5-25-2010

Annual Reports and Accounts 2010

Nationwide Building Society

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Annual Report and Accounts 2010

Our members' needs set our agenda

Proud to be different

Our members are at the heart of everything we do

In unprecedented economic conditions, our difference has been our strength. That difference is our absolute commitment and responsibility to the people who own us – our members.

- We exist to put their needs first and with no shareholders to answer to, that's the biggest difference of all.
- We exist to offer our members the products they need and which provide excellent long term value.
- We exist to provide an exceptional level of service through all of our channels.
- We exist to recognise the potential in our employees and to provide an environment in which they can flourish.
- We exist in harmony with the environment and remain committed to minimising the impact we have on it.
- We exist to enhance the communities we share with our members.

In short, our business is all about relationships, with our members, with our employees and with the communities in which we all live. Our aim is to make those relationships as fulfilling and as rewarding as possible, for everybody.

Nationwide. Proud to be different.

Becky and Annie, Melksham

Fran and Pete, Isle of Wight

Gavin, Birmingham

Vicki and Lawrie, Bristol

Front cover: Jenni, Hungerford branch

Contents

Financial Highlights

Reported profit before tax
£341 million

Underlying profit before tax
£212 million

Core Tier 1 ratio
12.2%

Results 2006-2010

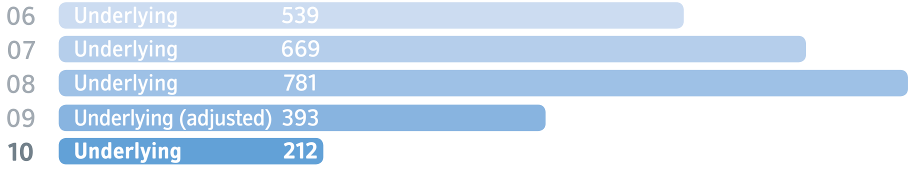
		2006	2007	2008	2009	2010
		Underlying	Underlying	Underlying	Underlying (adjusted)	Underlying
Profit before tax	£m	539	669	781	393	**212**
Total income	£m	1,636	1,923	2,212	2,117	**2,095**
Cost income ratio	%	60.6	56.6	55.7	60.0	**61.3**
Total assets	£m	120,586	137,379	179,027	202,353	**191,397**
Loans and advances to customers	£m	101,348	115,938	142,804	155,469	**152,429**
Member savings balances	£m	80,919	86,795	113,816	128,292	**120,943**
Total regulatory capital	£m	6,984	7,961	9,474	9,690	**9,734**

Underlying results

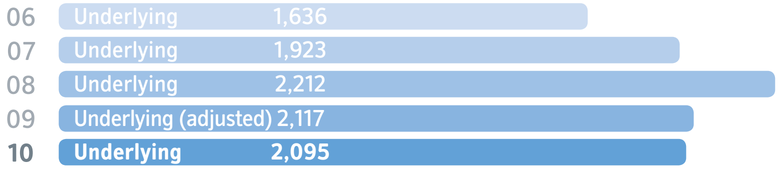
These results have been prepared in line with International Financial Reporting Standards accounting policies ('IFRS'). Where appropriate, certain aspects of the results are presented to reflect management's view of the underlying results in order to provide a clearer representation of the performance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

Underlying profit before tax equates to reported profit before tax adjusted for the impact of movements in the value of derivatives and hedge accounting of £34 million, a £117 million credit relating to a change in the basis of recognition of Financial Services Compensation Scheme (FSCS) levies, transformation costs of £62 million and a gain of £40 million on the acquisition of the former Dunfermline Building Society social housing portfolio, further information on which is provided in note 48. The comparative year additionally includes an adjustment for gains on business combinations (please refer to note 49).

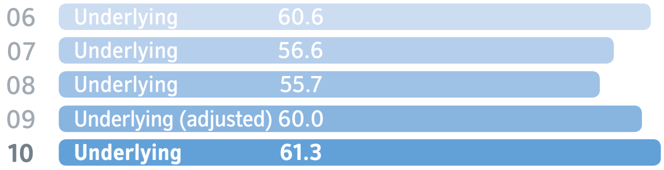
Profit before tax
(£million)



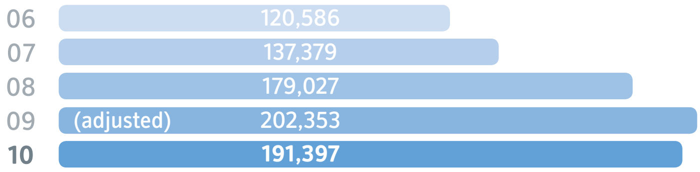
Total income
(£million)



Cost income ratio
(%)

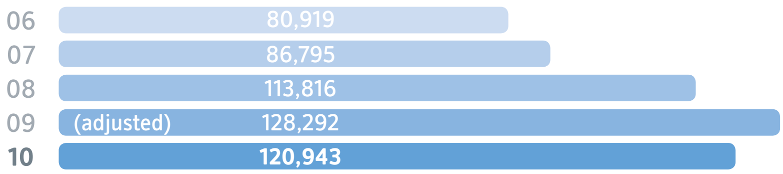


Total assets
(£million)

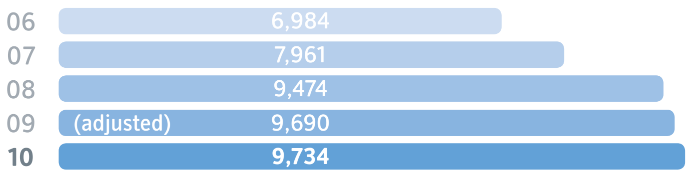


Loans and advances to customers *(£million)*

Member savings balances
(£million)



Total regulatory capital
(£million)



Chairman's Statement

Resilience our members can rely on

For the second year running, our industry has faced a challenging trading environment. The UK economy only started to turn the corner in the last quarter of 2009 and the recovery still looks fragile. Housing market transactions have remained subdued and the Bank of England base rate has been frozen at 0.5%. Both our core mortgage and savings markets have contracted and transaction volumes have remained low.

Our resilience in the face of these challenges can be seen in the strength of the financial performance we have delivered for our members. We have continued to conduct our business in a responsible manner and have maintained both a high level of liquidity and strong capital ratios. We have recorded an underlying operating profit of £212 million compared with £393 million in 2009, and have broadly maintained our underlying trading surplus, measured before impairment provisions, of £811 million compared with £846 million in 2009.

Challenges to the building society sector

Whilst our financial performance is testament to the resilience of Nationwide in the face of tough economic conditions, we face other challenges.

Clearly, there is immense public and political pressure on regulators to be seen to act decisively to prevent a repeat of the recent financial crisis. We support the objective of a more secure and stable framework for banking regulation. However, the framework they introduce to mitigate the danger of excessive institutional risk-taking must not inadvertently damage consumer interests by undermining the competitive position of the mutual sector. Increased capital requirements, enhancement and harmonisation of investor compensation schemes across Europe, and the potential introduction of a bank levy are all emerging proposals that may have a role to play in future regulatory regimes. It is vital that they are developed with the interests and legal framework of the mutual sector in mind to avoid the unintended consequences that may arise from a 'one size fits all' approach.

Delivering for our members

With a solid financial performance underpinning security for our members, we have sought to expand our range of products designed to provide real long term value.

In a suppressed mortgage market, members on our Base Mortgage Rate have continued to benefit from low interest charges. Additionally new homebuyers, so long as they have had their main current account with us, have benefited from some highly competitive 90% loan to value deals. We have also published our Homeowner's Charter, to spell out the help we provide to members who run into financial difficulty.

The savings market has been distorted by the difficulties some institutions have faced in raising money in the wholesale markets. In response, we have developed a number of innovative products designed to provide our members with long term good value. An example of this is our 'Champion Saver', a branch based savings account which automatically tracks the average of the best rates of equivalent savings products and provides an additional bonus on top. This innovative savings product has been particularly successful in attracting new savers and retaining existing members.

On the investment and insurance front, our partnerships with Legal & General and Liverpool Victoria have continued to enable us to offer our customers choice and value. Protected Equity Bonds have been particularly popular with customers looking to take a cautious first step beyond the world of savings accounts.

Members attach great importance to the quality of the service we provide so we are proud that our overall service ranks alongside the best in the industry. According to independent research, we have the highest levels of satisfaction amongst the big Current Account Providers*. Across all accounts, complaints from members fell by 24% over the past year and we were awarded 'Overall Most Trusted Financial Services Company' by Moneywise.

*Source: GfK NOP Financial Research Survey, top two box current account satisfaction, 12 months ending March 2010.

Listening to our members

The last financial year saw us hold Member TalkBacks across the country, with events in Belfast, Cardiff, Sheffield and London. These events give Nationwide members the opportunity to raise concerns and ask questions and Nationwide directors the chance to answer those questions.

Of course, such events can only be attended by a relatively small number of people when compared to the Society's total membership, so we also hold online Member TalkBacks and have developed the Members' Zone website to give members from across the country the opportunity to share views and catch up on the Society's latest news.

As members' views are vital, we record and act on comments and suggestions and also arrange for an external accredited research company to ring customers every month to gather feedback on their experiences for the Society's Customer Experience Tracker. Over the past year they have spoken to around 4,000 customers each month and will speak to even more in the current year.

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We have continued to conduct our business in a responsible manner and have maintained both a high level of liquidity and strong capital ratios.

Corporate responsibility

In line with our core principles, we have continued our commitment to the community and to charities across the UK, focusing on the key areas of housing and finance.

We have progressed our partnership with Shelter, the housing and homelessness charity and are now providing funding for three of their housing and homelessness services in Bristol, Dorset and Milton Keynes, supporting over 1,500 people since June 2009.

A number of new programmes, including Financial Capability and Sustainability, were launched on the award winning, free educational website NationwideEducation.co.uk which has now received over 5 million hits since September 2008, and won four awards over the last six months.

Mr & Mrs Shelley Isle of Wight

We are very pleased with the service we receive from Nationwide. The staff at our branch pointed out that we could earn more interest by switching to a different account. We chose a six year investment linked to the stock market.

MoneyActive, the £3 million financial education partnership between Nationwide and Citizens Advice, will enable the recruitment and training of 1,300 financial capability volunteers over three years. MoneyActive sessions are now up and running across the country. Unsurprisingly, debt is a big issue for the Citizens Advice Bureau, so this initiative is proving the right thing at the right time.

Nationwide employees voted overwhelmingly in the bi-annual employee charity vote to continue supporting Macmillan Cancer Support. The partnership is now in its 17th year, having raised over £6 million. The introduction of Nationwide Corporate Responsibility Days saw our employees and members raise over £600,000 for Action for Children, Comic Relief, Children in Need and Macmillan Cancer Support.

Closer to home, our ‘Working Together’ campaign ensured that we were the winner of the Responsible Credit Card Award for the third year running.

AGM

Members have the opportunity to show their support for Nationwide by voting for its Board and I would urge them to take it. Voting only takes a few minutes, and can be done online at nationwide.co.uk, through the post, or at any branch of the Nationwide, Cheshire, Derbyshire or Dunfermline.

Members are also welcome at the Annual General Meeting (AGM) in London on 22 July.

Board changes

Since our last AGM we have said farewell to two of our non executive directors. Mark Nicholls retired from the Board in December 2009 to become Chairman of the West Bromwich Building Society and Kevin Loosemore stepped down in April 2010. Our thanks and best wishes go with them.

Additionally, following a recent review of the Group’s senior management organisational structure, it has been decided to consolidate certain executive director responsibilities, and as a result, David Rigney will stand down from the Board in July 2010. We are grateful to David for the substantial contribution he has made to the Group’s progress over recent years and wish him well for the future.

This April saw us welcome to our Board Roger Perkin as a non executive director. A former partner at Ernst & Young, Roger has spent his career in the accounting profession, particularly specialising in financial services.

Finally, I would like to pay tribute to our employees for their commitment and dedication. It is thanks to them that Nationwide continues to deliver for its members and distinguish itself from its competitors.

Geoffrey Howe
Chairman
25 May 2010

Chief Executive's Review

Strong performance in a difficult trading environment

I am pleased to report the Group's results for the year ended 4 April 2010 as set out below. These results have been achieved against a backdrop of continuing disruption in financial markets and demonstrate the resilience of our business and the strength of our customer franchise.

	Year to 4 April 2010	Year to 4 April 2009
	£m	£m
Underlying profit	212	393
Reported profit before tax	341	190

Key highlights

- Underlying profit of £212 million despite difficult trading conditions, low interest rate environment and margin compression;
- Underlying pre-provisioning profit of £811 million, demonstrating the Group's capacity to sustain a relatively stable income performance;
- High quality assets with Nationwide originated residential mortgage accounts more than three months in arrears of 0.68% (2009: 0.64%) – less than a third of the Council of Mortgage Lenders (CML) industry average (2.22%);
- Strong capital ratios that are amongst the best in the industry: Core Tier 1 ratio of 12.2%, Tier 1 ratio of 15.3% and total solvency ratio of 19.4% (2009: 12.0%, 15.1% and 19.5% respectively);
- Increased core liquidity ratio to 13.8% (2009: 12.8%);
- Reduced the wholesale ratio to 27.8% (from 28.6%), prompted by a stronger second half performance of retail funding;
- Raised £8.5 billion equivalent of long term wholesale funding, demonstrating the strength and diversity of Nationwide's funding franchise;
- Launched innovative 'Champion' savings concept, offering long term good value to members by tracking our peer group's equivalent products and adding a bonus;
- Almost 60% increase in unit sales of Protection and Investment products with approximately £2.2 billion of customer investments in the year;
- Continued support for mortgage holders who have benefited from our Base Mortgage Rate (BMR) and our continued waiver of the contractual tracker floor; and
- Voted 'Most Trusted Financial Services Company' by leading personal finance publication Moneywise.

Our business

Our underlying profit, which includes £91 million of gains from the management of our liquidity portfolio, reflects the continuing impact of margin compression in a persistently low rate environment, but also our approach to margin management, which balances the challenge of low rates with our commitment to provide our members with long term good value products. We continue to support our members by honouring our BMR pledge ensuring that the majority of our mortgage customers have access to a rate which is capped at 2% above Bank of England (BoE) base rate. We estimate the cost of maintaining BMR at this level relative to other rates charged in the market has been in excess of £450 million over the past year. We have also continued to waive the contractual floor of 2.75% on tracker mortgages, instead applying the floor at 2%, representing a saving to our members of over £100 million in mortgage interest over the course of the year.

We have actively managed our balance sheet in the year, adjusting our business flows in response to the recessionary conditions and significant contraction in our core markets. In doing so, we have been competitive in the savings market and have launched a number of new products which are designed to reflect our fair and consistent approach. 'Champion Saver', launched in August 2009, is a branch based savings account that automatically tracks the average of the best rates of equivalent savings products and provides an additional bonus of 1.1%. This account has been particularly successful in attracting new funds with inflows of £3.4 billion. 'Champion ISA' which also tracks the best equivalent rates available on the high street and our new 'e-ISA' have also proved very popular during the current ISA season, with £1.8 billion of inflows to the end of April 2010.

Nationwide has lent £12.0 billion of mortgages representing a market share of 8.7% (2009: 9.0%) of gross lending in the UK. We continue to support borrowers with a focus on prime residential lending to existing customers and first time buyers. We recognise our responsibility to support the availability of credit in a dramatically reduced market, and to facilitate activity in the house purchase market we reduced the minimum customer deposit for house purchase from 15% to 10%. We have

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We have been competitive in the savings market and have launched a number of new products which are designed to reflect our fair and consistent approach.

also provided additional support for existing customers moving house, including negative equity products for high quality existing borrowers with a requirement to move.

In the current low rate environment investors have turned to equity based products for higher returns. Overall unit sales of protection and investment products have increased by almost 60% compared with the previous year, and approximately £2.2 billion of customer investments have been received. Specifically, sales of our Protected Equity Bonds (PEBs) have continued to prove popular, attracting over £1.2 billion of funds in the year, compared with £0.2 billion last year.

Managing costs

Controlling costs is an important and responsible measure that will allow us to compete effectively in our core markets and provide long term value to our members.

We have already demonstrated our commitment and ability to manage our cost base. Underlying costs have remained broadly flat, despite the additional cost base as a result of recent mergers of approximately £113 million, and are down 4% on a like for like basis. We have achieved this through a number of measures, including cost synergies and efficiency savings across the Group. In aggregate in the last three years we have identified and delivered total cost savings in excess of £150 million from merger integration and other operational savings across a range of Group activities.

We will continue to identify opportunities to achieve sustainable cost reductions with the objective of delivering a cost base that benchmarks favourably with industry standards over the medium term. Our ambition is to deliver an underlying cost income ratio, based on a normalised interest rate environment, of less than 50% by the end of 2012/13. This will enable us to remain competitive against our peer group and will allow us to continue to offer products that deliver real long term value for our members.

Initiatives to support our cost target over the medium term include a review of the Group’s distribution arrangements and potential rationalisation of our administration centre property footprint, as well as the ongoing integration of our Regional Brands and the reorganisation of central functions.

Asset quality

Prudent lending is the cornerstone of our business. The average loan to value (LTV) of new residential lending remains very low at 63% (2009: 60%) and the indexed LTV for the whole residential portfolio has reduced to 48% from 52%, reflecting positive House Price Index (HPI) movements during the year.

Our arrears position remains significantly better than the CML industry average of 2.22%, with the proportion of the Group’s originated mortgage accounts three months or more in arrears at 0.68%. The proportion of Nationwide originated prime mortgage accounts 3 months or more in arrears was even lower at 0.52%.

The UK commercial property market has been badly hit by the recession with peak to trough falls in capital values of 44%. However, since July 2009 there has been a 13% increase in values, as measured by the IPD index.

Becky & Annie Holloway Melksham

Our local branch went out of the way to ensure we could speak with a mortgage adviser just when it suited us. My husband and I have had a mortgage with the Society for 5 years and when I was expecting our daughter Annie we realised that we needed a bigger home. The help and advice we have received from Nationwide has been first class.

At 4 April 2010 the proportion of commercial balances in arrears was 2.77% (2009: 1.62%), with arrears balances of £42 million, and there are encouraging signs that the increasing arrears trend is now stabilising. Following a realistic assessment of all impaired cases we have booked a total commercial impairment charge of £119 million in the second half of the year, more than 30% lower than the charge in the first half of the year of £180 million. This supports our earlier view that our commercial impairment charge has peaked and that we will see lower levels of impairment in the future.

Chief Executive's Review

continued

Funding, liquidity and capital

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

	4 April 2010	4 April 2009
	%	%
Solvency ratio (Basel II)	**19.4**	19.5
Tier 1 ratio	**15.3**	15.1
Core Tier 1 ratio	**12.2**	12.0
Core liquidity ratio	**13.8**	12.8
Wholesale funding ratio	**27.8**	28.6

Our capital ratios are a key strength of our business, are in excess of current regulatory requirements and compare favourably with averages across the industry.

We have maintained a strong core liquidity ratio, with an expanded portfolio of high grade assets that we had initially built up in 2007/08 in an early response to deteriorating market conditions. At 4 April 2010 we held core liquid assets of over £23 billion, representing a core liquidity ratio of 13.8% (2009: 12.8%).

Although predominantly retail funded, we have a diverse wholesale funding capability. During the year we have raised the equivalent of £8.5 billion of long term, wholesale funding in sterling, dollar and euro markets, demonstrating the strength and diversity of our wholesale funding franchise. Over 50% of our portfolio now relates to balances due in more than one year (2009: 36.7%) as shown in the table below.

	4 April 2010		4 April 2009	
	%	£bn	%	£bn
Balances due in less than 1 year	**49.7**	**24.5**	63.3	34.0
Balances due in more than 1 year	**50.3**	**24.8**	36.7	19.7
Total	**100.0**	**49.3**	100.0	53.7

Reforming financial services

We support the objective of a more secure and stable framework for banking regulation. However, it is imperative that the full impact of proposed changes on the financial services sector is fully understood by the Authorities.

We remain concerned that some of the changes proposed could undermine the future of the building society sector, despite this sector having proved itself to be more resilient and less volatile than the banking sector throughout the financial crisis. In particular:

- Consultation on the future definition of capital has so far focused on instruments that replicate equity shares issued by PLCs. This risks imposing equity style ownership constraints on the mutual sector, which exists to reward its stakeholders, i.e. its members, in a different way. This, in turn, could dilute the mutual philosophy by which building societies and similar institutions are governed and hence remove the diversity they contribute to the financial system. Availability of a capital instrument that is consistent with mutual principles is necessary to support the future stability of the sector and allow it to compete effectively with banks, in the interests of consumers rather than shareholders.
- Building societies cannot currently provide full Financial Services Compensation Scheme (FSCS) cover to members who exceed the £50,000 limit only by virtue of holding multiple accounts across different brands within the same overall Group. This contrasts with many banking groups who are able to offer a full £50,000 limit for each separate subsidiary brand within their Group. This position unfairly disadvantages building societies and their members in relation to savings, which are at the core of their business. This inconsistency should be addressed as a matter of urgency.
- Allocation of industry FSCS levies on the basis of market share continues to result in the cost of compensation for failed institutions falling disproportionately on the low risk building societies sector.

Strategy

Our vision is to be the UK's leading mutual financial services provider and to offer a real and meaningful alternative to the PLC banking model.

We seek to optimise profit for our members rather than to maximise profit for shareholders. This means that we aim to make enough profit to maintain a prudent balance sheet and allow investment for the future. Beyond this, our sole objective is to look after the needs of our members with high levels of service, good quality products and to provide consistent good value.

Our customer strategy is to provide a broad range of personal financial services products. We will maintain our position as a leading provider of mortgage and savings products, and extend our capability and market presence in banking, personal loans, insurance and protection and investment products. We will achieve this by encouraging broader and deeper customer relationships. Increasing scale in these areas will, as well as supporting the needs of our customers, provide a more diversified business mix and reduce our reliance on margin income.

As a mutual, our philosophy is to have an open, honest and transparent relationship with our members, with a consistent long term good value customer proposition. We will seek to deliver a higher level of satisfaction and customer service than our competitors.

Our commitment to cost efficiency and customer service requires us to operate modern, flexible systems supported by knowledgeable, well trained employees. In this context we will continue to invest in the replacement of core legacy systems through our Voyager programme, which aims to deliver an integrated banking platform as its first major delivery. This year we have introduced a new point of sale mortgage system for intermediaries, a new work flow management system and increased our participation in the Faster Payments Scheme.

The mortgages and savings market is beginning to stabilise and improve

The housing market has performed much better than expected, with house prices rising by 9.0% over the course of the 2009/10 financial year.

Gavin Hyman Birmingham

I'm a saver and I'm really pleased to be able to invest a little each month and watch the balance grow. When everything these days seems to cost so much it's hard to save money but the staff at my local branch took time and care to explain what types of account work best for me.

Over the next six to twelve months, we expect a picture of broad stability in the housing market. An increase in property supply from the extreme lows of the last year should relieve some of the upward pressure on prices and lead to a relatively flat trend in property values. Unless there is a significant spike in interest rates, a major dip in prices is unlikely over the next year. At the same time, the upside potential for house prices is limited by the high level of prices relative to household earnings and the more restricted availability of mortgage credit relative to pre-crisis levels.

Evidence from the early months of 2010 suggests that the UK household savings market is beginning to improve. However, low real interest rates are leading many households to direct funds toward debt reduction or investments in the equity markets rather than to bank and building society deposits. This relative weakness in the savings market accentuates the need for continuation of the recovery in long term wholesale funding markets, which will be necessary to support availability of credit and the repayment by the industry of Government sponsored funding schemes due to mature during 2011/12.

Outlook

The Group's performance during 2009/10 has demonstrated resilience borne out of our strong customer franchise, our low risk appetite and our well capitalised balance sheet. These factors will continue to underpin the Group's performance, but market conditions remain both challenging and uncertain for all retail financial services providers.

Overall, we expect the lower levels of profitability experienced in the last eighteen months to continue throughout 2010/11, with scope for further downward pressure dependent on a number of influences, such as the consequences of a more austere economic environment. However, we believe that a progressive return to a more normalised interest rate environment in future years will result in a strong upturn in the overall level of Group profitability.

The subdued level of economic activity in the UK and associated low interest rate environment are expected to persist throughout 2010. These factors will continue to exert downward pressure on margin and non-margin income. Whilst residential property prices have performed surprisingly well in 2009 and unemployment trends have been better than expected, the prospect of fiscal tightening and public sector redundancies may result in an increase in mortgage arrears and subsequent losses in future years. Likewise, the recovery of the commercial property sector remains exposed to weak tenant demand and this may continue for some time whilst the economy fully recovers from the recession.

We plan to mitigate some of the pressure on profitability through a combination of increased diversification of our income streams and by exercising tight control over costs to move us towards our medium term cost income ratio target of 50%. In addition we expect aggregate asset impairments to be at levels that broadly match the experience and lower trend of the second half of 2009/10.

Nationwide has an extremely strong balance sheet with market leading capital ratios, high levels of core liquidity and an enviable retail funding franchise. This, combined with our low risk asset base, will ensure that we remain resilient and financially strong in the face of uncertain market conditions, allowing us to continue to provide good value products and high quality service to our members in the future.

Graham Beale
Chief Executive
25 May 2010

Business Review

Income Statement Overview

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

Underlying profit before tax equates to reported profit before tax adjusted for the impact of movements in the value of derivatives and hedge accounting of £34 million, a £117 million credit relating to a change in the basis of recognition of FSCS levies, transformation costs of £62 million and a gain of £40 million on the acquisition of the former Dunfermline Building Society social housing portfolio, further information on which is provided in note 48. The comparative year additionally includes an adjustment for gains on business combinations.

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

Year to 4 April 2009 (Adjusted)	As reported	FSCS costs	Reported profit pre FSCS costs	Movements on derivatives and hedge accounting	Transformation costs	Gain on business combinations*	Underlying
	£m	£m	£m	£m	£m	£m	£m
Net interest income	1,758	-	1,758	-	-	-	1,758
Other income	494	-	494	-	-	(135)	359
Fair value adjustments	10	-	10	(10)	-	-	-
Total income	2,262	-	2,262	(10)	-	(135)	2,117
Administrative expenses	1,252	-	1,252	-	(107)	-	1,145
Depreciation and amortisation	126	-	126	-	-	-	126
Impairment losses on loans and advances to customers	394	-	394	-	-	-	394
Provisions for liabilities and charges	249	(241)	8	-	-	-	8
Impairment losses on investment securities	51	-	51	-	-	-	51
Profit before tax	190	241	431	(10)	107	(135)	393

*Gains on business combinations at 4 April 2009 represent the net identifiable assets of Cheshire and Dunfermline at the dates of the respective merger and acquisition, minus consideration in respect of those transactions. The gain relating to the Dunfermline acquisition was determined provisionally in the 2009 Annual Report and Accounts and has therefore been adjusted – further detail is provided in notes 1 and 49.

Profit

A summary income statement on an underlying basis is as follows:

	Year to 4 April 2010	Year to 4 April 2009
	£m	£m
Net interest income	1,714	1,758
Other income	381	359
Total income	2,095	2,117
Expenses	1,284	1,271
Underlying pre-provisioning profit	811	846
Impairment losses on loans and advances	549	394
Impairment losses on investment securities and other provisions	50	59
Underlying profit before tax	212	393

Underlying profit for the year was £212 million (2009: £393 million), reflecting a strong performance under difficult market conditions that have resulted in increased impairment charges, particularly in commercial lending.

Despite increased margin compression, an underlying pre-provisioning profit of £811 million (2009: £846 million) has been broadly maintained, supported by growth in other income, management of the cost base and gains of £91 million from the management of our liquidity portfolio arising mainly in the first half of the year.

	Six months to 4 April 2010	Six months to 30 September 2009
	£m	£m
Net interest income	823	891
Other income	203	178
Total income	1,026	1,069
Expenses	648	636
Underlying pre-provisioning profit	378	433
Impairment losses on loans and advances	232	317
Impairment losses on investment securities and other provisions	51	(1)
Underlying profit before tax	95	117

As anticipated, performance in the second half of the year was lower than that achieved in the first half of the year. However, on a like-for-like basis, adjusting for the timing of the gains on the liquidity portfolio, the underlying pre-provisioning profit has been maintained, and impairment charges on loans and advances to customers have reduced by approximately 27%. The impairment charge on investment securities in the second half of the year includes £29 million relating to the impairment of a small number of US RMBS exposures.

Performance by income statement category

Net interest income, at £1,714 million was 3% lower than the previous year.

	Year to 4 April 2010	Year to 4 April 2009
	£m	£m
Net interest income	1,714	1,758
Weighted average total assets	197,320	189,624
	%	%
Net interest margin	0.87	0.93

The Group's net interest margin has declined 6 basis points to 0.87% in the year to 4 April 2010 compared with the prior year. The reduction reflects a combination of lower net interest income and a 4% growth in the average size of the balance sheet following the mergers with Derbyshire, Cheshire and Dunfermline.

Business Review
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Performance by income statement category (continued)

The net interest margin in the six months to 30 September 2009 was 0.91%. This has declined to 0.83% in the second half of the year, resulting in a full year margin of 0.87%. The results for the year have been supported by gains of £91 million arising from the management of our liquidity portfolio, of which £75 million was recognised in the first half of the year. These gains are the equivalent of 5 basis points on the full year margin. Without these gains, the net interest margin would have reduced to 0.83% in the first half of the year, and remained broadly stable for the second half of the year at 0.81%, with an 11 basis points full year reduction compared with the prior year margin of 0.93%.

The main factor driving the reduction in margin has been the increased cost of retail funding, reflecting the competitive savings market and the progressive re-pricing of long term wholesale funding. This has been partly offset by wider spreads on new mortgage pricing, the impact of which has been limited as liabilities continue to reprice faster than the asset side of the balance sheet due to very low levels of re-mortgage activity and our BMR commitment to existing borrowers referred to below.

The net interest margin has been constrained by our commitment to our historic BMR cap, which guarantees that our BMR mortgage will be no more than 200 basis points above the BoE base rate. It also reflects the fact that customers have continued to benefit from our decision to implement the mortgage tracker floor when base rates reached 2%, 0.75% below their contractual floor limit of 2.75%, saving our members over £100 million in mortgage interest over the course of the year.

Other income
Underlying other income of £381 million was £22 million higher than the previous year (2009: £359 million). The current year includes an increase of £9 million of income from Cheshire, Derbyshire and Dunfermline.

The growth in other income has been driven by strong sales of protection and investment products, resulting in increased initial commission and trail commission. However, this has been partly offset by lower current account fee income as customers have sought to manage their accounts more effectively in the current environment.

Expenses
Total underlying expenses amounted to £1,284 million representing an increase of 1% over the prior year. The mergers with Cheshire and Derbyshire, and acquisition of Dunfermline increased our cost base by approximately £113 million on a pro-forma basis and cost synergies in excess of £23 million have been achieved to date. Excluding the net £90 million of costs attributable to the mergers (2009: £22 million), underlying expenses on a like-for-like basis have decreased by 4%. This is despite a £25 million increase in the depreciation charge reflecting our increased investment in the business in recent years.

The overall decrease in expenses has been achieved through delivery of the final synergies arising from the Portman merger completed in 2007, together with further efficiencies and headcount reductions across the Group.

The underlying cost income ratio for the year was 61.3% (2009 adjusted: 60.0%). The increase reflects the pressure on income as a consequence of operating in a low interest rate environment, together with a modest increase in costs described above.

Impairment losses on loans and advances
The full year charge of £549 million is significantly more than the £394 million charge for the year to 4 April 2009, though it is encouraging that the charge over the second half of 2009/10, at £232 million, is markedly less than the first half charge of £317 million. The underlying quality of lending remains strong but is inevitably affected by recessionary conditions and falling asset values in the commercial sector.

Expenses	Year to 4 April 2010	Year to 4 April 2009
	£m	£m
Employee costs:		
• Wages and salaries	469	465
• Social security costs	44	40
• Pension costs	71	94
	584	599
Other administrative expenses	549	546
Depreciation and amortisation	151	126
	1,284	1,271

Impairment losses on loans and advances	Year to 4 April 2010	Year to 4 April 2009
	£m	£m
Prime	10	4
Specialist	79	87
Residential lending	89	91
Commercial lending	299	171
Other secured lending	36	18
Total secured lending	424	280
Unsecured lending	125	114
	549	394

The charge of £89 million (2009: £91 million) on residential lending is primarily related to specialist lending and is slightly lower than last year as an increase in cases with more serious arrears levels has been partly offset by lower early arrears and higher indexed property valuations. The charge on the prime book has increased to a modest £10 million (2009: £4 million) with the high quality and low average LTV profile of our prime mortgages making them more resilient to external market conditions and unemployment than specialist and commercial mortgages. Residential impairment provisions held on balance sheet increased by 32% to £160 million over the year, giving a coverage ratio against total balances of 0.13% (2009: 0.10%) and against balances more than three months in arrears of 13.7% (2009: 10.7%). In the same period balances more than three months in arrears increased by 4%.

In our Commercial Lending division, ongoing difficult market conditions resulted in an increase in commercial loan defaults and a charge for the year of £299 million. Signs of improvement have been seen in the second half of the year as the growth in impairments began to slow, resulting in a second half charge of £119 million compared with £180 million for the first half and £146 million for the six months to 4 April 2009. The increase in defaults has been triggered by tenant failures and our borrowers' subsequent inability to service loans, along with covenant breaches on LTVs and business failures on owner occupied properties.

The commercial portfolio includes £266 million of subordinated exposures of which £124 million are provided for, and the Group's residual exposure to subordinated loans is therefore restricted to the unprovided balances of £142 million (6 cases) which are currently fully performing. For Nationwide originated assets, the subordinated exposure is £197 million, of which £88 million is now fully provided.

The overall level of provision for commercial lending as a percentage of Nationwide originated assets is 1.97% (2009: 0.92%) and the provision coverage ratio against balances more than three months in arrears is 48% (2009: 62%).

The charge of £36 million (2009: £18 million) for other secured lending is in respect of a portfolio of European commercial loans acquired by our Treasury division. The portfolio is managed on our behalf by a leading European manager.

The increase in the charge for unsecured lending is due to two specific changes that we made to our assessment of provisions, to better reflect prevailing conditions, rather than being due to a change in underlying performance of these assets. The charge for 2008/09 included the benefit of a one off reduction to the provision for up to date assets and the charge for 2009/10 includes a significantly higher provision for cases subject to litigation. The underlying performance of unsecured lending remains strong and reflects our cautious approach and prudence in our underwriting.

Impairment losses on investment securities and other provisions	Year to 4 April 2010	Year to 4 April 2009
	£m	£m
Treasury investments	36	51
Other provisions	14	8
	50	59

Impairment losses on investment securities and other provisions

The treasury impairment charge of £36 million is both lower and very different in composition from the previous year. The prior year charge was driven by bank failures and included £34 million for Washington Mutual, £3 million for Lehman Brothers and £12 million for Icelandic banks. This year's charge of £36 million is driven by £29 million impairment of a small number of US RMBS exposures, and £7 million in respect of our private equity portfolio, the exposure to which totals £105 million including future commitments.

Other provisions in the year to 4 April 2010 represent allowances made in respect of various customer claims, including claims in relation to previous sales of payment protection insurance.

Derivatives and hedge accounting

All derivatives entered into by Nationwide are recorded on the balance sheet at fair value with any valuation movements being taken to the income statement. Derivatives are only used to limit the extent to which the Group will be affected by changes in interest rates, exchange rates or other market indices. Derivatives are therefore used exclusively to hedge risk exposures and are not used for speculative purposes.

The £34 million credit (2009: £10 million credit) relating to fair value adjustments on derivatives and hedge accounting represents the net fair value adjustment (after matching it with offsetting adjustments to the fair value of the related hedge items) on derivative instruments that are matching risk exposures on an economic basis. Some income statement volatility arises on these items due to accounting ineffectiveness of designated hedges or because hedge accounting has not been adopted or is not achievable. The charge, in so far as it relates to ineffectiveness, is primarily due to short term timing differences in cash flows and interest rate reset dates between the derivative instruments and the hedged assets and liabilities. The impact can be volatile but over time will trend to zero and has been excluded in reporting the Group's underlying performance.

Taxation

The statutory reported tax charge for the year is £77 million (2009 adjusted: £44 million). This represents an effective tax rate of 22.6% (2009 adjusted: 23.1%), which is lower than the statutory rate in the UK of 28%. The lower rate is due principally to adjustments to amounts provided in respect of prior periods. The effective tax rate is reconciled to the statutory rate in note 13 on page 92.

Business Review

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Balance Sheet

Loans and advances to customers	4 April 2010		4 April 2009	
	£bn	%	£bn	%
Prime residential mortgages	108.7	71.3	111.9	72.1
Specialist residential mortgages	18.7	12.2	18.2	11.7
Total residential mortgages	127.4	83.5	130.1	83.8
Commercial lending	22.2	14.6	22.1	14.2
Other lending	0.6	0.4	0.6	0.4
Consumer banking	2.3	1.5	2.4	1.6
Gross balances	152.5	100.0	155.2	100.0
Impairment provisions	(0.8)		(0.4)	
Fair value adjustments for micro hedged risk	0.7		0.7	
Total	152.4		155.5	

Loans and advances to customers

Lending remains predominantly concentrated on high quality secured products with residential mortgages accounting for 84% of our total loans and advances to customers, commercial lending 15%, and consumer banking 1%. The composition of lending has remained broadly consistent with that reported at 4 April 2009.

Residential

Prime residential mortgages are primarily Nationwide branded advances made through our branch network and intermediary channels. In addition, our balance sheet includes prime mortgages totalling £4.5 billion that were brought onto our balance sheet following our acquisitions of the Cheshire, Derbyshire and Dunfermline portfolios.

Specialist residential mortgages are made up of £15.7 billion of advances made through our Specialist Lending brands, The Mortgage Works UK plc (TMW) and UCB Home Loans Ltd (UCB), and £3.0 billion arising from acquisitions of the Cheshire, Derbyshire and Dunfermline portfolios. Loans were advanced primarily in the Buy to Let and self-certification markets. Buy to Let mortgages make up 66% of total specialist lending, 24% relates to self-certification mortgages, 7% relates to near prime and just 3%, amounting to approximately £0.5 billion, relates to sub prime, of which £0.4 billion was acquired as part of the mergers with Derbyshire and Cheshire and has been subject to rigorous fair value assessment at acquisition.

Gross prime lending in the year amounted to £10.3 billion (2009: £16.7 billion). Gross specialist lending in the year of £1.7 billion (2009: £2.2 billion) was almost exclusively in the Buy to Let sector, with insignificant amounts of self-certified lending and no sub or near prime lending.

We have continued to focus on affordability and loan to value (LTV) ratios in underwriting loans during the year. The average LTV of residential mortgages completed was 63% (2009: 60%), whilst the average indexed LTV of residential mortgages at 4 April 2010 has fallen to 48% (2009: 52%).

The table on page 15 shows that, on Nationwide originated lending, we have seen a small increase in prime arrears and a reduction in specialist arrears though we continue to maintain our very favourable position to the industry on both originated business and lending including acquired loans. The modest increase in prime arrears has been driven by external pressures impacting customers'

Loan to value analysis:	4 April 2010	4 April 2009
	%	%
Total book		
<50%	54	51
50% - 60%	10	9
60% - 70%	10	9
70% - 80%	10	9
80% - 90%	8	8
90% - 100%	6	8
>100%	2	6
	100	100
Average LTV of stock (indexed)	48	52
Average LTV of new business*	63	60

*The average LTV of new business profiles has been amended to exclude further advances which were previously included in remortgages. The 4 April 2009 comparative has been restated from 58% to 60% accordingly.

Cases 3 months or more in arrears as % of total book	**4 April 2010**	**4 April 2009**
	%	%
Nationwide self-originated mortgages:		
Prime	0.52	0.49
Specialist	2.28	2.45
Nationwide self-originated mortgages	**0.68**	**0.64**
Including effect of acquired societies:		
Prime	0.54	0.51
Specialist	3.37	3.72
Group – including acquired loans	**0.82**	**0.80**
Industry average	**2.22**	**2.41**

abilities to meet their mortgage repayments combined with our collections and forbearance strategies to work with customers to avoid possession where possible. Our originated specialist mortgages continue to perform well and remain broadly in line with the industry measure that includes prime.

The percentage of cases 3 months or more in arrears as a percentage of the total book for prime mortgages is now based on the CML definition, which calculates months in arrears by dividing the arrears balance by the latest contractual payment. Previously, arrears had been based on the number of missed payments, and so 4 April 2009 comparatives have been restated accordingly. The effect of the restatements has been to increase the 4 April 2009 figures for Nationwide self-originated mortgages and Group mortgages by 4 basis points.

Residential mortgage assets acquired with Cheshire, Derbyshire and Dunfermline brands were fair valued on a basis which included a credit risk adjustment of £199 million for anticipated losses over the remaining life of the loans. To date, £49 million of losses have been written off and, as reported at 4 April 2009, we continue to believe it is unlikely that these loans will contribute any significant losses to the Group in excess of the fair value allowance made at the time of acquisition. Accordingly, in evaluating the Group's exposure to losses, as well as the quality of its underwriting processes, it is relevant to focus on arrears levels excluding rather than including the effect of acquired assets.

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

If a customer demonstrates they are able to meet a revised payment schedule at a normal commercial rate for a period of six months, and only if they request it, we may capitalise the arrears on their account. This will result in an enlarged outstanding balance but no arrears and consequently these cases will no longer be reported as arrears. More information on capitalised cases is given in note 42 on page 129.

The number of Group borrowers in possession, including acquired societies, of 967 (2009: 1,248) represents 0.069% of the total portfolio (2009: 0.087%). As Buy to Let landlords may have more than one property, possession measures are slightly higher on a property basis but, at 1,088 (2009: 1,441) properties, representing 0.077% of our book (2009: 0.100%), this compares very well with the industry measure of 0.127% (2009: 0.211%). Excluding the impact of acquired societies, our position relative to the industry is even more favourable. The table below shows possessions as a percentage of book for both originated and acquired residential mortgages.

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

Possessions as % of total book (number of borrowers)	**4 April 2010**		**4 April 2009**
	Number of cases	%	%
Nationwide self-originated mortgages:			
Prime	245	0.021	0.021
Specialist	475	0.414	0.500
Nationwide self-originated mortgages	**720**	**0.055**	**0.058**
Including effect of acquired societies:			
Prime	270	0.021	0.022
Specialist	697	0.497	0.741
Group – including acquired loans	**967**	**0.069**	**0.087**

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Balance Sheet (continued)

During the year, 1,280 (2009: 941) properties relating to Nationwide original lending have been taken into possession representing only 2.89% (2009: 2.10%) of properties taken in by the industry as a whole against our par share of all cases of 11.58% (2009: 11.72%).

Possessions as % of total book (number of properties)	4 April 2010		4 April 2009
	Number of cases	%	%
Nationwide self-originated mortgages:			
Prime	245	0.021	0.021
Specialist	596	0.461	0.602
Nationwide self-originated mortgages	**841**	**0.064**	0.072
Including effect of acquired societies:			
Prime	270	0.021	0.022
Specialist	818	0.528	0.795
Group – including acquired loans	**1,088**	**0.077**	0.100
Industry cases/average %	**14,500**	**0.127**	0.211

Possessions taken in during the year as % of total book (number of borrowers)	4 April 2010		4 April 2009
	Number of cases	%	%
Nationwide self-originated mortgages:			
Prime	518	0.044	0.035
Specialist	593	0.517	0.307
Nationwide self-originated mortgages	**1,111**	**0.085**	0.056
Including effect of acquired societies:			
Prime	587	0.047	0.034
Specialist	1,087	0.775	0.498
Group – including acquired loans	**1,674**	**0.120**	0.076

Possessions taken in during the year as % of total book (number of properties)	4 April 2010		4 April 2009
	Number of cases	%	%
Nationwide self-originated mortgages:			
Prime	518	0.044	0.035
Specialist	762	0.590	0.434
Nationwide self-originated mortgages	**1,280**	**0.097**	0.070
Including effect of acquired societies:			
Prime	587	0.047	0.034
Specialist	1,256	0.811	0.582
Group – including acquired loans	**1,843**	**0.130**	0.089
Industry cases/average %	**44,300**	**0.389**	0.393

Commercial

Our commercial lending portfolio of £22.2 billion (2009: £22.1 billion) consists of £20.9 billion (2009: £21.1 billion) of self-originated lending and £1.3 billion (2009: £1.0 billion) of assets acquired from Derbyshire, Cheshire and Dunfermline building societies. Our originated portfolio comprises £12.5 billion secured on commercial property ('Property Finance'), £7.1 billion advanced to Registered Social Landlords and £1.3 billion advanced under the Private Finance Initiative (PFI). The £0.3 billion increase in acquired assets arose on the post merger acquisition of a social housing portfolio of the former Dunfermline Building Society. There are currently no arrears of three months or more on the Registered Social Landlord and PFI portfolios and our Property Finance portfolio is well diversified by industry type and by borrower. On self-originated lending we have only modest exposure to development finance with total balances of £155 million, and a total further commitment of £47 million, to three high quality office developments in the centre of London.

The self-originated portfolio includes £197 million of subordinated exposures, of which £88 million are impaired and fully provided for. The Group's residual exposure to these subordinated loans is therefore restricted to the unprovided balances of £109 million (five cases) which are currently fully performing.

The number of Nationwide originated commercial property cases more than three months in arrears increased from 179 cases at 4 April 2009 to 285 at 4 April 2010. This equates to 2.77% of commercial originated accounts (2009: 1.62%). Total arrears balances on these cases at 4 April 2010 were £42 million (2009: £17 million). Robust arrears management is carried out by dedicated teams who, supported by daily arrears reporting, maintain a focus on early intervention to maximise economic value and mitigate losses.

