impairment for losses on loans and advances (note 15), less property, plant and equipment, intangible assets and liquid assets.

Loans fully secured on residential property are the amount of principal owing by borrowers and interest accrued not yet payable.

Total 'shares and borrowings' are the aggregate of 'shares', 'amounts owed to credit institutions', 'amounts owed to other customers' and 'debt securities in issue' in the Group statement of financial position. Shares held by individuals are found in note 20.

2. Other percentages	2018 %	2017 %
As a percentage of shares and borrowings:		
Gross capital	6.55	6.55
Free capital	5.91	6.00
Liquid assets	13.38	13.60
As a percentage of mean total assets:		
Profit after taxation	0.24	0.31
Management expenses (Group)	1.09	1.10
Management expenses (Society)	0.95	0.92
As a percentage of year end assets:		
Return on assets	0.23	0.29

The above percentages have been calculated from the Group accounts.

'Shares and borrowings' are the aggregate of 'shares', 'amounts owed to credit institutions', 'amounts owed to other customers' and 'debt securities in issue' in the Group statement of financial position.

'Gross capital' is the aggregate of subscribed capital and aggregated reserves as shown in the Group statement of financial position.

'Free capital' is gross capital plus collective impairment for losses on loans and advances under IAS 39 (note 15) less property, plant and equipment and intangible assets in the Group statement of financial position.

'Mean total assets' are calculated by halving the aggregate of total assets at the beginning and end of the financial year for the Group/Society.

'Liquid assets' are the first three items on the asset side of the Group statement of financial position.

'Management expenses' are the aggregate of administrative expenses (excluding acquisition and merger costs) and depreciation and amortisation taken from the Group/Society statements of comprehensive income.

3. Information about the directors at 31 December 2018:

Director's name	Date of appointment	Age	Business occupation	Other directorships (and offices)
Simon Baum	18.06.18	56	Director	Baum Associates Ltd
John Edwards Chairman	10.01.12	63	Director	Saga Services Ltd GreyCastle Life Reinsurance (SAC) Ltd
Jane Kibbey BSc, MCIPD	01.05.06	68	Director	Governor Oundle School
David Marlow ACIB Chief Executive	16.01.06	53	Building Society Executive	Harrison Murray Limited HM Lettings Limited Nottingham Mortgage Services Ltd Nottingham Property Services Ltd Member of FCA Smaller Business Practitioner Panel
Daniel Mundy BA (Hons) Finance Director	19.04.17	42	Building Society Executive	Harrison Murray Limited HM Lettings Limited Nottingham Mortgage Services Ltd Nottingham Property Services Ltd
Andrew Neden MA, FCA	17.09.14	56	Director	ABC International Bank plc Aetna Insurance Company Ltd Ashmill Worcester Ltd Eltham College Grace Church Dulwich Ltd Northgate (Warwick) Developments Ltd The Great St Helen's Trust Ltd St Peter's Canary Wharf Trust Ltd Wesleyan Assurance Society
Kavita Patel	01.01.17	42	Director	Shakespeare Martineau LLP Philsec Ltd Meaujo Incorporations Ltd
Kerry Spooner LLB (Hons)	01.09.16	57	Director	Scotiabank Europe plc

Correspondence to directors jointly or individually should be addressed 'Private and Confidential' and c/o Ernst & Young LLP, 1 Bridgewater Place, Water Lane, Leeds LS11 5QR.

Directors' service contracts:

David Marlow entered into his contract as Chief Executive on 21 February 2011; however, he has been a Director of the Society since 16 January 2006. Daniel Mundy entered into his contract as Finance Director on 19 April 2017. Simon Taylor entered into his contract as Chief Operating Officer on 1 January 2013; however he has been a Director of the Society since 1 February 2011 until his departure on 30 November 2018.

All contracts are terminable at any time by the Society on 12 months' notice and by the individual on six months' notice. Unless notice to terminate is given by either party, the contracts continue automatically.

GLOSSARY

Set out below are the definitions of the terms used within the Annual Report and Accounts to assist the reader and to facilitate comparison with other financial institutions:

Additional Tier 1 capital (AT1)	Capital that meets certain rules under CRD IV and which comprises the Society's PIBS but only under the transitional provisions.
Arrears	A customer is in arrears when they are behind in meeting their contractual obligations with the result that an outstanding loan payment is overdue. The value of the arrears is the value of any payments that have been missed.
Basel III	Basel III became effective in the UK on 1 January 2014 through CRD IV and sets out the details of strengthened global regulatory standards on bank capital adequacy and liquidity.
Buy-to-let loans (BTL)	Buy-to-let loans are those loans which are offered to customers buying residential property specifically to let out and generate a rental income.
Capital Requirements Directive (CRD IV)	CRD IV is the European legislation which came into force from 1 January 2014 to implement Basel III. It is made up of the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD), outlining the capital requirements framework and introduced liquidity requirements, which regulators use when supervising firms.
Common Equity Tier 1 capital (CET1)	CET1 capital consists of internally generated capital generated from retained profits, other reserves less intangible assets and other regulatory deductions. CET1 capital is fully loss absorbing.
Common Equity Tier 1 ratio	Common Equity Tier 1 capital as a percentage of risk weighted assets.
Contractual maturity	The date at which a loan or financial instrument expires, at which point all outstanding principal and interest has been paid.
Credit risk	This is the risk that a customer or counterparty fails to meet their contractual obligations.
Debt securities	Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings excluding those issued by central banks.
Debt securities in issue	Transferable certificates of indebtedness of the Society to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit.
Derivative financial instruments	A derivative financial instrument is a contract between two parties whose value is based on an underlying price or index rate it is linked to, such as interest rates, exchange rates of stock market indices. The Society uses derivative financial instruments to hedge its exposure to interest rate risk.
Effective interest rate method (EIR)	The method used to measure the carrying value of a financial asset or liability and to allocate associated interest income or expense over the relevant period. The calculation includes all fees and penalties paid and received between parties which are integral to the contract.
Expected Credit Loss (ECL)	The present value of all cash shortfalls over the expected life of the financial instrument. The term is used for accounting for impairment provisions under the new IFRS 9 standard.
Exposure	The maximum loss a financial institution might suffer if a borrower, counterparty or group fails to meet their obligations.
Exposure at Default (EAD)	A component of the IFRS 9 expected credit loss calculation. The EAD model calculates the balance profile of each mortgage account over its expected behavioural lifetime.
Fair value	Fair value is the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
Fair value through other comprehensive income (FVOCI)	Financial assets held at fair value on the balance sheet with changes in fair value being recognised through other comprehensive income.
Fair value through profit or loss (FVPL)	Financial assets held at fair value on the balance sheet with changes in fair value being recognised through the income statement.
Financial Conduct Authority (FCA)	The statutory body responsible for conduct of business regulation and supervision of UK authorised firms.
Financial Services Compensation Scheme (FSCS)	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every firm authorised by the FCA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.

Forbearance strategies	Strategies to support borrowers in financial difficulty, such as agreeing a temporary reduction in the monthly payment, extending mortgage terms and a conversion to an interest-only basis. The aim of forbearance strategies is to avoid repossession.
Free Capital	The aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment and intangible assets.
Funding Limit	Measures the proportion of shares and borrowings (excluding the fair value adjustment for hedged risk) not in the form of shares held by individuals. The calculation of the funding limit is explained in the Annual Business Statement.
Funding for Lending Scheme (FLS)	A scheme launched by the Bank of England and HM Treasury, which provides funding to participating banks and building societies with the aim of stimulating lending within the economy.
General reserves	The accumulation of the Society's historic and current year profits which is the main component of Common Equity Tier 1 capital.
Gross capital	The aggregate of general reserves, fair value reserves and subscribed capital.
Impaired loans	Loans where there is objective evidence that an impairment event has occurred, meaning that the Society does not expect to collect all the contractual cash flows or expect to collect them later than they are contractually due.
Internal Liquidity Adequacy Assessment Process (ILAAP)	The Society's own assessment of the liquidity resources it requires in order to remain within the risk tolerances it has set. This will include an evaluation of potential stresses based on multiple market environments.
Individually/collectively assessed impairment	Under IAS 39, individual assessments are made of all mortgage loans where objective evidence indicates losses are likely or the property is in possession. A collective impairment provision is made against the remaining group of loans and advances where objective evidence indicates that it is likely that losses may be realised.
Interest rate risk	The risk of loss due to a change in market interest rates. Interest rate risk can have an impact on Society's mortgages and savings products.
Internal Capital Adequacy Assessment Process (ICAAP)	The Society's own assessment, as part of Basel III requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements for risks it faces under a business as usual scenario including stress events.
Lending limit	Measures the proportion of business assets not in the form of loans fully secured on residential property.
Leverage ratio	The ratio of Tier 1 capital divided by the total exposures, which includes on and off balance sheet items.
Liquid assets	Total of cash in hand, loans and advances to credit institutions, and debt securities.
Liquidity resources	Assets held in order to manage liquidity risk. Liquidity resources comprises cash and balances with the Bank of England, UK Government securities and multilateral development banks, other securities and bank deposits and Bank of England approved mortgage portfolios.
Liquidity risk	Liquidity risk is the risk that the Society is unable to meet its financial obligations as they fall due, or can only secure them at excessive cost. This risk arises from timing mismatches of cash inflows and outflows.
Loan to value ratio (LTV)	LTV expresses the amount of a mortgage as a percentage of the value of the property.
Loans past due	Loans on which a payment has not been made as of its due date.
Loss Given Default (LGD)	A component of the IFRS 9 expected credit loss calculation. The LGD model calculates the likely loss on asset disposal that the Society would suffer if a default event were to occur in any given month over the expected behavioural lifetime of a mortgage account.
Management expenses	The aggregate of administrative expenses, depreciation and amortisation. The management expense ratio is management expenses expressed as a percentage of mean total assets.
Market risk	The risk that movements in market risk factors, including foreign exchange rates, interest rates, credit spreads and customer-driven factors will create potential losses or decrease the value of the Society balance sheet.
Mean total assets	Represents the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.