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

Percentage of accounts more than 30 days in arrears	4 April 2010		4 April 2009*	
	NBS %	Industry %	NBS %	Industry %
Personal loans	7.07	19.6	7.15	15.8
Credit cards	5.15	6.64	5.70	8.06

*Industry numbers for personal loans and credit cards for the prior period have been restated by the FLA and APACS respectively.

of which relates to Dunfermline's social housing portfolio. A loan loss impairment charge of £10 million has been raised in the year as 12 individually assessed cases have an impairment provision requirement in excess of the original fair value adjustment. However, in most cases, the credit risk adjustment exceeds the current impairment provision requirement and we continue to believe that acquired loans are unlikely to contribute any significant net losses to the Group over their lifetime.

Although we continue to expect difficult market conditions, and further impairment provisions, we remain confident that our book, which is primarily focused on low risk lending, will perform better than most and this, combined with proactive management, will ensure that commercial lending continues to make a positive long term contribution to the Group.

Other lending

Other lending includes £299 million of secured European commercial loans and £277 million of unsecured lending relating to a student loan portfolio. The European commercial loan portfolio is spread across 72 separate entities and 11 countries with the maximum individual exposure amounting to £11.4 million. 13 of the 72 entities defaulted during the year resulting in an impairment charge of £36 million. There is no significant impairment on the student loan portfolio. This lending is included within the Head Office Functions and Other Operations business segment, as the portfolios were acquired by our Treasury division.

Consumer banking

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

In addition to the above, balances on current account overdrafts total £0.3 billion. The level of arrears on these overdrafts has remained relatively static and in line with expectations.

Funding and liquidity

Overview

The Society has a strong and well diversified funding base, which continues to be predominantly funded by retail savings. Over the course of the financial year, we have actively managed our balance sheet to respond to challenging market conditions in both wholesale and retail markets. In particular, we have carefully controlled the level and quality of lending undertaken. This has reduced our overall funding needs, resulting in absolute reductions in both retail and wholesale funding.

As a building society, we have always maintained a high level of unencumbered liquid assets relative to our banking peers and we have further increased our core liquidity ratio during the year. Liquidity and funding are intrinsically inter-connected and a number of steps have been taken to manage the Group's funding profile that have had beneficial impacts on the Group's overall liquidity position. Over the last two years we have steadily increased the amount of core liquidity in anticipation of the change in regulatory policy that was affirmed in the FSA's new approach to liquidity management (PS 09/16).

Liquidity

Liquidity, together with funding and capital, represents the cornerstone of the financial management of a financial institution. Much focus has been applied to this discipline by the regulatory authorities in recent years. This has resulted in the FSA publishing a new liquidity policy statement, PS 09/16, for BIPRU firms in the UK. In addition, the FSA has set out a separate risk management framework for building societies, PS 10/5. Compliance with these new policy statements given their strict and tight timescale has been a key objective of the Group during the course of the year and will continue to be so.

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

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

Core liquidity

The Group has continued to focus on the growth and diversification of its core liquidity portfolio through investing in a greater volume of highly liquid sovereign securities. The core portfolio is aligned to the 'Liquid Assets Buffer' defined by the FSA in Chapter 8 of PS 09/16 and comprises:

- Deposits held at, and securities issued by the Bank of England (BoE); and
- Highly rated securities of varying maturities issued by governments or multi-lateral development banks that are eligible collateral at the Bank's narrow Open Market Operations.

Business Review
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Balance Sheet (continued)

As at 4 April 2010, the core liquidity portfolio as a percentage of adjusted share, deposit and loan liabilities was 13.8% (2009: 12.8%). This calculation is made net of any core liquidity holdings that are subject to repo arrangements.

Other eligible central bank assets
In addition to the core portfolio, as at 4 April 2010 the Group held a stock of unencumbered securities (excluding self issuance) that are eligible collateral for either the European Central Bank's (ECB) repo operations or for the BoE's extended collateral repo operations. In terms of their relative liquidity characteristics, these assets may be viewed as the next tier below the core liquidity portfolio.

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

Self issued RMBS and covered bonds
The Group also holds a stock of issued AAA residential mortgage backed securities (RMBS) and covered bonds. These self issued securities are capable of repo financing either directly with the market or with central banks to which the Group has direct access.

The table below sets out the fair value – before any 'haircut' deduction – of each of the above liquidity types as at 4 April 2010 (given the developments in the management of liquidity during the year it would not be meaningful to provide comparative information). The table includes off balance sheet liquidity (including treasury bills held under the Special Liquidity Scheme and self issued RMBS and covered bonds) but excludes any encumbered assets.

	4 April 2010
	£bn
Core liquidity	23.4
Other central bank eligible assets	4.7
Other securities	3.4
Self issued RMBS and covered bonds	11.8
Total	43.3

Funding profile
The retail savings environment in the UK has become hugely competitive as many financial institutions sought to compensate for a lack of access in wholesale markets by focusing efforts on attracting retail deposits. Generally, this has been achieved by offering extremely attractive rates to generate demand. Nationwide has not responded in kind to this change in approach since the Group aims to offer good value over the longer term to its members. As a consequence members' balances fell by £7.3 billion over the period to £120.9 billion and reliance on highly volatile rate sensitive retail balances was reduced. The reduction in share balances occurred predominantly over the first 7 months of the year with balances then progressively stabilising and then increasing over the last two months of the year. As part of our approach to retail funding during the year we have sought to reduce our exposure to one year fixed term retail bonds and particularly during the second half of the year competed more keenly in the market for longer duration bonds, typically in the 3-5 year maturity segment. In addition we launched 'Champion Saver' during the year, a variable rate 60 day notice product which tracks the average of the top five rates available from major competitors and includes an additional bonus entitlement. 'Champion Saver' has been successful in providing an alternative mechanism for both attracting new balances and retaining existing balances as an alternative to the one year fixed term bond market where competition tends to be greatest and customer loyalty lowest. At 4 April 2010 our stock of one year fixed rate bonds was £11 billion (2009: £17 billion).

Over the course of the year wholesale funding balances have also decreased such that the wholesale funding level ended at 27.8% (2009: 28.6%). The stronger second half performance of retail funding and the reduction in the size of the balance sheet has prompted this decline, despite the small increase witnessed at the half year.

Over the year, the loan to deposit ratio increased to 116.8% (2009: 112.4%). However, the loan to deposit and long term funding ratio reduced over this same period, from 100.4% to 100.2%. Pending international consensus on an appropriate stable funding ratio definition, the Group does not set a target for either of these ratios but given that the former does not reflect the term of deposits, we believe the latter is a more appropriate representation of the structural development of the balance sheet during the year.

Wholesale funding
An analysis of the Group's wholesale funding (made up of deposits from banks, other deposits and debt securities in issue as disclosed on the balance sheet) is set out in the table on page 19.

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

Over the course of the last financial year the Group has been active in the term debt capital markets and has issued £8.5 billion equivalent of term unsecured and secured debt relative to £4 billion equivalent of maturing term debt. This has enabled the Group to both extend the

Wholesale funding mix	4 April 2010		4 April 2009	
	£bn	%	£bn	%
Repo and other secured arrangements	7.9	16.0	13.9	25.8
Deposits	6.1	12.4	6.7	12.4
Certificates of deposit	6.1	12.4	8.9	16.6
Commercial paper	6.4	13.0	5.3	9.9
Covered bonds	9.1	18.4	9.6	17.9
Medium term notes	10.1	20.5	8.6	16.1
Securitisations	2.2	4.5	-	-
Other	1.4	2.8	0.7	1.3
Total	49.3	100.0	53.7	100.0

maturity profile of its wholesale funding portfolio from 21 months to 26 months and to increase the split of the portfolio between short and long term (i.e. > one year remaining maturity – as illustrated in the wholesale funding residential maturity table below). Long term refinancing requirements for the Group remain modest for the forthcoming year, with only £1.8 billion equivalent of wholesale debt maturing in that period.

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

- In August 2009, US$4 billion of 3 year fixed and 2.75 year floating rate bonds under the Government's Credit Guarantee Scheme;
- In September 2009, £700 million 10 year fixed rate bonds, our longest ever sterling senior issue;
- In November 2009, £2.2 billion of five and seven year funding through the issue of floating and fixed residential mortgage backed securities (RMBS) through the Silverstone Master Trust vehicle – the Group's first ever external securitisation;
- In January 2010, €1.25 billion five year bonds, ending the Group's absence since 2005 from the Euro senior markets; and
- In February 2010, US$0.7 billion 5 year and US$0.8 billion 10 year fixed rate bonds, ending the Group's absence since 2005 from the unguaranteed US$ fixed rate markets.

The Group has reduced the amount of short term funding it holds to £16 billion (2009: £20 billion), but still enjoys a strong franchise in these markets, which is reflected in the average term at issuance of the short term funding book, being 155 days at 4 April 2010 (2009: 125 days).

Treasury asset quality

This section deals with asset quality of the on balance sheet treasury assets. The quantum of on balance sheet treasury assets, viewed from an asset quality perspective, will be different to the quantum from a liquidity perspective in that the former will exclude off balance sheet liquidity but will include encumbered assets that do not count for liquidity purposes.

Group treasury assets at 4 April 2010 were £29.4 billion (2009: £34.5 billion) and are held in two separate portfolios; the prudential portfolio and the investment portfolio. At 4 April 2010, the prudential portfolio totalled £25.7 billion (2009: £31.1 billion) with the investment portfolio totalling £3.7 billion (2009: £3.4 billion).

We have continued to manage the prudential portfolio to increase the quality and liquidity of the assets with 63% of the portfolio held in sovereign and supranational exposures compared with 50% as at 4 April 2009. Over 99% of the portfolio is rated A or better with 85% rated AA or above (2009: 99% rated A or better, 78% rated AA or better).

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

Wholesale funding residual maturity	4 April 2010		4 April 2009	
	£bn	%	£bn	%
Less than one year	24.5	49.7	34.0	63.3
One to two years	4.3	8.8	4.5	8.4
Two to five years	11.7	23.6	10.5	19.6
More than 5 years	8.8	17.9	4.7	8.7
Total	49.3	100.0	53.7	100.0

Our short and long term credit ratings from the major rating agencies as at 25 May 2010 are as follows:

	Long Term	Short Term	Subordinated	Date of last rating action*
Standard & Poor's	A+	A-1	BBB+	July 2009
Moody's	Aa3	P-1	Baa3	April 2009
Fitch	AA-	F1+	A	October 2009
DBRS	AA	R-1 (middle)	AA (low)	March 2009

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

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Balance Sheet (continued)

The following table shows an analysis of the on balance sheet prudential portfolio at 4 April 2010:

Prudential portfolio	4 April 2010	AAA	AA	A	Other	UK	US	Europe	Other	4 April 2009
	£bn	%	%	%	%	%	%	%	%	£bn
Bank of England	4.0	100	-	-	-	100	-	-	-	8.2
Loans to financial institutions	1.7	-	36	59	5	78	1	5	16	4.7
Other (including items in transit and clearing accounts)	0.3	-	-	-	-	100	-	-	-	0.4
Non AFS assets	6.0									13.3
Gilts	6.4	100	-	-	-	100	-	-	-	4.7
Non domestic government bonds	3.9	100	-	-	-	-	43	57	-	0.6
Supranational bonds	2.0	100	-	-	-	-	2	98	-	1.9
Residential mortgage backed securities (RMBS)	2.7	96	4	-	-	43	-	52	5	2.7
Covered bonds	0.9	89	11	-	-	-	3	90	7	0.9
Medium term notes/floating rate notes	3.8	4	25	61	10	26	3	57	14	6.0
Certificates of deposit and commercial paper	-	-	-	-	-	-	-	-	-	1.0
AFS assets	19.7									17.8
Total	25.7	78	7	14	1	55	7	34	4	31.1

Ratings are obtained from Standard & Poor's in the majority of cases, from Moody's if there is no Standard & Poor's rating available, with internal ratings used if neither is available.

We have no direct Sovereign exposure to Greece, Ireland, Italy, Portugal and Spain ("GIIPS").

Amounts shown above in respect of RMBS and covered bonds include securities collateralised on assets originated in GIIPS amounting in aggregate to £1.6 billion, of which 93% by value is secured on prime collateral, and 99% is rated AAA (89%) or AA (10%). As part of our normal credit risk management process we monitor all secured investments by reference to assumptions made on collateral performance at the time of investment. To date we have seen little evidence of deterioration in the performance of these investments, and we do not currently anticipate any impairments within this secured portfolio.

We also have £1.2 billion of medium term note exposures to financial institutions based in GIIPS, including £20 million to Greece, £208 million to Ireland, £221 million to Italy, £101 million to Portugal and £692 million to Spain. 85% of these note exposures are rated A (63%) or AA (22%) and the weighted average maturity of these exposures is less than 3 years.

The treasury investment portfolio was originally established to generate additional income for the Group. Over 87% of the investment portfolio is rated A or better (2009: 97%) with over 69% rated AA or better (2009: 76%). In light of current market conditions, we have not actively sought to expand the portfolio and we are managing the existing portfolio to minimise potential risk. During the year, £0.5 billion of paydowns have been received relating to the asset and mortgage backed securities held by the Group. The increase in the fair value of the portfolio to £3.7 billion (2009: £3.4 billion) is therefore due to improved pricing reflecting market recovery.

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

There have been no material changes in the profile of the investment portfolio over the course of the year and additional detail on the more material exposures is set out below. The portfolio has experienced some negative rating migration as a result of the ongoing implementation of rating agencies methodology changes and continued collateral deterioration particularly for CMBS and US RMBS. However, the overall credit quality remains strong with only a low level of impairment incurred.

The following table shows an analysis of the investment portfolio at 4 April 2010:

	Investment portfolio (All AFS assets)	4 April 2010	AAA	AA	A	Other	UK	US	Europe	Other	4 April 2009
		£bn	%	%	%	%	%	%	%	%	£bn
	Collateralised debt obligations (CDO)	0.1	-	-	-	100	-	100	-	-	0.1
(i)	Collateralised loan obligations (CLO)	0.6	33	59	8	-	25	75	-	-	0.5
(ii)	Commercial mortgage backed securities (CMBS)	0.6	60	19	11	10	47	14	39	-	0.6
	Corporate bond portfolio	0.1	-	13	17	70	36	28	36	-	0.2
	Credit card backed securities	0.3	99	-	-	1	42	58	-	-	0.3
(iii)	Financial institutions including subordinated debt	0.7	-	22	64	14	21	33	39	7	0.6
	Other corporate bonds	-	-	34	66	-	100	-	-	-	-
(iv)	Residential mortgage backed securities (RMBS)	0.3	24	23	23	30	61	36	3	-	0.2
(v)	US student loan	0.8	98	1	1	-	-	100	-	-	0.7
	Other investments	0.2	38	21	15	26	11	47	33	9	0.2
Total		3.7	49	20	18	13	27	55	16	2	3.4

Included under financial institutions, RMBS and other investments above are GIIPS related exposures totalling £152 million, of which £65 million relates to subordinated loans to financial institutions (£34 million to Ireland, £11 million to Italy and £20 million to Portugal). The remaining balance relates to secured or highly rated bank exposure.

Nationwide has £100 million exposure to monoline wrapped transactions which are shown above under their underlying holdings. For all but £2 million of these holdings, we anticipate full repayment without any assistance from the wrap provider. This is mainly as a result of the approach taken upon investment, where we placed no reliance on the wrap, requiring the investment to stand up to credit analysis in its own right.

(i) CLOs comprise £575 million of senior positions. 92% of this portfolio retains AA or AAA rating. Our focus on the selection of strong managers has provided some protection from downward rating migration.

(ii) 60% of the CMBS portfolio is AAA rated. The portfolio consists of exposures to established commercial real estate markets with the bulk of our holdings in the UK and Germany. Underlying collateral consists of office, retail, industrial and warehouse exposures with experienced sponsors supporting the underlying loans.

(iii) Included in the financial institutions portfolio are £462m of subordinated lower tier two bonds that were acquired as part of the process of eliminating SIV capital note investments.

(iv) Total investment holdings in RMBS are £338 million. The £121m of US exposure is made up of prime and Alt A RMBS. 17% of this US portfolio retains an AAA rating.

(v) The US student loan portfolio comprises 67% FFELP (Federal Family Education Loan Programme) originated loans which are 98% guaranteed by the US government, and 33% alternative student loans.

Available for sale reserve

Out of a total of £29.4 billion of treasury assets held in the prudential and investment portfolios, £23.4 billion are held as available for sale (AFS) and under IFRS they are marked to market through other comprehensive income and fair value movements are accumulated in reserves. The non AFS assets are predominantly short term loans to financial institutions or deposits with the Bank of England. Of the £23.4 billion of AFS assets only £106 million are classified as Level 3 (not based on observable market data) for the purposes of IFRS 7.

The fair value movement of AFS assets that are not impaired have no effect on the Group's profit for the period or its regulatory capital. The assets have been carefully reviewed based upon latest performance data and an impairment charge of £29 million has been booked against AFS assets with a further £7 million against private equity held as part of our small investment in equity shares portfolio which has a total balance of £58 million and further commitments of £47 million.

Business Review

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Balance Sheet (continued)

As at 4 April 2010, the balance on the AFS reserve had improved to £715 million negative, net of tax (2009: £2,009 million negative). The improvement in the AFS reserve is primarily a function of improvement in the pricing of RMBS, US student loans and financial institutions as market sentiment has improved.

In October 2008, the IASB issued an amendment to IAS39 allowing assets to be reclassified from AFS assets to loans and receivables. Nationwide has not reclassified any assets in this way.

	Cumulative AFS reserve 4 April 2010	Fair value on balance sheet 4 April 2010	Cumulative AFS reserve 4 April 2009	Fair value on balance sheet 4 April 2009
	£bn	£bn	£bn	£bn
Gilts and supranational bonds	(0.3)	12.3	(0.3)	7.2
Residential mortgage backed securities (RMBS)	0.2	2.7	0.7	2.7
Covered bonds and floating rate notes	0.1	4.7	0.3	6.9
Certificates of deposit and commercial paper	-	-	-	1.0
Prudential portfolio	-	19.7	0.7	17.8
Collateralised debt obligations (CDO)	-	0.1	0.1	0.1
Collateralised loan obligations (CLO)	0.1	0.6	0.2	0.5
Commercial mortgage backed securities (CMBS)	0.3	0.6	0.3	0.6
Corporate bond portfolio	-	0.1	-	0.2
Credit card backed securities	-	0.3	0.1	0.3
Financial institutions including sub debt	-	0.7	0.2	0.6
Residential mortgage backed securities (RMBS)	0.1	0.3	0.3	0.2
US student loan	0.1	0.8	0.3	0.7
Other investments	0.1	0.2	0.1	0.2
Investment portfolio	0.7	3.7	1.6	3.4
Negative AFS reserve before hedge accounting and taxation	0.7		2.3	
Hedge accounting adjustment for interest rate risk	0.3		0.5	
Taxation	(0.3)		(0.8)	
Negative AFS reserve (net)/Total value of AFS assets	0.7	23.4	2.0	21.2

Capital Structure

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

The Group is required to manage its capital in accordance with prudential rules issued by the FSA and from 1 January 2008 the Group has complied with these rules, which implement the EU Capital Requirements Directive (Basel II).

Since 4 April 2009 the Group has calculated its capital requirement on an Internal Ratings Based (IRB) approach.

The table opposite shows the Group capital position as at 4 April 2010. Figures for 2010 include the acquisition of the Registered Social Landlord portfolio of the former Dunfermline Building Society.

As at 4 April 2010, regulatory capital stood at £9.7 billion (2009: £9.7 billion) with the Group's total solvency ratio remaining strong at 19.4% (2009: 19.5%). The Core Tier 1 solvency ratio stood at 12.2% (2009: 12.0%).

	4 April 2010 Basel II IRB	4 April 2009 Basel II IRB (Adjusted)
	£m	£m
Tier 1		
General reserve	6,363	6,218
Permanent interest bearing shares (Note 1)	1,524	1,526
Pension fund net deficit add back (Note 2)	355	167
Intangible assets (Note 3)	(353)	(211)
Deductions from Tier 1 capital (Note 4)	(232)	(186)
	7,657	7,514
Tier 2		
Revaluation reserve	68	69
Subordinated debt (Note 1)	2,132	2,233
Collective impairment allowance	97	60
Deductions from Tier 2 capital (Note 4)	(232)	(186)
	2,065	2,176
Total capital	9,722	9,690
Risk weighted assets – Pillar 1 (Note 5)		
Retail mortgages	14,653	13,559
Commercial loans	18,316	18,751
Treasury	8,351	9,065
Other	4,375	4,702
Operational risk	4,328	3,704
Market risk	50	37
	50,073	49,818
Key capital ratios:		
Total capital	9,722	9,690
Core Tier 1 (%) (Note 6)	12.2	12.0
Tier 1 ratio (%) (Note 6)	15.3	15.1
Total capital (%) (Note 6)	19.4	19.5
Tier 2 to Tier 1 ratio (%)	27.0	29.0

(1) Permanent interest bearing shares and subordinated debt include any fair value adjustments arising from micro-hedging and adjustments for unamortised premiums and discounts that are included in the consolidated balance sheet and any amortisation of the capital value of lower Tier 2 instruments required by regulatory rules for instruments with less than five years to maturity.

(2) The regulatory capital rules allow the pension fund deficit to be added back to regulatory capital and a deduction taken instead for an estimate of the additional contributions to be made in the next 5 years, less associated deferred tax.

(3) Intangible assets do not qualify as capital for regulatory purposes.

(4) Certain deductions from capital are required to be allocated 50% to Tier 1 and 50% to Tier 2 capital. Deductions are subject to different treatment under IRB in respect of net expected loss over accounting provisions and certain securitisation positions. These are calculated in accordance with FSA guidance.

(5) The Basel II Pillar 1 capital requirements are calculated using the Retail IRB approach for prime mortgages (other than those originated by the Derbyshire, Cheshire and Dunfermline societies) and unsecured lending; Foundation IRB for treasury portfolios (other than corporates); and the Standardised approach for all other credit risk exposures.

(6) Solvency ratios are calculated as relevant capital divided by risk weighted assets. Core Tier 1 relates to Tier 1 capital excluding permanent interest bearing shares.

Business Review
continued

Capital Structure (continued)

The reform of the banking sector continues and various proposals in relation to capital, funding and liquidity continue to be put forward. We support the objective of a more secure and stable framework for banking regulation, however it is imperative that the cumulative impact of these changes on the financial services sector is fully understood by the Authorities. In particular, we remain concerned that some of the changes in the shifting regulatory landscape could undermine the future of the building society sector.

Specifically, the treatment of capital and access to external capital that can qualify as Core Tier 1 is fundamental to the future of any major financial institution. It is essential that the changes currently being contemplated do not result in Nationwide's access to the capital markets being restricted.

Consultations on the future definition of Core Tier 1 capital instruments published by the Basel Committee on Banking Supervision, the committee of European Banking Supervisors and the FSA have so far been predicated on a preference that, outside of retained earnings, Core Tier 1 should comprise predominantly instruments that replicate ordinary equity shares and pay uncapped, profit-participative dividends not linked to the principal amount. Consistent with this approach, the FSA has indicated that PIBS will no longer be regarded as Tier 1 capital. However, any equity-like instrument is inherently anti-mutual because it encourages societies to divert part of their profits to outside investors, thereby creating the potential to alter the way in which a society behaves towards its membership.

A new instrument will therefore need to be created that allows mutuals to access inorganic Core Tier 1 capital. Such an instrument needs to be capable of sustaining investor appetite, complying with capital requirements and allowing societies to remain committed to the mutual model, protecting the interests of members, who have historically been our key stakeholders.

We are responding to the recent HM Treasury discussion paper – 'Building Societies Capital and related issues' – and are reassured by the level of understanding around the capital issue facing the sector. We also continue to work with our trade body, the Building Societies Association, HM Treasury and the FSA to create an instrument that meets the needs of all its stakeholders and that provides Nationwide with a fair regulatory platform from which we can compete with the banking sector. We are in ongoing discussions with European institutions and are pleased that the European Commission's consultation document on CRD IV proposals recognises the important legal and constitutional differences of mutuals as compared to publicly quoted institutions. The European Commission is due to adopt revised text for the Capital Requirements Directive later in the year.

Pension Fund (Retirement Benefit Obligations)

The Group operates final salary and Career Average Revalued Earnings (CARE) defined benefit and defined contribution pension arrangements.

The total net retirement benefit liability measured under IAS 19, including the former Derbyshire and Cheshire defined benefit arrangements, is £508 million (2009: £331 million). The Group did not take over the defined benefit arrangements of the Dunfermline Building Society and the Portman defined benefit scheme was merged into Nationwide Pension Fund (NPF) on 1 October 2009.

The increase in the net liability reflects both a fall in the discount rate and an increase in the assumptions for long term inflation, partly offset by increases in the market values of the funds' assets during the year.

We have been actively managing the retirement benefit liability and have taken a number of steps to contain and reduce the deficit over recent years:

- NPF final salary arrangements closed to new members in 2001 and CARE arrangements closed in 2007;
- Employee contributions (for the NPF final salary arrangement) increased from 5% to 7%;
- Special contributions were paid following the last two NPF valuations, with £150 million paid in the period 2005-2007; and a further £50 million paid in 2008. This follows an initial special contribution of £100 million paid in 2003;
- Transfers in and new AVC arrangements were stopped from 31 December 2009; and
- All the Trustee boards continue to work closely with their advisors to optimise the investment strategy for the schemes' assets.

We will continue to review our options to manage the pension schemes in a responsible way. The next full triennial valuation of the NPF is as at 31 March 2010. The results will not be available until later in the year, after which a plan will be agreed between the Trustee board and the Group to manage the ongoing retirement benefit liability.

Performance by Business Stream

Nationwide classifies its business streams as follows:

Retail

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

Commercial

- Commercial lending.

Head office functions and other operations

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

As further explained in note 14, specialist residential mortgage lending is now included in Retail.

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

	Year to 4 April 2010 Underlying	Year to 4 April 2009 Underlying
	£m	£m
Retail	265	214
Commercial	(122)	(17)
Head office functions and other operations	69	196
Total contribution before tax	**212**	393

Retail Business Stream

The contribution from the Retail business stream has increased in the year to £265 million (2009: £214 million).

	Year to 4 April 2010 Underlying	Year to 4 April 2009 Underlying
	£m	£m
Total income	1,650	1,625
Expenses	1,156	1,199
Impairment and other provisions	229	212
Contribution from Retail	**265**	214

Total income, which includes income from Regional Brands as a result of mergers with Cheshire, Derbyshire and Dunfermline, has increased by 2% to £1,650 million. Further business related growth in non-margin income has been partly offset by margin compression as a result of the low interest rate environment and increased retail funding costs.

Despite the increase in the cost base from the mergers, total expenses have fallen, demonstrating our continued focus on cost reduction.

The retail impairment charge of £229 million represents a residential impairment charge of £89 million (2009: £91 million), a charge in relation to consumer banking of £126 million (2009: £113 million), and other provisions of £14 million (2009: £8 million). The residential charge has remained broadly stable throughout the year, which is a reflection of the quality of the prime and specialist portfolios in the current economic climate. The increase in the charge for consumer banking is due to two specific changes that we made to our assessment of unsecured lending provisions, to better reflect prevailing conditions, rather than being due to a change in underlying performance of these assets. The charge for 2008/09 included the benefit of a one off reduction to the provision for up to date assets and the charge for 2009/10 includes a significantly higher provision for cases subject to litigation. The underlying performance of unsecured lending remains strong and reflects our cautious approach and prudence in our underwriting.

Residential mortgage lending

Prime residential mortgage lending

The housing and mortgage markets have experienced a period of relative stability during 2009/10. These markets are subject to substantial external influence and remain fragile and vulnerable to future shocks. A particular feature of the market has been a continued reduction in remortgage and equity withdrawal as borrowers, either through choice or necessity, reduce their level of activity in this sector.

We have continued to lend in a prudent and responsible manner, to support our core mortgage markets. Group gross residential lending, including specialist lending, was £12.0 billion (2009: £18.9 billion), representing a market share of 8.7%. Prime residential gross lending was £10.3 billion (2009: £16.7 billion). Our primary focus has been to support the house purchase market. During the year we moved to reduce the minimum customer deposit for house purchase from 15% to 10%. We continue to provide additional support for existing mortgage customers moving house, offering a range of negative equity products for high quality existing borrowers with a requirement to move.

Business Review

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Retail Business Stream (continued)

Our long term commitment to prudent and responsible lending is reflected in our strong arrears performance. Nationwide originated prime residential mortgage cases 3 months or more in arrears as at 4 April 2010 was 0.52% (2009: 0.49%). In April 2009 Nationwide launched its Mortgage Charter setting out how customers in financial difficulties can expect to be treated. Repossession is always a last resort and we provide individual support to customers in financial difficulties – even if they are not yet in mortgage arrears.

Specialist residential mortgage lending
New lending in the Buy to Let sector was down on previous years, but the outstanding stock of Buy to Let mortgages actually increased, and according to the Council of Mortgage Lenders, contributed 65% of all net mortgage lending. While rental yields declined over the year tenant demand remained buoyant supporting landlords' investments.

Gross specialist lending in the year was £1.7 billion (2009: £2.2 billion). At 4 April 2010 the total specialist book was £18.7 billion (2009: £18.2 billion).

The percentage of Nationwide originated specialist mortgage cases 3 months or more in arrears at 4 April 2010 was 2.28% (2009: 2.45%). Specialist lending Buy to Let arrears declined over the year and continue to run well below our key competitors, and below the overall market level.

Consumer banking

Our aim continues to be to build a more diversified business through the growth of our consumer banking portfolio, which includes current accounts, credit cards and personal loans. These products already provide a valuable income stream and have the potential for significant growth from a relatively low current market share.

The majority of our credit cards and personal loans are opened by our prime FlexAccount customers. We aim for this to continue and want to encourage more of our existing customers to strengthen their relationships with us. In 2009/10 we launched the 'MORE for .. our current account customers' campaign to reward our prime FlexAccount customers with exclusive deals on our other products. Offers have included a market leading personal loan rate of 7.6%, three months additional interest free purchases on our credit card, and a high LTV mortgage for first time buyers.

We have 4.9 million current accounts and our aim is to increase the number of customers who use this as their main account. We have made our account transfer service even easier to use and have been promoting it throughout the year to both new and existing FlexAccount customers. We have focused on attracting customers looking to use it as their main current account and have opened 283,000 new accounts in the year.

We continue to target high quality unsecured lending. This has enabled us to maintain a 3% market share of live credit card accounts and a 2.5% share of gross lending. The Society retained the award for 'Most Responsible Credit Card Lending Practices' for the third successive year at the Card Awards 2010, and also the 'Best Achievement in Customer Service' award. The Society has reaffirmed its commitment to a positive order of payments, and is pleased to see the Department for Business, Innovation & Skills (BIS) endorse this in the findings of their Credit and Store Card consultation.

The transition to risk-based pricing on personal loans in December 2008 has created a strong foundation for high quality growth, enabling us to price competitively and to attract high quality business. This helped to increase our market share of new unsecured personal loans to 2.5% in 2009/10, which is approximately double the level of the previous year. For the second year running we were recognised for being 'Best Online Personal Loan Provider' by Your Money.

Retail funding

Retail deposits continue to be the primary source of funding for our retail lending activity and, despite the low interest rate environment, we have maintained our strategy of providing good long term value and security to our members.

We have actively managed our flow of retail savings during the year ensuring an optimum balance between securing funds at an economic rate and providing value to our members.

During the first half of the year intense competition in a contracting market led to a decision to allow a £5.6 billion net outflow of funds. During the second half of the year this outflow was largely stemmed as a result of new innovative product development. New products included Champion Saver, Combination Savings Bond (a savings bond partnered with a Protected Equity Bond), Over 50 FRISA and the recently launched e-ISA and Champion ISA. The latter two products have attracted inflows of £1.8 billion to the end of April 2010.

Overall, the year has seen a managed outflow from the savings book of £7.3 billion.

Protection and investments

Sales and income from Protection and Investments increased significantly in 2009/10, driven by product development and the low interest rate environment, which increased demand for asset backed investments as an alternative to traditional savings accounts.

Investment performance was driven by an increase in the sales of Protected (formerly 'Guaranteed') Equity Bonds attracting over £1.2 billion of funds in the year, compared with £0.2 billion last year.

Over the last 18 months we have increased the number of funds we offer our customers from 6 to 21 (including funds from some of the industry's leading fund managers) and launched an Investment Bond. This helped to deliver an increase in sales volumes and average case size, and commission from these sales delivered an important stream of non-margin income to the Group. High sales, combined with positive fund performance, delivered a 76% increase in funds under management.

Protection Annual Premium Equivalent (APE) increased by 36% on 2008/09 driven by an increase in the proportion of mortgages sold with life and critical illness cover.

General insurance

General insurance remains a strong non-margin income stream for the Group. There are 2 million insurance covers on the general insurance book, which generated a net income of over £80 million in the year.

Home and car insurance were both rated 5 Star by Defaqto in 2010 for the excellent levels of cover they offer compared to the market. The home book grew by 1.5% despite a depressed residential mortgage market. This was the result of successful standalone acquisition and retention activity, which focused on rewarding customer loyalty.

The Home Insurance Defaqto Compare tool was launched in January 2010 to reinforce our 5 Star cover benefits through the distribution channels.

Car and travel insurance sales increased by approximately 230% and 80% respectively in the calendar year following the launch of the LV= distribution deal with Liverpool Victoria in December 2008.

A record level of mortgage payment protection insurance claims have been handled this year as a consequence of the difficult economic conditions. Cardif Pinnacle has been appointed to supply Payment Protection Insurance (PPI) on our behalf from January 2011. The new arrangement will allow us to provide a flexible product offering for our customers.

Distribution channels supporting these product divisions

Performance across all distribution channels held up well over the past year, despite increasingly challenging economic conditions and lower business levels within the market. Benchmarked sales performance against Nationwide's main high street competitors has remained consistent throughout 2009/10 across all channels.

There has been a continued effort on improving efficiency and managing down costs within Group Distribution, whilst retaining a focus on delivering excellent customer service. Customer satisfaction has remained broadly stable for our branch network while an improving trend has been recorded by Group Telephony and Internet Channels.

Group Telephony has delivered significant improvements to customer service during the past year and benefited from a subsequent boost in sales performance. Despite lower call volumes, lead generation increased by 73% compared to 2008/09. The closure of the Swansea call centre in November 2009 and the impending closure of the Bournemouth call centre in June 2010, have contributed to delivering cost savings of £5.8 million in Telephony.

Internet sales performance was strong for the year, primarily driven by current account prime conversion volumes, aided by the online managed account transfer process launched in April 2009. Online personal loan and credit card sales were also strong in a tough market. The launch of e-ISA in February 2010 has filled a key product gap for Nationwide online with over 35,000 accounts opened by 31 March 2010.

Commercial Lending

After falling 44% from peak to trough between June 2007 and July 2009, UK commercial property values have now increased by 13% (IPD, March 2010); this improvement is focused on the prime London market and is not yet reflected in other UK regions. Market activity has primarily been driven by cash-rich institutional investors and income-seeking private investors, and as a result demand for debt finance has been subdued despite its improving availability during the year. The ongoing impact of a weak economy has also adversely impacted both UK commercial property rental growth and void levels, leading to an increasing number of tenant failures, particularly in the retail sector.

	Year to 4 April 2010 Underlying	Year to 4 April 2009 Underlying
	£m	£m
Total income	213	192
Expenses	36	38
Impairment and other provisions	299	171
Contribution from Commercial	**(122)**	(17)

Nationwide Commercial has remained open for business throughout the year across all of its main markets – Commercial Property Finance, Registered Social Landlord and Private Finance Initiative (PFI) lending – with gross lending totalling £1.8 billion during the year. However, higher than expected capital repayments and redemptions have resulted in the size of the book remaining virtually unchanged. All new lending was made in lower risk sectors on a very selective basis, and during the year we redefined our asset appetite to exclude housebuilder, equity, subordinated and/or European lending.

The commercial portfolio remained virtually unchanged in size at £22.2 billion (2009:

Business Review
continued

Commercial Lending (continued)

£22.1 billion). Loans to social housing providers increased to £7.9 billion (2009: £7.2 billion), loans to government sponsored Private Finance Initiatives increased to £1.3 billion (2009: £1.2 billion) while loans to investment property decreased to £13.0 billion (2009: £13.7 billion).

The commercial assets acquired via the merger with the Cheshire have now been incorporated within the main Commercial book, and commercial mortgage assets totalling £0.9 billion acquired through merger with Derbyshire and acquisition of Dunfermline social housing portfolio continue to perform within our original fair value expectations.

We remain a top 3 lender in the Registered Social Landlord market, despite having seen lower levels of activity than in previous years. In the PFI market we were delighted to be shortlisted for the Best Funder of the Year award at the Public Private Finance Awards 2010, as well as being ranked 2nd in the Infrastructure Journal European league table of mandated lead arrangers for Social Infrastructure 2009. We intend to continue to expand our PFI portfolio in the future.

There was a solid performance for Commercial lending income, which increased to £213 million (2009: £192 million) as a result of stable new business margins and strong fee income, which arose primarily from the repricing of maturing loans and agreed restructures with existing borrowers. Our commercial lending teams continue to work closely with commercial property customers to restructure borrowings where there is clear evidence of serviceability, effective asset management and a robust strategy to restore value over time.

However, the Commercial business stream made a loss in the period as the impairment charge on the commercial property finance book increased to £299 million (2009: £171 million) driven primarily by covenant breaches on LTVs, tenant failure/voids and business failures on owner occupied properties. During the second half of the year growth in impairments began to slow, with a charge of £119 million compared with £180 million in the first half of the year. No arrears or provisions were made in the Registered Social Landlord or PFI books.

The number of Nationwide commercial property cases more than three months in arrears increased over the year from 179 cases at 4 April 2009 to 285 at 4 April 2010. This equates to 2.77% of commercial accounts (2009: 1.62%). Total arrears balances on these cases at 4 April 2010 were £42 million (2009: £17 million). The increasing trend now appears to be stabilising and robust arrears management is carried out by dedicated teams who maintain a focus on early intervention to maximise value and to mitigate losses.

Our commercial property finance portfolio is well diversified by industry type, by borrower and by geographic spread. We have no house builder exposure, and only modest exposure to development finance with total balances of £155 million and a total further commitment of £47 million. The commercial portfolio includes £266 million of originated and acquired subordinated exposures of which £124 million are provided for, and the Group's residual exposure to subordinated loans is therefore restricted to the unprovided balances of £142 million (6 cases) which are currently fully performing.

We are cautiously optimistic that the recovery in commercial property values is likely to continue during 2010/11, but have yet to see that this recovery is evidenced across the UK. Notwithstanding this, we believe that our commercial provisions and impairments have now peaked and that we should see a decline in subsequent years.

Head Office Functions and Other Operations

Contribution from Head Office Functions and Other Operations was £69 million (2009: £196 million).

Total income of £232 million is £68 million lower than the prior year, despite including a £91 million gain from the management of the liquidity portfolio. The reduction reflects the lower interest earned on surplus capital and a reduction in the benefit accruing to the Group of the differential between Libor and bank base rate.

	Year to 4 April 2010 Underlying	Year to 4 April 2009 Underlying
	£m	£m
Total income	232	300
Expenses	92	34
Impairment and other provisions	71	70
Contribution from Head Office Functions and Other Operations	69	196

Administrative expenses have increased, reflecting higher investment spend and higher project depreciation.

Impairment and other provisions includes a charge of £36 million (2009: £18 million) which relates to loan losses on a portfolio of European commercial loans as outlined on page 13,

Head Office and Other Operations (continued)

together with a small release of £1 million (2009: £1 million charge) in relation to a portfolio of student loans. The remaining balance of this year's charge includes £29 million impairment of a small number of US RMBS exposures and £7 million in respect of private equity, part of our small investment in equity shares portfolio. Materially all of the balance of the charge in the comparative year was made up of bank failures, including Washington Mutual, Lehman and Icelandic banks.

Risk Management and Control

Overview

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

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

The Board has agreed statements of risk appetite within which it requires the business activities of the Group to be conducted. These overarching parameters are reflected in the key processes of corporate management which the Board oversees:

- Corporate planning, strategy and performance review;
- Capital planning; and
- Risk management for the Group.

Detailed risk management policies document our approach to the management and appetite of specific risks. These policies, including associated limits, are owned by the Board. Policies are reviewed annually and are also subject to continuous monitoring by the sub-committees of the Executive Risk Committee and the Board Risk Committee.

Governance structure at Group level

Risk governance is provided by a structure comprising seven key risk management committees. Each committee includes appropriate representation from amongst our executive and divisional directors as well as from our Risk Management division:

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

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

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

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

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

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

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

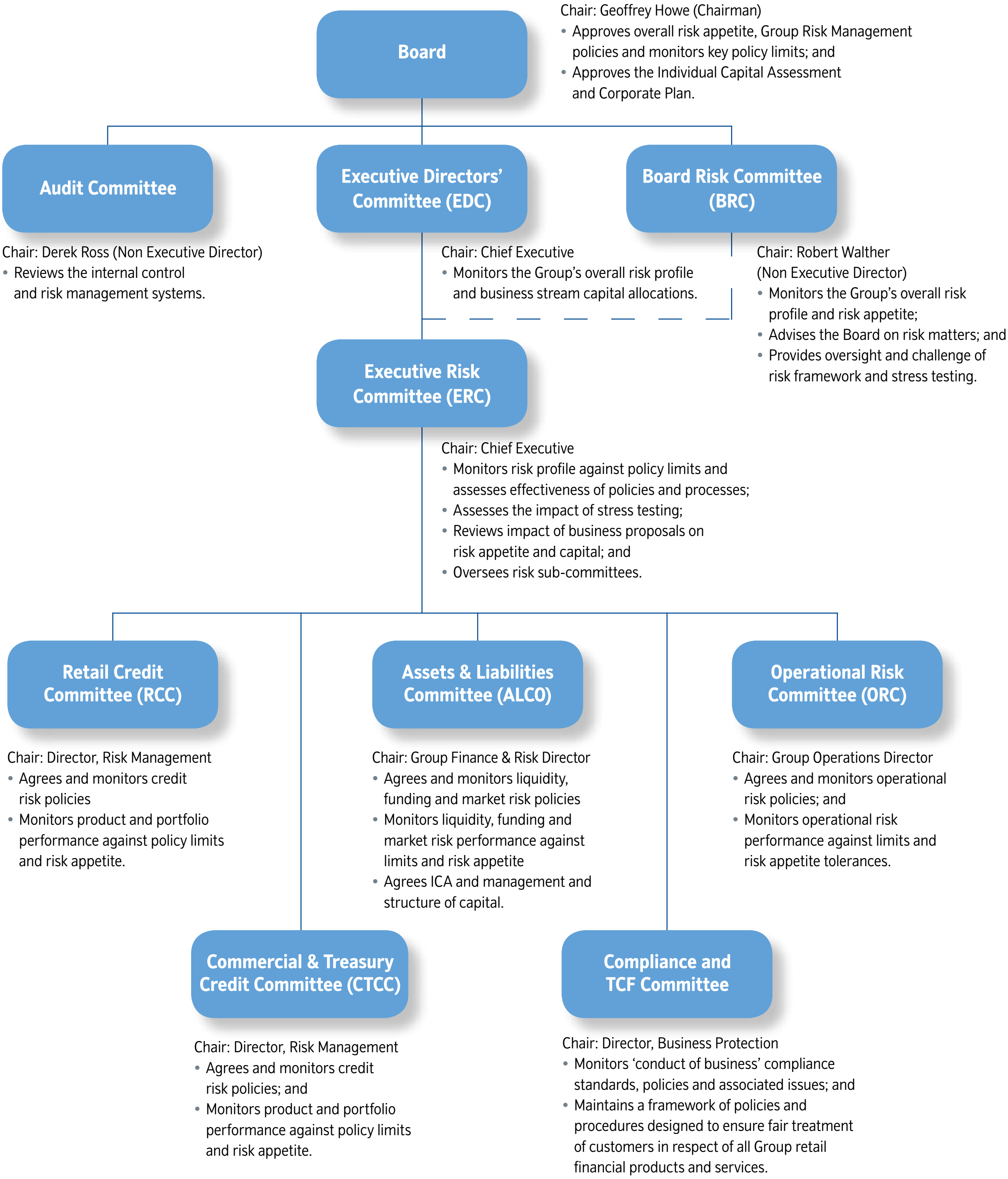
Group Internal Audit, which ultimately reports to the Audit Committee, provides independent assurance regarding the activities of business units and the specialist risk functions within Risk Management division. Information about the role of the Audit Committee can be found in the Corporate Governance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

Further detail of risk exposures will be available in our Pillar 3 Disclosures by August 2010 on our website:

nationwide.co.uk/about_nationwide/results_and_accounts/

Business Review
continued

Risk Management and Control (continued)



Credit risk

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

Market background

The key drivers of credit risk for residential mortgages and unsecured lending include the slowdown in the UK economy leading to higher unemployment, deterioration in household finances due to inflation or other pressures, and house price deflation. The extent of further economic slowdown, its impact upon arrears performance and falls in house prices affect the level of impairment losses.

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

Wholesale credit markets have improved consistently during the year and this is reflected in a significant positive movement in mark-to-market adjustments in the Group's portfolio of available for sale assets since the last year end. The improvement supports our continued expectation of minimal incidence of impairment in our prudential and investment portfolios.

Risk management response

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

a) Retail credit risks

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

In respect of our mortgage businesses, the focus remains on the quality of the business we write. We will continue to monitor applicant quality closely, defined in terms of credit, loan to value and affordability profile. In the light of current market conditions, we have maintained tightened lending criteria (particularly with respect to high loan to value lending) and we will continue to keep this under review. We remain cautious on unsecured retail lending, given the current stage of the economic cycle, and will continue to prioritise quality of lending ahead of volume targets in these portfolios.

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

Nationwide participates in the Government's Mortgage Rescue Scheme, but has chosen not to take part in the government Homeowner Mortgage Support Scheme. Instead, it has developed its own Homeowner Mortgage Charter which applies to all borrowers experiencing financial difficulties who are willing to work with us in good faith.

b) Commercial credit risks

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

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

Responsibility for new business generation, customer relationship management and account administration rests with Commercial

Business Review
continued

Risk Management and Control (continued)

division. Responsibility for the overall quality of the lending book and the adequacy of credit procedures and controls rests with the Commercial Credit Risk function within Risk Management division and the Commercial & Treasury Credit Committee.

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

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

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

Commercial lending relationships are subjected to regular reviews, at least once a year, to ensure that facilities are fully performing in accordance with the terms of original sanction and provide an opportunity to review Nationwide's exposure to each counterparty in the light of the most recently available financial and non-financial information and to refresh risk rating data.

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

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

c) Treasury credit risks

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

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

Nationwide's treasury risk appetite remains under active consideration and is regularly reviewed in response to any concerns highlighted by portfolio monitoring or in response to economic or market factors or changing business needs. In this respect the Group has increased the quality of its liquidity portfolio by increasing the weighting to certain sovereign exposures and this is expected to continue.

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

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

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

Liquidity and funding risk

Liquidity and funding risk is the risk that the Group is not able to meet its obligations as they fall due, or can do so only at excessive cost. In order to ensure that the Group continues to meet its funding obligations and maintain or grow its business generally, the Group has developed comprehensive liquidity policies, with the Group's operations funded primarily from retail sources supported by a well-diversified wholesale funding capability. The liquidity and funding policy has been fundamentally reviewed following the new liquidity regime introduced by the FSA in Policy Statement 09/16.

Market background

There has been a recent easing of wholesale market conditions and the successful issue of new asset backed funding. However, the planned withdrawal of Government backed funding is expected to impact the availability and cost of both wholesale and retail funding in the forthcoming year.

Despite some level of easing, availability and cost of funding has not returned to pre-2007 levels. These market circumstances have been mitigated by the provision of government guaranteed funding through the Special Liquidity Scheme (SLS) and Credit Guarantee Scheme (CGS).

The introduction of new liquidity regulations has led to increased demand for longer term funding and government issued debt for use as liquid assets. This is expected to continue with the phasing in of the regulations in forthcoming years.

Conditions in the wholesale market have led to increased competition and increased cost of retail savings, significantly influenced by institutions that are pursuing retail funding to replace potentially unavailable or expensive wholesale funding.

Nationwide, as a leading UK mortgage lender and savings institution, has been impacted by these developments. At times it has been appropriate for the Group to take advantage of its continuing ability to raise funds in the wholesale markets given its relative reputational strength.

Risk management response

Management has focused on its current and future funding strategy and on implementing a revised liquidity risk appetite. In line with new liquidity regulation – PS09/16 *Strengthening Liquidity Standards* – we have improved our systems for measuring and managing liquidity risk exposure, including management reporting systems, the pricing of risk and stress testing.

Internal methodologies for calculation of liquidity and funding risks are fully independent of financial accounting.

Liquidity risk is managed against limits using a number of stress scenarios. These limits have been increased further during the period, raising the minimum level of liquidity that is held. Stress scenarios are based upon forward liquidity ladders that extend for one day, two weeks and three months, with further limits in place for longer time horizons.

Secured transactions have been undertaken to increase Group liquidity through the receipt of both cash and other highly liquid assets. Collateral delivered to counterparties has included self-issued covered bonds, Retail Mortgage Backed Securities from our Silverstone programme and other liquid investments issued by third parties. Cash proceeds have been obtained from secured transactions in the money markets, through repurchase transactions and Bank of England Open Market Operations, and in the capital markets through structured borrowings. We made earlier use of the Bank of England Special Liquidity Scheme and Credit Guarantee Scheme which are due to start to mature in 2010/11.

The quality of the Group's liquidity has been increased to focus on the highest quality government issued debt. The proportion of short term funding has been significantly reduced over the year and the duration of term funding extended.

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

The Group remains around 70% funded from retail sources and we continue to be perceived as a safe harbour for savings. In the face of increased levels of competition for retail savings, we continue to enhance our savings range to maintain our competitive position.

Market risk

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

Interest rate risk

Market background

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

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

The Group's exposure to the mismatch between base rate and Libor-linked balances has changed during the period. At the start of the year the position was a net Libor asset, reflecting fixed rate mortgages hedged to Libor and funded through variable savings linked to

Business Review
continued

Risk Management and Control (continued)

base rate. During the year, customer preference has moved towards variable rate mortgages and fixed rate savings bonds and we have obtained wholesale funding where the rate is similar to base rate. These changes have resulted in a net base rate asset by the year end.

The lower interest rates and the relative easing of the mortgage market have exposed us to changes in customer behaviour, driven by associated changes in the financial dynamics of transactions, particularly with respect to early repayment of fixed rate mortgages. The effect of this, however, has not been material.

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

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

Currency risk
Foreign exchange risk arises from movements in the foreign exchange market adversely affecting the value of the Group's foreign currency holdings and planned future cash flows. A proportion of treasury funding and investment activity is undertaken in foreign currencies and some commercial loans are denominated in Euros.

Risk management response
Foreign currency exposure is hedged on the balance sheet or by using derivatives to reduce currency exposures to acceptable levels. After hedging we have no substantial net exposure on an economic basis to foreign exchange rate fluctuations or changes in foreign currency interest rates. The Assets and Liabilities Committee set and monitor limits on net currency exposure.

Pension obligation risk
The Group has funding obligations for a number of defined benefit schemes, the most significant being the Nationwide Pension Fund ("the Fund") which is closed to new entrants. Pension risk is the risk that the value of the Fund's assets, together with on-going employer and member contributions, will be insufficient to cover the projected obligations of the Fund over time. The return on assets, which includes equities and bonds, will vary with movements in equity prices and interest rates. The projection of the Fund's obligations includes estimates of mortality, inflation and future salary rises, the actual out-turn of which may differ from the estimates. The Fund is also exposed to possible changes in Pension legislation.

Risk management response
To mitigate these risks, management, together with the Trustees of the Fund, regularly review reports prepared by the Fund's independent actuaries to assess these risks and take appropriate actions which may, for example, include adjusting the investment strategy and/or contribution levels. The Triennial valuation of the Fund is due to take place during 2010.

Operational risk
Operational risk management is an integral part of the processes Nationwide operates to meet the needs of our members and generate sufficient profit to maintain a financially stable society. The purpose of operational risk management is to ensure the business puts in place appropriate strategies to avoid, transfer, mitigate and insure the risks that could impact the ability of the Group to meet their strategies and plans whilst protecting the Society's reputation.

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

- Third party;
- Business continuity;
- Change;
- Customer experience;
- Financial management & control;
- Fraud;
- Information security;
- Information technology;
- Legal & regulatory;
- People;
- Premises & physical assets; and
- Reputation.

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

To ensure there is accountability for the effective management of operational risk, Nationwide operates a 'Three Lines of Defence' model. Each division, as the first line of defence, has a dedicated operational risk officer. In the second line of defence the Group-wide network of operational risk officers is supported by a centralised Operational Risk Unit, whose role is to define and implement operational risk policies and processes consistent with corporate objectives, values and risk appetite.

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

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

Key operational risk categories

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

Third party

The Group conducts its business in a fair and open manner and is committed to maximising customer value when undertaking expenditure on goods and services. Risks are monitored to ensure appropriate selection and management of third party suppliers and outsourced services, including compliance with contract law. Significant outsourced arrangements include BT, who provide Network managed services and the management of voice and data networks across the Group, TSYS, who provide and manage the credit card product, and Computacenter who provide IT support and our IT service help desk.

Business continuity

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

- Maintains a safe and secure business for the benefit of our customers and members;
- Minimises the losses which arise from unexpected events;
- Protects the reputation of the Nationwide brand; and
- Contributes to the integrity of the UK financial services industry.

Change

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

Customer experience

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

Financial management & control

This category covers management of the risk associated with the efficient, effective and appropriate use of the Society's financial resources and their accurate recording and reporting. This includes the risk of not complying with relevant statutory and regulatory accounting and reporting requirements.

Fraud

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

The Group's fraud strategy is designed to:

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

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

Information security

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

Information technology (IT)

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

Legal & regulatory

As a regulated firm, Nationwide places significant importance on managing the business in a way that effectively manages the risk of fines or censure through non-compliance with laws and regulations. Oversight of legal & regulatory risks comprises:

- Breach of regulation; and
- Breach of law.

Nationwide identifies all material legal and regulatory requirements and relevant voluntary codes and standards affecting the Group and works with business areas to determine how it applies. This is supported by review mechanisms to ensure compliance with material regulatory and legal obligation and a suite of key risk indicators. This enables the business to monitor progress against the key

Business Review
continued

Risk Management and Control (continued)

legal and regulatory risk exposures and take action where we are operating outside of risk appetite.

This framework of support, challenge and monitoring:

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

People

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

Premises & physical assets

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

Reputation

A core part of the success of the operational risk framework is understanding and acting on the key causes and drivers of reputation and how these are managed and influenced across the business. Nationwide has defined reputation risk as 'the current and potential impact on earnings and capital arising from negative public opinion. This affects our ability to establish new relationships or services or continue servicing existing relationships. This risk may expose the Group to litigation, financial loss, or a decline in the customer base'.

Business risk

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

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

Tax risk

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

The Group takes a responsible approach to the management and control of its tax affairs and aims to be co-operative and transparent in its dealings with the tax authorities.

Capital management

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

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

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

Corporate Responsibility

corporate
responsibility

More than just words

As a modern mutual, owned by and run in the interests of our members, we have an inherent duty to be responsible – with our members' money, in the products and services we offer, in how we engage our employees and how we manage our wider social and environmental impact.

Day to day ownership of Corporate Responsibility (CR) lies with all our employees. However, our Board of Directors takes overall accountability for CR across the Group. Individual accountabilities have been listed below.

The Corporate Responsibility Committee, now chaired by the Group Operations Director, now meets bi-monthly and comprises senior managers and directors from across the business including Human Resources, Business Services, Products and Marketing, Procurement, Retail, Collections and Recoveries, Commercial Lending and Corporate Affairs.

In addition our Diversity and Equality of Opportunity Committee, chaired by the Divisional Director for Savings and Investments, is responsible for promoting equality of opportunity and diversity for all Nationwide employees and customers. In 2009 we achieved Silver in the Business in the Community's 'Opportunity Now' programme.

opportunitynow
men | women | workplace

Despite the challenges of the past year, we are proud to report that our Corporate Responsibility agenda has continued to gain momentum. Here is a selection of our successes and experiences over the past twelve months. A common theme that flows through them is being proactive, preventing people getting to crisis point and investing in future generations.

Issue	Board Member	Position
Workplace – occupational health & safety	Graham Beale	Chief Executive
Workplace – employee issues	Tony Prestedge	Group Development Director
Marketplace – customers/consumers	Chris Rhodes	Group Product & Marketing Director
Marketplace – supply chain	David Rigney	Group Operations Director
Environment	David Rigney	Group Operations Director
Corporate Responsibility	David Rigney	Group Operations Director

Our Corporate Responsibility strategy

Community

Being a responsible employer. Making a difference through our charitable partnerships.

At Nationwide we embrace diversity and continue to be committed to promoting equality of opportunity and creating a supportive and inclusive culture for all our employees, members and business partners. As a member of the local community, we are proud to support local causes and continue to make a difference through our national charitable partnerships.

Environment

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

Reducing our environmental impact is vital to our long term sustainability, cutting costs for our members and ensuring we meet government legislation now and in the future. That means setting comprehensive targets on energy, water, travel, waste, and paper and then delivering against them. We are also looking to have a wider positive impact through engaging our people and suppliers.

Housing

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

As the third largest mortgage lender in the UK and with a history spanning 150 years, Nationwide has a wealth of experience and expertise in housing. We want to put this expertise to good use and not only help those in housing need, but also prevent others from getting into difficulty in the future. As an established and leading funder of affordable housing we not only help provide homes for people who would otherwise struggle to afford a place of their own, we're in a position to influence the development of the UK's affordable housing policy.

Finance

Offering clear and transparent products and supporting people when they are in debt. Providing people with the skills and knowledge to avoid financial difficulty.

At Nationwide, being responsible starts with being prudent and operating in the long term interests of our members. Our responsible approach to lending is reflected in our arrears, which are less than a third of the national average. We all know prevention is better than cure; therefore a key priority of our CR work this year has been to expand our education programme. Our aim is to increase access to quality financial education and increase people's confidence and ability to manage their money independently and responsibly.

MoneyActive

Financial Capability

Community Investment

Back in 2008 we announced our £3 million MoneyActive partnership with Citizens Advice, which will increase the number of volunteers trained to deliver proactive, financial education from 100 to 1,400 over three years. MoneyActive volunteers run community-based training sessions to help people manage their money. Sessions are run in partnership with local community groups and target the specific needs of those attending, including families, ex-service personnel, people with disabilities, ex-offenders, young people, refugees, service personnel, single parents and jobseekers.

Citizens Advice Bureaux (CAB) across the UK started delivering MoneyActive sessions in April 2009 and in year one of the scheme 51 projects were funded, involving over 80 local bureaux. In addition a new Money Management section within the CAB website at adviceguide.org.uk went live in January 2010.

So far the reach of the project has been extremely promising:

- 434 volunteers involved in the MoneyActive project. The volunteers are making a significant time commitment to the project – the equivalent to over 50 full time workers; and
- 3,866 people trained.

A year on we are confident the MoneyActive training is building people's confidence with personal finances and giving them the skills to manage their money more effectively. 60% of those attending sessions reported that they had felt 'unconfident' or 'very unconfident' when dealing with money before the training sessions, but this figure decreased to 7% afterwards.

"I'm delighted with the session you did with my client. I saw the client for bankruptcy some years ago, and it's just so disheartening to see her back at the bureau again with debt problems, but she was very positive about being able to manage a budget for herself after your session."

CAB Debt Caseworker in Oxfordshire

It's not just about helping people manage their own affairs but also providing community workers with the tools, language and confidence to help their clients avoid debt in the future. The Nationwide funding has enabled 571 frontline workers to be trained in financial education. Before the training, only 29% of frontline workers felt 'fairly' or 'very' confident in giving advice to clients, after the training 68% felt 'fairly' or 'very' confident.

So far the project has provided training and support to 135 partner organisations. So, together with the volunteers and CAB advisors involved, we estimate we have reached nearly 20,000 people since the start of the project.

So what have we achieved?

"We know that financial education makes a difference. Equipping people in our communities with the skills and knowledge to manage their money, compare credit and save for a rainy day is crucial in preventing them from falling into problem debt. The MoneyActive programme, launched thanks to the support from Nationwide, has enabled bureaux to train their most valuable asset, their dedicated volunteers, in delivering financial capability training in group and one-to-one sessions. This kind of positive, proactive work is assisting individuals across the country to avoid financial crises, an outcome that cannot be underestimated."

David Harker CEO Citizens Advice

434 volunteers involved – equivalent to over 50 full time workers

Corporate Responsibility
continued

Nationwide Education

- Financial Capability
- Community Investment
- Sustainable Living
- Environmental Management

Our educational website NationwideEducation.co.uk has gone from strength to strength. Launched back in 2007 we have invested over £1,400,000 in its development. The site continues to be unique in providing free online education resources, linked to the National Curricula, for young people aged 4-18+, as well as adults, teachers and parents.

Nationwide Education is full of interactive games and activities, worksheets and factsheets and seeks to teach children and young people important life skills in a fun and engaging way. The site has received over five million hits since September 2008.

All materials are completely independent of Nationwide products and services and therefore provide high quality, trustworthy resources for all the family.

2009/10 has been an award winning year for Nationwide Education. Here is a selection of the awards the website has won:

- IVCA Gold Award – e-Learning;
- Children and Young People Now – Financial Capability Award (sponsored by Financial Services Authority, FSA);
- IVCA Clarion Award – Interactive Communications;
- ERA Finalist – Best Primary Resource; and
- Mortgage Finance Gazette – Community Services Award.

Nationwide Education is not just about finance.

Safety – Our original Road Safety programmes will be joined by a brand new Home Safety programme, designed for nursery children upwards and their parents and teachers. Our aim is to 'prevent the preventable' and reduce accidents in the home. We hope the information will give parents a new sense of confidence in keeping their homes safe and also engage children in fun and interactive ways.

Sustainability – We already have a Sustainable Housing programme covering issues like energy and building design. In February this year we launched our Sustainable Communities programmes for 12-16 year olds covering sustainable travel, sustainable schools, pollution, ethical consumerism and community cohesion.

Programme	Age Range
Financial Capability	4-18+
Sustainability	4-16
Road Safety	4-11
Employees	N/A

86% of the students taking part in this project thought that the learning was relevant

Nationwide Education in Action

SkillForce

92% of the instructors felt the learning was relevant

Nationwide has recently partnered with Skill Force, a charity that works with young people who are at risk of exclusion or underachievement in mainstream education. Exclusions are reduced six-fold and truancy is significantly lower in the schools where Skill Force works. The charity is currently using Nationwide Education to deliver a new module of Financial Awareness to 1,148 Year 10/Secondary 3 students; this will increase to 3,000 students when the programme has been developed for Year 11/Secondary 4.

Over the course of two years, the modules will enable young people who are often disengaged with the National Curricula to gain qualifications, and so will improve their chances of going on into further education, employment or training.

- 86% of the students taking part in this project thought that the learning was relevant;
- 92% of the instructors felt the learning was relevant; and
- 63% of the students thought the project was enjoyable.

"The partnership between Skill Force and Nationwide is great news for disengaged young people across the country."

Lord Freeman, Chairman of Skill Force

Responsible Lending

Responsible Lending

Our triage team – A new team has been formed to help our customers approaching financial difficulties but who are not currently in arrears. Together, we will explore options to alleviate customer worries. The phone support service went live in March 2010 and is open 9 to 5, Monday to Friday with an answer phone facility for outside hours. The Triage team also has a 'hot key' referral point into at least one non-fee charging agency. In addition our payment difficulties section of the website has been updated for customers with money worries with further information and contact details. Telephone 0845 600 5707, option 5 then option 1.

Responsible credit card – Nationwide won the prestigious ***"Most Responsible Credit Card Lending Practices"*** award for an unprecedented third year in February 2010. The award recognised Nationwide's *"Working Together"* initiative which took a fresh look at responsible lending and borrowing over every stage of the life of a credit card and aimed to give our customers the knowledge to help themselves, whilst also protecting Nationwide. The award cements Nationwide's position and reputation as a truly responsible lender. Nationwide also won the ***"Best Achievement in Customer Service"*** award for our credit card at the same event.

Winner/2009
THE CARD AWARDS

Nationwide's 'positive order of payments' saves credit cardholders money by ensuring that we clear their most expensive borrowing before their cheapest borrowing. We have recently campaigned for all credit card providers to adopt the same policy and welcomed the government's decision to enforce this approach across the industry.

Corporate Responsibility
continued

Altogether Better

Employee Engagement

Community Investment

Our members and employees have raised an amazing **£605,000** through our CR days in 2009

In September 2009 we launched our 'Altogether Better' campaign designed to get employees involved in community causes that mattered to them.

Vote – Employees were asked to select their Employee Charity of Choice from a shortlist of five, including Shelter, Alzheimer's, NSPCC and Age Concern/Help the Aged. Over 4,000 employees cast their vote and the winning charity was Macmillan Cancer Support.

Volunteer – A wide range of volunteering opportunities are now available on our internal intranet to encourage employees to get involved in the community including Nationwide Education school volunteering.

Give – Nationwide re-launched its payroll giving scheme in October 2009, again designed to provide choice to employees on how they support their favourite charity. We have almost doubled the number of people who give to charity through payroll over the past 12 months.

Corporate Responsibility engagement days

In 2009 we introduced four CR engagement days across the UK to increase employee involvement and raise additional money for charity. The charities supported were:

- Comic Relief;
- Action for Children;
- Macmillan World's Biggest Coffee Morning; and
- Children in Need.

Our members and employees have raised an amazing £605,000 through our CR days in 2009.

The spirit of our CR days was captured in the efforts of one Nationwide employee who, in aid of Action for Children, spent seven hours non stop on a cross trainer in the middle of the head office in Swindon. Peter Gough was joined by four of Nationwide's directors, who took turns to provide moral support on a neighbouring rowing machine. Peter ran a massive 153km – that's the equivalent of 3.5 marathons in one go.

The first CR engagement day in 2010 engaged employees across the business to raise money for local or regional charities including Children's Hospice South West, Maggies, NSPCC and the Ulster Cancer Foundation.

All of Nationwide's brands including the Cheshire, the Derbyshire and the Dunfermline got behind this year's CR engagement days. The Dunfermline proudly hosted their own Strictly Fun Dancing competition, which successfully bought members, employees, friends and family in support of Macmillian, raising over £2,300.

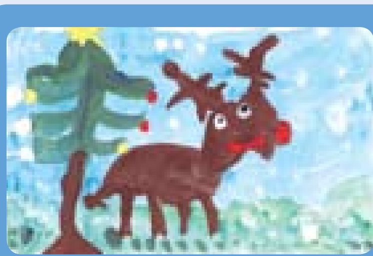
Local and International Community Support

Community Investment

As a mutual building society, supporting the local community is an important part of our Corporate Responsibility work.

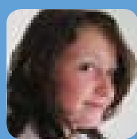
Season's Greetings – In 2009 we launched our first charity Christmas cards. All the proceeds from the card sales went to our charity partners – Macmillan, Shelter, Citizens Advice, Skill Force and Disability Sport Events. We asked children from local communities across the UK to design the card.

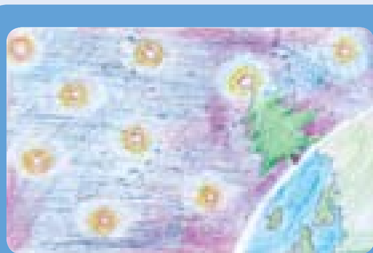
Haiti – We were immensely proud to witness the generosity of our employees and members who donated over £456,000 to the Haiti appeal following the devastating earthquake. A huge Thank You on behalf of our partner Y Care, who will now distribute 100% of the funds we collected to help people in the area.



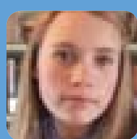
Joshua Ocone
Aged 7
Thornbury, South Glos

Kirsty Patterson
Aged 9
Dorset





Natasha Coleman
Aged 13
Lancashire



Corporate Responsibility
continued

Macmillan

WE ARE MACMILLAN. CANCER SUPPORT

Finance is the most important issue after pain, for people facing cancer. The priority for our partnership going forward is helping people affected by cancer to receive the financial support they need.

'Working together to reach and improve the lives of everyone affected by cancer'

We have launched a new vision of our partnership with three key objectives:

- **We Support** – To influence and change the lives of members, employees and people living with cancer.

For example – Nationwide is one of three UK institutions piloting the new 'Working Through Cancer' toolkit, which provides information for employees affected by cancer and their managers and carers. We hope our involvement will not only help our own employees but also lead the way to improved levels of support across the UK.

Critical illness cover is vital, so Nationwide, Macmillan and Legal & General have recently been working together to find out more about how a diagnosis affects their financial affairs.

Macmillan was asked to speak at an event attended by our retail branch managers to increase their awareness and appreciation of the financial issues facing members with cancer.

- **We Involve** – To create ways for members and employees to get involved.

For example – We make Macmillan volunteering opportunities available to our employees through our intranet on a regular basis and also encourage our employees to visit the projects Nationwide funds, so they can see first hand the impact our involvement can make.

- **We Fundraise** – To raise money to improve service levels for people living with cancer.

For example – In 2009/10 Nationwide donated £372,421 to Macmillan through employee, member and corporate donations. A massive £113,687 was collected through local branches. These funds have been allocated to services within the local communities where the funds were raised.

The money raised by Nationwide members voting at the 2009 AGM was used to help fund three welfare benefits advisor roles in Leicestershire and Rutland. These advisors help people complete long and complex forms, and talk them through the emotional impact that financial hardship brings. The benefits advisors will provide face-to-face support to over 500 people affected by cancer a year for the next five years of the project. Four hundred of these people helped will complete the benefits claims with the CAB case workers support, unlocking £800,000 in benefits. On average a Macmillan benefits advisor is able to unlock £2,000 for a person affected by the financial hardship a cancer diagnosis can bring.

Employees were incentivised to take part in the annual employee opinion survey, Viewpoint, by donating 50p for each questionnaire completed. We saw an increase in employees taking part in the survey and raised £7,616, which has been allocated to the welfare benefits advisor in Fife, Scotland.

Kristina, one of the advisers funded through Nationwide.

Building for the Future

Sustainable Housing/ Communities

Affordable Housing

Nationwide has a history of investing in socially responsible projects including schools, hospitals and social housing. We're also one of the UK's main funders of affordable housing. Altogether, we currently provide over £7.9 billion to over 350 housing associations throughout the UK. Some of our Housing Finance team also contribute to the sector by being volunteer housing association board members.

The government Private Finance Initiative (PFI) provides a way of funding major capital investments without using public money. One of the PFI projects we have invested in is the schools 'the Building for the Future' project. This is a government initiative to either renew or rebuild all secondary schools by 2020. The project had stalled due to lack of funding, but thanks to Nationwide it has now been able to commence.

Shelter

Shelter

Sustainable Housing/ Communities

Community Investment

Nationwide and Shelter are working in partnership to support people across the UK who are homeless or who have housing needs. To this end, we are developing a joint policy framework to benefit anyone looking for a secure, affordable place to live. More specifically Nationwide is providing funding for three of Shelter's housing and homelessness services – in Bristol, Dorset and Milton Keynes.

In 2009 Nationwide donated over £250,000 to help boost and sustain Shelter's services to help achieve our partnership priority – to prevent people from getting into housing difficulties now and in the future.

"Shelter's service was excellent beyond words. Without your help I would have been homeless by now."

Service user

1,247 people have been helped since June 2009 through Bristol and Milton Keynes services. In addition, the Nationwide's funding has helped Shelter Dorset find a base within Dorchester to help people within the county.

In January 2010 Nationwide launched a protection policy marketing campaign, which pledged £2 donation to Shelter for every quote. This promotion is set to raise £20,000 for the charity.

1,247 people have been helped since June 2009 through Bristol and Milton Keynes services

"Shelter is extremely proud to be working with Nationwide. The partnership has developed over a number of years and now supports a number of key areas of our work. This support means that we are not only able to directly help thousands of people in housing need every day but also influence best practice and campaign for change, ensuring that many more people have a secure and safe home for them and their families."

Campbell Robb, CEO Shelter

World Cup Fever

Shelter and Nationwide are encouraging the Great British public to get involved and 'Strip4Shelter' by replacing their regular work gear or school uniform with their football teams' strip or colours during the World Cup 2010. Those who take part are being asked to make a donation of £2 to the housing and homeless charity.

Corporate Responsibility

continued

Elderly Accommodation Counsel

Sustainable Housing/ Communities

Community Investment

With an ageing population, sheltered and retirement accommodation is an important consideration for many people across the UK, including our members, and it can affect people both directly and indirectly. Nationwide is proud to be partnering the Elderly Accommodation Counsel (EAC) and sponsoring the first Housing for Older People Awards.

EAC was exceptionally creative in their approach to the awards. Over 2,140 residents were engaged in the nomination process through an innovative card game, which generated a wealth of feedback that can now be used to improve the level of care and services available to others across the UK.

Over **2,140** residents were engaged in the nomination process through an innovative card game

Our New Data Centre

Environmental Management

Supply Chain

Building efficiency – One of our major focus areas for the next five years is to increase the efficiency of our buildings. This has included moving our call centre staff to a new building rated BREEAM 'Very Good'. BREEAM is the Building Research Establishment Environmental Assessment Method – a voluntary measurement system to rate the environmental performance of a building. Four BREEAM ratings are available: pass, good, very good and excellent.

We are in the process of constructing a new data centre, due to go live in 2011, which is on track to be rated BREEAM 'Very Good'. Sustainability has been a consideration throughout the process from location, design and fit out. As our data centres use a significant proportion of our total energy, this will help us minimise and control our energy use and carbon emissions.

Mace Technology, the company constructing Nationwide's new data centre, has achieved five stars in a British Safety Council five star environmental management system audit. The international standard sees auditors examine the whole environmental management system of a business, including compliance and best practice.

In addition to this, we have installed building management systems and automatic meter readers in a further 180 branches to help us control the energy we consume. We have also upgraded air conditioning equipment in our head office to a more energy-efficient type, and continued a programme to remove the greenhouse gas R22 from all our air conditioning equipment. Preliminary figures for the year suggest we have levelled out our historic growth in energy consumption.

The Nationwide Foundation

The Nationwide Foundation, a registered charity, has gone through a year of change as we implemented our new strategy 'Money Matters, Homes Matter, Families Matter'. This has enabled us to align ourselves more closely to the work of Nationwide Building Society, our principal funder, by focusing grant support on financial inclusion and housing related issues.

The Nationwide Foundation

Supporting communities nationwide

The beneficiaries identified for support until 2012 are survivors of domestic abuse and vulnerable older people. Independent research identified these as areas where we could make a significant difference to people's lives and achieve public benefit.

The new strategy targets funding through two grants programmes: the Small Grants Programme and the Investor Programme. The Investor Programme is designed to offer longer term support and makes grants of up to £300,000 over three years. Funding has been awarded to 10 charities. These charities are tackling housing and financial difficulties in a range of different ways. For example:

- Age Concern Wirral (based in Birkenhead) is recruiting staff to assist and represent people aged over 50 living with dementia in Wirral. The charity will support sufferers and their families who are making key decisions which affect their lives, in particular those around housing and financial matters. This will include advice about dealing with significant income decrease, maintaining homes and exploring options for alternative housing.
- Rowan Alba (based in Edinburgh) is offering a resettlement service for survivors of domestic abuse, providing support as they leave temporary accommodation and set up a new home free from abuse. The service will help beneficiaries as they make key decisions which affect their lives, in particular those around housing and financial matters. These are areas which domestic abuse perpetrators often control and on which abuse sufferers therefore need guidance when escaping abuse. The charities will offer beneficiaries advice and support about setting up a new home with utility services, budgeting, running a household alone and managing and avoiding debt.

The Foundation is unique in the way that it encourages and funds the charities which it supports through the Investor Programme to work in partnership with one another. This enables charities to share experience and knowledge of their sector. It also identifies ways in which duplication can be reduced, which saves valuable charitable resources and helps to achieve greater outcomes for beneficiaries. Some partnership projects are ongoing from previous funding. This includes the production of a manual for employers providing guidance on how to deal with domestic violence in the workplace, created jointly by Refuge and Respect.

In addition to encouraging partnership, we are committed to helping the charities we fund to build resilience and strengthen their organisations. We can therefore provide support in areas such as financial management, strategic planning and handling risk. This year, we have formed a partnership with Charity Trustee Networks (CTN), a national charity aiming to promote the efficiency and effectiveness of charities by improving their governance. CTN is well known and well respected in the voluntary sector. Through this partnership, the Foundation is able to offer the trustees of grant recipients a number of membership benefits, including peer networks and newsletters.

The Small Grants Programme offers one-off grants of up to £5,000 to registered charities with an income of under £500,000. Grants are awarded every two months and this programme has been running for a number of years. The Small Grants Programme complements the Investor Programme by funding charities which are supporting the same groups of beneficiaries. The Programme has a very simple application process and we pride ourselves on administering grants quickly. This level of service is especially important to and appreciated by smaller charities.

Both grant programmes are being independently evaluated by Cass Business School's Centre for Charity Effectiveness. The evaluation will inform the Foundation of how effective our grant making strategy and programmes are, with lessons on how to improve. Such lessons will be shared with other funders to encourage good practice across the funding sector. The evaluation will also review charities funded to provide them with a valuable resource on how effective their services are and to measure the tangible impacts they achieve among beneficiaries.

We were delighted when our Chairman, John Kingston, and one of our Trustees, Lucy Gampell, were awarded OBEs in the 2010 New Year's Honours List. They received these for services to the voluntary sector and services to disadvantaged people respectively.

The recession continues to have a detrimental impact on vulnerable groups in relation to housing and financial issues. This means that our funding has been in even greater demand. The work we are currently funding through the Investor Programme will benefit over 11,000 people over the next three years and, in addition, many more people will receive help from the Foundation through Small Grants. So within this downturn, the Foundation will continue to help tackle some of the issues which are at the heart of society.

Email:
enquiries@nationwidefoundation.org.uk

Website:
nationwidefoundation.org.uk

Board of Directors

As at 4 April 2010

1. Geoffrey Howe *(60)*

Chairman

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

2. Graham Beale *(51)*

Chief Executive

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

3. Stella David *(47)*

Non Executive Director

Stella David joined the Board in 2003 and became Chairman of the Remuneration Committee in 2006. She brings considerable expertise in marketing, general management, branding and the management of consumer goods. She is the Chief Executive Officer of William Grant & Sons Limited and was formerly Global Chief Marketing Officer of Bacardi Limited and prior to this she was Vice President of its Global Operations. Stella is also a non executive director of New Look Retail Group Limited.

4. Michael Jary *(46)*

Non Executive Director

Michael Jary joined the Board in January 2009. He is the Managing Partner of OC&C Strategy Consultants, a global strategy consulting firm with 15 offices worldwide, having been one of the founders of the firm in 1987. He is an advisor to the boards of leading retail and consumer companies in Europe, the USA and Asia. He is a regular commentator on the retail industry, the co-author of a number of books including 'Retail Power Plays' and a guest lecturer at INSEAD Business School. He is also Chairman of Duchy Originals and of The Prince's Social Enterprises.

5. Bill Tudor John *(65)*

Joint Deputy Chairman

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

6. Kevin Loosemore *(51)*

Non Executive Director

Kevin Loosemore joined the Board in January 2009. He has a strong information technology background, having held senior executive positions at IBM, De La Rue, Motorola and Cable & Wireless. He is currently Chairman of both Micro Focus International plc and Morse plc and a director of Farnham Castle. During his career Kevin has run businesses in software, services, communications and manufacturing and has overseen the delivery of major IT and transformation programmes.

7. Tony Prestedge *(40)*

Group Development Director

Tony Prestedge was appointed to the Board in August 2007 and was previously Group Operations Director of Portman Building Society. He has held a number of senior management and executive roles at Barclays Bank PLC, including Managing Director Home Finance, and was a member of the Retail Banking Executive Committee. Tony is accountable for the Group's Strategic Transformation and his divisional reports include Transformation Planning and IT Strategy, Transformation Delivery and Change Management, Human Resources and Technology Services. Additionally Tony is accountable for leading the implementation of the Banking Systems Replacement Programme.

8. Mark Rennison *(49)*
Group Finance Director

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

9. Chris Rhodes *(47)*
Group Product & Marketing Director

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

10. David Rigney *(46)*
Group Operations Director

David Rigney joined the Society in 1999 and was appointed to the Board in 2006. He is currently responsible for Member Account Administration, Business Protection, Lending Control, Business Services, Procurement and Regional Brands. He is a director of various Society subsidiaries and was formerly a non executive director of HM Land Registry. Prior to joining the Society, David held a number of senior management positions in both the public and private sector.

11. Derek Ross *(59)*
Non Executive Director

Derek Ross joined the Board in 2004 and became Chairman of the Society's Audit Committee in 2006. He has extensive experience in audit and financial advisory services, particularly in the areas of treasury and risk management. Prior to his appointment he was a senior partner of Deloitte & Touche LLP for 18 years and previously for seven years a corporate treasurer and tax manager with Black & Decker. He is currently a director and Chairman of the Audit Committee of European Central Counterparty Limited and of Access Bank. He also serves as a director of Friends Provident (UK) Holdings Limited and of Friends Provident Group Limited.

12. Suzanna Taverne *(50)*
Non Executive Director

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

13. Robert Walther *(66)*
Joint Deputy Chairman and Senior Independent Director

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

14. Matthew Wyles *(51)*
Group Distribution Director

Matthew Wyles was appointed to the Board in August 2007 and was previously Group Development Director of Portman Building Society. Prior to joining Portman in 1997, Matthew's career was in general insurance, latterly as Executive Director within the Global Reinsurance Division at Willis plc. Matthew is responsible for the branch network, the Group's call centres, online operations and group intermediary sales across all of the Group's brands. He is also currently serving a second term as Chairman of the Council of Mortgage Lenders.

Directors' Report

For the year ended 4 April 2010

The directors have pleasure in presenting their Annual Report and Accounts for the year ended 4 April 2010.

As set out more fully in the Statement of Accounting Policies, this Annual Report and Accounts has been prepared in accordance with International Financial Reporting Standards (IFRS). All financial information given in this Directors' Report is taken solely from the statutory results prepared on this basis. Unaudited, like-for-like results which allow comparison between 2010 and 2009 are given in the Business Review on pages 10 to 36.

Business objectives

The principal purpose of the Society and its subsidiaries (the Group) is to provide a diverse range of personal financial services, offering competitive pricing and excellent service. Underpinning this objective are our core values, which are to be open, honest and fair in our dealings with customers, to deliver long term good value, and to provide a safe and secure home for our members' savings.

Business Review and future developments

The Group's business and future plans are reviewed by the Chairman and Chief Executive on pages 4 to 9 and in the Business Review on pages 10 to 36.

Key Performance Indicators

Key Performance Indicators (KPIs) have continued to evolve, increasing our focus on preserving our financial strength and profitability and transforming the business to meet future challenges. Details of significant KPIs are as follows:

Measure	KPIs	Why is it used?
Employees and Customers	• Pay & reward change programme; • Treating Customers Fairly assessment; • % of customers rating overall service excellent/poor; and • Complaint volume reduction.	We exist to serve the needs of our members. It is important that we independently measure how successful we are in meeting members' needs. We know that having a committed workforce means we can deliver better customer service and therefore, retaining our best employees is important to us.
Products and Markets	• Pricing benefit; • Net mortgage lending; • Change in Retail deposit balances; and • Consumer Finance, General Insurance and Protection & Investment income.	To be successful we must deliver a broad range of financial products that meet members' needs whilst preserving the financial strength of the Society.
Operational Transformation	• Voyager delivery; • Merger integration; • Other system platforms; and • Controls, risk & compliance.	We need to be prepared for future challenging conditions. The business needs to deliver a modern systems platform (Voyager project) to meet the Society's and its members' future needs. We monitor the levels of risk we take on and the quality of the control environment within the business to manage our exposure to unforeseen losses.
Financial Performance and Strength	• Underlying profit before tax; • Total income & costs; • Provisions charge; • Return on capital; • Core liquidity & Core Tier 1 solvency ratios; and • Credit performance assessment.	As a mutual we manage our costs and the amount of income we generate very carefully in order to make enough money to ensure the continuing financial strength of the Society. Return on capital informs us about whether we are growing profitably and maintaining the financial security for our members and investors. High quality lending reduces the risk of future mortgage losses.

The KPIs include financial indicators and non financial indicators. Performance against financial KPIs is covered in the Chief Executive's Review from page 6 and Business Review from page 10.

In addition to the KPIs outlined above there are further indicators to measure our corporate responsibilities including the commitment of our employees and our commitment to the environment. These include:

- Employee voluntary turnover. Our staff resignation rate is better than the industry benchmark;
- Employee absence. Our total absence rate is slightly greater than the benchmark, however, our short term absence rate has improved in the year and there is evidence that we are outperforming this industry benchmark. Various initiatives to decrease absence are beginning to take effect, helping employees return to work;
- Employee commitment. During the tough economic conditions of the last year, employee commitment to Nationwide, as demonstrated by our annual employee engagement survey, has increased by 5% to 64%. In future the survey results will be split into employee enablement and employee engagement allowing comparison to industry benchmarks. The most recent survey highlighted enablement as a core strength with scores higher than the Financial Services norm at 67%. Scores for engagement were slightly down on the previous year and were lower than the Financial Services norm at 54%;

- Environmental performance. As a business we remain committed to managing our carbon dioxide emissions. Last year we set a KPI to achieve a 0% increase in energy use against a 2008/09 benchmark for our operational estate. Our current consumption data suggests that we have slightly outperformed this KPI target and achieved a reduction of 1.18% in energy consumed from electricity and gas sources. Our carbon emissions reduced by 0.6% (tCO2). The work under way to ensure compliant registration under the Carbon Reduction Commitment Energy Efficiency Scheme is improving our carbon measuring and reporting, and affordable improvement initiatives are being implemented and planned to continue to manage our energy consumption and emissions; and
- Investing in the Community. Nationwide is committed to attaining the BiTC Community Mark accreditation in 2010-2011. This standard recognises businesses leading the field in community investment and making real impacts on society.

Profits and capital

Profit before tax was £341 million (2009: £190 million). The profit after tax transferred to the general reserve was £264 million (2009: £146 million).

Total Group reserves at 4 April 2010 were £5,716 million (2009: £4,278 million). Further details on the movements of reserves are given in the Group Statement of Movements in Members' Interests on page 72.

Gross capital at 4 April 2010 was £9,406 million (2009: £8,037 million) including £2,166 million (2009: £2,233 million) of subordinated debt and £1,524 million (2009: £1,526 million) of subscribed capital. The ratio of gross capital as a percentage of shares and borrowings at 4 April 2010 was 5.4% (2009: 4.3%) and the free capital ratio was 4.8% (2009: 3.9%). The Annual Business Statement on page 155 gives an explanation of these ratios.

The comparative figures given above have been adjusted, as explained in note 1 and 49.

Mortgage arrears

The Group mortgage portfolios at 4 April 2010 included 2,857 mortgage accounts (2009: adjusted 2,568), including those in possession, where payments were more than 12 months in arrears. The total amount of principal loans outstanding in these cases was £493 million (2009: adjusted £425 million). The total amount of arrears in these cases was £33 million (2009: adjusted £35 million) or 0.03% (2009: adjusted 0.03%) of total mortgage balances. The mortgage arrears methodology is now based on the CML definition, which calculates months in arrears by dividing the balance by the latest contractual payment. Previously, arrears had been based on the number of missed payments and so therefore, the 2009 comparatives have been adjusted.

Charitable and political donations

Results for the year include charitable donations of £3,463,912 (2009: £4,473,993) including £2,000,000 (2009: £2,055,000) to the Nationwide Foundation, a report on which is given on page 47. No contributions were made for political purposes. However, as a result of the Political Parties, Elections and Referendums Act 2000, time allowed to employees to carry out civic duties can amount to a donation. The Group supports a very small number of employees in this way.

Creditor payment policy

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

The Society's creditor days were 18 days at 4 April 2010 (2009: 21 days).

Risk management

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

The financial management objectives and policies of the Group are shown in the Business Review on pages 10 to 36 and in notes 41 to 45 on pages 123 to 147.

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

- Credit risk;
- Liquidity and funding risk;
- Market risk including interest rate risk and currency risk;
- Operational risk;
- Business risk; and
- Tax risk.

The Group has established a number of committees and policies to manage these risks. These are set out in the Risk Management and Control Section of the Business Review on page 29.

In addition to these financial risks the Group is exposed to the effects of the economic cycle, particularly relating to the UK residential housing market, and the competitive nature of the UK personal financial services markets in which we operate. These are discussed in the Chief Executive's Review on pages 6 to 9.

Employees

During the financial year the Society has maintained focus on the engagement of its employees. We have reviewed and refined our internal communication approach to maximise the opportunity we have to share information with our employees; this includes an extensive intranet site, team briefings, meetings, newsletters and circulars which clearly set out our performance, objectives and the market conditions in which we operate.

The Society continues to consult actively with the Nationwide Group Staff Union and the Employee Involvement Committee, chaired by the Group Development Director, and its

Director's Report

continued

For the year ended 4 April 2010

sub-committees act as forums where representatives from the business and the Union consult and share information on a range of business and employment issues.

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

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

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

This statement, which should be read in conjunction with the Independent Auditors' Report on page 68, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Accounts, the directors' emoluments disclosures within the Report of the Directors on Remuneration, the Annual Business Statement and the Directors' Report.

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

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

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

In addition to the Annual Accounts, the Act requires the directors to prepare, for each financial year, an Annual Business Statement and a Directors' Report, each containing prescribed information relating to the business of the Society and its connected undertakings.

In October 2009, the British Bankers' Association published a draft Code for Financial Reporting Disclosure. The draft Code sets out five disclosure principles together with supporting guidance. The principles are that UK banks will:

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

The Group and major UK banks have voluntarily adopted the draft Code in their 2009/10 financial statements. The Group's 2009/10 financial statements have therefore been prepared in compliance with the draft Code's principles.

A copy of the Annual Accounts is placed on Nationwide Building Society's website. The directors are responsible for the maintenance and integrity of statutory and audited information on the website. Information published on the internet is accessible in many countries with different legal requirements. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' statement pursuant to the Disclosure and Transparency Rules

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

- The financial statements, prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group and Society; and

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

Directors' responsibilities in respect of Accounting Records and Internal Control

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

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

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

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

Directors' responsibilities in respect of going concern

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

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

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Chief Executive's Review on pages 6 to 9. The financial position of the Group, its capital structure and risk management and control processes for managing exposure to credit, liquidity, market, interest, currency, operational, business and tax risk are described in the Business Review on pages 10 to 36. In addition, note 41 to the financial statements includes further information on the Group's objectives, policies and processes for managing its exposure to interest, credit, foreign exchange and liquidity risk, details of its financial instruments and hedging activities.