GLOSSARY (continued)

Member	A person who has a share investment or a mortgage loan with the Society.
Net interest income	The difference between interest receivable on assets and similar income and interest paid on liabilities and similar charges.
Operational risk	The risk of loss arising from inadequate or failed internal processes, people and systems, or from external events.
Permanent interest bearing shares (PIBS) / Subscribed capital	Unsecured, deferred shares of the Society that are a form of Additional Tier 1 capital under the transitional rules of CRD IV. PIBS rank behind the claims of all depositors, payables and investing members of the Society. PIBS are also known as subscribed capital.
Probability of Default (PD)	A component of the IFRS 9 expected credit loss calculation. An estimate of the probability that a borrower will default on their credit obligation over a fixed time period. A 12 month ECL uses a 12 month PD, whilst a lifetime ECL uses the estimated PD over the remaining contractual life of the loan.
Prudential Regulation Authority (PRA)	The statutory body responsible for the prudential supervision of banks, building societies, insurers and small number of significant investment firms in the UK. The PRA is a subsidiary of the Bank of England.
Renegotiated loans	Loans are classed as renegotiated where an agreement between a borrower and a lender has been made to modify the loan terms either as part of an on-going relationship or if the borrower is in financial difficulties. The renegotiated loan may no longer be treated as past due or impaired.
Residential loans	Loans that are loaned to individuals rather than institutions and are secured against residential property.
Risk appetite	The articulation of the level of risk that the Society is willing to accept (or not accept) in order to safeguard the interests of the Society's members whilst also achieving business objectives.
Risk weighted assets (RWA)	The value of assets, after adjustment, under the relevant Basel III capital rules to reflect the degree of risk they represent.
Secured business lending (SBL)	Loans secured on commercial property which is only made available to Small and Medium sized Enterprises.
Shares	Funds deposited by a person in a retail savings account with the Society. Such funds are recorded as liabilities for the Society.
Shares and borrowings	The aggregate of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.
Significant increase in credit risk (SICR)	A significant increase in credit risk on a financial asset is judged to have occurred when an assessment, using quantitative and qualitative factors, identifies at a reporting date that the credit risk has moved significantly since the last asset was originally recognised.
Special Purpose Vehicle (SPV)	A legal entity (usually a limited company) created to fulfil narrow, specific or temporary objectives. In the context of the Society, the SPV is used in relation to securitisation activities.
SPPI test	An assessment of whether the contractual terms of the financial asset give rise to cash flows that are in substance solely payments of principal and interest.
Stage 1	A component of the IFRS 9 expected credit loss calculation. Stage 1 assets are assets which have not experienced a significant increase in credit risk since the asset was originally recognised on the balance sheet. 12 month ECL are recognised as the impairment provision for all financial assets on initial recognition. Interest revenue is the EIR on the gross carrying amount.
Stage 2	A component of the IFRS 9 expected credit loss calculation. Stage 2 assets have experienced a significant increase in credit risk since initial recognition. Lifetime ECL is recognised as an impairment provision. Interest revenue is the EIR on the gross carrying amount.
Stage 3	A component of the IFRS 9 expected credit loss calculation. Stage 3 assets are identified as in default and considered credit impaired. Lifetime ECL is also recognised as an impairment provision. Interest revenue is the EIR on the net carrying amount.
Standardised approach	The basic method used to calculate capital requirements for credit risk. In this approach the risk weighting used in the capital calculation are determined by specified percentages.
Term Funding Scheme (TFS)	A scheme launched by the Bank of England and HM Treasury, which provides funding to participating banks and building societies with the aim of stimulating lending within the economy.

Tier 1 capital	A component of regulatory capital, it comprises CET1 and AT1.
Tier 1 ratio	Tier 1 capital as a percentage of risk weighted assets.
Tier 2 capital	Comprises the collective impairment allowance (for exposures treated on a Standardised basis), less certain regulatory deductions.
Total Capital Requirement (TCR)	The total amount of capital the regulator requires the Society to hold, which is made up of Pillar 1 and Pillar 2A capital.
Underlying profit	Profit before tax adjusted to exclude derivative fair value movements and the FSCS levy charge.
Wholesale funding	Amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.

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