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

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

Directors

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

G M T Howe MA (Cantab) (Chairman)

W Tudor John MA (Cantab), D.L. (Joint Deputy Chairman)

R P Walther MA, FIA (Joint Deputy Chairman and Senior Independent Director)

G J Beale BSc, ACA (Chief Executive Officer)

S D M Bernau BSc (Econ), FCIB, MCT (Group Product and Marketing Director) (Retired from the Board 16 July 2009)

T P Prestedge (Group Development Director)

M M Rennison BA, FCA (Group Finance Director)

C S Rhodes ACA (Group Product and Marketing Director) (Appointed to the Board 20 April 2009)

D J Rigney ACMA, MBA (Group Operations Director)

M P V Wyles ACII (Group Distribution Director)

Mrs S J David MA (Cantab)

Mrs S C Ellen BSc (Retired from the Board 16 July 2009)

M K Jary MA (Oxon), MBA

K Loosemore

M P Nicholls MA (Cantab), MBA (Retired from the Board 31 December 2009)

D A Ross BSc, LLB, FCA, ACMA, CTA (Fellow), FCT

Ms S Taverne

G J Beale, M M Rennison, C S Rhodes, M P V Wyles, Mrs S J David and D A Ross will retire from the Board at the Annual General Meeting on 22 July 2010. DJ Rigney will step down from the Board on 21 July 2010. G J Beale, M M Rennison and M P V Wyles will stand for re-election and C S Rhodes will stand for election.

Subsequent to the year end R K Perkin was appointed to the Board as a non executive director on 20 April 2010. Roger Perkin brings a wealth of experience with him, as he is a former partner of Ernst & Young. In addition, K Loosemore retired from the Board on 21 April 2010.

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

The auditors

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

Geoffrey Howe
Chairman
25 May 2010

Report of the Directors on Corporate Governance

For the year ended 4 April 2010

The Board seeks to maintain the highest standards of corporate governance throughout the Group and believes that good corporate governance is essential to the Board's commitment to running Nationwide's business in the best interests of its members.

This report provides members with information on Nationwide's corporate governance framework, based on the principles and provisions of the Combined Code on Corporate Governance (the Code). The Board considers that the Society complied with the BSA Guidance for Building Societies on the Code throughout the year.

Board composition and responsibilities

As at 4 April 2010 the Board comprised the Chairman, six executive and seven non executive directors. All of the non executive directors are considered to be independent. Details of changes during the year and those subsequent to the year end are set out in the Directors' Report on page 53. The Board considers that the range of skills and experience of the executive and non executive directors is appropriate to achieve Nationwide's goals and carry out its strategy.

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

The Board focuses on formulation of strategy, control and review of business performance, and is also responsible for ensuring that risks are appropriately identified and managed, and that a sound system of internal controls is maintained. As Chairman of the Society, Geoffrey Howe is responsible for leading the Board. Graham Beale, in his role as Chief Executive, has responsibility for running the Society's business under delegated authority from the Board, and for implementing the policies and strategy set by the Board, supported by a series of executive management and risk committees. Robert Walther, a Deputy Chairman, is the Senior Independent Director.

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

Nationwide's High Level Business Control Manual sets out Board members' individual responsibilities, the Society's governance and management structure and delegated authorities to management. The Manual is regularly reviewed and updated for developments in Nationwide's governance and management structure.

The non executive directors are expected to commit a minimum of 25 days per annum in exercise of their duties, however, membership of the various Board committees extends this time commitment, particularly in respect of the committee chairmen. The Chairman spends a minimum of two and a half days a week on the Society's business and details of his other directorships are set out on page 156. The Board believes that the Chairman remains wholly committed to his role and allocates sufficient time to meet its ever increasing demands.

The Board's terms of reference are available at nationwide.co.uk and include a number of specific matters reserved to the Board which are set out below:

- Strategy and management, including long term objectives, oversight of operations and review of performance;
- Corporate structure, capital and funding;
- Approval of financial statements and any significant changes in accounting policy;
- Ensuring maintenance of a sound system of internal control and risk management, and approval of the Group's risk appetite and policy statements;
- Approval of major projects and contracts;
- Approval of major lending proposals;
- Approval of resolutions to be put forward to members at a general meeting, and of circulars and listing particulars;
- Changes to the structure, size and composition of the Board, succession planning for the Board, appointment of Board members and remuneration policy for directors;
- Appointment of the external auditor; and
- Approval of terms of reference for Board Committees, review of corporate governance arrangements and reviewing the performance of the Board, its committees, and individual directors.

The Board receives regular reports from a number of business areas including Finance, Risk, Customer Experience and the Voyager project to enable it to make decisions on the basis of timely and relevant information.

Board Committees

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

The Audit Committee is responsible for reviewing the adequacy of the systems of financial and business control maintained by the Group. Its activities in the year are set out on pages 57 to 58 below.

The Remuneration Committee determines and agrees with the Board the framework for the remuneration of the Chairman, the executive directors, the Secretary and the other senior executives of the Society.

Its activities in the year are set out in the Report of the Directors on Remuneration on pages 59 to 67.

The Nomination Committee is responsible for reviewing the structure, size and composition of the Board, succession planning for the Board and identifying suitable candidates to fill Board vacancies. Its activities in the year are set out on page 57 below.

The Board Risk Committee was established in January 2010 to review the Society's risk management framework to ensure that it is appropriate to manage and mitigate current and prospective risks arising from the Group's business activities and future agreed strategy, and to ensure that the Group operates in line with its stated risk appetite. Its activities since inception are set out on page 58.

The terms of reference of the above Committees are available at nationwide.co.uk or on request from the Society.

Induction, professional development and Board performance evaluation

Nationwide offers a detailed and structured induction programme to enable new directors to make an early effective contribution. This includes briefings from other directors and senior managers across the business as well as provision of key information about Nationwide.

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

In order to ensure the ongoing competence of the Board a new, structured approach to professional development is being adopted to cover the knowledge, skills and expertise required. Existing development processes will be supplemented by additional training from specialist areas within the business, such as Treasury and Risk Management.

An independent evaluation of the performance and effectiveness of the Board, was undertaken by Dr Tracy Long from the consulting firm Boardroom Review, through the use of confidential interviews, Board observation and a review of relevant papers. Boardroom Review has no other relationships with the Society. The current intention is that a Board review of this kind will be carried out by an external facilitator every third year.

Individual non executive directors were evaluated on a one to one basis by the Chairman, with an evaluation of the Chairman's performance carried out by the Senior Independent Director with input provided by the other Board members. Executive directors were assessed against predetermined performance targets by the Chief Executive, whose performance was in turn evaluated by the Chairman. Executive directors' targets were identified at Group, Divisional and individual level. In accordance with best business practice, a balanced scorecard approach to target setting was utilised, which included the dimensions of financial performance, operational efficiency and transformation, risk and compliance, customers and employees.

Board appointments and re-elections

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

Following a review of the Board's composition, it was determined that two new non executive directors should be recruited, one with appropriate banking experience who would chair the Board Risk Committee, and a further candidate who would serve on the Audit Committee and, in due time, would succeed the current committee Chairman. The Nomination Committee, in conjunction with an independent executive search consultant, was responsible for recommending the appointment of Roger Perkin to fulfil the latter role and he joined the Board on 20 April 2010 at which time he also became a member of the Audit Committee and Board Risk Committee. It is intended that Roger Perkin will become Chairman of the Audit Committee following the retirement of Derek Ross at the AGM in July 2010. A further appointment of a non executive director with appropriate banking experience is expected to be made in the next few months.

Following Stella David's retirement at the AGM, it is intended that Robert Walther will become Chairman of the Remuneration Committee.

Additionally, members of the Society have the right under the Society's Rules to nominate candidates for election to the Board.

The Society's Rules require that all directors are submitted for election at the AGM following their first appointment to the Board, except where their appointment occurs during the period starting with the beginning of the Society's financial year and ending with the AGM itself, in which case they must seek election at the AGM in the following year. In accordance with these requirements Chris Rhodes stands for election at the 2010 AGM.

All directors are required to seek re-election every three years. Three executive directors, Graham Beale, Mark Rennison and Matthew Wyles stand for re-election at the 2010 AGM.

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

Mark Nicholls and Kevin Loosemore, both non executive directors, resigned from the Board with effect from 31 December 2009 and 21 April 2010, respectively. Derek Ross and Stella David will retire from the Board at the AGM on 22 July 2010. David Rigney, executive director, will stand down as a member of the Board at the Board Meeting in July 2010.

Report of the Directors on Corporate Governance

continued

Board activities in the year

During the year the Board held twelve meetings and details of the directors' attendance record is shown below.

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

- Regular reports from the Chief Executive and Group Finance Director covering updates on business performance, customer service and financial position including capital, liquidity and funding;
- Strategy papers from a variety of business areas, reporting on key business priorities and progress;
- Economic and market conditions and outlook;
- Reports on the Group's overall risk profile relative to its stated risk appetite and pricing limits;
- Regulatory developments; and
- Minutes and reports from each of the Board Committees.

Board and Committee Attendance

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

Current Directors	Board	Audit Committee	Nomination Committee	Remuneration Committee	Board Risk Committee
Graham Beale*, Chief Executive	12 (12)				
Stella David, Chairman of the Remuneration Committee	10 (12)		5 (6)	8 (8)	
Geoffrey Howe, Chairman of the Board and the Nomination Committee	12 (12)		6 (6)		
Michael Jary	12 (12)			7 (8)	
Bill Tudor John, Joint Deputy Chairman	12 (12)		6 (6)	8 (8)	2 (2)
Kevin Loosemore	10 (12)	6 (6)			
Tony Prestedge*	12 (12)				
Mark Rennison*	12 (12)				
Chris Rhodes* (appointed to the Board 20 April 2009)	11 (11)				
David Rigney*	12 (12)				
Derek Ross, Chairman of the Audit Committee	12 (12)	6 (6)			2 (2)
Suzanna Taverne	12 (12)	6 (6)		7 (8)	
Robert Walther, Joint Deputy Chairman and Senior Independent Director and Chairman of the Board Risk Committee	12 (12)		6 (6)	6 (8)	2 (2)
Matthew Wyles*	9 (12)				

Former Directors	Board	Audit Committee	Nomination Committee	Remuneration Committee	Board Risk Committee
Stuart Bernau* (retired 16 July 2009)	3 (4)				
Susan Ellen (retired 16 July 2009)	4 (4)	2 (2)			
Mark Nicholls (resigned 31 December 2009)	8 (9)	4 (4)		7 (7)	

*Executive directors

Risk management and internal control

Nationwide's system of internal control is designed to enable the Group to achieve its corporate objectives within a managed risk profile, not to eliminate risk. The principal categories of financial risk inherent in the Group's business are described in greater detail in the Business Review under the heading Risk Management and Control on page 29, together with an explanation of the structure adopted within the Group for managing financial risk (including the roles of the Executive Risk Committee (formerly the Group Risk Committee), Credit Committees and the Assets and Liabilities Committee). In addition, a new Board Risk Committee has been created in line with industry best practice. This Committee met for the first time in January 2010.

The Board has ultimate responsibility for risk management and control and has approved a risk appetite statement and supporting risk policies for the Group. The Board Risk Committee reports to the Board so that non executive directors are able to provide focused support and advice on risk governance including risk appetite, stress testing, the risk management framework and the risk policies. More detail about this new Committee can be found on page 58.

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

Performance against risk appetite is monitored monthly at the Executive Risk Committee, reported to the Board Risk Committee at each meeting, and reported to the Board quarterly. Risk appetite monitoring includes review of the Group's position against a number of key limits in relation to liquidity, funding, capital, asset quality, quality of earnings and operational risk, as well as reviews of a range of external indicators to provide context.

Risk Management Division ensures that appropriate risk management systems are in place across the Group's operations, and provides expertise and support to the business in its management of risk on a day to day basis.

The management of operational risk is overseen by the Operational Risk Committee, and management of compliance and regulatory risk is overseen by the Compliance Committee, both of which report into the Executive Risk Committee.

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

Nomination Committee

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

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

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

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

Audit Committee and auditors

As at the date of this report the Audit Committee comprises three non executive directors: Derek Ross (Chairman), Suzanna Taverne and Roger Perkin. Kevin Loosemore was a member of the Committee until 21 April 2010.

Derek Ross and Roger Perkin, former partners of Deloitte & Touche and Ernst & Young respectively, are considered to have recent and relevant financial experience by virtue of this and their other non executive directorships. By invitation, Audit Committee meetings are also attended by the Chairman of the Board, the Chief Executive, the Group Finance Director, the divisional directors of Risk Management and Business Protection, the Chief Internal Auditor and the external auditors.

The Audit Committee's terms of reference include responsibility for review of the financial statements, including accounting policies, methods and judgements; review of internal controls and risk management systems including regulatory compliance; responsibility for recommending to the Board on the appointment, reappointment and removal of external auditors; maintenance of an appropriate relationship with the Society's external auditors; and review of the effectiveness of the internal audit function.

In order to satisfy itself that the risk and control framework is operating effectively, the Committee members received a range of reports and other information.

Meetings covered matters including:

- Discussion of papers detailing any significant accounting judgements and estimates, with particular focus on asset valuations and impairment provisions, including significant assumptions made;
- Detailed review of the interim and year end financial statements and recommendation for approval by the Board;
- Discussion of reports and presentations from business areas on control and governance arrangements, and on Nationwide's whistle blowing arrangements;
- Approval of the annual plans for Group Internal Audit and for the Compliance function;
- Review of regular reports from the Chief Internal Auditor and divisional director with responsibility for Compliance, setting out the results of work carried out, conclusions on the effectiveness of the control environment and progress made by management in addressing any issues raised;
- Review and discussion of reports from the external auditors following the interim and year end audit process, and of Internal Control Reports from the external auditors;

Report of the Directors on Corporate Governance
continued

- Approval of the audit fee for the external audit, approval of proposals for appointment of the external auditors for non-audit work, and regular review of non-audit fees paid to the external auditors. The Committee also formally approves the policy for the use of the external auditors for non-audit work; and
- Formal assessments of the effectiveness of the external audit and internal audit functions.

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

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

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

Board Risk Committee

As at the date of this report, the Board Risk Committee comprises four non executive directors: Robert Walther (Chairman), Derek Ross, Bill Tudor John and Roger Perkin who joined the Committee following his appointment on 20 April 2010. The Chairman of the Board is not a member of the Committee although he usually attends meetings of the Committee by invitation. The Group Finance Director and the Divisional Director, Risk Management are expected to attend Committee meetings, while other directors and senior managers may also be invited to attend. All members of the Board Risk Committee receive supplementary fees in recognition of their additional responsibilities. Under its terms of reference, the Board Risk Committee's responsibilities include reviewing and making recommendations to the Board about risk appetite, strategies, frameworks, policies, models and limits for risk as defined in the Group Risk management policies. The Board Risk Committee is also responsible for reviewing and challenging the Group's assessment and measurement of key risks, providing oversight and challenge to the design and execution of stress and scenario testing, and monitoring the performance of the Executive Risk Committee.

The Board Risk Committee has met twice since its inception in January 2010 and is scheduled to meet at least seven times in the coming year. In its first two meetings it has monitored the key risks and associated metrics and, in addition, reviewed and recommended to the Board a revised risk appetite, revised risk policies and the results of stress testing of capital and liquidity. Following the revisions the Committee is satisfied that the risk appetite, risk management framework, risk policies and approach to stress testing are appropriate for the Group.

Relations with members

As a mutual, the Society has a membership comprising around 15 million individuals, all of whom are the Society's customers. The Society actively seeks the views of members in various ways. Member TalkBack events (both face-to-face and via the internet) give members an opportunity to ask questions or express points to directors. For example, at our London TalkBack in February 2010 members were able to meet the Chairman and three non executive directors. Such direct contact helps promote good corporate governance as it assists non executive directors in their understanding of members' requirements, which are then discussed at Board level. Such engagement also helps to shape the products and services that members are offered.

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

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

An external credited research company rings customers every month to gather feedback on their experiences for the Society's Customer Experience Tracker. Over the past year they have spoken to around 4,000 customers each month and will speak to even more in the current year.

Constructive use of the AGM

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

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

Geoffrey Howe
Chairman
25 May 2010

Report of the Directors on Remuneration

For the year ended 4 April 2010
Introduction

Dear Member

I am pleased to present the Remuneration Committee's report on Directors' remuneration for the year to 4 April 2010.

The volatility and uncertainty in the financial services sector which began in 2008 continued over the past year. New regulations and guidelines around financial services pay have been published, in particular the Financial Services Authority (FSA) Remuneration Code which came into force on 1 January 2010 and the recommendations of Sir David Walker's review of corporate governance in financial institutions.

The last financial year has been another difficult year because of the lasting impact of the financial crisis and the economic recession. Despite these conditions, the Society has performed strongly and ahead of expectation and Corporate Plan targets set at the start of the year. The Remuneration Committee has taken these factors into account when determining the remuneration arrangements for the year ending 4 April 2010.

We have reviewed our pay principles and structures during the year. We believe that our approach to pay meets the relevant regulatory requirements and reflects emerging best practice in the financial services industry.

We intend to keep our approach to executive remuneration under review during 2010/11. Emerging regulation, in particular the Capital Requirements Directive 3 which is currently in consultation, may have a significant impact on remuneration structures. To the extent that our strategy and regulation imposes new requirements on us, we may need to change the balance of fixed and variable pay. The Committee has supported the request of the executive directors not to be considered for a pay rise for 2010/11 for the second year in a row, but consider that it would not be desirable for this to continue indefinitely. Therefore, in 2010/11 the Committee will review total remuneration levels for the executive directors, and the balance between different elements of pay, to ensure that future remuneration arrangements continue to support the business and meet regulatory requirements.

The key points to be aware of for this financial year are as follows:

- There will have been no base pay increase for executive or non executive directors between 1 April 2009 and 31 March 2011;
- In recognition of the strong individual and corporate performances last year the Committee has approved payments under the Annual Performance Pay Plan (APPP) and the Medium Term Performance Pay Plan (MTPPP);
- The Committee was minded to award the Chief Executive a payment of £534,000 (82.1% of base pay) in line with the achievement of targets in the APPP. The Chief Executive requested that any payment be capped at £231,000 such that his total cash payments in 2009/10 would be no more than his earnings in the previous year. Consequently, the Chief Executive gave up potential value of £303,000.

The Remuneration Committee has concluded that the executive directors have continued to deliver a strong performance compared with our competitors in difficult trading conditions. The Society continues to deliver consistent value to our Members and this report reflects the valuable contribution made by the executive directors. I would like to express our thanks to the executive directors for their achievements and efforts this year.

The total emoluments included in the tables at the end of this report are audited numbers.

I hope that you will endorse the approach outlined in our report.

Stella David
Chairman of the Remuneration Committee

Report of the Directors on Remuneration

continued

The Remuneration Committee

Nationwide adopts high standards of corporate governance so, although as a mutual we are not required to, we provide full details of our directors' remuneration and ask our Members to approve the Remuneration Report at the AGM. This report includes the key disclosure requirements of the Combined Code on Corporate Governance and follows market best practice in so far as it applies to Nationwide as a mutual building society.

The Remuneration Committee is responsible for:

- Determining the policy for the remuneration of the Chairman, the executive directors and divisional directors of the Society as well as any other employees who are deemed to fall within Principle 8 of the FSA Code. The objective of such policy is to ensure that the relevant individuals are provided with appropriate incentives to encourage enhanced performance and are rewarded, in a fair and reasonable manner, for their individual contributions to the success of the Society;
- Determining, within the terms of the agreed policy, the specific remuneration packages for the Chairman, the executive directors, divisional directors and Principle 8 employees both on appointment and on review;
- Approving the design and performance targets for any performance related pay schemes operated by the Society for the benefit of employees within the Committee's remit, and approving the total annual payments under such schemes;
- Overseeing the remuneration policy throughout the Society, with a specific focus on the risks posed by remuneration policies.

The Committee's terms of reference were reviewed and updated in April 2009. The full terms of reference are available on the Society's website. The Remuneration Committee also oversees pay policies elsewhere in the business.

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

Stella David (Chairman)

Suzanna Taverne

Robert Walther (Chairman of Board Risk Committee)

William Tudor John

Michael Jary

Mark Nicholls (stepped down from the Board with effect from 31 December 2009).

The Committee met 8 times during the year. Activities during the year included:

- Reviewing the impact of the FSA Remuneration Code on Nationwide's remuneration policy and practices;
- Reviewing the approach taken for measuring performance under the APPP and MTPPP; and
- Agreeing the remuneration arrangements for new appointments and the remuneration arrangements for departing directors.

The Committee is supported by Geoffrey Howe (Chairman of the Board), the Divisional Director, Human Resources and where appropriate the Chief Executive, who may also be invited to attend Committee meetings to provide further background. Following the establishment of the Board Risk Committee, the Remuneration Committee is supported by that Committee on risk related matters including incentive plan design and the performance of the Divisional Directors, Risk and Business Protection. In no case is any person present when their own remuneration is discussed.

In performing its duties, the Remuneration Committee draws on the advice of independent external consultants. Hay Group provided independent advice during the year on market rates of pay, best practice and remuneration trends.

Remuneration policy

The Committee is guided by the following principles:

1. Pay will enable the attraction and retention of high quality people;
2. There will be a clear link between performance and remuneration;
3. Our approach to pay will be simple and uncomplicated;
4. Levels of remuneration will be determined by reference to the market for similar jobs within the UK financial services sector;
5. Pay will reflect the market but not drive it;
6. No pay arrangements should directly or indirectly expose Nationwide to inappropriate risk.

There are three main elements of pay which are as follows:

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

Management of Risk

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

- Ensuring variable pay overall and on an individual-by-individual basis remains an appropriate proportion of total pay;
- Ensuring performance for all variable pay plans is measured by reference to a range of factors including non-financial objectives, which take into account risk, sustainability of performance and Nationwide's values in order to take a rounded view of performance;
- Not offering guaranteed bonuses over a period of more than 12 months for any employee;
- Setting limits on variable pay for senior employees that are low by sector standards and which place greater emphasis on long term than short term performance; and

- Retaining the discretion to change or cancel payments under Nationwide's incentive plans if it is felt they do not properly reflect the Society's performance or are otherwise unaffordable.

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

A review will be carried out during 2010/11 to assess the continued effectiveness of our current executive remuneration structures and that the relationship between risk and reward remains appropriate. This will include a review of the approach to measuring performance in our incentive plans, including the extent to which risk is taken into account on the vesting outcome.

Main components of remuneration

The table below summarises the Society's policies in respect of each of the key elements of executive directors' remuneration as they applied during the year and will apply in 2010/11.

Element	Policy	Details
Base Pay	• Reflects the size of the role and what other similar companies would pay, as well as reflecting the individual's skills, experience and performance. Internal pay relativities are also taken into account in determining base salary.	• Base pay is designed to ensure Nationwide pays around the median market rate for the job and our aim is to be neither the highest nor the lowest payer in base pay terms.
Annual Performance Pay Plan (APPP)	• Rewards the achievement of challenging performance targets for a single financial year against a range of financial and non-financial metrics.	• APPP awards are based on a combination of Group, divisional and individual performance measures, as appropriate for each role. • For the Chief Executive and executive directors, the APPP is designed to represent c 40% of variable remuneration.
Medium Term Performance Pay Plan (MTPPP)	• Recognises sustained performance and achieving challenging financial targets over a three year performance cycle. A new three year performance cycle starts each year, representing the deferred element of remuneration.	• MTPPP awards have historically been measured on a comparative basis against the Society's competitors based on three measures: pre tax profit plus pricing benefit; cost income ratio; and a customer experience measure. • The measures which will apply to the remaining outstanding and future award cycles are under review to ensure that they are compliant with the Code. • For the Chief Executive and executive directors, the MTPPP is designed to represent c 60% of variable remuneration.
Benefits	• Provides part of the fixed element of remuneration.	• Executive directors receive certain benefits in line with market practice, including a car allowance, healthcare and mortgage allowance.
Pension	• Provides post-retirement benefits for participants in a cost efficient manner.	• The Society operates a number of approved pension arrangements. • The policy for new appointments (since June 2007) is to provide a pension contribution or allowance as a fixed percentage of salary.

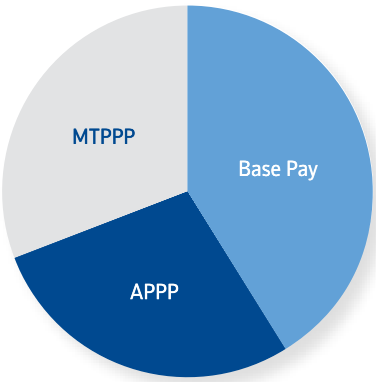
Report of the Directors on Remuneration

continued

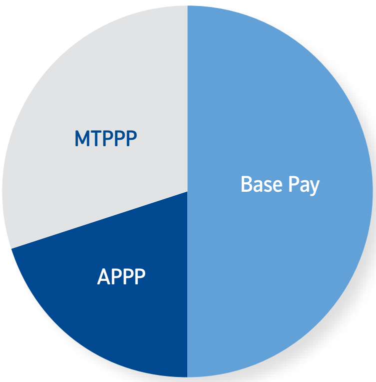
2010 Remuneration policy – Balance of the elements of remuneration

Nationwide strongly believes in pay for performance, whilst ensuring that an appropriate proportion of the total package is fixed so as not to incentivise inappropriate risk. The chart below illustrates the balance of fixed and variable and short and medium term reward for our executive directors at target levels of performance, based on our 2009/10 incentive plan opportunities:

Chief Executive – Target



Other executive directors – Target



Base pay

The Committee normally reviews base pay on an annual basis, taking into account the size of the role and what other similar companies would pay, as well as the individual's skills, experience and performance. The pay and employment conditions in the wider organisation are also taken into account in determining executive directors' remuneration. Changes to base pay are normally effective from 1 April each year.

The Society's policy is to pay at around the median market rate for the job and our aim is to be neither the highest nor the lowest payer. Base pay for the majority of the executive director roles are currently positioned below market median. Despite this, taking into account the broader economic environment, no increase was made to base pay at 1 April 2009. The executive directors have requested that they not be considered for an increase in base pay at 1 April 2010. Accordingly, the Committee agreed that for the second year in a row there would be no change in base pay for 2010/11.

The base pay for executive directors which were in effect during the year and will apply for 2010/11 are set out below.

	2009/10 Base pay	2010/11 Base pay	% increase from 2009/10 to 2010/11
	p.a.	p.a.	
G J Beale	£650,000	£650,000	nil
T P Prestedge	£350,000	£350,000	nil
M M Rennison	£440,000	£440,000	nil
C S Rhodes*	£350,000	£350,000	nil
D J Rigney	£350,000	£350,000	nil
M P V Wyles	£350,000	£350,000	nil

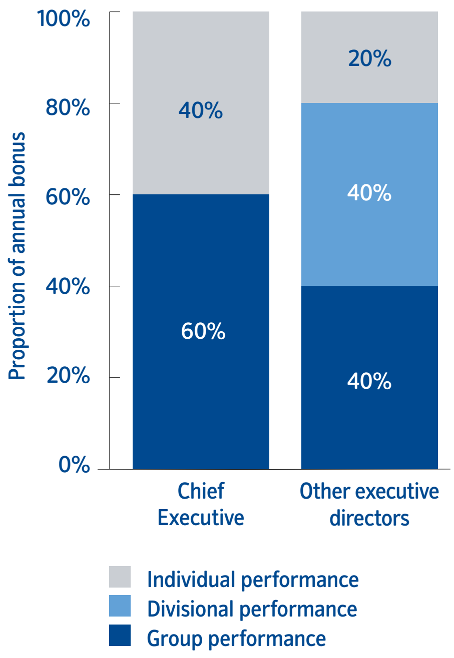
*Appointed to the Board in April 2009.

Annual Performance Pay Plan (APPP)

The APPP is based on three main performance elements:

- A Group element against which Nationwide's performance is measured based on a balanced scorecard of four equally weighted quadrants (Products & Markets, Financial Performance & Strength, Employees & Customers and Operational Transformation) containing a range of financial and non-financial metrics. These include risk and compliance metrics as well as measures which are focused on the longer term value of the business;
- A Divisional element, based on the performance objectives of the relevant division or function; and
- An Individual element.

The balance of the different elements for the executive directors is illustrated below:



	2009/10		2008/09	
	APPP award £000	% of 2009/10 base pay	APPP award £000	% of 2008/09 base pay
G J Beale*	231	35.5%	nil	-
T P Prestedge	224	63.9%	nil	-
M M Rennison	259	58.9%	nil	-
C S Rhodes**	198	58.9%	nil	-
D J Rigney	136	38.9%	nil	-
M P V Wyles	199	56.9%	nil	-

*The Remuneration Committee was minded to award the Chief Executive an APPP payment of 82.1% but taking into account the request of the Chief Executive, this was capped at 35.5%.
**Appointed to the Board in April 2009.

The balanced scorecard approach ensures that participants cannot generate significant additional reward by delivering very high levels of performance in a single area. Payments can be reduced if performance is poor in certain critical areas (by reducing the relevant quadrant to zero).

The APPP is discretionary and the Remuneration Committee has the discretion to amend payments if it believes that they are not representative of overall performance. The Remuneration Committee also has discretion to reduce, defer or withhold payments in the event of Nationwide making a loss.

From 2009/10 there has been a shift in balance of the variable pay opportunity to place a greater emphasis on longer term performance assessed over three years through the MTPPP. The maximum annual variable pay opportunity for 2009/10 was therefore reduced to 105% of base pay for the Chief Executive (previously 125% of base pay) and to 80% of base pay for other executive directors (previously 85% of base pay).

The Remuneration Committee believes that the executive directors have steered the Society successfully this year in what continued to be challenging times. Despite this being the second year of very difficult trading conditions, the Society has not required any direct financial support from the government and the executive directors have delivered above plan performance for 2009/10.

Based on the performance of the Society and his individual contribution, the Remuneration Committee was minded to award the Chief Executive an APPP payment of 82.1% of base pay, which would amount to £534,000; however in light of the continuing economic conditions, the Chief Executive requested prior to the determination of the payment that his total cash compensation for 2009/10 be capped at the same level as in 2008/09. As a result of this request, the Chief Executive was awarded an APPP payment of 35.5% of base pay which equals £231,000, having effectively given up £303,000 of variable pay.

The APPP payments made in respect of 2009/10 are shown in the table above, together with the comparative figures for 2008/09.

The Remuneration Committee is in the process of reviewing executive remuneration arrangements, including the APPP, to ensure they remain fit for purpose and take into account emerging best practice guidelines. For the 2010/11 performance year, the annual variable opportunity will be capped at 90% of salary for the Chief Executive and 67.5% of salary for other executive directors.

Report of the Directors on Remuneration

continued

Medium Term Performance Pay Plan (MTPPP)

The MTPPP rewards sustained performance and the achievement of challenging financial targets over a three year performance cycle. A new three year performance cycle starts each year. Payouts under the plan are payable in cash and capped as a percentage of base pay. To ensure compliance with the deferral requirements introduced by the FSA Remuneration Code, two-thirds of the award earned for each cycle will be paid following the end of the three year performance cycle and payment of the remaining one-third will be deferred for an additional year. During this further deferral period, awards will be subject to clawback.

Awards under the plan have historically been based on the Society's comparative performance against its competitors in the following areas:

- Pre tax profit plus Pricing Benefit;
- Cost income ratio; and
- Customer Experience measure.

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

Following a review of the plan against the FSA Remuneration Code, and in agreement with the FSA, the Committee decided to close down the 2007-2010 cycle of the plan early, and to review the targets for outstanding and future award cycles.

The 2007 MTPPP award was therefore assessed and paid out in December 2009. Based on the outstanding performance of the Society against the peer group, the measures set for these awards were met in full. In recognition of the shortened performance period and early payment of this plan cycle, payments to the Chief Executive and executive directors under this scheme were reduced by one-third. The amounts paid out under the plan in respect of the 2007-2010 award cycle are shown in the emoluments table on page 66.

The Remuneration Committee is in the process of reviewing executive remuneration arrangements, including the MTPPP, to ensure they remain fit for purpose and take into account emerging best practice guidelines. The measures that will apply to outstanding cycles are therefore still being determined but will be no less challenging than the original plan. The current intention is that awards will continue to be assessed against a range of long term business metrics, with a gateway measure based on risk. Details of the approach taken will be disclosed in next year's annual report.

The maximum opportunities under the MTPPP have been reduced for the cycle beginning in 2010/11. For the 2009-2012 MTPPP cycle, the maximum incentive opportunity for the Chief Executive was 200% of salary, and for other executive directors it was 160% of salary. For the 2010-2013 MTPPP cycle the maximum incentive opportunity has been reduced to 180% for the Chief Executive and 135% for the other executive director roles.

Executive Directors' joining and leaving arrangements in 2009/10

Stuart Bernau

Stuart Bernau retired from the Board on 16 July and left Nationwide on 31 July 2009. The remuneration arrangements on leaving that were approved by the Committee were:

- A payment for twelve months base pay and benefits in lieu of notice;
- Payments in respect of outstanding variable pay plan awards, pro-rated for time and performance; and
- A payment in respect of his pension arrangements to take into account the anticipated benefits at the time when these were put in place.

All amounts were paid on or before 22 August 2009.

Chris Rhodes

Chris Rhodes was appointed as Executive Director, Product and Marketing in April 2009 on the standard terms for an executive director. He was provided with relocation assistance to enable him to take up this role.

As Chris Rhodes joined during the course of the 2007-2010 MTPPP cycle he did not receive a full entitlement under that cycle, but was awarded a reduced payment in lieu of an award in respect of that MTPPP cycle.

Pensions and benefits

Graham Beale is a member of the executive section of the Nationwide Pension Fund and accrues a pension of one-thirtieth of pensionable salary for each year of service, up to a maximum of two-thirds of pensionable salary. Pension entitlements are reduced to take account of any entitlement a director may have under the Group's funded unregistered pension scheme and any elections to restrict pension accrual. Two executive directors have elected to receive pension allowances in compensation for restricting pension accrual and details can be found in notes to the directors' remuneration tables on pages 66 and 67.

David Rigney ceased pension accrual from 1 October 2009 and receives a pension allowance in lieu of future pension accrual. His accrued pension benefits remain linked to pensionable salary.

Tony Prestedge is a member of the Nationwide Group Personal Pension arrangement.

Mark Rennison receives payments to compensate him for pension benefits that he gave up when he left his previous employer to join the Society. He also receives pension accrual under our one-fifty fourth Career Average Revalued Earnings Pension Scheme and a monthly pension allowance.

Matthew Wyles is a member of the Portman Final Salary Executive section of the Nationwide Pension Fund and is able to accrue a pension of 3% of pensionable salary for each year of service, up to a maximum of two-thirds of the Scheme earnings cap (currently £135,000). He also receives a monthly pension allowance.

Chris Rhodes receives a cash allowance of 33% of base pay to fund personal pension arrangements.

In addition, executive directors receive other benefits including a car allowance, healthcare and mortgage allowance.

Service contracts

All current executive directors have a contractual notice period of 12 months.

Chairman and non executive directors

The fees payable to non executive directors are set after reviewing the responsibilities of the non executive directors' roles compared with roles in similar organisations. The Chairman's fee is reviewed and approved by the Remuneration Committee. The fees of other non executive directors are reviewed and approved by the executive directors and by the Chairman.

The current non executive directors are paid a basic fee, with an additional supplement paid for serving on or chairing a committee. The current non executive directors do not take part in any performance pay plans or in any pension arrangement. The fee policy was reviewed during the year.

	Fees for 2009/10	Fees for 2010/11	% increase from 2009/10 to 2010/11
Chairman	£250,000	£250,000	nil
Basic fee	£47,250	£47,250	nil
Joint Deputy Chairman fee	£30,000	£30,000	nil
Chairman of the Audit Committee, Board Risk Committee or Chairman of the Pension Fund	£35,000	£35,000	nil
Member of the Audit Committee or Board Risk Committee	£10,000	£10,000	nil
Remuneration Committee Chairman	£20,000	£20,000	nil
Remuneration Committee member	£4,000	£4,000	nil
Nomination Committee member	£2,500	£2,500	nil

Non executive directors maybe asked to attend additional ad hoc committees, for which fees may be payable.

Non executive directors	2010 Society & Group Fees (Note 1) (Note 2)	2009 Society & Group Fees (Note 4)
	£'000	£'000
G M T Howe (Chairman)	250	250
Mrs S J David	70	70
Ms S C Ellen	19	57
M K Jary	51	13
K Loosemore	57	14
M P Nicholls	46	61
D A Ross	94	91
Ms S Taverne	61	61
W Tudor John (Joint Deputy Chairman)	95	93
R P Walther (Joint Deputy Chairman)	128	119
Total	871	829
Pension payments to past directors in respect of services as directors (Note 3)	378	381

Audited information

PricewaterhouseCoopers LLP have audited the information contained in the non executive directors table (left) and the two executive directors tables (on page 66).

Notes:

1. Ms S C Ellen, retired from the Board on 16 July 2009. M P Nicholls retired from the Board on 31 December 2009.
2. In addition to his non executive director fees, R P Walther also received additional fees as Chairman of the Nationwide Pension Scheme (£33,750).
3. These are pension payments in respect of past non executive directors. The Society stopped granting pension rights to non executive directors who joined the Board after January 1990.
4. M K Jary and K Loosemore joined the Board on 1 January 2009.

Report of the Directors on Remuneration

continued

Executive directors

The tables below show the remuneration received for the years ended 4 April 2010 and 4 April 2009.

Executive directors	Salary (Note 1) (Note 2)	Pension allowance	Other Pension allowances (Note 3) (Note 4)	Annual Performance Pay	Benefits	Medium Term Performance Pay	Increase in accrued pension	Total before contractual/ other settlements	Contractual/ other settlements (Note 5)	Total
2010	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
G J Beale	650	101	-	231	23	521	13	1,539	-	1,539
S D M Bernau	139	-	-	-	8	-	-	147	1,772	1,919
T P Prestedge	350	-	107	224	18	216	-	915	-	915
M M Rennison	440	108	-	259	24	272	10	1,113	-	1,113
C S Rhodes	333	-	110	198	151	150	-	942	-	942
D J Rigney	350	76	-	136	23	216	5	806	-	806
M P V Wyles	350	66	-	199	13	216	7	851	-	851
	2,612	351	217	1,247	260	1,591	35	6,313	1,772	8,085

Executive directors	Salary (Note 1) (Note 2)	Pension allowance	Other Pension allowances (Note 3)	Annual Performance Pay	Benefits	Medium Term Performance Pay	Increase in accrued pension	Total before contractual/ other settlements	Contractual/ other settlements	Total
2009	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
G J Beale	650	101	-	-	24	752	23	1,550	-	1,550
S D M Bernau	416	-	-	-	25	371	24	836	-	836
T P Prestedge	331	-	99	-	26	296	-	752	-	752
M M Rennison	440	108	-	-	23	393	8	972	-	972
D J Rigney	350	12	-	-	23	312	18	715	-	715
J A Sutherland	170	68	-	-	18	-	-	256	749	1,005
M P V Wyles	348	67	-	-	13	310	5	743	-	743
	2,705	356	99	-	152	2,434	78	5,824	749	6,573

Notes:

1. £252,000 of the salary of G J Beale has been paid in non pensionable form. G J Beale receives a pension allowance on this non pensionable salary in lieu of an alternative pension benefit. At the start of the year D J Rigney received a pensions allowance of £30,500 paid in non pensionable form and he received a pensions allowance on this non pensionable salary in lieu of an alternative pension benefit. From 1 October 2009 he ceased accruing pension service but retained the salary link to all past service. Since 1 October 2009 he has been in receipt of an allowance in lieu of pension service accrual of £140,000 in addition to his basic salary.
2. J A Sutherland resigned from the Board on 3 September 2008 and retired from the Society on 31 October 2008. S D M Bernau retired from the Board on 16 July 2009 and from the Society on 31 July 2009. C S Rhodes joined the Board on 20 April 2009. D J Rigney will step down from the Board at the July 2010 Board Meeting and his remuneration details above reflect his earnings in the year in the normal course of business and not his leaving arrangements, details of which will be disclosed in the 2011 report.
3. Other pension allowances are the contributions made by the Society in respect of directors' defined contribution arrangements. T P Prestedge is a member of the Nationwide Group Personal Pension arrangement to which the Society makes contributions. The director and Society contributions in the tables above and on page 67 include contributions due but not paid by 4 April 2010.
4. C S Rhodes is not a member of a Society pension scheme. He has opted to receive a cash allowance of 33% of his salary in lieu of any pension accrual. C S Rhodes' benefits include relocation assistance that was provided to enable him to take up his new role.
5. The contractual settlement is made up of salary and performance pay for the balance of the notice period for the departing director, earned Medium Term Performance Pay Plan payments (based on the Society's performance and reduced to take into account that the director left the Society before the end of the normal plan cycles) and other payments that the director is entitled to.

The table below shows the pension benefits accrued for the year ended 4 April 2010.

Executive directors	Accrued pension at 4.4.10 (Note 1)	Accrued pension at 4.4.09	Transfer value at 4.4.10 (Note 2) (Note 3)	Transfer value at 4.4.09	Change in transfer value (Note 2) (Note 3)	Additional pensions earned in year	Transfer value of the increase	Directors' contributions in year
	£'000 (a)	£'000 (b)	£'000 (c)	£'000 (d)	£'000 (c)-(d)	£'000 (e)	£'000 (f)	£'000 (g)
G J Beale	242	229	4,480	4,053	427	13	223	28
S D M Bernau	122	288	3,105	6,190	(3,085)	-	-	10
M M Rennison	42	32	732	550	182	10	152	22
D J Rigney	86	81	1,438	1,298	140	5	76	22
M P V Wyles	51	44	995	1,108	(113)	7	118	7

Notes:

1. C S Rhodes is not a member of a Society pension scheme. He has opted to receive a cash allowance of 33% of his salary in lieu of any pension accrual. T P Prestedge is a member of the Nationwide Group Personal Pension arrangement to which the Society makes contributions. He made contributions totalling £18,000 to the scheme in the year.
2. S D M Bernau was a member of the Nationwide Pension Fund as well as a member of the Society's funded unregistered pension scheme which provides benefits in the form of a lump sum. He retired from the Society on 31 July 2009 and took a net combined lump sum from both arrangements of £1,822,000 which is reflected in his lower pension and transfer value at 4 April 2010.
3. M P V Wyles was a member of the Portman Pension Scheme which merged with the Nationwide Pension Fund on 30 September 2009. As a result, the assumptions used to calculate transfer values changed. The transfer value calculated at 4 April 2010 is consistent with the transfer values calculated for other directors who are members of the Nationwide Pension Fund.

Explanations:

(a) and (b) show deferred pension entitlements at 4 April 2010 and 2009 respectively.

(c) is the transfer value of the deferred pension in (a) calculated at 4 April 2010.

(d) is the equivalent transfer value at 4 April 2009 of the deferred pension in (b) on the assumption that the director left service on that date.

(e) is the increase in pension built up during the year recognising the additional service completed and the effect of pay changes in 'real' (inflation adjusted) terms on the pension already earned at the start of the year.

(f) is the capital value of the pension in (e).

(g) contributions are inclusive of salary sacrifice contributions.

Other directorships

The Group supports executive directors who wish to take non executive directorships to contribute to industry-wide developments or broaden their experience. Directors are entitled to retain any fees they may receive. Graham Beale is a director of Visa Europe Limited and Visa Europe Services Incorporated for which he has received fees of €30,000. These fees have been voluntarily assigned to the Group for the year end 4 April 2010. David Rigney was a director of HM Land Registry until 23 March 2010 and has received fees of £18,000.

Stella David
Chairman of the Remuneration Committee
25 May 2010

Independent Auditors' Report

To the members of Nationwide Building Society

We have audited the Group and Society Annual Accounts of Nationwide Building Society for the year ended 4 April 2010 which comprise the Income Statements, Statements of Comprehensive Income, Balance Sheets, Statements of Movements in Members' Interests and Cash Flow Statements for the Group and Society together with their related notes. These Annual Accounts have been prepared under the accounting policies set out therein. We have also audited the information in the Report of the Directors on Remuneration that is described as having been audited.

We have examined the Annual Business Statement (other than the details of Directors and Officers upon which we are not required to report) and the Directors' Report.

Respective responsibilities of Directors and Auditors

The Directors' responsibilities for the preparation of the Annual Report, including the Annual Accounts, the Report of the Directors on Remuneration, the Annual Business Statement and the Directors' Report, in accordance with applicable law and International Financial Reporting Standards (IFRS), as adopted by the European Union, are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the Annual Accounts and the part of the Report of the Directors on Remuneration to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for, and only for, the Society's Members as a body in accordance with Section 78 of the Building Societies Act 1986 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the Annual Accounts give a true and fair view and whether the Annual Accounts and the part of the Report of the Directors on Remuneration to be audited have been properly prepared in accordance with the Building Societies Act 1986, regulations made under it and Article 4 of the IAS Regulation. We also report to you our opinion as to whether certain information included within the Annual Business Statement gives a true representation of the matters in respect of which it is given, whether the information given in the Directors' Report is consistent with the accounting records and the Annual Accounts, and whether the Annual Business Statement and the Directors' Report have been prepared in accordance with the applicable requirements of the Building Societies Act 1986 and regulations made under it.

We also report to you if, in our opinion, the Annual Accounts are not in agreement with the accounting records, or if we have not received all the information and explanations we require for our audit.

We read other information contained in the Annual Report and consider whether it is consistent with the audited Annual Accounts. This other information comprises only the Financial Highlights, the Chairman's Statement, the Chief Executive's Review, the Business Review, the Corporate Responsibility Report, Nationwide Foundation, Board Biographies, the Report of the Directors on Corporate Governance and the unaudited part of the Report of the Directors on Remuneration.

We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Annual Accounts, the Annual Business Statement or the Directors' Report. Our responsibilities do not extend to any other information.

Basis of Audit Opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Annual Accounts, the Annual Business Statement and the part of the Report of the Directors on Remuneration to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Annual Accounts, and of whether the accounting policies are appropriate to the Group's and Society's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Annual Accounts and the part of the Report of the Directors on Remuneration to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Annual Accounts and the part of the report of the Directors on Remuneration to be audited.

Opinion

In our opinion:

- The Annual Accounts give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's and the Society's affairs at 4 April 2010 and of the Group's and the Society's income and expenditure and cash flows for the year then ended;
- 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;
- The information given in the Directors' Report is consistent with the accounting records and the Annual Accounts; and
- The Annual Accounts, the part of the Report of the Directors on Remuneration to be audited, the Annual Business Statement and the Directors' Report have each been prepared in accordance with the applicable requirements of the Building Societies Act 1986 and regulations made under it and, as regards the Annual Accounts, Article 4 of the IAS Regulation.

Richard Oldfield
Senior Statutory Auditor
For and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
25 May 2010

Income Statements

For the year ended 4 April 2010

		Group		Society	
		2010	2009 (Adjusted)	2010	2009 (Adjusted)
	Notes	£m	£m	£m	£m
Interest receivable and similar income	3	4,568	9,250	4,616	9,365
Interest expense and similar charges	4	2,854	7,492	3,226	7,941
Net interest income		1,714	1,758	1,390	1,424
Fee and commission income	5	378	359	364	336
Fee and commission expense	6	(5)	(4)	(4)	(3)
Income from investments	7	1	16	353	37
Other operating income	8	47	123	46	127
Gains from derivatives and hedge accounting	9	34	10	31	11
Total income		2,169	2,262	2,180	1,932
Administrative expenses	10	1,195	1,252	1,151	1,202
Depreciation and amortisation		151	126	150	125
Impairment loss on loans and advances to customers	12	549	394	450	256
Provisions for liabilities and charges	33	(103)	249	(106)	249
Impairment losses on investment securities	16	36	51	36	51
Profit before tax		341	190	499	49
Analysed as:					
• Profit before tax, FSCS levies, transformation costs, gains from derivatives and hedge accounting, gains on business combinations and portfolio acquisition		212	393	373	251
• FSCS levies – release/(charge)	33	117	(241)	117	(241)
• Transformation costs	10	(62)	(107)	(62)	(107)
• Gains from derivatives and hedge accounting		34	10	31	11
• Gains on business combinations and portfolio acquisition	8	40	135	40	135
Profit before tax		341	190	499	49
Taxation	13	77	44	18	8
Profit after tax		264	146	481	41

The audited 4 April 2009 income statements have been adjusted to reflect changes made to the initial accounting for the acquisition of core parts of the Dunfermline Building Society. Further information is given in notes 1 and 49.

The accounting policies and notes on pages 75 to 154 form part of these Accounts.

Statements of Comprehensive Income

For the year ended 4 April 2010

	Notes	Group 2010	Group 2009 (Adjusted)	Society 2010	Society 2009 (Adjusted)
		£m	£m	£m	£m
Profit after tax		**264**	146	**481**	41
Other comprehensive income:					
Available for sale investments:					
• Fair value movements taken to equity		**1,834**	(2,216)	**1,788**	(2,218)
• Amount transferred to income statement		**(55)**	4	**(55)**	4
• Taxation	13	**(485)**	621	**(486)**	621
		1,294	(1,591)	**1,247**	(1,593)
Revaluation of property:					
• Revaluation before tax		**1**	(72)	**1**	(72)
• Taxation	13	**-**	20	**-**	20
		1	(52)	**1**	(52)
Actuarial loss on retirement benefit obligations:					
• Actuarial loss before tax	37	**(169)**	(321)	**(169)**	(321)
• Taxation	13	**48**	90	**48**	90
		(121)	(231)	**(121)**	(231)
Cash flow hedge amortisation		**-**	(2)	**-**	(2)
Total comprehensive income		**1,438**	(1,730)	**1,608**	(1,837)

The audited 4 April 2009 statements of comprehensive income have been adjusted to reflect changes made to the initial accounting for the acquisition of core parts of the Dunfermline Building Society. Further information is given in notes 1 and 49.

The accounting policies and notes on pages 75 to 154 form part of these Accounts.

Balance Sheets

At 4 April 2010

		Group		Society	
		2010	2009 (Adjusted)	**2010**	2009 (Adjusted)
	Notes	**£m**	£m	**£m**	£m
Assets					
Cash and balances with the Bank of England		**3,994**	8,205	**3,994**	8,197
Loans and advances to banks	15	**2,017**	5,033	**1,960**	4,987
Investment securities – available for sale	16	**23,385**	21,223	**23,294**	21,214
Derivative financial instruments	17	**4,852**	5,859	**1,932**	2,820
Fair value adjustment for portfolio hedged risk	18	**2,638**	3,408	**2,638**	3,408
Loans and advances to customers	19	**152,429**	155,469	**133,133**	135,432
Investments in equity shares	20	**86**	81	**26**	20
Investments in group undertakings	21	**-**	-	**18,853**	20,985
Intangible assets	22	**353**	211	**341**	199
Property, plant and equipment	23	**916**	886	**907**	873
Investment properties	24	**9**	9	**9**	9
Accrued income and expenses prepaid	25	**77**	743	**2,803**	1,805
Deferred tax assets	26	**357**	866	**314**	785
Other assets		**284**	360	**293**	359
Total assets		**191,397**	202,353	**190,497**	201,093
Liabilities					
Shares	27	**120,943**	128,292	**120,943**	128,292
Deposits from banks	28	**8,031**	13,283	**7,009**	12,450
Other deposits	29	**4,509**	5,673	**11,359**	10,888
Due to customers	30	**5,085**	4,371	**973**	810
Debt securities in issue	31	**36,802**	34,794	**32,184**	32,452
Fair value adjustment for portfolio hedged risk	18	**106**	239	**106**	239
Derivative financial instruments	17	**4,942**	5,986	**5,554**	7,080
Other liabilities	32	**529**	671	**2,708**	743
Provisions for liabilities and charges	33	**118**	271	**115**	271
Accruals and deferred income	34	**376**	354	**369**	363
Subordinated liabilities	35	**2,166**	2,233	**2,166**	2,233
Subscribed capital	36	**1,524**	1,526	**1,524**	1,526
Current tax liabilities		**42**	51	**17**	60
Retirement benefit obligations	37	**508**	331	**507**	331
Total liabilities		**185,681**	198,075	**185,534**	197,738
General reserve		**6,363**	6,218	**5,624**	5,262
Revaluation reserve		**68**	69	**68**	69
Available for sale reserve		**(715)**	(2,009)	**(729)**	(1,976)
Total reserves & liabilities		**191,397**	202,353	**190,497**	201,093

The audited 4 April 2009 balance sheets have been adjusted to reflect changes made to the initial accounting for the acquisition of core parts of the Dunfermline Building Society. Further information is given in notes 1 and 49.

The accounting policies and notes on pages 75 to 154 form part of these Accounts.

Approved by the Board of Directors on 25 May 2010.

G M T Howe Chairman
R P Walther Joint Deputy Chairman
G J Beale Director and Chief Executive
M M Rennison Group Finance Director

Group Statement of Movements in Members' Interests

For the year ended 4 April 2010

	General reserve	Revaluation reserve	AFS reserve	Cash flow reserve	Total
	£m	£m	£m	£m	£m
At 5 April 2009 (adjusted)	6,218	69	(2,009)	-	4,278
Profit for the year	264	-	-	-	264
Net movement in available for sale reserve	-	-	1,294	-	1,294
Revaluation of property	-	1	-	-	1
Reserve transfer	2	(2)	-	-	-
Net actuarial loss on retirement benefit obligations	(121)	-	-	-	(121)
Total comprehensive income	145	(1)	1,294	-	1,438
At 4 April 2010	6,363	68	(715)	-	5,716

For the year ended 4 April 2009 (adjusted)

	General reserve	Revaluation reserve	AFS reserve	Cash flow reserve	Total
	£m	£m	£m	£m	£m
At 5 April 2008	6,303	121	(418)	2	6,008
Profit for the year	146	-	-	-	146
Net movement in available for sale reserve	-	-	(1,591)	-	(1,591)
Revaluation of property	-	(52)	-	-	(52)
Net actuarial loss on retirement benefit obligations	(231)	-	-	-	(231)
Cash flow hedge amortisation	-	-	-	(2)	(2)
Total comprehensive income	(85)	(52)	(1,591)	(2)	(1,730)
At 4 April 2009 (adjusted)	6,218	69	(2,009)	-	4,278

The 4 April 2009 profit for the year has been adjusted to reflect changes made to the initial accounting for the acquisition of core parts of the Dunfermline Building Society. Further information is given in notes 1 and 49.

Society Statement of Movements in Members' Interests

For the year ended 4 April 2010

	General reserve	Revaluation reserve	AFS reserve	Cash flow reserve	Total
	£m	£m	£m	£m	£m
At 5 April 2009 (adjusted)	5,262	69	(1,976)	-	3,355
Profit for the year	481	-	-	-	481
Net movement in available for sale reserve	-	-	1,247	-	1,247
Revaluation of property	-	1	-	-	1
Reserve transfer	2	(2)	-	-	-
Net actuarial loss on retirement benefit obligations	(121)	-	-	-	(121)
Total comprehensive income	362	(1)	1,247	-	1,608
At 4 April 2010	5,624	68	(729)	-	4,963

For the year ended 4 April 2009 (adjusted)

	General reserve	Revaluation reserve	AFS reserve	Cash flow reserve	Total
	£m	£m	£m	£m	£m
At 5 April 2008	5,452	121	(383)	2	5,192
Profit for the year	41	-	-	-	41
Net movement in available for sale reserve	-	-	(1,593)	-	(1,593)
Revaluation of property	-	(52)	-	-	(52)
Net actuarial loss on retirement benefit obligations	(231)	-	-	-	(231)
Cash flow hedge amortisation	-	-	-	(2)	(2)
Total comprehensive income	(190)	(52)	(1,593)	(2)	(1,837)
At 4 April 2009 (adjusted)	5,262	69	(1,976)	-	3,355

The 4 April 2009 profit for the year has been adjusted to reflect changes made to the initial accounting for the acquisition of core parts of the Dunfermline Building Society. Further information is given in notes 1 and 49.

The accounting policies and notes on pages 75 to 154 form part of these Accounts.

Cash Flow Statements

For the year ended 4 April 2010

		Group		Society	
		2010	2009 (Adjusted)	2010	2009 (Adjusted)
	Notes	£m	£m	£m	£m
Cash flows from operating activities					
Profit before tax		341	190	499	49
Adjustments for:					
• Non-cash items included in profit before tax	47	580	493	582	399
• Changes in operating assets	47	5,377	(11,416)	4,966	(9,565)
• Changes in operating liabilities	47	(11,305)	9,425	(11,099)	7,974
• Interest paid on subordinated liabilities		(91)	(102)	(91)	(102)
• Interest paid on subscribed capital		(87)	(127)	(87)	(127)
• Dividend Income		(1)	(16)	(353)	(37)
• Taxation		(17)	69	(21)	69
Net cash flows from operating activities		(5,203)	(1,484)	(5,604)	(1,340)
Cash flows from investing activities					
Purchase of investment securities		(12,942)	(14,681)	(12,942)	(14,681)
Sale and maturity of investment securities		11,283	18,159	11,325	18,014
Purchase of property, plant and equipment		(153)	(205)	(152)	(203)
Sale of property, plant and equipment		10	4	8	4
Sale of investment properties		-	2	-	-
Purchase of intangible assets		(184)	(61)	(184)	(61)
Purchase of Dunfermline social housing portfolio	48	(377)	-	(377)	-
Dividends received		1	16	353	37
Cash and cash equivalents acquired on transfer of engagements and acquisition		-	2,754	-	2,754
Net cash flows from investing activities		(2,362)	5,988	(1,969)	5,864
Cash flows from financing activities					
Maturity of subordinated liabilities		(15)	(325)	(15)	(325)
Net cash flows from financing activities		(15)	(325)	(15)	(325)
Net (decrease)/increase in cash		(7,580)	4,179	(7,588)	4,199
Cash and cash equivalents at start of year		13,391	9,212	13,342	9,143
Cash and cash equivalents at end of year	47	5,811	13,391	5,754	13,342

The 4 April 2009 cash flow statements have been adjusted to reflect changes made to the initial accounting for the acquisition of core parts of the Dunfermline Building Society. Further information is given in notes 1 and 49.

Notes to the Accounts

Statement of Accounting Policies 01

Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC), as adopted by the European Union (EU), and with those parts of the Building Societies (Accounts and Related Provisions) Regulations 1998 (as amended) applicable to organisations reporting under IFRS. The financial statements have been prepared under the historical cost convention as modified by the revaluation of investment properties, land and buildings, available for sale assets and certain other deposits and derivatives. A summary of the Group's accounting policies is set out below.

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates. Further details on critical accounting estimates are given in note 2.

The Group's provisioning methodology for the Financial Services Compensation Scheme levy has been reviewed during the year in light of emerging industry consensus. The review has resulted in the amount provided by the Group at 4 April 2010 being restricted to levies in respect of scheme years triggered by the reporting date. Further details are given in note 33.

Business combinations and portfolio acquisition

The Society acquired the Derbyshire, the Cheshire and core parts of the Dunfermline building societies on 1 December 2008, 15 December 2008 and 30 March 2009 respectively. These business combinations have been accounted for following the requirements of IFRS 3 (2008 Revised) 'Business Combinations' which was endorsed by the EU in June 2009. Further information is provided in notes 49 and 50.

The former Dunfermline Building Society social housing portfolio was not part of the original acquisition on 30 March 2009. This portfolio was acquired from DBS Bridge Bank Limited on 30 June 2009. The acquisition of the social housing portfolio has been treated as the purchase of a mortgage book in line with IAS 39 'Financial Instruments: Recognition and Measurement'. Further information is provided in note 48.

Gains on portfolio acquisition of £40 million relate to the acquisition of the Dunfermline Building Society social housing portfolio. The 2009 gains on business combinations totalling £135 million relate to the acquisitions of the Cheshire Building Society and core parts of the Dunfermline Building Society. Further details are provided in notes 48 to 50.

Transformation costs totalling £62 million relate to the acquisition of the Dunfermline Building Society and other costs relating to the restructuring of parts of our business (2009: £107 million relating to the acquisition of the Derbyshire and the Cheshire building societies, core parts of the Dunfermline Building Society and other costs relating to the restructuring of parts of our business). Further details of transformation costs are given in note 10.

Results relating to the acquisition of the Derbyshire, the Cheshire and the Dunfermline building societies are included with effect from the date of completion of the acquisitions, 1 December 2008, 15 December 2008 and 30 March 2009 respectively. Results relating to the acquisition of the Dunfermline Building Society social housing portfolio are included with effect from the date of completion of the acquisition, 30 June 2009.

Adjustment to audited 4 April 2009 comparative information

As the acquisition of core parts of the Dunfermline Building Society took place on 30 March 2009, immediately prior to the 4 April 2009 year end, the information required to value the acquisition was incomplete. The initial accounting for Dunfermline was thus determined provisionally in the 2009 Annual Report and Accounts. In accordance with IFRS 3 (2008 Revised) adjustments to the provisional amounts disclosed in the 2009 Annual Report and Accounts have been recognised as if the final accounting for the business combination had been completed at the acquisition date. The audited comparative information for 4 April 2009 has thus been adjusted. The impact on the 4 April 2009 consolidated income statement is to reduce other operating income and profit before tax by £22 million, to reduce taxation by £6 million and to reduce profit after tax by £16 million. Further information is given in note 49.

Changes in accounting policy

The following IFRS and IFRIC pronouncements, relevant to the Group, have been adopted:

- IFRS 7 'Improving disclosures about financial instruments': The amendment clarifies and enhances disclosures concerning fair value measurement and the liquidity risk of financial instruments. The amendment has resulted in enhanced disclosures regarding fair value measurement which are provided in notes 44 and 45;
- IFRS 8 'Operating segments': IFRS 8 replaces IAS 14 'Segment reporting', and requires the reporting of information on operating segments based on how financial information is reported and evaluated internally. The Group has reviewed its processes of internal reporting of operating segments to the chief operating decision maker for the purposes of allocating resources to segments and assessing segmental performance. Further details on the changes are given in note 14;
- IAS 1 'Presentation of financial statements': Adoption of the revised standard has amended the presentation of the financial statements. The effect has been to replace the statements of recognised income and expense and movements in reserves with a statement of comprehensive income and a statement of movements in members' interests. There has been no change to the recognition, measurement or disclosure of transactions and events resulting from the adoption of the revised IAS 1;
- IAS 23 'Borrowing costs': The revised IAS 23 eliminates the option to recognise all borrowing costs immediately as an expense to the extent that they relate to assets that take a substantial time to get ready for intended use or sale. The revised standard requires such

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Statement of Accounting Policies (continued) 01

costs to be capitalised. This is in accordance with the Group's current policy. The Group has reviewed the revised standard with reference to the ongoing investment in systems and infrastructure and will continue to capitalise directly attributable interest. In the year ended 4 April 2010 the Group capitalised £6 million on this basis;

- IFRIC 13 'Customer loyalty programmes': The IFRIC addresses accounting by entities who grant customer loyalty awards to customers as part of sales transactions which can be redeemed in the future for free or discounted goods or services. The Group does not grant customer loyalty awards which fall within the scope of this IFRIC. The IFRIC has thus had no impact on the results to 4 April 2010;
- 'Improvements to IFRSs' (May 2008): The pronouncement includes several small amendments which have had no significant impact for the Group;
- IFRIC 16 'Hedges of a net investment in foreign operations': The IFRIC applies to an entity that hedges foreign currency risk arising from net investments in foreign operations and wishes to qualify for hedge accounting in accordance with IAS 39. The Group currently has no such hedges of net investments in foreign operations. The IFRIC has thus had no impact on the results to 4 April 2010;
- IFRIC 9 & IAS 39 'Embedded Derivatives': The amendments clarify that, on reclassification, an entity would be required to assess whether an embedded derivative would have to be separately accounted for under IAS 39. The amendment has had no impact on the results to 4 April 2010; and
- IAS 32 'Financial Instruments: Presentation' & IAS 1 'Presentation of financial statements – puttable financial instruments and obligations arising on liquidations (amended)': The amendment requires some puttable financial instruments and some financial instruments, that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation, to be classified as equity (currently would be classified as financial liabilities). The Society has issued no such instruments and thus this amendment has had no impact on the results to 4 April 2010.

Future Accounting Developments

The following pronouncements will be relevant to the Group but were not effective at 4 April 2010 and have not been applied in preparing these financial statements. The full impact of these accounting changes is being assessed by the Group; however, the initial view is that these pronouncements, with the exception of IFRS 9, are not expected to cause any significant impact on the Group accounts, as outlined in the following tables.

The following pronouncements, potentially relevant to the Group, have been adopted by the European Union (EU) but are not yet effective:

Pronouncement	Nature of change	Effective date
IAS 27 (Revised) Consolidated and separate financial statements	The amendment requires the effects of all transactions with non controlling interests to be recorded in equity if there has been no change in control. It also specifies the accounting when control is lost.	Accounting periods (AP) beginning on or after 1 July 2009
IAS 39 & IFRIC 9 Eligible Hedged Items (July 2008)	The amendment clarifies how existing principles underlying hedge accounting should be applied in two particular situations: a) one sided risk in a hedged item; and b) inflation in a financial hedged item.	AP beginning on or after 1 July 2009
IFRIC 14 Prepayments of a minimum funding requirement	The amendment applies when an entity makes an early payment of minimum funding requirements. The amendment permits such an entity to treat the benefit of an early payment as an asset.	AP beginning on or after 1 January 2011
Improvements to IFRS's (April 2009)	Several small amendments with no significant impact for the Group.	Varies, mainly AP beginning on or after 1 January 2010

The following pronouncement, relevant to the Group, is neither adopted by the EU nor effective for this financial year:

Pronouncement	Nature of change	Effective date
IFRS 9 Financial Instruments – Classification and Measurement	The new standard addresses phase 1 of the IASB's project to replace IAS 39 'Financial Instruments' and requires financial assets to be classified as at amortised cost or at fair value. The available for sale (AFS) category currently used by the Group will not be available. Phase 1 will have a significant impact on the classification and measurement of financial assets for the Group. Early adoption is permitted, once endorsed by the EU. The impact of IFRS 9 on the Group is currently being considered.	AP beginning on or after 1 January 2013

Statement of Accounting Policies (continued) 01

Basis of consolidation

The Group accounts consolidate the assets, liabilities and results of the Society and all its subsidiaries.

Subsidiaries are all entities, including special purpose entities, over which the Society has the power to govern the financial and operating policies generally. Subsidiaries are fully consolidated from the date on which control is transferred to the Group and are de-consolidated from the date that control ceases. Upon consolidation, inter-company transactions, balances and unrealised gains on transactions are eliminated.

Investments in subsidiary undertakings are stated in the Society accounts at cost less provisions for any impairment in value. The Directors consider it appropriate for administrative and commercial reasons that subsidiary undertakings have financial years ending on 31 March. Certain special purpose entities have year ends other than 31 March and are therefore consolidated using internal management accounts prepared to that date. Adjustment is made for individually significant transactions arising between 31 March and the Society's year end.

On 1 February 2010 Nationwide Building Society acquired the personal loan business of subsidiary company Nationwide Trust Limited. This transfer of the business has occurred between Group entities using the historic cost of the assets. This is the approach permitted by IFRS 3 for transactions between entities under common control. With effect from 1 February 2010 all new personal loans are advanced by the Society and the Society has legal responsibility for all existing personal loans. Nationwide Trust Limited has ceased to trade and will become a dormant company. Therefore the Society income statement includes the results of the personal loan business since the transfer date. This transaction has no impact on the Group results.

Securitisation transactions

The Group has securitised certain mortgage loans by the transfer of the loans to special purpose entities (SPEs) controlled by the Group. The securitisation enables a subsequent issuance of debt, either by the Society or the SPEs, to investors who gain the security of the underlying assets as collateral. The SPEs are fully consolidated into the Group's accounts.

The transfers of the mortgage loans to the SPEs are not treated as sales by the Society. The Society continues to recognise the mortgage loans on its own balance sheet after the transfer because it retains their risks and rewards through the receipt of substantially all of the profits or losses of the SPEs. In the accounts of the Society, the proceeds received from the transfer are accounted for as a deemed loan repayable to the SPEs.

As explained in note 19, the Group has also entered into self issuances of debt to be used as collateral for repurchase ('repo') and similar transactions. Investments in self issued debt and the equivalent deemed loan, together with the related income, expenditure and cash flows are not recognised in the Society's financial statements. This avoids the 'grossing-up' of the financial statements that would otherwise arise.

To manage interest rate risk, the Society enters into derivative transactions with the SPEs, receiving a rate of interest based on the securitised mortgages and paying a rate inherent in the debt issuances. In accordance with IAS 39, these internal derivatives are treated as part of the deemed loan and not separately fair valued because the relevant mortgage loans are not derecognised. Cash flows arising from these internal derivatives are accounted for on an accruals basis. All other derivatives relating to securitisations are treated as explained in the derivatives and hedge accounting policy below.

Interest receivable and interest expense

For instruments measured at amortised cost the effective interest rate (EIR) method is used. The EIR method is used to measure the carrying value of a financial asset or a liability and to allocate associated interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

In calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument (for example, early redemption penalty charges) but does not consider future credit losses. The calculation includes all fees received and paid and costs borne that are an integral part of the effective interest rate and all other premiums or discounts above or below market rates.

Interest income on available for sale assets, derivatives and other financial assets at fair value through the income statement is included in interest receivable and similar income. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Fees and commissions

Fees and costs which are directly attributable and incremental to generating a financial instrument are deferred and spread as interest receivable or expense on an effective interest rate basis.

Other fees and commissions are recognised on the accruals basis as services are provided, or on the performance of a significant act.

Segmental reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the Executive Directors' Committee. The Executive Directors' Committee, which is responsible for allocating resources and assessing performance of operating segments, has been identified as the chief operating decision maker.

No segmental analysis is presented on geographical lines because substantially all of the Group's activities are in the United Kingdom, the Isle of Man and the Republic of Ireland.

Intangible assets

(a) Goodwill

Goodwill represents the excess of the consideration transferred for an acquisition over the fair value of the Group's share of the net identifiable assets (including the fair value of contingent liabilities) of the acquired

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Statement of Accounting Policies (continued) 01

business at the date of acquisition. Goodwill on acquisitions is included as an intangible asset. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. The impairment test compares the carrying value of goodwill to the underlying associated asset value in use. If the carrying value exceeds the value in use, goodwill is considered impaired. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

A bargain purchase resulting in negative goodwill arises when the fair value of net identifiable assets acquired exceeds the cost of an acquisition. Negative goodwill is recognised as a gain in the income statement.

(b) Computer Software

IAS 38 'Intangible Assets' requires the capitalisation of certain expenditure relating to software development costs. Software development costs are capitalised if it is probable that the asset created will generate future economic benefits. Costs incurred to establish technological feasibility or to maintain existing levels of performance are recognised as an expense.

Web development costs are capitalised where the expenditure is incurred on developing an income generating website.

Where software costs are capitalised, they are amortised using the straight line method over their estimated useful lives (3 to 10 years). The amortisation periods used are reviewed annually.

Computer application software licences are recognised as intangible fixed assets and amortised using the straight line method over their useful lives.

(c) Other intangibles

Other intangibles, which largely represents core deposit intangibles acquired by the Group, are amortised using the straight line method over their estimated useful lives of between 5 and 10 years. The amortisation period is reviewed annually.

Leases

Leases entered into by the Group are primarily operating leases. Operating leases are leases that do not transfer substantially all the risks and rewards incidental to ownership to the lessee.

(a) As lessee

The Group has entered into operating leases for land and buildings. Operating lease payments are charged to the income statement on a straight line basis over the life of the lease.

(b) As lessor

Lease income receivable under operating leases is credited to the income statement on a straight line basis over the life of the lease.

Taxation including deferred tax

Corporation tax payable on profits, based on the applicable tax law in each jurisdiction, is recognised as an expense in the period in which profits arise. The tax effects of tax losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is determined using tax rates and laws that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred tax is provided on temporary differences arising from investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future.

Tax related to the fair value re-measurement of available for sale assets, which is charged or credited to other comprehensive income, is also credited or charged to other comprehensive income and is subsequently reclassified from other comprehensive income to the income statement together with the deferred gain or loss.

Tax related to movements in the valuation of property, which are charged or credited to other comprehensive income and accumulated in the revaluation reserve, is also credited or charged to other comprehensive income and accumulated in the revaluation reserve.

Tax related to actuarial losses or gains on retirement benefit obligations, which are charged or credited to other comprehensive income, is also credited or charged to other comprehensive income.

Property, plant and equipment

Freehold and long leasehold properties comprise mainly branches and office buildings.

Branches and non specialised buildings are stated at revalued amounts, being the fair value, determined by market based evidence, at the date of the valuation less any subsequent accumulated depreciation and subsequent impairment. Valuations are completed annually by independent surveyors.

Increases in the valuations of branches and non specialised buildings are credited to other comprehensive income except where they reverse decreases for the same asset previously recognised in the income statement, in which case the increase in the valuation is recognised in the income statement. Decreases in valuations are recognised in the income statement except where they reverse amounts previously credited to other comprehensive income for the same asset, in which case the decrease in valuation is recognised in other comprehensive income.

Other property, plant and equipment, including specialised administration buildings and short leasehold buildings, are included at historical cost less accumulated depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items, major alterations and refurbishments. Where applicable, directly attributable borrowing costs incurred in the construction of qualifying assets are capitalised.

Statement of Accounting Policies (continued)

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Land is not depreciated. Depreciation on other assets commences when the assets are ready for their intended use and is calculated using the straight line method to allocate their cost or valuation over the following estimated useful lives:

Branches and non specialised buildings	60 years
Specialised administration buildings	up to 60 years
Short leasehold buildings	over the period of the lease
Other equipment	3 to 10 years

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

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing the net disposal proceeds with the carrying amount of the asset and are included in the income statement.

Investment properties

Investment properties, which comprise properties held for rental, are stated at fair value. The properties are revalued annually by independent surveyors supported by market evidence. Changes in fair value are included in the income statement. Depreciation is not charged on investment properties.

Employee benefits

(a) Pensions

The Group operates a number of defined benefit and defined contribution pension arrangements. The majority of the Group's employees are members of the defined benefit plans. A defined benefit plan is one that defines the benefit an employee will receive on retirement, depending on such factors as age, length of service and salary.

The liability recognised in the balance sheet in respect of the defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets. The defined benefit obligation is calculated by the independent actuary using the projected unit credit method and assumptions agreed with the Group. The present value of the defined benefit obligation is determined by discounting the estimated future cash flows using interest rates of high-quality corporate bonds that have terms to maturity approximating to the terms of the related pension liability.

Actuarial gains and losses arise from experience adjustments (the effects of differences between previous actuarial assumptions and what has actually occurred) and changes in actuarial assumptions. Actuarial gains and losses are recognised in full, in the year they occur, in other comprehensive income.

The Group also operates defined contribution arrangements. A defined contribution arrangement is one into which the Group and the employee pay fixed contributions, without any further obligation to pay further contributions. Payments to defined contribution schemes are charged to the income statement as they fall due.

Past service costs are recognised immediately in the income statement, unless the changes to the benefits are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs are amortised on a straight line basis over the vesting period.

(b) Other post-retirement obligations

The Group provides post-retirement healthcare to a small number of former employees. The Group recognises this obligation and the actuarial gains and losses in a similar manner to the defined benefit pension plans.

(c) Other long term employee benefits

The cost of bonuses payable twelve months or more after the end of the year in which they are earned are recognised in the year in which the employees render the related service.

(d) Short term employee benefits

The cost of short term employee benefits, including wages and salaries, social security costs and healthcare for current employees is recognised in the year of service.

Provisions

A provision is recognised where there is a present obligation as a result of a past event, it is probable that the obligation will be settled and it can be reliably estimated.

Nationwide has an obligation to contribute to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet compensation claims from, in particular, retail depositors of failed banks. A provision is recognised to the extent it can be reliably estimated based on information provided by the FSCS, forecasted future interest rates and our historic share of industry protected deposits. Further details are included in note 33.

Assets classified as held for sale and associated liabilities

In accordance with IFRS 5 'Non-current assets held for sale and discontinued operations', the Group classifies assets and liabilities as held for sale, where they will be recovered principally through a sale transaction rather than through continuing use. The assets and liabilities are carried at the lower of their carrying amount and fair value less cost to sell except for financial assets which are included at fair value.

At 4 April 2010 assets classified as held for sale of £1 million (2009: £2 million) were included within other assets on the balance sheet. These assets were not shown separately on the balance sheet due to the insignificant size of the balance.

Financial assets

The Group classifies its financial assets at inception into the following four categories:

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Statement of Accounting Policies (continued)

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(a) Financial assets at fair value through the income statement
This category consists of derivative financial assets and those assets designated as financial assets at fair value through the income statement at inception, including all mortgage commitments entered into where a loan has not yet been made. The Group does not hold any financial assets classified as held for trading.

Financial assets at fair value through the income statement are carried at fair value. The fair values of derivative instruments are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from counterparties.

Gains and losses arising from the changes in the fair values are recognised in the income statement.

(b) Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Group's residential and commercial mortgage loans, unsecured lending and loans to banks are classified as loans and receivables.

Loans are recognised when the funds are advanced to customers. Loans and receivables are carried at amortised cost using the effective interest rate method less provisions for impairment. Further details are included in note 45.

Loans and receivables acquired through business combinations have been recognised at fair value at the acquisition date. This fair value at acquisition becomes the new amortised cost for acquired loans and receivables.

(c) Available for sale (AFS)
AFS assets are non-derivative financial assets that are not classified into either of the two categories above. AFS assets are measured at fair value. Details of the fair value measurements are given in note 45.

Interest on available for sale assets is determined using the effective interest rate method (see interest receivable above).

Unrealised gains and losses arising from changes in the fair values are recognised in other comprehensive income, except for impairment losses and foreign exchange gains and losses, which are recognised in the income statement. Gains and losses arising on the sale of AFS assets, including any cumulative gains or losses previously recognised in other comprehensive income, are reclassified to the income statement.

(d) Investments in equity
Investments in equity include certain investments which are held at fair value. Movements in fair value are recognised in other comprehensive income and accumulated in the AFS reserve.

The Group has not classified any financial assets into the held to maturity category.

Purchases and sales of financial assets are accounted for at trade date.

Financial assets are derecognised when the rights to receive cash flows have expired or where the assets have been transferred and substantially all of the risks and rewards of ownership have been transferred.

The impact of hedging on the measurement of financial assets is detailed in the derivatives and hedge accounting policy below.

Impairment of financial assets

(a) Assets carried at amortised cost
The Group assesses at each balance sheet date whether, as a result of one or more events that occurred after initial recognition, there is objective evidence that a financial asset or group of financial assets is impaired. Evidence of impairment may include:

(i) indications that the borrower or group of borrowers is experiencing significant financial difficulty;

(ii) default or delinquency in interest or principal payments;

(iii) debt being restructured to reduce the burden on the borrower.

The Group first assesses whether objective evidence of impairment exists either individually for assets that are separately significant or individually or collectively for assets that are not separately significant. If there is no objective evidence of impairment for an individually assessed asset it is included in a group of assets with similar credit risk characteristics and collectively assessed for impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. The resultant provisions are deducted from the appropriate asset values in the balance sheet.

In the case of commercial loans that are considered individually significant, we assess cash flows on a case by case basis considering the following factors:

(i) our aggregate exposure to the customer;

(ii) the viability of the customer's business model and their capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;

(iii) the amount and timing of expected receipts and recoveries;

(iv) the likely dividend available on liquidation or bankruptcy;

(v) the extent of other creditors' commitments ranking ahead of Nationwide's, and the likelihood of other creditors continuing to support the company;

(vi) the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;

(vii) the realisable value of security (or other credit mitigants) and likelihood of successful repossession;

(viii) the likely deduction of any costs involved in recovery of amounts outstanding;

Statement of Accounting Policies (continued)

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(ix) when available, the secondary market price of the debt.

In the case of loans that are not considered individually significant, cash flows are estimated based on past experience combined with our view of the future considering the following factors:

(i) our aggregate exposure to the customer;

(ii) based on the number of days in arrears at the balance sheet date, the likelihood that a loan will progress through the various stages of delinquency and ultimately be written off;

(iii) the amount and timing of expected receipts and recoveries;

(iv) the realisable value of any security;

(v) the likely deduction of any costs involved in the recovery of amounts outstanding.

The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised the provision is adjusted and the amount of the reversal is recognised in the income statement.

Where a loan is not recoverable, it is written off against the related provision for loan impairment once all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the income statement.

Loans subject to collective impairment assessment and whose terms have been renegotiated are no longer considered to be past due or impaired, assuming that there is no change to the total estimated future cash flows, but are treated as new loans after the minimum required number of payments under the new arrangements have been received. Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired or are considered to be past due.

(b) Available for sale assets

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets are impaired. If any such evidence exists for available for sale financial assets, the cumulative loss, measured as the difference between the current amortised cost and the current fair value, less any impairment loss on that asset previously recognised, is recognised in the income statement.

A subsequent decline in the fair value of an investment security classified as available for sale is recognised in the income statement when there is further objective evidence of impairment as a result of further decreases in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised in other comprehensive income. If the fair value of an investment debt security classified as available for sale increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement to the extent of the increase in fair value.

Financial liabilities

Borrowings, including shares, deposits, debt securities in issue and subordinated liabilities are recognised initially at fair value, being the issue proceeds net of premiums, discounts and transaction costs incurred.

With the exception of deposits relating to the sale of protected equity bonds (previously called guaranteed equity bonds) all borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is adjusted for the amortisation of any transaction costs premiums and discounts. The amortisation is recognised in interest expense and similar charges using the effective interest method.

Permanent interest bearing shares (subscribed capital) are classified as financial liabilities.

Financial liabilities are derecognised when the obligation is discharged, cancelled or has expired.

Borrowings that are designated as hedged items are subject to measurement under the hedge accounting requirements described in the derivatives and hedge accounting policy below.

Protected equity bonds (PEBs)

Certain non-derivative financial liabilities relating to the sale of PEBs sold by the Group on behalf of Legal & General, included within other deposits, have been designated at fair value upon initial recognition in the balance sheet. Changes in fair value are recognised through the income statement in gains from derivatives and hedge accounting. The PEBs are economically matched using equity-linked derivatives, which do not meet the requirements for hedge accounting. Recording changes in fair value of both the derivatives and the related liabilities through the income statement most closely reflects the economic reality of the transactions. In so doing, this accounting treatment eliminates a measurement inconsistency that would otherwise arise from valuing the PEBs at amortised cost and the derivatives at fair value.

Income received from Legal & General upon inception of the PEB transaction is deferred and recognised in interest expense and similar charges in the income statement on an effective interest basis over the term of the product.

Derivatives and hedge accounting

Derivatives are entered into to reduce exposures to fluctuations in interest rates, exchange rates, market indices and credit risk.

(a) Derivative financial instruments

Derivatives are carried at fair value with movements in fair values recorded in the income statement. Fair values are calculated by discounted cash flow models using yield curves that are based on

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observable market data or are based on valuations from counterparties. In the first instance fair values are calculated using mid prices, with an adjustment then made to derivative assets and liabilities to value them on a bid and offer basis respectively (see note 17). An assessment is also made as to whether an adjustment is required for counterparty or own credit risk (see note 43). All derivatives are classified as assets where their fair value is positive and liabilities where their fair value is negative. Where there is the legal ability and intention to settle net, then the derivative is classified as a net asset or liability, as appropriate.

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

(b) Embedded derivatives

A number of complex contracts contain both a derivative and a non-derivative component, in which case the derivative is termed an embedded derivative. If the economic characteristics and risks of embedded derivatives are not closely related to those of the host contract, and the overall contract itself is not carried at fair value, the embedded derivative is accounted for separately and reported at fair value with gains and losses being recognised in the income statement.

For derivatives acquired through business combinations, the assessment of whether the contracts are treated as embedded derivatives or not is carried out at the acquisition date.

(c) Hedge accounting

When transactions meet the criteria specified in IAS 39, the Group applies fair value hedge accounting so that changes in the fair value of the underlying asset or liability that are attributable to the hedged risk are recorded in the income statement to offset the fair value movement of the related derivative.

To qualify for hedge accounting at inception the hedge relationship must be clearly documented. At inception the derivative must be expected to be highly effective in offsetting the hedged risk, and effectiveness must be tested throughout the life of the hedge relationship.

The Group discontinues hedge accounting when:

(i) it is evident from testing that a derivative is not, or has ceased to be, highly effective as a hedge;

(ii) the derivative expires, or is sold, terminated or exercised; or

(iii) the underlying item matures or is sold or repaid.

The Group may also decide to cease hedge accounting even though the hedge relationship continues to be highly effective by ceasing to designate the financial instrument as a hedge.

If the derivative no longer meets the criteria for hedge accounting, the cumulative fair value hedging adjustment is amortised over the period to maturity of the previously designated hedge relationship. If the underlying item is sold or repaid, the unamortised fair value adjustment is immediately reflected in the income statement.

In a micro hedge, the carrying value of the hedged item is adjusted for the change in value of the hedged risk. In the case of a portfolio hedge, the adjustment is included in fair value adjustments for hedged risk.

Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet if, and only if, there is a currently enforceable legal right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise an asset and settle the liability simultaneously.

Sale and repurchase agreements (including stock borrowing and lending)

Investment and other securities may be lent or sold subject to a commitment to repurchase them (a 'repo'). Such securities are retained on the balance sheet when substantially all the risks and rewards of ownership remain within the Group, and the counterparty liability is included separately on the balance sheet as appropriate.

Similarly, where the Group borrows or purchases securities subject to a commitment to resell them (a 'reverse repo') but does not acquire the risks and rewards of ownership, the transactions are treated as collateralised loans, and the securities are not included in the balance sheet.

The difference between sale and repurchase price is accrued over the life of the agreements using the effective interest method.

Foreign currency translation

The consolidated financial statements are presented in Sterling, which is the functional currency of the Society. Items included in the financial statements of each of the Group's entities are measured using their functional currency. Foreign currency transactions are translated into Sterling using the exchange rates prevailing at the dates of the transactions. Monetary items denominated in foreign currencies are retranslated at the rate prevailing at the year end.

Foreign exchange gains and losses resulting from the retranslation and settlement of these items are recognised in the income statement.

Exchange differences on equities held at fair value through the income statement, are reported as part of the fair value gain or loss. Fair values are translated using the exchange rate at the date that the fair value was determined.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including: cash and non-restricted balances with central banks, treasury bills and other eligible bills, loans and advances to banks, other amounts due from banks and short term government securities.

Judgements in applying accounting policies and critical accounting estimates 02

The Group has to make judgements in applying its accounting policies which affect the amounts recognised in the accounts. In addition, estimates and assumptions are made that could affect the reported amounts of assets and liabilities within the following financial year. The most significant areas where judgements and estimates are made are as follows:

Impairment provisions on loans and advances

At 4 April 2010 loans and advances to customers totalled £152,527 million (2009 adjusted: £155,220 million) against which impairment provisions of £750 million (2009: £470 million) have been made.

In accordance with the accounting policy on the impairment of financial assets carried at amortised cost, where objective evidence exists that a loss has been incurred, the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate.

Key assumptions included in the measurement of the incurred loss include data regarding the probability of any account going into default, the probability of defaulted accounts progressing to possession and the eventual loss incurred in the event of forced sale or write off. These assumptions are based on observed historical data and updated as management considers appropriate to reflect current conditions. The accuracy of the impairment provision would therefore be affected by unexpected changes in the above assumptions.

To the extent that actual cash flows differ from those estimated by 10%, the impairment provision on loans and advances would change by an estimated £109 million (2009: £67 million). On our residential mortgage books our estimate of future House Price Index (HPI) movements is also a key assumption. To the extent that future HPI movements were to differ from expectations by 5%, the impact on the impairment provision would be £17 million (2009: £12 million).

Impairment of available for sale assets

At 4 April 2010 the fair value of investment securities – available for sale assets totalled £23,385 million (2009 adjusted: £21,223 million). At 4 April 2010 impairment losses of £29 million (2009: £48 million) have been charged to the income statement and are included in the £36 million impairment of losses on investment securities.

The Group determines that available for sale assets are impaired when it is considered that there is objective evidence of impairment. In determining whether this evidence exists, the Group evaluates, among other factors, the normal volatility in valuation together with consideration of the appropriateness of valuations under the current market conditions, evidence of deterioration in the financial health of the investee, industry and sector performance and operational and financing cash flows. This determination has been supported by rigorous credit assessment, undertaken by Risk Management division, independently of our Treasury division. Further details on investment securities – available for sale assets are included in note 43.

Fair value of financial instruments

Derivative financial instruments and available for sale assets are stated at fair value.

Derivative financial instruments are principally valued by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from counterparties.

Available for sale assets are, in the majority of cases, valued using market prices or, as markets become inactive, prices obtained from market participants. In sourcing valuations, the Group makes use of a consensus pricing service, in line with standard industry practice. In cases where market prices or prices obtained from market participants are not available, discounted cash flow valuation models are used. Changes in the assumptions used in the models could affect the reported fair value of available for sale assets. In addition, prices obtained from market participants in an illiquid market are inherently less reliable and therefore careful judgement is required in applying them. Further information is provided in note 45.

Other assets and liabilities stated at fair value include mortgage commitments and our liability in relation to the protected equity bond product (PEB). Fair values for the former are calculated using discounted cash flow valuation models. The calculation of the fair value of the PEB liability includes an estimate of the expected investment return payable on maturity of the product. Further information is given in note 45.

Retirement benefit obligations (Pensions)

At 4 April 2010 net retirement obligations totalled £508 million (2009: £331 million).

The Group has to make assumptions on the discount rate, expected return on pension plan assets, mortality, inflation and future salary rises when valuing its pension liability and the cost of benefits provided. Changes in assumptions could affect the reported liability, service cost and expected return on pension plan assets.

The impact of a 0.1% increase in the inflation assumption would be to increase the carrying value of the pension obligations by approximately £60 million and vice versa. The impact of a 0.1% increase in the discount rate would be to reduce the value of the pension obligations by approximately £61 million and vice versa. The impact of a one year increase in the life expectancy at age 60 would be to increase the value of the pension obligations by approximately £70 million and vice versa. Further details on the assumptions used in valuing the retirement benefit obligations can be found in note 37.

Financial Services Compensation Scheme (FSCS)

The Group's ultimate liability for levies payable to the FSCS in respect of those financial institutions which failed during 2008 and 2009 remains uncertain.

Notes to the Accounts

continued

Judgements in applying accounting policies and critical accounting estimates (continued) 02

In the year ended 4 April 2009 the Group made a provision of its estimated share of the levies which it expected to incur in respect of the initial three year loan facility from HM Treasury and the potential compensation costs resulting from any asset recovery shortfalls to the extent they could be reliably estimated.

As at 4 April 2010 the amount provided by the Group has been restricted to the latest estimates of its share of levies in respect of scheme years triggered by the reporting date. This treatment aligns our approach with emerging industry consensus and, together with a significant reduction in the provision due principally to interest rates being lower than previously anticipated, has resulted in a credit of £117 million to the income statement for the year.

Further fees, in respect of any refinancing after the maturity of the initial 3 year loan facility, additional compensation payments should the FSCS fail to recover sufficient funds to repay its loans and amounts payable in respect of the failure of the Dunfermline Building Society, are all possible. These additional fees cannot be reliably estimated.

The provided amount is dependent upon the following factors:

- Future interest rates;
- The Group's share of industry protected deposits as at 31 December 2009; and
- The principal balance of the HM Treasury loans, including the extent to which the FSCS can recover assets to fund their repayment and validation of the costs of the savings accounts of the failed institutions that were transferred to Abbey, ING and Nationwide.

The impact of a 1% increase in the interest rate assumption would be to increase the carrying value of the FSCS provision by approximately £19 million and vice versa. The impact of the Group's share of industry protected deposits at 31 December 2009 increasing by 1% would be to increase the carrying value of the FSCS provision by approximately £4 million and vice versa. The impact of an increase in the principal balance of the HM Treasury loans of £100 million would be to increase the carrying value of the FSCS provision by approximately £1 million and vice versa.

If the Group had applied the provisioning basis previously applied at 4 April 2009 and 30 September 2009 an additional provision of £143 million would have been recognised in the balance sheet at 4 April 2010. If the current basis of estimation had been used at both 4 April 2009 and 4 April 2010 then, including the impact of changes in interest rates during the year, a net charge of £22 million would have been recognised in the income statement for the year ended 4 April 2010.

Further detail of the FSCS and the provision are included in note 33.

Interest receivable and similar income 03

	Group		Society	
	2010	2009 (Adjusted)	2010	2009 (Adjusted)
	£m	£m	£m	£m
On residential mortgages	5,289	6,473	4,469	5,605
On other loans:				
• Connected undertakings	-	-	960	710
• Other	1,150	1,526	1,007	1,340
On investment securities	1,056	1,249	1,060	1,709
On other liquid assets	47	261	101	260
Foreign exchange differences	20	-	13	-
Net expense on financial instruments hedging assets	(3,116)	(410)	(3,116)	(410)
Expected return on pension assets (note 37)	122	151	122	151
	4,568	9,250	4,616	9,365

Interest receivable and similar income (continued) 03

Included within interest receivable and similar income is interest accrued on loans 3 or more months in arrears: Group £78 million, Society £40 million (2009: Group £49 million, Society £20 million) and the unwind of the discount on the impairment provisions: Group £30 million, Society £25 million (2009: Group £10 million, Society £10 million) (note 12).

Interest receivable on residential mortgages and interest receivable on other loans, which are primarily commercial loans and loans to Registered Social Landlords, are net of amortisation of fair value adjustments relating to the acquisitions of the Derbyshire and the Cheshire building societies, core parts of the Dunfermline Building Society and the Dunfermline Registered Social Landlord loan portfolio.

The foreign exchange difference of £20 million reflects gains on foreign exchange derivatives held to mitigate to economic risk of future payments in foreign currencies.

Interest receivable on investment securities includes £76 million (2009: £24 million) relating to the sale of investment securities, which comprises a £91 million gain from the sale of gilts, offset by losses on the cancellation of interest rate swaps. Of the £76 million of net gains, £72 million was recognised in the first half of the year. The gains were achieved as a result of market movements that were driven in part by the Bank of England's policy of Quantitative Easing.

Interest expense and similar charges 04

	Group		Society	
	2010	2009	2010	2009
	£m	£m	£m	£m
On shares held by individuals	2,326	4,724	2,326	4,724
On subscribed capital	96	85	96	85
On deposits and other borrowings:				
• Subordinated liabilities	95	93	95	93
• Connected undertakings	-	–	167	270
• Other	384	1,130	299	1,437
On debt securities in issue	884	1,376	818	1,324
Foreign exchange differences	-	4	-	15
Net income on financial instruments hedging liabilities	(1,077)	(61)	(721)	(148)
Pension interest cost (note 37)	146	141	146	141
	2,854	7,492	3,226	7,941

Interest expense on shares held by individuals includes amortisation of fair value adjustments relating to the acquisitions of the Derbyshire and the Cheshire building societies and core parts of the Dunfermline Building Society.

Notes to the Accounts
continued

Fee and commission income 05

	Group		Society	
	2010	2009	2010	2009
	£m	£m	£m	£m
Mortgage related fees	28	24	21	18
Banking and savings fees	153	161	153	161
General insurance fees	124	124	117	108
Other fees and commissions	73	50	73	49
	378	359	364	336

Fee and commission expense 06

	Group		Society	
	2010	2009	2010	2009
	£m	£m	£m	£m
Mortgage related fees	1	1	-	-
Other fees and commissions	4	3	4	3
	5	4	4	3

Income from investments 07

	Group		Society	
	2010	2009	2010	2009
	£m	£m	£m	£m
Income from equity shares	1	16	1	13
Income from shares in subsidiary undertakings	-	-	352	24
	1	16	353	37

The increase in income from shares in subsidiary undertakings reflects the repatriation to the Society of reserves held by subsidiaries that are no longer operationally active.

Other operating income 08

	Group		Society	
	2010	2009 (Adjusted)	2010	2009 (Adjusted)
	£m	£m	£m	£m
Gains on portfolio acquisition and business combinations	40	135	40	135
Loss on revaluation of property, plant and equipment	(5)	(16)	(3)	(13)
Loss on revaluation and sale of investment properties	-	(6)	-	(5)
Rental income	6	7	5	7
Profit/(loss) on sale of fixed assets	1	(3)	1	(3)
Income from subsidiary undertakings	-	-	1	1
Other	5	6	2	5
	47	123	46	127

The gain on portfolio acquisition and business combinations for the year ended 4 April 2010 of £40 million relates to the social housing portfolio acquired from DBS Bridge Bank Limited on 30 June 2009. The social housing portfolio was not part of the original acquisition of core parts of the Dunfermline Building Society on 30 March 2009. Further details are provided in note 48.

Gains on portfolio acquisition and business combinations for the year ended 4 April 2009 comprised £89 million in relation to the acquisition of the Cheshire Building Society and £46 million in relation to the acquisition of core parts of the Dunfermline Building Society. The acquisition of the Dunfermline Building Society was finalised during the year as detailed in note 49.

Gains from derivatives and hedge accounting 09

	Group		Society	
	2010	2009	2010	2009
	£m	£m	£m	£m
Gains less losses on derivatives:				
• Derivatives designated as fair value hedges	895	(3,340)	817	(4,076)
• Attributable to hedged risk	(984)	3,213	(883)	3,916
	(89)	(127)	(66)	(160)
• Other assets and liabilities	174	(146)	148	(112)
• Mortgage pipeline	(51)	283	(51)	283
	34	10	31	11

Derivatives are used exclusively to hedge risk exposures and are not used for speculative purposes.

Derivatives relating to other assets and liabilities and the mortgage pipeline are those used for economic hedging but which are not in an IAS 39 hedge accounting relationship.

Notes to the Accounts

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Administrative expenses 10

	Group		Society	
	2010	2009	2010	2009
	£m	£m	£m	£m
Employee costs:				
• Wages and salaries	469	465	449	441
• Social security costs	44	40	42	38
• Pension costs (note 37)	71	94	69	91
	584	599	560	570
Other administrative expenses	611	653	591	632
	1,195	1,252	1,151	1,202
Other administrative expenses include:				
• Property operating lease rental	43	42	42	41
• Other property costs	74	67	74	65
• Postage and communications	67	68	67	68
• Computer costs	76	65	76	65
• Marketing and advertising	12	23	12	23
• Money transmission and other bank costs	70	64	69	64
• Legal and professional	27	25	23	24
• Training, education and other staff related costs	119	182	117	176
• Other	123	117	111	106
	611	653	591	632

Administrative expenses include £62 million (2009: £107 million) of transformation costs, including £7 million directly relating to business combinations (2009: £32 million). The remaining £55 million (2009: £75 million) of transformation costs primarily relate to the restructuring of parts of our business.

Directors' emoluments are shown as part of the Report of the Directors on Remuneration in accordance with Schedule 10A, paragraphs 1 to 9 to the Building Societies Act 1986.

The Finance Act 2010 has introduced a bank payroll tax of 50% applicable to bonuses over £25,000 awarded to UK bank and building society employees between 9 December 2009 and 5 April 2010. Based on this, and in accordance with IAS 19 – Employee benefits, the Group has accrued for estimated tax payable in respect of employee services. Employee costs include £2.5 million provision for these costs.

Administrative expenses (continued) 10

The remuneration of the auditors, PricewaterhouseCoopers LLP, is set out below:

	Group		Society	
	2010	2009	2010	2009
	£m	£m	£m	£m
Audit fees for the Group and Society statutory audit	1.4	1.7	1.4	1.7
Fees payable for other services:				
• Audit of subsidiaries pursuant to legislation	0.4	0.4	-	-
• Other services pursuant to legislation	0.7	0.7	0.7	0.7
• Services in relation to recruitment and retention	0.1	0.1	0.1	0.1
• All other services	0.7	2.0	0.7	2.0
	3.3	4.9	2.9	4.5

The Group policy in relation to the use of its auditors on non-audit engagements sets out the types of services they are generally precluded from performing. All non-audit services, where the fee is expected to exceed a de minimis limit, are subject to pre-approval by the Audit Committee. The 4 April 2009 fee payable for other services included extra work in respect of the acquisitions of the Derbyshire and the Cheshire building societies and acquisition of core parts of the Dunfermline Building Society.

Other services pursuant to legislation includes regulatory reporting under listing rules for the Group's funding programmes.

Employees 11

	Group		Society	
	2010	2009	2010	2009
The average number of persons employed during the year was:				
• Full-time	13,247	13,409	12,707	12,701
• Part-time	5,283	5,526	5,207	5,435
	18,530	18,935	17,914	18,136
Society				
• Central administration	8,665	8,575	8,665	8,575
• Branches	9,249	9,561	9,249	9,561
Subsidiaries	616	799	-	-
	18,530	18,935	17,914	18,136

The reduction in the average number of employees in branches reflects the centralisation of some non customer-facing administrative tasks together with the consolidation of branches in some locations following the acquisitions.

Central administration employee numbers include employees engaged in direct customer-facing operations in administrative centres.

Employee numbers for 4 April 2009 include 734 staff that transferred to the Society from Derbyshire Building Society, 627 that transferred from Cheshire Building Society and 534 that transferred from Dunfermline Building Society.

Notes to the Accounts

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Impairment provisions on loans and advances to customers 12

2010 Group	Prime residential £m	Specialist residential £m	Consumer banking £m	Commercial lending £m	Other lending £m	Total £m
At 5 April 2009	20	101	136	194	19	470
Charge for the year	10	79	126	299	35	549
Amounts written off during the year	(14)	(33)	(120)	(54)	(38)	(259)
Amounts recovered during the year	2	1	13	-	4	20
Unwind of discount of provision	(1)	(5)	(7)	(17)	-	(30)
At 4 April 2010	17	143	148	422	20	750

2009 Group	Prime residential £m	Specialist residential £m	Consumer banking £m	Commercial lending £m	Other lending £m	Total £m
At 5 April 2008	19	19	135	30	9	212
Charge for the year	4	87	113	171	19	394
Amounts written off during the year	(4)	(5)	(119)	(3)	(13)	(144)
Amounts recovered during the year	1	-	13	-	4	18
Unwind of discount of provision	-	-	(6)	(4)	-	(10)
At 4 April 2009	20	101	136	194	19	470

The Group impairment provision of £750 million at 4 April 2010 (2009: £470 million) comprises individual provisions of £440 million (2009: £229 million) and a collective provision of £310 million (2009: £241 million).

2010 Society	Prime residential £m	Specialist residential £m	Consumer banking £m	Commercial lending £m	Other lending £m	Total £m
At 5 April 2009	20	-	82	194	-	296
Charge for the year	10	-	96	290	-	396
Amounts written off during the year	(14)	-	(89)	(54)	-	(157)
Amounts recovered during the year	2	-	9	-	-	11
Transfer from subsidiary	-	-	57	-	-	57
Unwind of discount of provision	(1)	-	(7)	(17)	-	(25)
At 4 April 2010	17	-	148	413	-	578

The Society impairment provision of £578 million at 4 April 2010 (2009: £296 million) comprises individual provisions of £377 million (2009: £174 million) and a collective provision of £201 million (2009: £122 million).

In addition to the Society's £396 million current year charge shown in table above, the Society's impairment loss on loans and advances to customers in the income statement of £450 million includes a £54 million provision relating to the Society's loan to a subsidiary undertaking, driven by the impairment of corporate loans held within the subsidiary. Within the figures reported above for the Group, the impairment of the underlying corporate loans is shown within other lending. Of the £54 million of impairment provision raised against the corporate loans, £38 million has been utilised in relation to balances written off in the year to 4 April 2010.

Impairment provisions on loans and advances to customers (continued) 12

2009 Society	Prime residential	Specialist residential	Consumer banking	Commercial lending	Other lending	Total
	£m	£m	£m	£m	£m	£m
At 5 April 2008	19	-	77	30	-	126
Charge for the year	4	-	81	171	-	256
Amounts written off during the year	(4)	-	(80)	(3)	-	(87)
Amounts recovered during the year	1	-	10	-	-	11
Unwind of discount of provision	-	-	(6)	(4)	-	(10)
At 4 April 2009	20	-	82	194	-	296

These provisions have been deducted from the appropriate asset values in the balance sheet.

Taxation 13

	Group		Society	
	2010	2009 (Adjusted)	**2010**	2009 (Adjusted)
	£m	£m	**£m**	£m
Current Tax:				
• UK corporation tax	**38**	32	**11**	-
• Corporation tax – adjustment in respect of prior years	**(24)**	(7)	**(29)**	(6)
	14	25	**(18)**	(6)
Overseas income tax	**-**	6	**-**	-
Total current tax	**14**	31	**(18)**	(6)
Deferred tax (note 26):				
• Current year	**66**	16	**38**	12
• Adjustment in respect of prior years	**(3)**	(3)	**(2)**	2
Total deferred taxation	**63**	13	**36**	14
	77	44	**18**	8

The Society's tax charge includes charges in respect of the surrender of tax losses to subsidiary undertakings in earlier periods totalling £4 million (2009: receipts for the surrender of tax losses of £3 million). The prior year items arise from a reassessment during the year of tax due to HMRC on funding and intra Group transactions in prior years.

Further information about deferred tax is presented in note 26.

Notes to the Accounts
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Taxation (continued) 13

The actual tax charge differs from the theoretical amount that would arise using the standard rate of corporation tax in the UK as follows:

	Group		Society	
	2010	2009 (Adjusted)	2010	2009 (Adjusted)
	£m	£m	£m	£m
Profit before tax	341	190	499	49
Tax calculated at a tax rate of 28%	95	53	140	14
Effect of different tax rates in other countries	(3)	(3)	-	-
Expenses/(income) not taxable/deductible for tax purposes:				
• Building depreciation	3	2	3	1
• Non taxable dividend received	-	-	(97)	(5)
• Other	9	2	3	2
Adjustments in respect of prior years	(27)	(10)	(31)	(4)
	77	44	18	8

The tax on items through other comprehensive income is as follows:

	Group		Society	
	2010	2009	2010	2009
	£m	£m	£m	£m
Available for sale investments	485	(621)	486	(621)
Revaluation of property	-	(20)	-	(20)
Actuarial loss on retirement benefit obligations	(48)	(90)	(48)	(90)
	437	(731)	438	(731)

The Group tax charge through the available for sale reserve of £485 million is made up of a charge of £498 million through deferred tax and a credit of £13 million through current tax.

Operating segments 14

Operating segments are reported in a manner consistent with the internal reporting provided to the Executive Directors' Committee. The Executive Directors' Committee, which is responsible for allocating resources and assessing performance of operating segments, has been identified as the chief operating decision maker.

The following section analyses the Group's performance by business segment. For management reporting purposes, the Group is organised into the following business groupings, determined according to similar economic characteristics and customer base:

- Retail;
- Commercial; and
- Head office functions and other operations.

These business groupings reflect how management assesses performance and makes decisions on allocating resources to the business on the basis of product and customers. Revenues from external and internal customers are allocated to the appropriate business segment.

Operating segments (continued) 14

Goodwill is allocated by management to segments of cash generating units on a segment level. Goodwill relates to the acquisition of The Mortgage Works (UK) plc by Portman Building Society and that arising on the acquisition of the Derbyshire Building Society and is allocated to the Retail segment. Goodwill is subject to an annual impairment test.

Retail

Retail functions include prime residential lending, specialist residential lending, consumer banking, retail funding (savings products), insurance and investments and retail products marketed by our Regional Brands. The distribution channels supporting these products are included in this segment. This grouping reflects how internal reporting is provided to management and how management allocates resources and assesses performance of its products and customer relationships in the personal financial services sector.

Commercial

This segment comprises the commercial lending business stream. This grouping reflects how internal reporting is provided to management and how management allocates resources and assesses performance of its products and customer relationships in the commercial business sector.

Head office functions and other operations

Head office functions and other operations comprise treasury operational and income generation activities, head office and central support functions, and consolidation adjustments.

Head office and central support functions includes: executive management, corporate secretariat, legal services, human resources, strategy and planning, finance, risk management, capital management, corporate affairs, property services and internal audit. Consolidation adjustments largely reflect the elimination of inter-segment transactions.

This grouping reflects how management assesses performance and allocates resources.

Group reporting changes in the year ended 4 April 2010

As a result of changes of executive management structure and organisation and the application of IFRS 8 there have been certain changes in the reporting of business segments compared to the results reported in the 2009 Annual Report and Accounts. There is no impact on the Group income statement or balance sheet; comparative figures have been restated accordingly.

The main change to business segments reported is that the specialist lending business has been transferred to the Retail business segment. Previously specialist lending was grouped with commercial lending.

The majority of revenue for the Group is derived from interest. Net interest income is used to assess the performance of each segment. Therefore, interest income is presented net of interest expense. The presentation shown below, whereby net interest income is adjusted for revenue from other segments reflects how management receives information to assess performance and allocate resources.

2010	Retail	Commercial	Head office functions & other operations	Total
	£m	£m	£m	£m
Net interest income/(expense) from external customers	2,998	865	(2,149)	1,714
(Charge)/Revenue from other segments	(1,712)	(663)	2,375	-
	1,286	202	226	1,714
Other income (note i)	364	11	6	381
Total revenue	1,650	213	232	2,095
Expenses (note ii)	1,156	36	92	1,284
Impairment and other provisions (note iii)	229	299	71	599
Segment results/underlying profit/(loss) before tax	265	(122)	69	212
FSCS levies – release	117	-	-	117
Transformation costs and gain on portfolio acquisition	(62)	40	-	(22)
Gains from derivatives and hedge accounting	-	-	34	34
Profit/(loss) before tax	320	(82)	103	341
Taxation				77
Profit after tax				264
Total assets	129,456	22,417	39,524	191,397
Total liabilities	126,017	-	59,664	185,681

Notes to the Accounts
continued

Operating segments (continued) 14

Year to 4 April 2009 (Adjusted)	Retail	Commercial	Head office functions & other operations	Total
	£m	£m	£m	£m
Net interest income/(expense) from external customers	1,832	1,268	(1,342)	1,758
(Charge)/revenue from other segments	(559)	(1,085)	1,644	-
	1,273	183	302	1,758
Other income/(expense) (note i)	352	9	(2)	359
Total revenue	1,625	192	300	2,117
Expenses (note ii)	1,199	38	34	1,271
Impairment and other provisions (note iii)	212	171	70	453
Segment results/underlying profit/(loss) before tax	214	(17)	196	393
FSCS levies – (charge)	(241)	-	-	(241)
Transformation costs and gains on business combinations	(42)	(5)	75	28
Gains from derivatives and hedge accounting	-	-	10	10
(Loss)/profit before tax	(69)	(22)	281	190
Taxation				44
Profit after tax				146
Total assets	132,146	22,622	47,585	202,353
Total liabilities	132,541	-	65,534	198,075

Notes

(i) Other income excludes gains/losses from derivatives and hedge accounting and gain on portfolio acquisition.

(ii) Expenses exclude transformation costs.

(iii) Impairment and other provisions includes impairment losses on loans and advances to customers, provisions for liabilities and charges (excluding FSCS) and impairment losses on investment securities.

The Group operates predominantly in the UK, the Isle of Man and the Republic of Ireland and accordingly no geographical analysis has been presented.

Loans and advances to banks

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	Group		Society	
	2010	2009 (Adjusted)	2010	2009 (Adjusted)
	£m	£m	£m	£m
Placements with banks with a maturity on acquisition of:				
• Accrued interest	2	23	2	20
• Less than three months	1,815	4,232	1,758	4,194
• More than three months but less than one year	-	567	-	562
• More than one year but less than five years	-	38	-	38
	1,817	4,860	1,760	4,814
Mandatory reserve deposits with the Bank of England	200	173	200	173
	2,017	5,033	1,960	4,987

Placements with banks with a maturity on acquisition of less than three months are included in the total cash and cash equivalents figure in note 47.

Mandatory reserve deposits with the Bank of England are not available for use in the Group's day to day operations.

Investment securities – available for sale

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	Group		Society	
	2010	2009 (Adjusted)	2010	2009 (Adjusted)
	£m	£m	£m	£m
Government and supranational investment securities	12,346	7,191	12,346	7,191
Other public sector investment securities	3	-	3	-
Private sector investment securities:				
• Listed	11,036	12,877	10,945	12,868
• Unlisted	-	1,155	-	1,155
	23,385	21,223	23,294	21,214
Investment securities have remaining maturities as follows:				
• Accrued interest	196	284	196	284
• In not more than one year	2,141	3,037	2,141	2,972
• In more than one year	21,048	17,902	20,957	17,958
	23,385	21,223	23,294	21,214

Notes to the Accounts

continued

Investment securities – available for sale (continued) 16

Investment securities included in the table above with a carrying value of £3,734 million (2009: £5,795 million) have been sold under sale and repurchase agreements. Of the £3,734 million sold under sale and repurchase agreements £3,303 million are private listed securities and £431 million government securities (April 2009: £3,892 million private listed securities and £1,903 million government securities). These assets have not been derecognised as Nationwide has retained substantially all the risks and rewards of ownership. The proceeds of all repurchase agreements of £6,441 million (2009: £11,054 million) are included within deposits from banks (note 28).

Nationwide does not hold any collateral under reverse sale and repurchase agreements at 4 April 2010 (2009: collateral with a fair value of £578 million). These transactions are conducted under terms that are usual and customary to standard stock lending, securities borrowing and reverse repurchase agreements. Nationwide is permitted to sell or repledge the assets received as collateral in the absence of their default. Nationwide is obliged to return equivalent securities. At 4 April 2010 no collateral was repledged (2009: collateral with a fair value of £546 million). Nationwide does not recognise securities received under reverse sale and repurchase agreements on the Group and Society balance sheets.

Where the investment securities portfolio contains highly liquid instruments which have an initial contractual life of 3 months or less, these securities are classified as cash equivalents in accordance with IAS 7 'Cash Flow Statements'. In the Group and Society accounts there are no such investment securities at 4 April 2010 included in the total cash and cash equivalents figure in note 47 (2009: £931 million).

The impairment charge on investment securities of £36 million (2009: £51 million) comprises a £29 million charge on investment securities available for sale (2009: £48 million) and £7 million (2009: £3 million) in respect of other investment securities managed by our Treasury department. This year's charge on investment securities available for sale relates to the impairment of a small number of US Alt A RMBS exposures. The prior year charge was driven by bank failures and included £34 million for Washington Mutual and £12 million for Icelandic banks.

Derivative financial instruments 17

All derivative financial instruments are held for economic hedging purposes although not all derivatives are designated as hedging instruments under the terms of IAS 39 'Financial Instruments: Recognition and Measurement'. The table opposite analyses derivatives between those designated as hedging instruments and those which, whilst in economic hedging relationships, are not designated as hedging instruments.

Derivative financial instruments (continued) 17

	2010			2009		
	Contract/ notional amount	Fair value		Contract/ notional amount	Fair value	
		Assets	Liabilities		Assets (Adjusted)	Liabilities
	£m	£m	£m	£m	£m	£m
Derivatives held for hedging						
(a) Society						
Derivatives designated as fair value hedges:						
• Interest rate swaps	126,283	1,238	5,025	137,046	1,736	5,884
Other derivatives:						
• Cross currency interest rate swaps	8,909	621	370	9,833	850	901
• Caps, collars and floors	703	3	5	294	-	5
• Forward foreign exchange	1,689	34	3	1,829	90	30
• Forward rate agreements	3,428	1	-	4,812	1	2
• Swaptions	484	1	26	521	-	31
• Interest rate futures	1,669	-	-	3,997	-	1
• Interest rate and equity index swaps	30,544	34	124	33,592	134	226
• Credit default swaps	87	-	1	169	9	-
	173,796	1,932	5,554	192,093	2,820	7,080
(b) Subsidiary						
Derivatives designated as fair value hedges:						
• Interest rate swaps	11,716	953	-	13,623	850	-
Other derivatives:						
• Cross currency interest rate swaps	12,373	2,579	-	14,594	3,283	-
Intra Group swap elimination	(11,007)	(612)	(612)	(18,434)	(1,094)	(1,094)
Group	186,878	4,852	4,942	201,876	5,859	5,986

As described in note 43 it is common practice for cash collateral to be passed between parties to derivative transactions in order to mitigate the market contingent counterparty risk inherent in the outstanding positions. Where cash collateral is received, to mitigate the risk inherent in amounts due to us, it is included as a liability within deposits from banks. Where Nationwide provides cash collateral, to mitigate the perceived risk inherent in amounts due from us, it is included as an asset in loans and advances to banks.

As also explained in note 43, the Group has made no credit valuation adjustment on derivative assets or debit valuation adjustment in respect of our own credit risk on derivative liabilities.

The fair values shown above reflect the adjustment of mid prices for derivative assets and liabilities to bid and offer prices respectively.

The bid-offer adjustment is calculated on a portfolio basis and reflects the costs that would be incurred if substantially all residual net portfolio market risks were closed using available hedging instruments or by disposing of or unwinding actual positions. The methodology for determining the bid-offer adjustments involves netting between long and short positions and the bucketing of risk by strike and term in accordance with hedging strategy. Bid-offer spreads are derived from market sources such as broker data and are reviewed periodically.

Contract/notional amount indicates the amount on which payment flows are derived at the balance sheet date and does not represent amounts at risk.

Further information on the fair value of derivatives is included in note 45.

Notes to the Accounts
continued

Derivative financial instruments (continued) 17

Group	2010			2009		
	Contract/ notional amount	Fair value		Contract/ notional amount	Fair value	
		Assets	Liabilities		Assets (Adjusted)	Liabilities
	£m	£m	£m	£m	£m	£m
Derivatives have remaining maturities as follows:						
• In not more than one year	79,239	551	532	97,477	1,599	584
• In more than one year	107,639	4,301	4,410	104,399	4,260	5,402
	186,878	4,852	4,942	201,876	5,859	5,986

Society	2010			2009		
	Contract/ notional amount	Fair value		Contract/ notional amount	Fair value	
		Assets	Liabilities		Assets (Adjusted)	Liabilities
	£m	£m	£m	£m	£m	£m
Derivatives have remaining maturities as follows:						
• In not more than one year	80,546	551	709	101,236	1,599	1,027
• In more than one year	93,250	1,381	4,845	90,857	1,221	6,053
	173,796	1,932	5,554	192,093	2,820	7,080

Fair value adjustment for portfolio hedged risk 18

As discussed in the statement of accounting policies, when specific criteria are met, the Group applies fair value hedge accounting. In a micro hedge, the carrying value of the hedged item is adjusted for the change in the fair value of the hedged risk. In the case of a portfolio hedge, the adjustment is included in this heading. The fair value adjustment for portfolio hedged risk for Group and Society at the year end was £2,638 million for assets (2009: Group and Society £3,408 million) and liabilities £106 million (2009: Group and Society £239 million).

Loans and advances to customers 19

	Group		Society	
	2010	2009 (Adjusted)	2010	2009 (Adjusted)
	£m	£m	£m	£m
Prime residential mortgages	108,704	111,873	108,554	111,709
Specialist residential mortgages	18,609	18,043	1,167	1,250
Consumer banking	2,143	2,230	2,143	1,090
Commercial lending	21,765	21,943	20,617	20,664
Other lending	556	661	-	-
	151,777	154,750	132,481	134,713
Fair value adjustment for micro hedged risk	652	719	652	719
	152,429	155,469	133,133	135,432

Maturity analysis

Loans and advances to customers have remaining contractual maturities as follows:

	Group		Society	
	2010	2009 (Adjusted)	2010	2009 (Adjusted)
	£m	£m	£m	£m
Repayable on demand	1,247	1,313	1,246	1,178
Other loans and advances by residual maturity repayable:				
• In not more than three months	1,365	1,726	1,233	1,040
• In more than three months but not more than one year	4,416	3,831	4,299	3,371
• In more than one year but not more than five years	24,538	22,898	23,824	21,235
• In more than five years	120,961	125,452	102,457	108,185
	152,527	155,220	133,059	135,009
Impairment provision on loans and advances (note 12)	(750)	(470)	(578)	(296)
Fair value adjustment for micro hedged risk	652	719	652	719
	152,429	155,469	133,133	135,432

The maturity analysis is produced on the basis that where a loan is repayable by instalments, each such instalment is treated as a separate repayment. Arrears are spread across the remaining term of the loan.

The maturity analysis is based on contractual maturity rather than actual redemption levels experienced by the Group or Society, which are likely to be materially different.

Certain loans and advances to customers are used to secure debt securities in issue (funding) as follows:

	2010		2009	
	Assets pledged	Secured funding	Assets pledged	Secured funding
	£m	£m	£m	£m
Covered bonds	39,917	9,050	38,130	9,408
Securitisations and other secured lending	32,371	3,749	29,401	1,498
	72,288	12,779	67,531	10,906

Notes to the Accounts

continued

Loans and advances to customers (continued) 19

Pledged assets include those available to Nationwide Covered Bonds LLP, Silverstone Master Trust and other funding vehicles, even where they have not yet been used to provide collateral to support external funding transactions. Secured funding disclosed above, however, is that obtained from issuance to external counterparties and does not include self issuances that may be used in the future as collateral for repo and other similar type operations. As a result, the relationship between pledged assets and secured funding above is not representative of the haircut applied to collateral values in determining the available level of funding.

The Society established Nationwide Covered Bonds LLP in November 2005. The LLP provides security for issues of covered bonds made by the Society to external counterparties and also for the purpose of creating collateral.

The Society established the Silverstone Master Trust securitisation structure on 16 July 2008. Notes are issued by Silverstone Master Issuer plc (Securities 2008 - 1 and 2009 - 1) to external counterparties and the Society, either for the purposes of creating collateral to be used for funding or for subsequent sale of notes to investors outside the Group.

On 22 October 2009 Silverstone Master Issuer plc announced an issuance of a residential mortgage backed securitisation for settlement on 3 November 2009. £3.5 billion 5-7 year bonds were issued of which £2.25 billion were publicly purchased. The remaining £1.25 billion bonds were issued to the Society and used to raise £1 billion 5 year funding via a sale and repurchase agreement. The 2008 - 2 series of notes (self issuance) totalling £6.8 billion were cancelled on 2 November 2009.

All of the assets pledged are retained in the Society's balance sheet as the Society substantially retains the risks and rewards relating to the loans.

Investments in equity shares 20

	Group		Society	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
At 5 April	81	61	20	19
Acquired on transfer of engagements:				
• Derbyshire	**-**	1	**-**	1
Additions	**8**	13	**-**	-
Disposals	**(1)**	(13)	**-**	(11)
Increase in fair value	**5**	19	**6**	11
Impairment	**(7)**	-	**-**	-
At 4 April	**86**	81	**26**	20

Investments in equity shares include investments of £85 million (2009: £80 million) carried at fair value. The equity shares investments include £17 million as a result of our participation in industry wide banking and credit card service operations. The remaining investments, which are private equity holdings, are long term in nature.

The impairment of £7 million relates to one fund within our private equity portfolio. The impairment has been included in impairment losses on investment securities in the income statement.

Investments in group undertakings 21

	Shares £m	Loans £m	Total £m
At 5 April 2009 (adjusted)	645	20,340	20,985
Additions	134	1,341	1,475
Impairment	-	(61)	(61)
Disposals, redemptions and repayments	(386)	(3,160)	(3,546)
At 4 April 2010	393	18,460	18,853

The additions to investments in shares predominantly relate to the re-capitalisation of a mortgage subsidiary during the year.

The £61 million impairment on loans to group undertakings comprises £7 million which relates to a subsidiary with a portfolio of investment securities (included in impairment losses on investment securities in the income statement), together with £54 million relating to a subsidiary that holds a corporate loan portfolio (included in impairment loss on loans and advances to customers in the income statement).

The interests of the Society in its principal subsidiary undertakings, all of which are consolidated, as at 4 April 2010 are set out below:

100% held subsidiary undertakings	Nature of business
First Nationwide	Investment company
Nationwide International Limited *	Offshore deposit taker
Nationwide Syndications Limited	Syndicated lending
Nationwide Trust Limited **	Consumer banking
The Mortgage Works (UK) plc *	Centralised mortgage lender
UCB Home Loans Corporation Limited *	Centralised mortgage lender
Derbyshire Home Loans Limited*	Centralised mortgage lender
E-MEX Home Funding Limited*	Centralised mortgage lender

* Regulated entities which are subject to regulations which require them to maintain capital at agreed levels and so govern the availability of funds for distribution as dividends.

** The personal loan business and all material assets and liabilities of Nationwide Trust Limited were transferred to the Society with effect from 1 February 2010. Nationwide Trust Limited has ceased to trade and will become a dormant company.

All the above subsidiary undertakings are limited liability companies except First Nationwide which is an unlimited liability company with share capital.

All of the above companies are registered in England and Wales and operate in the UK except for Nationwide International Limited which is registered and operates in the Isle of Man.

The Group has interests in a number of entities which give rise to the risks and rewards that are in substance no different than if they were subsidiary undertakings. As a consequence, these entities are consolidated in the Group accounts.

The interests of the Society in these principal entities as at 4 April 2010 are set out below:

Other subsidiary undertakings	Nature of business	Country of registration	Country of operation
Nationwide Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds	England and Wales	UK
Silverstone Master Issuer plc (Securities 2008 - 1 and 2009 - 1)	Funding vehicle	England and Wales	UK
Pride No. 1 LLP	Funding vehicle	England and Wales	UK

Notes to the Accounts

continued

Intangible assets 22

2010 Group	Computer software		Total Computer Software	Other Intangible Assets	Goodwill	Total
	Externally acquired	Internally developed				
	£m	£m	£m	£m	£m	£m
Cost						
At 5 April 2009	287	57	344	42	16	402
Additions	159	25	184	-	-	184
Disposals	(31)	(33)	(64)	-	-	(64)
At 4 April 2010	415	49	464	42	16	522
Amortisation						
At 5 April 2009	146	45	191	-	-	191
Charge for the year	26	10	36	6	-	42
Disposals	(31)	(33)	(64)	-	-	(64)
At 4 April 2010	141	22	163	6	-	169
Net book value						
At 4 April 2010	274	27	301	36	16	353

Other intangible assets are in respect of core deposits and customer relationships arising on the acquisitions of the Derbyshire and the Cheshire building societies and core parts of the Dunfermline Building Society. Full details of the acquired intangibles are given in notes 49 and 50.

£12 million of goodwill relates to the acquisition of The Mortgage Works (UK) plc on 30 November 2001 by Portman Building Society.

A further £4 million of goodwill arose on the acquisition of the Derbyshire Building Society on 1 December 2008. Goodwill is subject to annual impairment testing.

Additions of £184 million relate primarily to the Society's investment in a new systems platform to meet the future needs of the business.

2009 Group	Computer software		Total Computer Software	Other Intangible Assets	Goodwill	Total
	Externally acquired	Internally developed				
	£m	£m	£m	£m	£m	£m
Cost						
At 5 April 2008	239	53	292	-	12	304
Additions	51	10	61	-	-	61
Acquired on transfer of engagements:						
• Derbyshire	2	-	2	17	4	23
• Cheshire	2	-	2	10	-	12
• Dunfermline	-	-	-	15	-	15
Disposals	(7)	(6)	(13)	-	-	(13)
At 4 April 2009	287	57	344	42	16	402
Amortisation						
At 5 April 2008	144	23	167	-	-	167
Charge for the year	8	27	35	-	-	35
Disposals	(6)	(5)	(11)	-	-	(11)
At 4 April 2009	146	45	191	-	-	191
Net book value						
At 4 April 2009	141	12	153	42	16	211

Intangible assets (continued) 22

2010 Society	Computer software		Total Computer Software	Other Intangible Assets	Goodwill	Total
	Externally acquired	Internally developed				
	£m	£m	£m	£m	£m	£m
Cost						
At 5 April 2009	287	57	344	42	4	390
Additions	159	25	184	-	-	184
Disposals	(31)	(33)	(64)	-	-	(64)
At 4 April 2010	415	49	464	42	4	510
Amortisation						
At 5 April 2009	146	45	191	-	-	191
Charge for the year	26	10	36	6	-	42
Disposals	(31)	(33)	(64)	-	-	(64)
At 4 April 2010	141	22	163	6	-	169
Net book value						
At 4 April 2010	274	27	301	36	4	341

2009 Society	Computer software		Total Computer Software	Other Intangible Assets	Goodwill	Total
	Externally acquired	Internally developed				
	£m	£m	£m	£m	£m	£m
Cost						
At 5 April 2008	239	53	292	-	-	292
Additions	51	10	61	-	-	61
Acquired on transfer of engagements:						
• Derbyshire	2	-	2	17	4	23
• Cheshire	2	-	2	10	-	12
• Dunfermline	-	-	-	15	-	15
Disposals	(7)	(6)	(13)	-	-	(13)
At 4 April 2009	287	57	344	42	4	390
Amortisation						
At 5 April 2008	144	23	167	-	-	167
Charge for the year	8	27	35	-	-	35
Disposals	(6)	(5)	(11)	-	-	(11)
At 4 April 2009	146	45	191	-	-	191
Net book value						
At 4 April 2009	141	12	153	42	4	199

Notes to the Accounts
continued

Property, plant and equipment 23

2010 Group	Branches and non specialised buildings	Specialised administration buildings	Short leasehold buildings	Total land and buildings	Plant and machinery	Equipment, fixtures, fittings and vehicles	Total
	£m	£m	£m	£m	£m	£m	£m
Cost or valuation							
At 5 April 2009	274	142	45	461	156	975	1,592
Additions	2	-	1	3	8	141	152
Revaluation	(4)	-	-	(4)	-	-	(4)
Disposals	(5)	-	-	(5)	(59)	(222)	(286)
At 4 April 2010	267	142	46	455	105	894	1,454
Depreciation							
At 5 April 2009	-	56	28	84	104	518	706
Charge for the year	-	4	2	6	12	91	109
Disposals	-	-	-	-	(59)	(218)	(277)
At 4 April 2010	-	60	30	90	57	391	538
Net book value							
At 4 April 2010	267	82	16	365	48	503	916

2009 Group	Branches and non specialised buildings	Specialised administration buildings	Short leasehold buildings	Total land and buildings	Plant and machinery	Equipment, fixtures, fittings and vehicles	Total
	£m	£m	£m	£m	£m	£m	£m
Cost or valuation							
At 5 April 2008	355	104	37	496	130	805	1,431
Acquired on transfer of engagements							
• Derbyshire	11	4	2	17	1	1	19
• Cheshire	5	7	1	13	1	2	16
• Dunfermline	4	3	-	7	-	3	10
Transfer	(24)	24	-	-	-	-	-
Additions	15	1	5	21	25	170	216
Revaluation	(90)	-	-	(90)	-	-	(90)
Disposals	(2)	(1)	-	(3)	(1)	(6)	(10)
At 4 April 2009	274	142	45	461	156	975	1,592
Depreciation							
At 5 April 2008	-	53	26	79	93	448	620
Charge for the year	-	3	2	5	11	75	91
Disposals	-	-	-	-	-	(5)	(5)
At 4 April 2009	-	56	28	84	104	518	706
Net book value							
At 4 April 2009	274	86	17	377	52	457	886

Property, plant and equipment (continued) 23

2010 Society	Branches and non specialised buildings	Specialised administration buildings	Short leasehold buildings	Total land and buildings	Plant and machinery	Equipment, fixtures, fittings and vehicles	Total
	£m	£m	£m	£m	£m	£m	£m
Cost or valuation							
At 5 April 2009 (adjusted)	266	139	45	450	154	963	1,567
Additions	2	-	1	3	8	140	151
Revaluation	(2)	-	-	(2)	-	-	(2)
Disposals	(5)	-	-	(5)	(58)	(212)	(275)
At 4 April 2010	**261**	**139**	**46**	**446**	**104**	**891**	**1,441**
Depreciation							
At 5 April 2009	-	56	28	84	102	508	694
Charge for the year	-	4	2	6	12	90	108
Disposals	-	-	-	-	(58)	(210)	(268)
At 4 April 2010	**-**	**60**	**30**	**90**	**56**	**388**	**534**
Net book value							
At 4 April 2010	**261**	**79**	**16**	**356**	**48**	**503**	**907**

2009 Society	Branches and non specialised buildings	Specialised administration buildings	Short leasehold buildings	Total land and buildings	Plant and machinery	Equipment, fixtures, fittings and vehicles	Total
	£m	£m	£m	£m	£m	£m	£m
Cost or valuation							
At 5 April 2008	342	104	37	483	128	794	1,405
Acquired on transfer of engagements							
• Derbyshire	10	4	2	16	1	1	18
• Cheshire	5	7	1	13	1	2	16
• Dunfermline (adjusted)	4	-	-	4	-	3	7
Transfer	(24)	24	-	-	-	-	-
Additions	16	1	5	22	25	167	214
Revaluation	(85)	-	-	(85)	-	-	(85)
Disposals	(2)	(1)	-	(3)	(1)	(4)	(8)
At 4 April 2009 (adjusted)	266	139	45	450	154	963	1,567
Depreciation							
At 5 April 2008	-	53	26	79	91	437	607
Charge for the year	-	3	2	5	11	74	90
Disposals	-	-	-	-	-	(3)	(3)
At 4 April 2009	-	56	28	84	102	508	694
Net book value							
At 4 April 2009 (adjusted)	266	83	17	366	52	455	873

Notes to the Accounts

continued

Property, plant and equipment (continued) 23

In the year ended 4 April 2010 £6 million of borrowing costs have been capitalised for Group and Society using a capitalisation rate of 2.15%.

During the year ended 4 April 2009 one Society held property was transferred from branches and non specialised buildings to specialised administration buildings in order to provide a more accurate reflection of the nature and use of the property.

Branches and non specialised buildings are included at fair value. Valuations, performed by independent surveyors, consist of a mixture of full and interim valuations and were undertaken as at 4 April 2010 in accordance with the Appraisal and Valuation manual published by the Royal Institution of Chartered Surveyors. Valuations are based on active market prices.

Specialised administration buildings and short leasehold buildings are included at cost less accumulated depreciation.

Investment properties 24

	Group		Society	
	2010	2009	2010	2009
	£m	£m	£m	£m
At 5 April	9	15	9	12
Acquired on transfer of engagements				
• Cheshire	-	2	-	2
Revaluation	-	(6)	-	(5)
Disposals	-	(2)	-	-
At 4 April	**9**	9	**9**	9

Investment properties are carried at fair value. The valuations are undertaken by independent valuers in accordance with the Appraisal and Valuation manual published by the Royal Institution of Chartered Surveyors. Valuations are based on active market prices.

Accrued income and expenses prepaid 25

	Group		Society	
	2010	2009	2010	2009
	£m	£m	£m	£m
Amounts owed by subsidiary undertakings	-	-	**2,728**	1,114
Treasury transactions awaiting clearing	**5**	625	**5**	625
Other	**72**	118	**70**	66
	77	743	**2,803**	1,805

Deferred tax assets 26

Deferred tax is provided in full on temporary differences under the liability method at the standard UK corporation tax rate of 28%.

The movements on the deferred tax account are as follows:

	Group		Society	
	2010	2009 (Adjusted)	**2010**	2009 (Adjusted)
	£m	£m	**£m**	£m
At 5 April	**866**	116	**785**	109
Transfer from:				
• Derbyshire	**-**	63	**-**	(1)
• Cheshire	**-**	2	**-**	(4)
• Dunfermline	**-**	1	**-**	-
Income statement charge	**(63)**	(13)	**(36)**	(14)
Reclassification to current tax	**4**	(17)	**-**	(17)
Transfer of trade of subsidiary	**-**	-	**3**	-
Available for sale investments	**(3)**	3	**-**	1
Property revaluation	**-**	20	**-**	20
Retirement benefit obligations	**48**	90	**48**	90
Cash flow hedge reserve	**-**	1	**-**	1
Tax losses carried forward	**(495)**	600	**(486)**	600
Taxation on items through other comprehensive income	**(450)**	714	**(438)**	712
At 4 April	**357**	866	**314**	785

Deferred tax assets and liabilities are attributable to the following items:

	Group		Society	
	2010	2009 (Adjusted)	**2010**	2009 (Adjusted)
	£m	£m	**£m**	£m
Retirement benefit obligations	**141**	92	**141**	92
Provisions for loan impairment	**30**	35	**11**	13
Other provisions	**48**	91	**41**	49
Accelerated tax depreciation	**(9)**	(4)	**(9)**	(4)
Property revaluation	**(18)**	(20)	**(21)**	(23)
Tax losses carried forward	**165**	672	**151**	658
	357	866	**314**	785

Notes to the Accounts

continued

Deferred tax assets (continued) 26

The majority of deferred tax assets are anticipated to be recoverable after 1 year. The Group considers that there will be sufficient future trading profits in excess of profits arising from the reversal of existing taxable temporary differences to utilise the deferred tax asset.

As at the balance sheet date there are £6 million (Group and Society) of unused capital losses (2009: Group and Society £8 million) and £36 million (Group) of unused trading losses (2009: Group £40 million) for which no deferred tax asset is recognised.

Following changes to the taxation of foreign dividends there are no longer any unrecognised deferred tax liabilities in respect of unremitted earnings of overseas subsidiaries (2009: Group and Society £86 million).

The deferred tax charge in the income statement comprises the following temporary differences (note 13):

	Group		Society	
	2010	2009 (Adjusted)	2010	2009 (Adjusted)
	£m	£m	£m	£m
Accelerated tax depreciation	3	10	2	9
Retirement benefit obligations	(3)	10	(3)	10
Provisions for loan impairment	15	(4)	2	2
Other	63	10	49	(6)
Tax losses carried forward	(15)	(13)	(14)	(1)
	63	13	36	14

Shares 27

	Group & Society	
	2010	2009 (Adjusted)
	£m	£m
Held by individuals	120,938	128,287
Other shares	5	5
	120,943	128,292
Shares are repayable from the balance sheet date in the ordinary course of business as follows:		
Accrued interest	470	808
Repayable on demand	71,566	83,678
Other shares by residual maturity repayable:		
• In not more than three months	7,495	7,792
• In more than three months but not more than one year	19,843	24,090
• In more than one year but not more than five years	21,560	11,913
• In more than five years	9	11
	120,943	128,292

In addition to the changes made on finalisation of fair values in relation to the acquisition of core parts of the Dunfermline Building Society, the 2009 comparatives have been amended to reflect the current year's presentation.

Deposits from banks 28

	Group		Society	
	2010	2009	2010	2009
	£m	£m	£m	£m
Deposits from banks are repayable from the balance sheet date in the ordinary course of business as follows:				
Accrued interest	20	115	20	112
Repayable on demand	1,154	484	132	152
Other amounts owed to banks with residual maturity repayable:				
• In not more than three months	6,280	8,651	6,280	8,650
• In more than three months but not more than one year	577	3,398	577	3,356
• In more than one year but not more than five years	-	66	-	1
• In more than five years	-	569	-	179
	8,031	13,283	7,009	12,450

Deposits from banks include £6,441 million (2009: £11,054 million) in respect of sale and repurchase agreements. The carrying value of assets of £3,734 million (2009: £5,795 million) sold under sale and repurchase agreements are included within investment securities (note 16).

Other deposits 29

	Group		Society	
	2010	2009	2010	2009
	£m	£m	£m	£m
Amounts owed to subsidiary undertakings	-	-	6,850	5,216
Other	4,509	5,673	4,509	5,672
	4,509	5,673	11,359	10,888
Other deposits are repayable from the balance sheet date in the ordinary course of business as follows:				
Accrued interest	21	50	21	50
Repayable on demand	2	1	6,852	5,217
Other amounts owed to depositors with residual maturity repayable:				
• In not more than three months	2,476	4,158	2,476	4,157
• In more than three months but not more than one year	817	1,182	817	1,182
• In more than one year but not more than five years	173	282	173	282
• In more than five years	1,020	-	1,020	-
	4,509	5,673	11,359	10,888

Notes to the Accounts

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Other deposits (continued) 29

Other deposits comprise wholesale deposits placed with our Treasury department and amounts relating to the sale of PEBs by the Group on behalf of Legal & General.

The PEBs are held in the Group and Society at a fair value of £1,128 million (2009: £75 million), which is management's current best estimate of the amounts that will be paid at contractual maturity. Fair value includes the current value of the expected investment return payable.

Changes in fair value of the PEB liability are recognised in the income statement. None of the change in the fair value during the year in the Group and Society has been attributable to changes in credit risk (2009: £nil).

The minimum amount on an undiscounted basis that the Group and Society are contractually required to pay at maturity for the PEBs is £1,231 million (2009: £109 million). The maximum additional amount which would also be payable at maturity in respect of additional investment returns on two tranches with a combined fair value of £76 million (2009: £60 million) is uncapped. The maximum additional amount which would also be payable at maturity in respect of additional investment returns on all other tranches is £500 million (2009: £16 million). The payment of additional investment returns is dependent upon performance of certain specified stock indices during the period of the PEB. The Group has entered into equity-linked derivatives with external counterparties which economically match the PEB's investment returns.

Due to customers 30

	Group		Society	
	2010	2009	2010	2009
	£m	£m	£m	£m
Amounts due to customers are repayable from the balance sheet date in the ordinary course of business as follows:				
Accrued interest	26	42	1	-
Repayable on demand	4,139	3,229	912	798
Other amounts owed to customers with residual maturity repayable:				
• In not more than three months	352	422	14	10
• In more than three months but not more than one year	430	678	45	2
• In more than one year but not more than five years	138	-	1	-
	5,085	4,371	973	810

Group amounts due to customers include savings deposit balances held in our off-shore subsidiary Nationwide International Limited. These savings accounts do not confer membership rights.

Debt securities in issue 31

	Group		Society	
	2010	2009	2010	2009
	£m	£m	£m	£m
Certificates of deposit and commercial paper	12,588	14,083	12,588	14,083
Fixed and floating rate notes	20,996	19,807	19,251	18,030
Other debt securities	2,472	244	240	245
	36,056	34,134	32,079	32,358
Fair value adjustment for micro hedged risk	746	660	105	94
	36,802	34,794	32,184	32,452
Debt securities in issue are repayable from the balance sheet date in the ordinary course of business as follows:				
Accrued interest	178	214	155	209
Residual maturity repayable:				
• In not more than one year	14,398	18,033	14,398	18,033
• In more than one year	21,480	15,887	17,526	14,116
	36,056	34,134	32,079	32,358
Fair value adjustment for micro hedged risk	746	660	105	94
	36,802	34,794	32,184	32,452

Debt securities in issue include Group and Society £12,799 million (2009: £10,906 million) secured on certain loans and advances to customers. Further information is given in note 19.

Other liabilities 32

	Group		Society	
	2010	2009	2010	2009 (Adjusted)
	£m	£m	£m	£m
Third party income tax withheld	98	269	98	269
Liabilities to subsidiary undertakings	-	-	2,232	80
Other liabilities	431	402	378	394
	529	671	2,708	743

Notes to the Accounts

continued

Provisions for liabilities and charges 33

	Group			Society		
	FSCS	Other Provisions	Total	FSCS	Other Provisions	Total
	£m	£m	£m	£m	£m	£m
At 5 April 2009	258	13	271	258	13	271
Provisions utilised	(48)	(2)	(50)	(48)	(2)	(50)
(Release)/charge for the year	(117)	14	(103)	(117)	11	(106)
At 4 April 2010	**93**	**25**	**118**	**93**	**22**	**115**
At 5 April 2008	-	16	16	-	16	16
Acquired on acquisitions:						
• Derbyshire	7	-	7	7	-	7
• Cheshire	6	-	6	6	-	6
• Dunfermline	4	-	4	4	-	4
Provisions utilised	-	(11)	(11)	-	(11)	(11)
Charge for the year	241	8	249	241	8	249
At 4 April 2009	258	13	271	258	13	271

Financial Services Compensation Scheme (FSCS)

Based on its share of protected deposits, the Group pays levies to the FSCS to enable the scheme to meet claims against it. In 2008 and 2009 a number of institutions were declared in default by the FSA. The FSCS has met the claims by way of loans received from HM Treasury. The terms of these loans are interest only for the first three years and the FSCS recovers the interest cost, together with ongoing management expenses, by way of annual levies on member firms over this period.

The FSCS may have a further liability if there are insufficient funds available from the realisation of the assets of the financial institutions to fully repay the HM Treasury loans. To the extent that the loans have not been repaid in full by 2012, the FSCS will agree a schedule of repayments with HM Treasury. The FSCS will then levy the industry (including Nationwide) accordingly.

In the year ended 4 April 2009, the Group made a provision for £258 million, being the Group's estimated share of the levies which it would incur in respect of the period of the initial three year loan facility from HM Treasury. At that time, the Group did not provide for its estimated share of potential compensation costs because these could not be reliably estimated.

The amount provided by the Group as at 4 April 2010 of £93 million has been restricted to the latest estimates of its share of levies in respect of scheme years ending on and before 31 March 2011, for which our liability to scheme levies is already confirmed. The change, together with a significant reduction in the provision due principally to interest rates being lower than previously anticipated, resulted in a release of £117 million and aligns our approach with emerging industry consensus.

As further information is provided by the FSCS scheme the Group will continue to update its estimate of the amount of FSCS levies it will ultimately be required to pay.

Other provisions

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

Accruals and deferred income 34

	Group		Society	
	2010	2009	2010	2009
	£m	£m	£m	£m
Interest accrued on subordinated liabilities	29	29	29	29
Interest accrued on subscribed capital	17	17	17	17
Deferred income on PEBs	65	-	65	-
Owed to subsidiary undertakings	-	-	-	21
Other	265	308	258	296
	376	354	369	363

The amounts above described as 'other' represent standard operational accruals incurred during the normal course of business.

Deferred income on PEBs relates to income received, which is deferred and recognised in the income statement on an effective interest basis over the term of the product. Changes in the balance are as follows:

	Group		Society	
	2010	2009	2010	2009
	£m	£m	£m	£m
At 5 April	-	-	-	-
Additions	71	-	71	-
Releases	(6)	-	(6)	-
At 4 April	65	-	65	-

Notes to the Accounts

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Subordinated liabilities 35

	Group & Society	
	2010	2009
	£m	£m
6.74% Subordinated loan due 2014 (£)	-	15
5¼% Subordinated notes due 2014 ($225m)	148	152
3⅜% Subordinated notes due 2015 (€750m)	665	678
5% Subordinated notes due 2015 ($400m)	262	269
5.875% Fixed rate subordinated notes 2015 (£)	100	100
Subordinated floating rate notes due 2016 (€300m)	266	272
7.125% Subordinated notes due 2016 (£)	75	75
5¾% Callable reset subordinated notes 2016 (£)	35	35
5¼% Subordinated notes due 2018 (£)	200	200
8⅝% Subordinated notes due 2018 (£)	125	125
6.73% Subordinated loan due 2019 (£)	15	15
5.25% Subordinated loan due 2020 (£)	150	150
6.5% Callable reset subordinated notes 2022 (£)	30	30
	2,071	2,116
Fair value adjustment for micro hedged risk	104	127
Unamortised premiums and issue costs	(9)	(10)
	2,166	2,233

All of the Society's subordinated liabilities are unsecured. The Society may, with the prior consent of the FSA, redeem some of the subordinated notes early as follows:

- All (but not some only) of the 3⅜% notes due 2015 at par (100%) on 17 August 2010 (or each subsequent interest payment date), by giving not less than 15 nor more than 30 days notice to the holders. In the event the Society does not redeem the notes early the interest rate will convert to a floating rate equal to the aggregate of 3 month Euribor and 0.76%;
- All or some of the 5.875% fixed rate subordinated notes due 2015 on 17 December 2010 by giving not less than 15 nor more than 30 days notice to the holders. In the event the Society does not redeem the notes on 17 December 2010 the initial annual interest of 5.875% will be reset at 0.5% over the prevailing five year gilt rate. These notes were acquired on the acquisition of the Derbyshire Building Society;
- All (but not some only) of the floating rate notes due 2016 at par (100%) on 22 December 2011, by giving not less than 15 nor more than 30 days notice to the holders. In the event the Society does not redeem the notes on 22 December 2011 the initial interest margin of 0.22% over Euribor will increase by a further 0.5%;
- All of the 7.125% subordinated notes due 2016 may, with the prior consent of the FSA, be redeemed on 10 October 2011, five years before the final maturity date, by giving not less than 30 nor more than 60 days notice to the holders. In the event that the Society does not redeem the notes early the interest rate will convert to a rate referenced to the then current five year gilt rate plus 3.2%;
- All of the 5.75% notes due 2016 on 6 December 2011 and every six months thereafter until the final maturity date of 6 December 2016. If the issue is not repaid on the first call date, the coupon will be reset to yield 1.62% over the prevailing five year gilt benchmark. These notes were acquired on the acquisition of the Cheshire Building Society;
- All (but not some only) of the 5¼% notes due 2018 at par (100%) on 12 February 2013, by giving not less than 15 nor more than 30 days notice to the holders. In the event the Society does not redeem the notes on 12 February 2013 the fixed rate of interest will become an aggregate of 1.98% and the then current five year benchmark gilt rate;
- All or some of the 8⅝% notes due 2018 at the higher of par (100%) or the benchmark 8¾% 2017 gilt, by giving not less than 30 nor more than 60 days notice to the holders;

Subordinated liabilities (continued) 35

- All of the 6.73% subordinated loan due 2019 may, with the prior consent of the FSA, be redeemed on 7 April 2014, five years before the final maturity date, by giving no less than 2 days notice to the holders. In the event that the Society does not redeem the notes early the interest rate will convert to a rate referenced to the then current five year gilt rate plus 3.1%;
- All of the 5.25% subordinated loan due 2020 may, with the prior consent of the FSA, be redeemed on 23 November 2015, five years before the final maturity date, by giving not less than 30 days notice to the holders. In the event that the Society does not redeem the notes early the interest rate will convert to a floating rate equal to the then current 3 month Libor plus 1.54%; and
- All or some of the 6.5% notes due 2022 on 1 March and 1 September 2017. If the issue is not repaid on the first call date, the coupon will be reset to yield 300 basis points over the prevailing five year gilt benchmark. These notes were acquired on the acquisition of the Cheshire Building Society.

The subordinated notes rank pari passu with each other and behind the claims against the Society of all depositors, creditors and investing members (other than holders of permanent interest bearing shares) of the Society.

The interest rate risk arising from the issuance of fixed rate subordinated debt has been mitigated through the use of interest rate swaps.

On 7 May 2009 the Group, with the consent of the FSA, redeemed early the £15 million 6.74% subordinated loan due 2014 at a cost of £15 million.

Subscribed capital 36

	Group & Society	
	2010	2009
	£m	£m
6.024% Permanent interest bearing shares	350	350
6.875% Permanent interest bearing shares	30	30
7.971% Permanent interest bearing shares	200	200
7.25% Permanent interest bearing shares	60	60
6.25% Permanent interest bearing shares	125	125
5.769% Permanent interest bearing shares	400	400
7.859% Permanent interest bearing shares	100	100
Floating rate permanent interest bearing shares	10	10
6% Permanent interest bearing shares	140	140
	1,415	1,415
Fair value adjustment for micro hedged risk	155	161
Unamortised premiums and issue costs	(46)	(50)
	1,524	1,526

Notes to the Accounts
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Subscribed capital (continued) 36

All permanent interest bearing shares (PIBS) are unsecured and denominated in Sterling. Repaying the PIBS requires the prior consent of the FSA.

- The 7.971% PIBS are repayable, at the option of the Society, in whole on 13 March 2015 or any fifth anniversary thereafter;
- The 7.25% PIBS are repayable, at the option of the Society, in whole on 5 December 2021 and every fifth successive 5 December thereafter;
- The 6.25% PIBS are repayable, at the option of the Society, in whole on 22 October 2024 and every fifth successive 22 October thereafter;
- The 5.769% PIBS are repayable, at the option of the Society, in whole on 6 February 2026 or any fifth anniversary thereafter; and
- The 7.859% PIBS are repayable, at the option of the Society, in whole on 13 March 2030 or any fifth anniversary thereafter.

If the above five tranches of PIBS are not repaid on a call date then the interest rate is reset at a margin to the yield on the then prevailing five year benchmark gilt rate.

- The 6.024% PIBS are repayable, at the option of the Society, in whole on 13 February 2016 or any interest coupon date thereafter. If the 6.024% PIBS are not repaid on their first call date then the interest rate is reset at a margin of 50 basis points over 3 month Libor. If the 6.024% PIBS have not been repaid by 6 February 2018, the interest rate is reset at a margin of 150 basis points over 3 month Libor;
- The 6.875% PIBS are repayable at the option of the Society, in whole on 10 January 2019, or any fifth anniversary thereafter. If the PIBS are not repaid on a call date, then the interest rate is reset at a margin of 300 basis points over the yield on the prevailing five year gilt benchmark. These PIBS were acquired on the acquisition of the Cheshire Building Society;
- Interest on the floating rate PIBS is at 2.4% above 6 month Libor. These PIBS are only repayable in the event of winding up the Society. These PIBS were acquired on the acquisition of the Cheshire Building Society; and
- The 6% PIBS are repayable at the option of the Society, in whole on 15 December 2016, or any interest coupon date thereafter. If the PIBS are not repaid on their first call date then the interest rate is reset at a margin of 249 basis points over 3 month Libor. These PIBS were acquired on the acquisition of the Derbyshire Building Society.

PIBS rank pari passu with each other. They are deferred shares of the Society and rank behind the claims against the Society of all subordinated noteholders, depositors, creditors and investing members of the Society.

The interest rate risk arising from the issuance of fixed rate PIBS has been mitigated through the use of interest rate swaps.

Retirement benefit obligations 37

	Group		Society	
	2010	2009	2010	2009
	£m	£m	£m	£m
Present value of funded obligations	2,963	2,253	2,958	2,250
Fair value of plan assets	(2,468)	(1,936)	(2,464)	(1,933)
	495	317	494	317
Present value of unfunded obligations	10	11	10	11
Total pension liabilities	505	328	504	328
Post retirement healthcare	3	3	3	3
	508	331	507	331

Retirement benefit obligations (continued) 37

The Group operates both defined benefit arrangements and defined contribution arrangements. The principal defined benefit pension arrangement is the Nationwide Pension Fund. This is a contributory defined benefit arrangement, with both final salary and career average earnings sections. The assets of the fund are held and managed by the fund trustees separately from the assets of the Group. Contributions to the fund are assessed in accordance with the advice of the independent actuary, and are agreed between the trustees and the Group. The fund was closed to new entrants on 31 May 2007. Since that date new employees are able to join a defined contribution arrangement.

The contribution rates, including employees' contributions, vary between 8.0% and 27.5%.

The Nationwide Pension Fund merged with the Portman Building Society Pension and Assurance Scheme on 1 October 2009. The Group operates other pension arrangements for former employees of the Derbyshire and Cheshire building societies, certain current and former directors and officers, as well as for one subsidiary company. The defined benefit arrangements for the former employees of the Dunfermline Building Society were not transferred to the Group.

The amounts recognised in the income statement are as follows:

	Group		Society	
	2010	2009	2010	2009
	£m	£m	£m	£m
Defined benefit current service cost	62	83	60	80
Defined contribution cost	9	5	9	5
Past service cost	5	14	5	14
Curtailment	(5)	(7)	(5)	(7)
	71	95	69	92
Capitalised as intangible fixed assets	-	(1)	-	(1)
Included in employee costs (note 10)	71	94	69	91
Expected return on pension assets (note 3)	(122)	(151)	(122)	(151)
Pension interest cost (note 4)	146	141	146	141
	95	84	93	81

Changes in the present value of defined benefit pension obligations are as follows:

	Group		Society	
	2010	2009	2010	2009
	£m	£m	£m	£m
At 5 April	2,264	2,169	2,261	2,166
Acquired on transfer of engagements				
• Derbyshire	-	67	-	67
• Cheshire	-	57	-	57
Current service cost	62	83	60	80
Past service cost	24	14	24	14
Curtailment	(5)	(7)	(5)	(7)
Pension interest cost	146	141	146	141
Employee contributions	2	2	2	1
Subsidiary undertakings contributions	-	-	1	3
Actuarial losses/(gains)	562	(198)	561	(197)
Benefits paid	(82)	(64)	(82)	(64)
At 4 April	2,973	2,264	2,968	2,261

Notes to the Accounts

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Retirement benefit obligations (continued) 37

The past service cost of £24 million includes amounts that were provided for the year ended 4 April 2009 as part of the transformation costs relating to restructuring parts of our business.

The Group does not charge the net defined benefit cost to the subsidiary undertakings that participate in the defined benefit arrangements. The pension cost to the subsidiary undertakings equals the contributions payable to the Fund.

Changes in the fair value of plan assets are as follows:

	Group		Society	
	2010	2009	2010	2009
	£m	£m	£m	£m
At 5 April	1,936	2,132	1,933	2,130
Acquired on transfer of engagements				
• Derbyshire	-	68	-	68
• Cheshire	-	64	-	64
Expected return on assets	122	151	122	151
Actuarial gains/(losses)	393	(519)	392	(518)
Contributions by employer	97	102	96	98
Employee contributions	2	2	2	1
Subsidiary undertakings contributions	-	-	1	3
Benefits paid	(82)	(64)	(82)	(64)
At 4 April	**2,468**	1,936	**2,464**	1,933

The actual return on assets was 23.4% (2009: negative 18.1%). Contributions by the Group included additional deficit contributions of £5 million (2009: £5 million).

The major categories of plan assets for the pension funds, stated at fair value, are as follows:

	Group		Society	
	2010	2009	2010	2009
	£m	£m	£m	£m
Equities	1,210	882	1,208	881
Government bonds	377	320	376	319
Corporate bonds	387	386	387	386
Infrastructure	121	106	121	106
Property	211	69	211	69
Other	162	173	161	172
	2,468	1,936	2,464	1,933

None of the funds' assets are invested in the Nationwide Group (2009: £2 million).

Retirement benefit obligations (continued) 37

The amounts recognised in respect of pension obligations in the statement of comprehensive income are as follows:

	Group		Society	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Cumulative actuarial (losses)/gains at 5 April	(162)	159	(162)	159
Actuarial losses in the year	**(169)**	(321)	**(169)**	(321)
Cumulative actuarial losses at 4 April	**(331)**	(162)	**(331)**	(162)

Experience gains and losses in respect of pension obligations for the current and the previous years are as follows:

	Group					Society				
	2010	2009	2008	2007	2006	2010	2009	2008	2007	2006
	£m	£m	£m	£m	£m	**£m**	£m	£m	£m	£m
Experience gains/(losses) on plan liabilities	**55**	12	(41)	(6)	8	**55**	12	(41)	(6)	8
Changes in actuarial assumptions	**(617)**	186	245	39	(220)	**(616)**	185	245	39	(220)
Actuarial (losses)/gains on plan liabilities	**(562)**	198	204	33	(212)	**(561)**	197	204	33	(212)
Experience gains/(losses) on plan assets	**393**	(519)	(143)	(32)	205	**392**	(518)	(143)	(32)	205
	(169)	(321)	61	1	(7)	**(169)**	(321)	61	1	(7)

The present value of the defined benefit obligation and the fair value of plan assets including post retirement healthcare for the current and previous years are:

	Group					Society				
	2010	2009	2008	2007	2006	**2010**	2009	2008	2007	2006
	£m	£m	£m	£m	£m	**£m**	£m	£m	£m	£m
Present value of defined benefit obligation	**2,976**	2,267	2,172	1,953	1,837	**2,971**	2,264	2,169	1,951	1,835
Fair value of plan assets	**2,468**	1,936	2,132	1,781	1,543	**2,464**	1,933	2,129	1,779	1,541
Total deficit	**508**	331	40	172	294	**507**	331	40	172	294

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continued

Retirement benefit obligations (continued) 37

The principal actuarial assumptions used were as follows:

	Group & Society	
	2010	2009
	%	%
Discount rate	5.6	6.5
Expected return on plan assets	7.0	6.5
Future salary increases	4.6	4.4
Future pension increases	3.4	3.3
Inflation	3.6	3.4
Medical cost trend rate	4.4 - 8.0	4.4 - 8.0

To derive the expected long term rate of return on assets assumption, the Group considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for the future returns of each asset class. Assets with higher volatility are assumed to generate higher returns consistent with widely accepted capital market principles. The expected overall return was then calculated based on the asset allocation at 4 April 2010. This resulted in the selection of the 7.0% assumption as at 4 April 2010 (2009: 6.5%). A deduction is made for the expenses of the Fund.

The assumptions on mortality are determined by the following actuarial tables:

	2010	2009
Retired and non-retired members	PNXA 00 BY MC	PNXA 00 BY MC

The mortality tables used at 4 April 2010 make an allowance for future mortality improvements to be at least 1.0% p.a. (2009: 1.0%) for males and 0.5% p.a. (2009: 0.5%) for females.

The assumptions are illustrated by the following years of life expectancy at age 60:

	2010	2009
Retired members		
• Males	27.1	27.0
• Females	29.1	29.0
Non-retired members		
• Males	29.2	29.1
• Females	30.3	30.2

The Group estimates that its contributions to the defined benefit pension funds during the year ended 4 April 2011 will be £79 million.

The next full triennial valuation of the Nationwide Pension Fund is at 31 March 2010. The results will not be available until later in the year, after which a plan will be agreed between the Trustee board and the Group to manage the ongoing retirement benefit liability. The trustees are in the process of agreeing the assumptions. Initial indications suggest that a number of the assumptions will have changed, which may lead to a further increase in the total deficit.

Financial commitments 38

2010	Group Contract amount	Group Credit risk weighted amount	Society Contract amount	Society Credit risk weighted amount
	£m	£m	£m	£m
Irrevocable undrawn loan facilities	2,669	708	2,508	680
Undrawn formal standby facilities, credit lines and other commitments to lend	5	1	5	1
	2,674	709	2,513	681

2009	Group Contract amount	Group Credit risk weighted amount	Society Contract amount	Society Credit risk weighted amount
	£m	£m	£m	£m
Irrevocable undrawn loan facilities	2,661	668	2,550	651
Undrawn formal standby facilities, credit lines and other commitments to lend	10	1	10	1
	2,671	669	2,560	652

Irrevocable undrawn loan facilities relate to undrawn commercial loan commitments. Undrawn formal standby facilities, credit lines and other commitments to lend are in respect of Treasury lending facilities.

In addition to the figures shown above, the Group has, as part of its Retail operations, commitments of £7,192 million (2009: £7,951 million) in respect of residential mortgages, credit card and overdraft facilities. These commitments represent agreements to lend in the future, subject to certain conditions. Such commitments are cancellable by the Group, subject to notice requirements and given their nature are not expected to be drawn down to the full level of exposure.

Capital and leasing commitments 39

Capital commitments	Group 2010	Group 2009	Society 2010	Society 2009
	£m	£m	£m	£m
Capital expenditure contracted for but not provided for in the Accounts	140	95	140	95

The Group leases various offices, branches and other premises under non-cancellable operating lease arrangements. The leases have various terms, escalation, renewal rights and in some cases contingent rent payable.

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Capital and leasing commitments (continued) 39

Leasing commitments	Group 2010 £m	Group 2009 £m	Society 2010 £m	Society 2009 £m
At the balance sheet date, future minimum payments under operating leases relating to land and buildings were as follows:				
Amounts falling due:				
• Within one year	33	35	33	35
• Between one and five years	101	104	100	102
• After five years	133	115	131	113
	267	254	264	250
Leasing payments due as lessor At the balance sheet date, subleasing payments receivable under non-cancellable subleases	15	18	15	18
At the balance sheet date, future minimum lease payments receivable under non-cancellable operating leases were as follows:				
Amounts falling due:				
• Within one year	6	5	6	5
• Between one and five years	17	18	17	18
• After five years	16	17	16	17
	39	40	39	40

The 2009 comparatives have been amended to reflect the current year's presentation.

Contingent liabilities 40

(a) *Bank charges*

On 27 July 2007, following agreement between the UK Office of Fair Trading (OFT) and a number of UK financial institutions, the OFT issued High Court legal proceedings against those institutions, including Nationwide Building Society, to determine the legal status and enforceability of certain of the charges applied to their personal current account customers in relation to requests for unauthorised overdrafts.

The High Court's original judgement that the charges were assessable for fairness was appealed by the financial institutions to the Court of Appeal. The judgement of the Court of Appeal upheld the original decision of the High Court. A further appeal by the financial institutions to the Supreme Court (formerly the House of Lords) was heard and a judgement delivered on 25 November 2009. The Supreme Court ruled that unauthorised overdraft charges are not assessable for fairness on the basis of costs. This meant that the test case between the OFT and the financial institutions, including the Society came to an end. The decision cannot be appealed any further. On 22 December 2009 the OFT, after detailed consideration of the judgement and the various options available to it, concluded against taking forward any investigation under the Unfair Terms in Consumer Contract Regulations 1999.

The Society continues to assert that its charges are fair and transparent, and that, given the legal circumstances outlined above, there is no longer a contingent liability relating to this matter.

(b) *Legal proceedings*

During the ordinary course of business the Society is subject to threatened or actual legal proceedings. All such material cases are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of incurring a liability. The Society does not expect the ultimate resolution of any proceedings to have a significant adverse effect on the financial position of the Society and has not disclosed the contingent liabilities associated with such claims, either because they cannot reasonably be estimated or because such disclosure could be seriously prejudicial to the conduct of the claims.

Financial instruments

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Strategy in using financial instruments

Financial instruments incorporate the vast majority of the Group and Society's assets and liabilities. Given the dominant position of the Society within the Group structure, the term 'Group' is used in the remainder of this note to cover the activities of both Group and Society. Furthermore, because the risks of the organisation are managed on a Group basis, the risk disclosures in notes 42 to 44 are presented only on a consolidated basis.

The Group accepts deposits from customers at fixed, floating and variable interest rates for various periods and seeks to earn an interest margin by investing these funds in high quality assets – predominantly mortgages. The principal risks which arise from this core activity, and which need to be managed by the Group, are interest rate risks (including basis risk), credit risks, foreign exchange risks and liquidity and funding risks.

The Group uses derivative instruments to manage various aspects of risk. However, in doing so it complies with the Building Societies Act 1986 which limits our use of derivatives to the mitigation of consequences arising from changes in interest rates, exchange rates or other factors defined by the Act.

Derivatives

The principal derivatives used in balance sheet risk management are interest rate swaps, forward rate agreements, interest rate options, cross-currency interest rate swaps, interest rate futures, foreign exchange contracts, credit derivatives and equity index swaps. Derivatives are used to hedge balance sheet and income exposures arising, inter alia, from fixed rate mortgage lending, fixed rate savings products, funding and investment activities in foreign currencies or involving fixed rate instruments or instruments with embedded options. Group risk exposures are recorded on the Society's information systems and monitored accordingly.

The following table describes the significant activities undertaken by the Group, the risks associated with such activities and the types of derivatives which are used in managing such risks. Such risks may alternatively be managed using cash instruments as part of an integrated approach to risk management.

Activity	Risk	Type of derivative instrument used
Savings products and funding activities involving instruments which are fixed rate instruments with embedded options	Sensitivity to changes in interest rates	Interest rate swaps, interest rate futures, swaptions, forward rate agreements
Mortgage lending and investment activities involving instruments which are fixed rate or which include explicit or embedded options	Sensitivity to changes in interest rates, including differential between base rate and Libor	Interest rate swaps including basis swaps, interest rate futures, swaptions, caps, collars and forward rate agreements
Investment and funding in foreign currencies	Sensitivity to changes in foreign exchange rates	Cross-currency swaps and foreign exchange contracts
Investment of liquid resources in debt securities	Sensitivity to changes in obligor credit risk leading to default	Credit default swaps
Protected equity bond (PEBs) savings products	Sensitivity to changes in stock indices	Equity index swaps

The accounting policy for derivatives and hedge accounting is described in the Statement of Accounting Policies. Where possible, fair value hedge accounting is employed but no use is made of cash flow hedge accounting.

The Board and the Assets and Liabilities Committee (ALCO) are responsible for setting certain parameters respectively over the Group exposure to interest rates, foreign exchange rates and other indices. The Board exercises oversight over these exposures. The Commercial and Treasury Credit Committee sets Group credit policy and regularly monitors and reviews credit exposures arising in all aspects of Group operations, including derivatives. All risk committees are overseen by the Board Risk Committee on behalf of the Board.

All exchange-traded instruments are subject to cash requirements under the standard margin arrangements applied by the individual exchanges. Such instruments are not subject to significant credit risk. Credit exposures arising on derivative contracts with certain counterparties are collateralised (e.g. with cash deposits) to mitigate credit exposures. All Group derivatives activity is contracted with OECD financial institutions.

The principal financial risks to which the Group is exposed are interest rate, credit, foreign exchange, liquidity and funding risk. Each of these is considered below.

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Financial instruments (continued) 41

Interest rate risk

The primary market risk faced by the Group is interest rate risk. The net interest income and market value of the Group's assets are exposed to movements in interest rates. This exposure is managed on a continuous basis, within parameters set by ALCO, using a combination of derivative instruments, cash instruments (such as loans, deposits and bonds), and contractual terms within products and associated procedures.

The Group does not run a trading book and therefore does not have the higher risk exposure run by many banking institutions. Given our policy of hedging fixed rate assets and liabilities back to floating rate, interest rate market value risk arises mainly from the Board's decision to invest the Group's reserves according to a specified fixed rate maturity profile. The level of risk can deviate from this, subject to limits, in particular as a result of decisions made by the Group's Treasury department to temporarily deviate from the specified fixed rate maturity profile in the light of market conditions.

Interest rate earnings risk arises mainly from the diversity of product terms and associated procedures adopted by the Group in originating and administering retail and commercial products. Should reported exposure approach internal risk parameters, action is initiated by ALCO to mitigate such exposure, through changes to these product terms and procedures, or through the use of derivatives.

The Group uses several metrics to monitor interest rate risk and details of these are set out below. The limits around these metrics have been set by ALCO and reflect the Group's low risk appetite.

Value at Risk (VaR). This is a technique that estimates the potential losses that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence. In its day-to-day monitoring Nationwide uses a 10-day horizon and a 99% confidence level.

The VaR model used by Nationwide incorporates underlying risk factors based on interest rate volatilities and correlations. Potential movements in market prices are calculated by reference to daily market data from the last two years equally weighted. Exposures against limits are reviewed daily by management. Actual outcomes are monitored periodically to test the validity of the assumptions and factors used in the VaR calculation.

Although a valuable guide to risk, VaR needs to be viewed in the context of the following limitations:

- Historic data is not necessarily a good guide to future events;
- The use of a 99% confidence level, by definition, does not take account of changes in value that might occur beyond this level of confidence. The VaR numbers may not encompass all potential events, particularly those that are extreme in nature; and
- VaR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures.

Sensitivity analysis (PV01 sensitivity). This is used to assess the change in value of the Group's current net worth against a one basis point (0.01%) parallel shift in interest rates. As is the case with VaR, this analysis is done on a daily basis separately for each currency (but with the main risk arising from Sterling exposures) and in aggregate.

Stress testing. PV200 sensitivity is calculated in a similar manner to PV01 but against a much more severe 200 basis point (2.0%) parallel shift in interest rates. Both PV01 and PV200 numbers are generated and monitored daily.

Change in value of the Group's current net worth is also calculated against a range of non-linear stresses to the yield curve. This output is reported and monitored on a monthly basis.

The average gross exposures (before deduction of the above-mentioned specified fixed rate maturity profile for the Group's reserves) through the reporting period are as follows:

	Average 2010 £m	High 2010 £m	Low 2010 £m	Average 2009 £m	High 2009 £m	Low 2009 £m
VaR	83	88	79	68	86	47
Sensitivity analysis (PV01)	2	2	2	2	2	1
Stress testing (PV200: all currencies)	390	463	362	374	427	295

Financial instruments (continued) 41

All exposures include investment of the Group's reserves. VaR reflects the impact of the rise of interest rates volatilities in the reference period.

Earnings risk. Interest rate earnings risks, such as basis risk (the risk of loss arising from changes in the relationship between interest rates which have similar but not identical characteristics, for example Libor and Bank of England base rate and prepayment risk (the risk of loss arising from early repayment of fixed rate mortgages and loans) are also monitored closely and regularly reported to ALCO.

Earnings risks are calculated using a variety of stochastic and deterministic scenarios.

Credit risk

The Group takes on exposure to credit risk, which is defined as the risk that a counterparty will be unable to pay amounts in full when due. Impairment provisions are provided for losses that have been incurred at the balance sheet date (see notes 12 and 16). Significant changes in the economy, or a sector that represents a concentration in the Group's portfolio, could result in losses that are different from those provided for at the balance sheet date. Management, therefore, carefully monitors its exposure to credit risk.

The Group's Credit Committees for Retail and Commercial and Treasury are responsible for approving and monitoring the Group's credit exposures which they do through formal annual review and approval of the Group's lending policies. Regular monitoring and review of lending is undertaken through detailed management information including the performance of credit scoring systems for all retail lending. Formal limits are set and reviewed at individual, segment and portfolio levels based on credit exposures split by individual counterparties, geographical location and industry sector. Summary minutes of the Credit Committees together with key risk monitoring metrics are reviewed by the Executive Risk Committee.

Prior to advancing funds, an assessment is made of the credit quality of borrowers and other counterparties for all lending to both retail and corporate customers. Retail lending is subject to credit scoring and lending policies. Corporate lending is based on counterparty assessment that includes the use of multiple rating methodologies.

Credit risk within our Treasury division arises primarily from the investments held by Treasury for liquidity and investment purposes and for general business purposes. This aspect of credit risk is managed by Treasury division and the Commercial and Treasury Risk function within Risk Management division. The Commercial and Treasury Risk team underwrites all new facilities and monitors existing facilities. They also set and monitor compliance with policy and limits, reporting to the Commercial and Treasury Credit Committee. In addition, counterparty credit risk arises from the Group's derivatives where the market values are positive. The impact of counterparty credit risk on derivatives is discussed further in note 43.

The Treasury Credit Risk function monitors exposure concentrations against a variety of criteria including industry sector, asset class, and country of risk. The Treasury portfolio exposure is well spread across both industry sectors and jurisdictions. Nationwide has no exposure to emerging markets or hedge funds and only minimal exposure to non investment grade debt.

Maximum credit risk exposure at 4 April 2010 was £194.5 billion (2009: £206.6 billion) which includes the carrying value for all assets and commitments.

The classes of financial instruments to which the Group is most exposed are loans and advances to customers (note 19), loans and advances to banks (note 15), investment securities – available for sale (note 16), and derivative financial instruments (note 17). Additional information on credit risk for loans and advances to customers is set out in note 42 and for treasury instruments in note 43.

Foreign exchange risk

Foreign exchange risk is the risk that the Sterling value of, or net income from, assets and liabilities that are denominated in foreign currency changes as a consequence of changes to foreign exchange rates.

In addition to commercial loans denominated in Euro, a significant proportion of Treasury funding and investment activity is undertaken in foreign currencies. Foreign currency exposure is hedged on the balance sheet or by using derivatives to reduce currency exposures to acceptable levels.

In line with the prudential guidance applying to all building societies and after taking account of foreign currency derivatives, the Group has no substantial net exposure to foreign exchange rate fluctuations or changes in foreign currency interest rates. ALCO sets limits on the level of exposure by currency which are monitored daily.

VaR is used to monitor the risk arising from open foreign currency positions. Open currency positions represent the net value of assets, liabilities and derivatives in foreign currency. The parameters of the VaR methodology, and frequency of reporting are exactly as described above under Interest rate risk.

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Financial instruments (continued) 41

The average gross Sterling equivalent exposures for foreign exchange risk through the year are as follows:

	2010			2009		
	Average	High	Low	Average	High	Low
	£m	£m	£m	£m	£m	£m
VaR	0.2	0.6	-	0.2	0.5	-

The foreign exchange difference of £20 million for the year ended 4 April 2010, included in interest receivable and similar income (note 3), reflects gains on foreign exchange derivatives held to mitigate the economic risk of potential future payments in foreign currency.

Liquidity

Liquidity risk is the risk that the Group is not able to meet its financial obligations as they fall due (including any unexpected adverse cash flow), to smooth out the effect of maturity mismatches, or to maintain public confidence.

The Group liquidity policy is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding, to retain full public confidence in the solvency of the Group and to enable it to meet all financial obligations. This is achieved through maintaining a prudent level of high quality liquid assets, through management and stress testing of business cash flows, and through management of funding facilities. The Group liquidity policy is reconsidered annually by the Board.

Liquid assets are categorised according to their liquidity characteristics, and the most liquid category of assets is the focus of management attention. This portfolio predominantly comprises holdings of sovereign-issued securities and deposits with the central bank and is aligned to the 'liquid asset buffer' defined in the FSA's policy statement on liquidity management PS 09/16. Assets may be acquired through direct purchase, through repurchase agreements or through collateral swaps. Encumbered assets are excluded from the calculation of liquid assets which is conducted on a daily basis.

The Board is responsible for setting limits over the level and composition of liquidity balances. A series of liquidity stress tests is performed to confirm that the limits remain appropriate. Previously for a forward period of one month, a liquidity model has been used on a monthly basis to apply a number of stress scenarios to the Group contractual and behavioural forward cash flows. The minimum level of liquidity to be held was determined through one of these stress scenarios, and internal liquidity limits are increased, where required, on a monthly basis. This process has now been enhanced to include daily calculations of stressed cashflows over forward periods of both shorter and longer duration.

ALCO is responsible for setting more detailed limits within the context of overall Board limits, including the level and maturity profile of wholesale funding, and for monitoring the composition of the Group balance sheet. Wholesale funding maturities are monitored to ensure that future maturities are not concentrated on a calendar basis. This enhances the ability of the Group to refinance maturing liabilities throughout forward months and quarters. A consolidated cash flow forecast is maintained on a continuous basis and reviewed by ALCO. Going forward, limits regarding the maturity concentration and composition of savings portfolio are being monitored.

A Contingency Funding Plan has been approved by ALCO, and describes procedures and available actions to manage the Group's liquidity resources through a period of market disruption or heavy retail outflows. This is reviewed on a biannual basis.

Additional quantitative information on liquidity risk is contained in note 44.

Credit risk – Loans and advances to customers 42

Our £152.5 billion of loans and advances to customers continues to have a low risk profile when compared to industry benchmarks. The mix of lending has remained broadly consistent over the year.

Lending remains predominantly concentrated on high quality, secured products with residential mortgage lending making up 83.5% (2009: 83.8%), commercial loans 14.6% (2009: 14.2%) and consumer banking 1.5% (2009: 1.6%). Sub prime lending within Specialist residential mortgages accounts for just 0.4% of the retail loan portfolio.

Credit risk – Loans and advances to customers (continued) 42

Loans and advances to customers	Notes	2010 £bn	2010 %	2009 (Adjusted) £bn	2009 (Adjusted) %
Prime residential mortgages		108.7	71.3	111.9	72.1
Specialist residential mortgages		18.7	12.2	18.2	11.7
Total residential mortgages		127.4	83.5	130.1	83.8
Consumer banking		2.3	1.5	2.4	1.6
Retail loan portfolio	(a)	129.7	85.0	132.5	85.4
Commercial lending	(b)	22.2	14.6	22.1	14.2
Other lending operations	(b)	0.6	0.4	0.6	0.4
Total gross balance		152.5	100.0	155.2	100.0

(a) *Retail loan portfolio*

The retail portfolio is predominantly made up of £127.4 billion of residential mortgages (2009: £130.1 billion) with £2.3 billion of consumer banking lending (2009: £2.4 billion). By their nature, our retail lending books comprise a large number of smaller loans and have low volatility of credit risk outcomes and are intrinsically highly diversified.

Residential mortgages are only secured against UK properties. The Group operates across the whole of the UK with a bias towards the South East of England and Greater London, reflecting the concentration of branches in that region and historically higher asset value growth trends. As at 4 April 2010 around 34% (2009: 34%) of the retail mortgage book was made up of exposures concentrated in the South East and Greater London.

	2010 %	2009 %
South East England (excluding London)	12	12
Central England	22	22
Northern England	19	19
Greater London	22	22
South West England	9	9
Scotland	9	9
Wales and Northern Ireland	7	7
Total	100	100

The make up of specialist lending is as follows:

	2010 £bn	2010 %	2009 £bn	2009 %
Self-certified	4.5	24	4.9	27
Buy to Let	12.3	66	11.2	61
Near prime	1.4	7	1.6	9
Sub prime	0.5	3	0.5	3
Specialist lending	18.7	100	18.2	100

Notes to the Accounts

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Credit risk – Loans and advances to customers (continued) 42

Near prime is defined as a borrower with a County Court Judgement (CCJ) or default less than or equal to £1,000 or one missed mortgage payment in the last 12 months. Sub prime lending is defined as a borrower with a CCJ or default in excess of £1,000 or more than one missed mortgage payment in the last 12 months.

Specialist lending operates through TMW, primarily in the Buy to Let and self-certification markets with a very small exposure to the adverse market. In addition, the portfolio contains assets acquired from the Cheshire, Derbyshire and Dunfermline building societies along with assets originated under our UCB brand.

Asset quality of residential mortgages remains strong and we have retained our clear focus on affordability and loan to value (LTV) ratios. The overall number of residential mortgages 3 or more months in arrears as a proportion of the book remains very low at 0.82% (4 April 2009: 0.80%). Overall, our level of arrears remains strong compared with the industry average of 2.22% (4 April 2009: 2.41%).

The number of Group borrowers in possession, including acquired societies, of 967 (4 April 2009: 1,248) represents 0.069% of the total portfolio (4 April 2009: 0.087%). As Buy to Let landlords may have more than one property, possession measures are slightly higher on a property basis but, at 1,088 (4 April 2009: 1,441) properties, representing 0.077% of our book (4 April 2009: 0.100%), this compares very well with the industry measure of 0.127% (4 April 2009: 0.211%). Excluding the impact of acquired societies, our position relative to the industry is even more favourable.

The average LTV of residential mortgages is 48% (4 April 2009: 52%) whilst the average LTV of new lending was 63% (4 April 2009: 60%). The value of residential property is updated on a quarterly basis to reflect changes in the House Price Index (HPI). The percentage of cases per LTV band and an analysis of our gross residential mortgage lending during the year by borrower type are set out below:

	2010	2009
	%	%
Loan to value analysis:		
<50%	54	51
50% - 60%	10	9
60% - 70%	10	9
70% - 80%	10	9
80% - 90%	8	8
90% - 100%	6	8
>100%	2	6
	100	100
Average loan to value of stock (indexed)	48	52
Average loan to value of new business	63	60
New business profile:		
First-time buyers	26	15
Home movers	38	27
Remortgagers	18	50
Buy to Let	18	8
	100	100

The analysis of new business profile at 4 April 2009 has been amended to exclude further advances, which were previously included in remortgages. The analysis at 4 April 2010 likewise excludes further advances. Further advances have also been excluded from the analysis of average loan to value of new business.

Credit risk – Loans and advances to customers (continued) 42

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

	2010					2009				
	Prime lending	Specialist lending	Consumer banking	Total		Prime lending	Specialist lending	Consumer banking	Total	
	£bn	£bn	£bn	£bn	%	£bn	£bn	£bn	£bn	%
Not impaired:										
Neither past due nor impaired	106.3	16.5	2.1	124.9	96	109.5	15.7	2.2	127.4	96
Past due up to 3 months but not impaired	1.9	1.2	-	3.1	3	1.9	1.4	0.1	3.4	3
Impaired	0.5	1.0	0.2	1.7	1	0.5	1.1	0.1	1.7	1
	108.7	18.7	2.3	129.7	100	111.9	18.2	2.4	132.5	100

The status 'Past due up to 3 months but not impaired' includes any asset where a payment due under strict contractual terms is received late or missed. The amount included is the entire financial asset balance rather than just the payment overdue.

Loans in the analysis above which are less than 3 months past due have collective impairment allowances set aside to cover credit losses on loans which are in the early stages of arrears. Loans acquired from the Cheshire, Derbyshire and Dunfermline have been fair valued on a basis which makes allowances for anticipated losses over the remaining life of the loans. Impaired loans totalling £403 million in the above analysis for 4 April 2010 have thus been fair valued and are therefore unlikely to contribute any significant further losses to the Group.

Impaired retail assets are further analysed as follows:

	2010					2009				
	Prime lending	Specialist lending	Consumer banking	Total		Prime lending	Specialist lending	Consumer banking	Total	
	£m	£m	£m	£m	%	£m	£m	£m	£m	%
Impaired status:										
Past due 3 to 6 months	280	342	60	682	39	262	443	61	766	44
Past due 6 to 12 months	174	282	67	523	30	147	320	66	533	30
Past due over 12 months	81	222	45	348	20	59	117	32	208	12
Possessions	30	160	-	190	11	34	215	-	249	14
	565	1,006	172	1,743	100	502	1,095	159	1,756	100

Possession balances represent properties which Nationwide has taken ownership of pending their sale.

£329 million (2009: £94 million) of loans that would be past due or impaired have had their terms renegotiated or capitalised in the last 12 months. Customers with arrears are only permitted to renegotiate where they have demonstrated their ability to meet a repayment schedule at normal commercial terms for a continuous six month period.

Notes to the Accounts
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Credit risk – Loans and advances to customers (continued) 42

Collateral held against past due or impaired retail residential mortgages:

	2010				2009			
	Prime lending		Specialist lending		Prime lending		Specialist lending	
	£m	%	£m	%	£m	%	£m	%
Past due but not impaired	1,884	100	1,159	99	1,904	100	1,323	99
Impaired	532	99	829	98	465	99	862	98
Possessions	29	97	150	94	33	97	206	96
	2,445	100	2,138	98	2,402	100	2,391	98

Collateral held in relation to secured loans that are either past due or impaired is capped to the amount outstanding on an individual loan basis. The percentage, in the table above, is the cover over the asset.

Negative equity on retail residential mortgages:

	2010		2009	
	Prime lending	Specialist lending	Prime lending	Specialist lending
	£m	£m	£m	£m
Past due but not impaired	5	10	7	17
Impaired	3	17	3	18
Possessions	1	10	1	9
	9	37	11	44

In consumer banking personal loans and credit cards have arrears levels significantly lower than averages for the industry (FLA and APACS) as shown in the table below:

Percentage of accounts more than 30 days in arrears:

	2010		2009	
	NBS	Industry	NBS	Industry*
	%	%	%	%
Personal loans	7.07	19.6	7.15	15.8
Credit card	5.15	6.64	5.70	8.06

*Industry numbers for personal loans and credit cards for the prior period have been restated by the FLA and APACS respectively.

Credit risk – Loans and advances to customers (continued) 42

(b) *Commercial and other operations loan portfolio*

Commercial lending comprises loans secured on commercial property, loans to Registered Social Landlords and loans advanced under Private Finance Initiatives. Balances for other operations shown below include a secured European commercial loan portfolio of £299 million (2009: £369 million) and unsecured lending of £277 million (2009: £311 million) relating to a student loan portfolio. These investments were acquired by Treasury division and are therefore held within the Head office functions and other operations business segment.

Our commercial loan portfolio of £22.2 billion (2009: £22.1 billion) comprises the following:

	2010		2009	
	£bn	%	£bn	%
Property finance	13.0	58	13.7	62
Registered Social Landlords	7.9	36	7.2	33
Private Finance Initiative	1.3	6	1.2	5
	22.2	100	22.1	100

Loans to Registered Social Landlords are secured on residential property and loans advanced under the Private Finance Initiative are secured on cash flows from Government backed contracts. We have never suffered losses on our lending in these markets and there are currently no arrears of three months or more on these portfolios. Our property finance portfolio is well diversified by industry type and by borrower and we have no significant exposure to development finance. The proportion of property finance cases three months or more in arrears as at 4 April 2010: was 3.64%, and equates to 334 cases (2009: 2.25%, 223 cases).

Property finance lending is well diversified by industry type and an analysis is provided below:

	2010		2009	
	£bn	%	£bn	%
Retail	4.3	33	4.1	30
Office	3.0	23	3.2	23
Residential	2.0	15	2.5	18
Industrial and warehouse	2.0	15	2.1	16
Leisure and hotel	1.1	9	1.0	7
Owner occupied	0.3	3	0.7	5
Other	0.3	2	0.1	1
	13.0	100	13.7	100

In terms of counterparty concentration, the largest single commercial customer, including undrawn commitments, represents only 1% (2009: 1%) of the total book.

Notes to the Accounts

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Credit risk – Loans and advances to customers (continued) 42

The tables below provide further information on the commercial and other operations loan portfolio by payment due status as at 4 April:

	2010				2009			
	Commercial		Other operations		Commercial		Other operations	
	£bn	%	£bn	%	£bn	%	£bn	%
Not impaired:								
Neither past due nor impaired	20.9	94	0.6	100	21.1	95	0.6	100
Past due up to 3 months but not impaired	0.4	2	-	-	0.6	3	-	-
Impaired	0.9	4	-	-	0.4	2	-	-
	22.2	100	0.6	100	22.1	100	0.6	100

The status 'Past due up to 3 months but not impaired' includes any asset where a payment due under strict contractual terms is received late or missed. The amount included is the entire financial asset rather than just the payment overdue.

Loans in the analysis above which are less than 3 months past due have collective impairment allowances set aside to cover credit losses on loans which are in the early stages of arrears. This analysis includes commercial mortgage assets totalling £1.3 billion acquired through the acquisitions of the Cheshire, the Derbyshire and the Dunfermline. These loans have been fair valued on a basis which makes credit loss adjustments, totalling £165 million, for anticipated losses over the remaining life of the loans. We therefore believe these loans should not contribute any significant losses to the Group for the foreseeable future.

Impaired commercial and other operations assets are further analysed as follows:

	2010				2009			
	Commercial		Other operations		Commercial		Other operations	
	£m	%	£m	%	£m	%	£m	%
Impaired status:								
Past due 3 to 6 months	291	31	14	42	118	31	6	40
Past due 6 to 12 months	397	43	15	46	229	60	4	27
Past due over 12 months	238	26	4	12	21	6	5	33
Possessions	-	-	-	-	12	3	-	-
	926	100	33	100	380	100	15	100

Commercial assets totalling £960 million (2009: £359 million) have individual provisions against them. This includes cases which are not more than 3 months past due.

Possession balances represent properties which Nationwide has taken ownership of pending their sale.

£175 million (2009: £257 million) of loans that would be past due or impaired have had their terms renegotiated in the last 12 months. In addition, we may restructure maturing loans and those with actual or potential covenant breaches. In these cases, the renegotiated payments of capital and interest do not indicate impairment.

Credit risk – Loans and advances to customers (continued)

42

Collateral held against past due or impaired commercial lending	2010		2009	
	£m	%	£m	%
Past due but not impaired	382	97	521	94
Impaired	834	90	341	93
Possessions	-	-	12	100
	1,216	92	874	94

Collateral held in relation to secured loans that are either past due or impaired is capped to the amount outstanding on an individual loan basis. The percentage, in the table above, is the cover over the asset.

Negative equity on commercial lending	2010	2009
	£m	£m
Past due but not impaired	11	34
Impaired	92	27
Possessions	-	-
	103	61

There are £38 million (2009: £21 million) past due or impaired balances classified above as other operations. Of this, £27 million (2009: £6 million) relates to the European commercial loan portfolio which is secured on the business assets of the borrower. Collateral in respect of these assets is £25 million (2009: £1 million).

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Credit risk – Treasury financial instruments 43

Treasury assets are held in two portfolios – the prudential portfolio and the investment portfolio. At 4 April 2010 the prudential portfolio totalled £25.7 billion (2009: £31.1 billion) and the investment portfolio totalled £3.7 billion (2009: £3.4 billion). Analysis of each of these portfolios by credit rating and by location of issuer is given below, with further commentary provided in the business review on pages 19 to 22.

Prudential portfolio	April 2010	AAA	AA	A	Other	UK	US	Europe	Other
	£bn	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Cash and balances with the Bank of England	4.0	100	-	-	-	100	-	-	-
Loans to financial institutions	1.7	-	36	59	5	78	1	5	16
Other (including items in transit and clearing accounts)	0.3	-	-	-	-	100	-	-	-
Non AFS assets	6.0								
Gilts	6.4	100	-	-	-	100	-	-	-
Non domestic Government bonds	3.9	100	-	-	-	-	43	57	-
Supranational bonds	2.0	100	-	-	-	-	2	98	-
Residential mortgage backed securities (RMBS)	2.7	96	4	-	-	43	-	52	5
Covered bonds	0.9	89	11	-	-	-	3	90	7
Floating rate notes	3.8	4	25	61	10	26	3	57	14
AFS assets	19.7								
Total prudential portfolio	25.7	78	7	14	1	55	7	34	4

Ratings are obtained from Standard & Poors in the majority of cases, from Moody's if there is no Standard & Poors rating available, and internal ratings are used if neither is available.

We have continued to increase the quality of the prudential portfolio, with over 63% (2009: 50%) of assets held in sovereign and supranational exposures and over 99% (2009: 99%) of the portfolio rated A or better with 85% (2009: 78%) rated AA or above.

Credit risk – Treasury financial instruments (continued) 43

Prudential portfolio	April 2009	AAA	AA	A	BBB	UK	US	Europe	Other
	£bn	%	%	%	%	%	%	%	%
Cash and balances with the Bank of England	8.2	100	-	-	-	100	-	-	-
Loans to financial institutions	4.7	-	48	52	-	89	-	1	10
Other (including items in transit and clearing accounts)	0.4	-	-	-	-	100	-	-	-
Non AFS assets	13.3								
Gilts	4.7	100	-	-	-	100	-	-	-
Non domestic Government bonds	0.6	100	-	-	-	-	-	100	-
Supranational bonds	1.9	100	-	-	-	-	5	95	-
Residential mortgage backed securities (RMBS)	2.7	99	1	-	-	40	-	53	7
Covered bonds	0.9	86	14	-	-	-	3	91	6
Floating rate notes	6.0	16	26	56	2	37	2	50	11
Certificates of deposit and commercial paper	1.0	-	25	75	-	100	-	-	-
AFS assets	17.8								
Total prudential portfolio	31.1	64	14	22	-	70	1	25	4

Investment portfolio – all AFS assets	April 2010	AAA	AA	A	Other	UK	US	Europe	Other
	£bn	%	%	%	%	%	%	%	%
Collateralised debt obligations (CDO)	0.1	-	-	-	100	-	100	-	-
Collateralised loan obligations (CLO)	0.6	33	59	8	-	25	75	-	-
Commercial mortgage backed securities	0.6	60	19	11	10	47	14	39	-
Corporate bond portfolio	0.1	-	13	17	70	36	28	36	-
Credit card backed securities	0.3	99	-	-	1	42	58	-	-
Financial institutions including subordinated debt	0.7	-	22	64	14	21	33	39	7
Other corporate bonds	-	-	34	66	-	100	-	-	-
Residential mortgage backed securities (RMBS)	0.3	24	23	23	30	61	36	3	-
US student loan	0.8	98	1	1	-	-	100	-	-
Other investments	0.2	38	21	15	26	11	47	33	9
Total	3.7	49	20	18	13	27	55	16	2

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Credit risk – Treasury financial instruments (continued) 43

Ratings are obtained from Standard and Poors in the majority of cases, from Moody's if there is no Standard and Poors rating available, and internal ratings are used if neither is available.

Over 87% (2009: 97%) of the investment portfolio is rated A or better with 69% (2009: 76%) rated AA or better.

Nationwide has £100 million exposure to monoline wrapped transactions which are shown above according to their underlying holdings. For all but £2 million of this exposure, we anticipate full repayment without any assistance from the wrap provider.

Investment Portfolio – all AFS assets	April 2009	AAA	AA	A	Other	UK	US	Europe	Other
	£bn	%	%	%	%	%	%	%	%
Collateralised debt obligations (CDO)	0.1	5	-	-	95	-	100	-	-
Collateralised loan obligations (CLO)	0.5	100	-	-	-	26	70	4	-
Commercial mortgage backed securities	0.6	93	6	1	-	50	11	39	-
Corporate bond portfolio	0.2	13	7	80	-	17	16	67	-
Credit card backed securities	0.3	97	3	-	-	47	53	-	-
Financial institutions including subordinated debt	0.6	-	26	69	5	22	35	36	7
Other corporate bonds	-	-	46	54	-	100	-	-	-
Residential mortgage backed securities (RMBS)	0.2	54	22	17	7	55	39	6	-
US student loan	0.7	98	1	1	-	-	100	-	-
Other investments	0.2	30	30	37	3	17	45	35	3
Total	3.4	65	11	21	3	27	52	19	2

Credit risk – Treasury financial instruments (continued) 43

In assessing impairment, the Group evaluates among other factors, the normal volatility in valuation, evidence of deterioration in the financial health of the investee, industry and sector performance and operational and financing cash flows. An impairment loss of £29 million (2009: £48 million) has been recognised in the income statement in respect of the prudential and investment portfolios. In addition an impairment charge of £7 million (2009: nil) has been recognised on investments in equity shares (see note 20).

Collateral held as security for Treasury assets is determined by the nature of the instrument. Loans, debt securities, treasury and other eligible bills are generally unsecured with the exception of asset backed securities and similar instruments, which are secured by pools of financial assets. In addition, in 2009 collateral, predominantly gilts, was held under reverse sale and repurchase agreements as described in note 16.

The fair value of derivative assets at 4 April 2010 was £4.9 billion (2009: £5.9 billion). Additional information on these assets is set out in note 17. The International Swaps and Derivatives Association (ISDA) Master Agreement is Nationwide's preferred agreement for documenting derivative activity. It is common for a Credit Support Annex (CSA) to be executed in conjunction with the ISDA Master Agreement. Under a CSA, cash collateral is passed between parties to mitigate the market contingent counterparty risk inherent in the outstanding positions. Where cash collateral is received, to mitigate the risk inherent in amounts due to us, it is included as a liability within deposits from banks. Where cash collateral is given to mitigate the risk inherent in amounts due from us, it is included as an asset in loans and advances to banks.

Netting arrangements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis. The Group's legal documentation for derivative transactions grants legal rights of set-off for those transactions. Accordingly, the credit risk associated with such contracts is reduced to the extent that negative mark to market values on derivatives will offset positive mark to market values on derivatives in the calculation of credit risk, subject to an absolute exposure of zero.

Cash collateral on certain derivative assets with a fair value of £2.0 billion (2009: £2.3 billion) is only triggered when the counterparty rating falls to a specified rating level and the trigger event has not yet occurred. The exposure to these counterparties is all to AA rated banks and the credit risk attaching to these banks should materially therefore already be factored into the Libor curve used to fair value those positions.

As a consequence of the above no credit valuation adjustment is made on derivative assets nor has any debit valuation adjustment to reflect own credit risk been taken in our derivative liabilities.

Treasury portfolio credit mitigation

The Group has credit derivatives in place to cover the credit risk on a £88 million notional (2009: £153 million notional) of assets within the available for sale portfolio.

All of the credit derivatives have been undertaken with A+ or above rated US and European banking institutions.

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Liquidity risk 44

For each material class of financial liability a maturity analysis is provided in notes 27 to 31.

The table below analyses the carrying value of financial assets and financial liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. In practice, customer deposits will be repaid later than on the earliest date on which repayment can be required.

The carrying values of derivative financial instruments are included in the columns according to their contractual maturity.

At 4 April 2010 Residual maturity	Repayable on demand	Up to 3 months	3 - 12 months	1 - 5 years	More than 5 years	Total
	£m	£m	£m	£m	£m	£m
Assets						
Liquid assets	5,773	602	1,773	7,406	13,842	29,396
Loans and advances to customers	497	1,365	4,420	24,722	121,425	152,429
Derivative financial instruments	-	214	337	2,867	1,434	4,852
Other financial assets	-	19	175	2,038	492	2,724
Total assets	6,270	2,200	6,705	37,033	137,193	189,401
Liabilities						
Shares	71,675	7,573	19,987	21,699	9	120,943
Amounts owed to banks, customers and debt securities in issue	5,295	18,910	7,403	15,787	7,032	54,427
Derivative financial instruments	-	68	463	2,901	1,510	4,942
Other financial liabilities	-	10	(14)	111	(1)	106
Subordinated liabilities	-	-	800	773	593	2,166
Subscribed capital	-	-	-	35	1,489	1,524
Total liabilities	76,970	26,561	28,639	41,306	10,632	184,108
Net liquidity gap	(70,700)	(24,361)	(21,934)	(4,273)	126,561	5,293

In addition to the assets and liabilities shown in the table above, residential commitments as at the year end for the Group stood at £2,272 million (2009: £4,680 million) and for the Society £1,936 million (2009: £4,128 million). These commitments can be drawn at any time, but have a 6 month expiry from inception.

Commercial commitments for both Group and Society shown in note 38 can be drawn at any time. They have expiry dates that are specific to each contract and these can be in excess of 5 years. Of the Group commitments outstanding at the year end, £61 million have a maturity of less than 3 months, £224 million have a maturity of within 3 to 12 months, £1,499 million mature within 1 to 5 years and £885 million mature after 5 years. Of the Society commitments outstanding at the year end, £57 million have a maturity of less than 3 months, £210 million have a maturity of within 3 to 12 months, £1,408 million mature within 1 to 5 years and £833 million mature after 5 years.

Liquidity risk (continued) 44

At 4 April 2009 (Adjusted) Residual maturity	Repayable on demand	Up to 3 months	3 - 12 months	1 - 5 years	More than 5 years	Total
	£m	£m	£m	£m	£m	£m
Assets						
Liquid assets	12,410	1,772	2,165	8,703	9,411	34,461
Loans and advances to customers	861	1,726	3,840	23,078	125,964	155,469
Derivative financial instruments	-	650	949	2,849	1,411	5,859
Other financial assets	-	37	210	2,746	496	3,489
Total assets	13,271	4,185	7,164	37,376	137,282	199,278
Liabilities						
Shares	84,405	7,806	24,136	11,934	11	128,292
Amounts owed to banks, customers and debt securities in issue	3,714	26,848	10,723	12,173	4,663	58,121
Derivative financial instruments	-	149	435	3,800	1,602	5,986
Other financial liabilities	-	65	124	50	-	239
Subordinated liabilities	-	16	-	1,595	622	2,233
Subscribed capital	-	-	-	-	1,526	1,526
Total liabilities	88,119	34,884	35,418	29,552	8,424	196,397
Net liquidity gap	(74,848)	(30,699)	(28,254)	7,824	128,858	2,881

Liquid assets include cash in hand and balances with the Bank of England, loans and advances to banks and available for sale investment securities.

Other financial assets and liabilities include the fair value adjustments for portfolio hedged risk and investments in equity shares.

The analyses above exclude other assets including property, plant and equipment, intangible assets, investment property, other assets, deferred tax assets and accrued income and expenses prepaid, and other liabilities including provisions for liabilities and charges, accruals and deferred income, current tax liabilities, other liabilities and retirement benefit obligations.

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Liquidity risk (continued)

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The following is an analysis of gross undiscounted contractual cash flows payable under financial liabilities:

Gross contractual cash flows 2010	Repayable on demand	Up to 3 months	3 - 12 months	1 - 5 years	More than 5 years	Total
	£m	£m	£m	£m	£m	£m
Shares	71,675	7,794	20,448	22,541	9	122,467
Amounts owed to banks, customers and debt securities in issue	5,295	18,964	7,512	16,114	7,128	55,013
Derivative financial instruments	-	702	1,907	2,463	56	5,128
Other financial liabilities	-	10	(13)	112	(1)	108
Subordinated liabilities	-	6	851	933	619	2,409
Subscribed capital	-	10	81	872	1,393	2,356
Total liabilities	76,970	27,486	30,786	43,035	9,204	187,481

Gross contractual cash flows 2009 (Adjusted)	Repayable on demand	Up to 3 months	3 - 12 months	1 - 5 years	More than 5 years	Total
	£m	£m	£m	£m	£m	£m
Shares	84,405	8,020	24,521	12,445	12	129,403
Amounts owed to banks, customers and debt securities in issue	3,714	26,982	10,941	12,736	4,816	59,189
Derivative financial instruments	-	692	1,926	2,919	536	6,073
Other financial liabilities	-	66	125	51	-	242
Subordinated liabilities	-	22	82	1,688	676	2,468
Subscribed capital	-	10	81	694	1,662	2,447
Total liabilities	88,119	35,792	37,676	30,533	7,702	199,822

The analysis of gross contractual cash flows above differs from the analysis of residual maturity due to the inclusion of interest accrued at current rates, for the average period until maturity on the amounts outstanding at the balance sheet date.

Classification and measurement 45

The tables summarise the classification of carrying amounts of the Group's primary financial assets and liabilities.

2010 Group	Available for sale	Loans and receivables	Fair value through income statement	Liabilities at amortised cost	Total
	£m	£m	£m	£m	£m
Financial assets					
Cash and balances with the Bank of England	-	3,994	-	-	3,994
Loans and advances to banks	-	2,017	-	-	2,017
Investment securities	23,385	-	-	-	23,385
Derivative financial instruments	-	-	4,852	-	4,852
Loans and advances to customers	-	152,429	-	-	152,429
Fair value adjustment for portfolio hedged risk	-	2,638	-	-	2,638
Investments in equity shares	86	-	-	-	86
Other financial assets*	-	-	167	-	167
Total financial assets	23,471	161,078	5,019	-	189,568
Other non financial assets					1,829
Total assets					191,397
Financial liabilities					
Shares	-	-	-	120,943	120,943
Deposits from banks	-	-	-	8,031	8,031
Other deposits	-	-	1,128	3,381	4,509
Due to customers	-	-	-	5,085	5,085
Debt securities in issue	-	-	-	36,802	36,802
Fair value adjustment for portfolio hedged risk	-	106	-	-	106
Derivative financial instruments	-	-	4,942	-	4,942
Subordinated liabilities	-	-	-	2,166	2,166
Subscribed capital	-	-	-	1,524	1,524
Total financial liabilities	-	106	6,070	177,932	184,108
Corporation tax					42
Other non financial liabilities					1,531
Total liabilities					185,681

*Other financial assets represents the fair value movement in mortgage commitments entered into where a loan has not yet been made.

Notes to the Accounts
continued

Classification and measurement (continued) 45

2009 (Adjusted) Group	Available for Sale	Loans and Receivables	Fair value through income statement	Liabilities at amortised cost	Total
	£m	£m	£m	£m	£m
Financial assets					
Cash and balances with the Bank of England	-	8,205	-	-	8,205
Loans and advances to banks	-	5,033	-	-	5,033
Investment securities	21,223	-	-	-	21,223
Derivative financial instruments	-	-	5,859	-	5,859
Loans and advances to customers	-	155,469	-	-	155,469
Fair value adjustment for portfolio hedged risk	-	3,408	-	-	3,408
Investments in equity shares	81	-	-	-	81
Other financial assets*	-	-	218	-	218
Total financial assets	21,304	172,115	6,077	-	199,496
Other non financial assets					2,857
Total assets					202,353
Financial liabilities					
Shares	-	-	-	128,292	128,292
Deposits from banks	-	-	-	13,283	13,283
Other deposits	-	-	75	5,598	5,673
Due to customers	-	-	-	4,371	4,371
Debt securities in issue	-	-	-	34,794	34,794
Fair value adjustment for portfolio hedged risk	-	239	-	-	239
Derivative financial instruments	-	-	5,986	-	5,986
Subordinated liabilities	-	-	-	2,233	2,233
Subscribed capital	-	-	-	1,526	1,526
Total financial liabilities	-	239	6,061	190,097	196,397
Corporation tax					51
Other non financial liabilities					1,627
Total liabilities					198,075

*Other financial assets represents fair value movements in mortgage commitments entered into where a loan has not yet been made.

Classification and measurement (continued)

Fair values of financial assets and liabilities

The following table summarises the carrying amounts and fair values of those financial assets and liabilities not presented on the Group balance sheets at fair value:

2010	Group		Society	
	Carrying value	Fair value	Carrying value	Fair value
	£m	£m	£m	£m
Financial assets				
Loans and advances to banks	2,017	2,017	1,960	1,960
Loans and advances to customers:				
Residential mortgages	127,313	124,746	109,721	107,077
Consumer banking	2,143	2,164	2,143	2,164
Commercial lending	22,417	22,724	21,269	21,522
Other lending	556	556	-	-
Financial liabilities				
Shares	120,943	121,423	120,943	121,423
Deposits from banks	8,031	8,035	7,009	7,013
Other deposits	4,509	4,514	11,359	11,364
Due to customers	5,085	5,085	973	973
Debt securities in issue	36,802	36,793	32,184	32,848
Subordinated liabilities	2,166	2,025	2,166	2,025
Subscribed capital	1,524	1,152	1,524	1,152

2009 (Adjusted)	Group		Society	
	Carrying value	Fair value	Carrying value	Fair value
	£m	£m	£m	£m
Financial assets				
Loans and advances to banks	5,033	5,033	4,987	4,987
Loans and advances to customers:				
Residential mortgages	129,916	132,116	112,959	114,973
Consumer banking	2,230	2,230	1,090	1,090
Commercial lending	22,662	21,997	21,383	20,664
Other lending	661	661	-	-
Financial liabilities				
Shares	128,292	128,903	128,292	128,903
Deposits from banks	13,283	13,297	12,450	12,464
Other deposits	5,673	5,648	10,888	10,863
Due to customers	4,371	4,371	810	810
Debt securities in issue	34,794	32,852	32,452	31,075
Subordinated liabilities	2,233	1,518	2,233	1,518
Subscribed capital	1,526	753	1,526	753

Notes to the Accounts

continued

Classification and measurement (continued) 45

Loans and advances to customers

Loans and advances are net of provisions for impairment. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates to determine fair value.

Deposits and borrowings

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest-bearing deposits and other borrowings without quoted market price is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

Debt securities in issue

The aggregate fair values are calculated based on quoted market prices. For those notes where quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity.

Fair value measurement

The following table provides an analysis of financial assets and liabilities held on the Group balance sheet at fair value, grouped into levels 1 to 3 based on the degree to which the fair value is observable:

2010 Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Investment securities – AFS	12,130	11,149	106	23,385
Investments in equity shares	-	7	79	86
Derivative financial instruments	-	4,852	-	4,852
	12,130	16,008	185	28,323
Financial liabilities				
Derivative financial instruments	-	(4,898)	(44)	(4,942)
Other deposits – PEB	-	-	(1,128)	(1,128)
	-	(4,898)	(1,172)	(6,070)

2009 (Restated) Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Investment securities – AFS	6,895	14,146	182	21,223
Investments in equity shares	-	5	76	81
Derivative financial instruments	-	5,859	-	5,859
	6,895	20,010	258	27,163
Financial liabilities				
Derivative financial instruments	-	(5,948)	(38)	(5,986)
Other deposits – PEB	-	-	(75)	(75)
	-	(5,948)	(113)	(6,061)

Level 1: Fair value derived from unadjusted quoted prices in active markets for identical assets or liabilities, e.g. G10 government securities.

Level 2: Fair value derived from inputs other than quoted prices that are observable for the asset or liability, either directly (i.e. a price) or indirectly (i.e. derived from prices), e.g. most investment grade and liquid bonds, asset backed securities, certain Collateralised Debt Obligations (CDOs), Collateralised Loan Obligations (CLOs) and OTC derivatives.

Level 3: Inputs for the asset or liability are not based on observable market data (unobservable inputs), e.g. private equity investments, derivatives including an equity element, deposits including an equity element, some CDOs and certain asset backed securities and bonds.

Classification and measurement (continued) 45

Following guidance issued subsequent to publishing the 2009 Annual Report and Accounts the Group has reviewed the allocation of assets into the above three categories. Previously, only investments in equity shares were classified in the Level 3 portfolio (2009: £81 million) and UK government securities in the Level 1 portfolio (2009: £4,720 million) with all other items classified in the Level 2 portfolio.

There were no significant transfers between the Level 1 and 2 portfolios during the year. Composition of and movements in the Level 3 portfolio are described below.

The main constituents of the Level 3 portfolio are as follows:

Investment securities – AFS

Collateralised Debt Obligations

CDOs purchased from third parties valued on the basis of the status of the asset. Impaired assets are priced on the basis of recoverability using an internal model based on observable and unobservable performance assumptions. Not impaired assets are valued using independent, third party quotes.

Financial institutions

Investments in Icelandic institutions valued on the basis of recoverability using the latest market information on the underlying position of the issuing institution.

Other

Bonds and asset backed products, one-off in relation to the remainder of the book or not actively traded in the market. These instruments are valued on the basis of the status of the asset, with those considered to be impaired valued through an assessment of recoverability and those not impaired priced from independent, third party quotes, based on proxy assets where necessary.

Investments in equity shares

Investments in unquoted equity instruments. Valuations are subjective in nature but have been consistently applied over time. Full valuations are performed bi-annually using details of the underlying funds combined with earnings estimates and applicable discount rates at the reporting date.

Derivative financial instruments – liabilities

Equity linked derivatives with external counterparties which economically match the investment return payable by the Group to customers invested in the PEB product. The derivative is linked to the performance of specified stock market indices and has been valued by the external counterparty.

Other deposits – PEB

Deposit accounts with the potential for stock market correlated growth linked to the performance of specified stock market indices. The PEB liability is valued at a discount to reflect the time value of money, overlaid by a fair value adjustment representing the expected return payable to the customer. The fair value adjustment has been constructed from the valuation of the associated derivative as valued by the external counterparty.

Level 3 portfolio – movements analysis

The table below analyses movements in the Level 3 portfolio:

2010 Group	Investment securities – AFS	Investments in equity shares	Derivative financial instruments – liabilities	Other deposits	Total
	£m	£m	£m	£m	£m
At 5 April 2009 (Restated)	182	76	(38)	(75)	145
Total (loss)/gain:					
• Income statement	(6)	(8)	(6)	14	(6)
• Other comprehensive income	31	4	-	-	35
Purchases	-	8	-	-	8
Issues	-	-	-	(1,068)	(1,068)
Settlements	(83)	(1)	-	1	(83)
Transfers out of Level 3	(18)	-	-	-	(18)
At 4 April 2010	106	79	(44)	(1,128)	(987)

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Classification and measurement (continued)

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Income statement losses on investment securities – AFS relate to foreign exchange revaluation losses (£7 million) offset by an impairment reversal (£1 million). Income statement losses for investments in equity shares are mostly due to impairment of one of the funds. Losses on derivative financial instruments – liabilities and other deposits relate to mark to market activity in the period.

Movements in other comprehensive income are unrealised gains in the AFS reserve on investment securities – AFS and investments in equity shares due to increases in the prices obtained from the market for the instruments held.

Transfers out of the Level 3 portfolio were largely due to increased market activity on instruments with previously unobservable prices and relate primarily to commercial mortgage backed securities.

Gains/losses recognised during the year on the Level 3 portfolio held at the year end (excluding settlements and transfers) have been recognised in the income statement or statement of comprehensive income as follows:

2010 Group	Investment securities – AFS	Investments in equity shares	Derivative financial instruments – liabilities	Other deposits	Total
	£m	£m	£m	£m	£m
Recognised in the income statement					
• Net interest (expense)/income	(4)	(1)	1	-	(4)
• Other income/(expense)	1	(7)	(7)	14	1
Recognised in other comprehensive income					
• Fair value movement taken to equity	24	4	-	-	28

Level 3 portfolio – sensitivity analysis

The table below provides sensitivity analysis of reasonably possible alternative valuation assumptions for the assets in the Level 3 portfolio.

2010 Group	Carrying value	Increase in fair value	Decrease in fair value
	£m	£m	£m
Investment securities – AFS:			
• Collateralised debt obligations	69	33	(67)
• Financial institutions	13	8	(4)
• Other investments	24	7	(3)
Investments in equity shares	79	2	(15)
	185	50	(89)
Increases/(decreases) in fair value would be recognised in:			
• Income statement	-	15	(6)
• Statement of other comprehensive income (accumulated in the AFS reserve)	-	35	(83)
	-	50	(89)

The stresses take account of the nature of valuation techniques used, as well as the availability and reliability of observable proxy and historic data. The sensitivity methodologies are based on a reliable reference source or scenario based on alternative market views. The level of shift of scenarios applied is considered for each product and varied according to the quality of the data and variability of the underlying market.

The sensitivities used to derive the results in the above table have not been offset by the impact of hedge accounting. Increases in fair values of the PEB derivative financial instruments would be offset by decreases in the fair values of the associated PEB deposit and vice versa. These items have therefore been excluded from the table above.

Classification and measurement (continued) 45

Investment securities – AFS

Collateralised debt obligations

Impaired assets in this category are highly leveraged and therefore all potential outcomes are considered. Sensitivity on assets which have not been impaired has been calculated by assessing movements in the preceding 12 months on an applicable market index.

Financial institutions

All assets of this type are impaired and therefore the unobservable input relates to the underlying assets and liabilities of the related institution. Sensitivities have been calculated by considering the possible net asset position of these institutions.

Other investments

The diverse range of assets included in other investments, some of which are impaired, dictates that a variety of methods be used to calculate potential sensitivities. These include:

- A local authority bond where the impact of applicable credit spreads has been calculated;
- A corporate bond where a shift of +/-1% in underlying values has been used;
- A government guaranteed backed security where the preceding 12 months on an applicable market index were used; and
- A UK student loan security where, for the note held, all potential outcomes are considered.

Investments in equity shares

Sensitivities in these holdings have been based on the variance in underlying valuation seen in these holdings over the past 12 months.

Related party transactions 46

Subsidiary, parent and ultimate controlling party

The Group is controlled by the Nationwide Building Society registered in England and Wales which is also considered to be the ultimate parent. Details of principal subsidiary undertakings can be found in note 21 to these accounts.

Key management compensation

The directors of the Society are considered to be the key management personnel as defined by IAS 24 ('Related Party Disclosures').

Total compensation for key management personnel for the year by category of benefit was as follows:

	2010	2009 (Adjusted)
	£'000	£'000
Short term employee benefits	5,558	4,141
Post employment benefits	35	78
Other long term benefits	1,591	2,434
Contractual / other settlements	1,772	749
Total key management personnel compensation for the year	8,956	7,402

The total for short term employee benefits for 2009 has been adjusted to include an amount of £99,000 that was contributed by the Society to a director's stakeholder pension scheme. This amount was separately disclosed in the narrative of last year's related party note.

The Derbyshire and the Cheshire building societies directors' emoluments relating to the prior year were disclosed in notes 5(c) and 4 of the Derbyshire and the Cheshire building societies' respective cessation accounts. No directors from the Derbyshire or the Cheshire transferred to Nationwide.

Transactions with related parties

A number of transactions are entered into with related parties in the normal course of business. These include loans, deposits and the payment and recharge of administrative expenses. The volumes of related party transactions, outstanding balances at the year end, and the related income and expenses for the year are as follows:

Notes to the Accounts
continued

Related party transactions (continued) 46

	Society Subsidiaries		Group and Society Key management personnel	
	2010	2009 (Adjusted)	2010	2009
	£m	£m	£m	£m
Loans payable to the Society				
Loans outstanding at 5 April	20,340	15,693	0.4	0.3
Acquired on transfer of engagements	-	4,096	-	-
Loans issued during the year	**1,341**	2,201	**0.6**	0.5
Loans impaired	**(61)**	-	-	-
Loan repayments during the year	**(3,160)**	(1,650)	**(0.1)**	(0.4)
Loans outstanding at 4 April	**18,460**	20,340	**0.9**	0.4
Deposits payable by the Society				
Deposits outstanding at 5 April	5,216	3,304	4.9	2.7
Deposits issued during the year	**2,833**	1,940	**27.4**	15.1
Deposit repayments during the year	**(1,199)**	(28)	**(27.3)**	(12.9)
Deposits outstanding at 4 April	**6,850**	5,216	**5.0**	4.9
Net interest income				
Interest receivable	**960**	710	-	-
Interest expense	**167**	270	**0.1**	0.1
Other income and expenses				
Dividends payable to the Society	**352**	24	-	-
Fees and expenses paid to the Society	**1**	1	-	-
Other balance sheet items				
Amounts owed to the Society	**2,728**	1,114	-	-
Other liabilities payable by the Society	**2,232**	80	-	-
Accruals payable by the Society	-	21	-	-

The related party interest expense for 2009 has been amended to reflect the current year's presentation.

Transactions with key management personnel

Transactions with key management personnel are on the same terms and conditions applicable to other employees within the Group.

A register is maintained by the Society containing details of loans, transactions and arrangements made between the Society or its subsidiary undertakings and Directors of the Society or persons connected with Directors of the Society.

The register will be available for inspection by members at the Annual General Meeting on 22 July 2010 and during normal office hours at the Society's principal office (Nationwide House, Pipers Way, Swindon) during the period of 15 days prior to the meeting.

Transactions with Group companies

Transactions with Group companies arise in the normal course of business. Interest on outstanding loans and deposits accrues at a transfer price rate agreed between the Society and its subsidiaries.

Notes to the cash flow statements

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	Group		Society	
	2010	2009 (Adjusted)	2010	2009 (Adjusted)
	£m	£m	£m	£m
Non-cash items included in profit before tax				
Net increase in impairment provisions	280	258	282	170
Impairment losses on investment securities	36	51	36	51
Depreciation and amortisation	151	126	150	125
(Profit)/loss on sale of fixed assets	(1)	3	(1)	3
Interest on subordinated liabilities	92	93	92	93
Interest on subscribed capital	91	85	91	85
Loss on the revaluation of land and buildings	5	16	3	13
Loss on the revaluation of investment properties	-	6	-	5
Gain from derivatives and hedge accounting	(34)	(10)	(31)	(11)
Gain on portfolio acquisition and business combinations	(40)	(135)	(40)	(135)
	580	493	582	399
Changes in operating assets				
Loans and advances to banks	578	(325)	573	(330)
Investment securities	(1,434)	(543)	(1,394)	(542)
Derivative financial instruments and fair value adjustment for portfolio hedged risk	1,811	(7,085)	1,689	(5,224)
Deferred tax assets	509	(659)	471	(659)
Loans and advances to customers	3,177	(2,483)	2,434	(1,937)
Other operating assets	736	(321)	1,193	(873)
	5,377	(11,416)	4,966	(9,565)
Changes in operating liabilities				
Shares	(7,349)	4,490	(7,349)	4,490
Deposits from banks, customers and others	(5,702)	856	(4,807)	689
Derivative financial instruments and fair value adjustment for portfolio hedged risk	(1,177)	4,769	(1,659)	5,772
Debt securities in issue	2,008	356	(268)	(2,240)
Retirement benefit obligations	177	298	176	298
Other operating liabilities	738	(1,344)	2,808	(1,035)
	(11,305)	9,425	(11,099)	7,974
Cash and cash equivalents				
Cash and balances with the Bank of England	3,994	8,205	3,994	8,197
Loans and advances to other banks repayable in 3 months or less	1,817	4,255	1,760	4,214
Investment securities with a maturity period of 3 months or less	-	931	-	931
	5,811	13,391	5,754	13,342

Notes to the Accounts

continued

Notes to the cash flow statements (continued) 47

Changes in other operating liabilities include movements in the Group's wholesale funding balances of deposits from banks, other deposits and debt securities in issue. These are considered operating activities as they relate to the Group's lending activity and liquidity management and so form part of the normal course of business. Movements in subordinated liabilities and subscribed capital are considered financing activities because these form part of our capital management for solvency purposes.

The Group is required to maintain balances with the Bank of England which, at 4 April 2010, amounted to for the Group and Society £200 million (2009: £173 million). These balances are included within loans and advances to banks on the balance sheet and are not included in the cash and cash equivalents in the cash flow statement as they are not liquid in nature.

The decrease in cash and balances with the Bank of England reflects a decision to manage down our Reserve Account with the Bank of England and invest in a range of highly liquid UK and foreign government securities.

Dunfermline social housing portfolio acquisition 48

The social housing portfolio was not part of the original acquisition of core parts of the Dunfermline Building Society on 30 March 2009. The social housing portfolio was acquired from DBS Bridge Bank Limited on 30 June 2009. The acquisition of the social housing portfolio has been treated as the purchase of a mortgage book in line with IAS 39 'Financial Instruments: Recognition and Measurement' as follows:

	£m
Observable market price of portfolio	420
Related deposit liability assumed	(3)
	417
Purchase price of portfolio on acquisition	377
Gain on acquisition	40

The acquisition of the social housing portfolio has been accounted for as an acquisition of a portfolio under IAS 39. In certain limited circumstances, IAS 39 permits the rebuttal of the presumption that the cash price paid represents fair value of the acquired portfolio and the fair value of the acquired portfolio can instead be calculated using a valuation technique based on available market observable data. The Society has determined that the acquisition of the social housing portfolio is such a circumstance, and has accordingly valued the portfolio based upon its margins and amortisation profile, and using a discount rate derived from observable market data. The result of this valuation is a fair value for the portfolio of £417 million and hence a gain of £40 million based upon the purchase price of £377 million.

The gain of £40 million has been taken to the income statement on acquisition. The initial value of the loan portfolio will be amortised up to the redemption value of the portfolio over the life of the loans.

Dunfermline acquisition – revised fair values 49

On 30 March 2009 the Society acquired the retail and wholesale deposits, branches, head office and originated residential mortgages (other than social housing loans and related deposits) of the Dunfermline Building Society. As the acquisition of the core parts of the Dunfermline took place immediately prior to the 4 April 2009 year end, the information required to value the acquisition was incomplete. The initial accounting for Dunfermline was thus determined provisionally in the 2009 Annual Report and Accounts. In accordance with IFRS 3 (2008 Revised) adjustments to the initial provisional accounting for the Dunfermline disclosed in the 2009 Annual Report and Accounts have been recognised as if the final accounting for the business combination had been completed at the acquisition date. Comparative information for 4 April 2009 has thus been adjusted, with the effect being a decrease in reported profit before tax of £22 million.

The revised fair values of assets and liabilities acquired of the Dunfermline Building Society are set out below:

	Notes	Final acquisition fair values £m	Provisional acquisition fair values £m
Assets			
Cash and balances with the Bank of England		6	2
Loans and advances to banks		571	578
Investment securities – available for sale		9	9
Derivative financial instruments		51	53
Loans and advances to customers	i	1,019	1,032
Intangible assets	ii	15	15
Property, plant and equipment	iii	10	10
Accrued income and expenses prepaid		2	2
Deferred tax asset		1	-
Other assets		35	35
Total assets		1,719	1,736
Liabilities			
Shares	iv	2,314	2,306
Deposits from banks	iv	50	50
Derivative financial instruments		76	76
Other deposits	iv	731	731
Provisions for liabilities and charges	v	4	4
Accruals and deferred income		2	2
Total liabilities		3,177	3,169
Net identifiable liabilities		1,458	1,433
Cash consideration		1,504	1,501
Imputed consideration		-	-
Total consideration		1,504	1,501
Gain on acquisition	vi	46	68

The 4 April 2010 consolidated income statement includes acquisition related administrative expenses for the Dunfermline of £4 million (4 April 2009: £2 million).

Notes to the Accounts
continued

Dunfermline acquisition – revised fair values (continued) 49

We expect to receive all gross contractual amounts receivable relating to the above financial assets with the exception of the following:

	Acquisition fair value	Gross contractual amounts receivable	Cash flows not expected to be collected
	£m	£m	£m
Loans and advances to customers	1,019	1,014	8

The gross contractual amounts receivable represents the take on balance before provisions and other fair value adjustments. Cash flows not expected to be collected are the undiscounted credit losses associated with the balance.

Explanation of material fair value adjustments

(i) Loans and advances to customers have been adjusted to reflect both credit and interest rate risk associated with these assets. Only originated residential mortgages were acquired. The adjustment to the credit risk value reflected additional analysis of cases using data that was not available at the time of the initial valuation. The revisions to the interest rate adjustment to the mortgage book was due to the greater granularity of data that became available subsequent to the original valuation allowing improved segmentation of loan to value characteristics.

(ii) Identifiable intangible assets recognised under IFRS 3 (2008 Revised) are in respect of core deposits (recognising the intrinsic value of the retail savings book), customer relationships (recognising the income streams from renewable contracts – primarily insurance) and brand. These intangibles will be amortised over their useful lives of between 5 and 10 years.

(iii) We have classified the former head office of the acquired society as a specialised administration building.

(iv) Shares, deposits from banks and other deposits have been adjusted to reflect the revised modelling of interest rate risk associated with these liabilities.

(v) This represents recognition of the FSCS liability relating to the Dunfermline savings balances transferred to the Group.

(vi) The gain on acquisition primarily represents the discount given as part of commercial negotiations prior to the purchase of the identified assets and liabilities by the Society. The consequence of the finalisation of the fair values, including tax, is a reduction in the General Reserve of £16 million as at 4 April 2009.

(vii) The Group did not acquire any rights, obligations or liabilities in respect of the Dunfermline Building Society pension scheme.

Acquisitions – the Derbyshire and the Cheshire building societies 50

On 1 December 2008 and 15 December 2008, the Society acquired all of the Derbyshire Building Society Group (Derbyshire) and all of the Cheshire Building Society Group (Cheshire) respectively, by way of a transfer of engagement under the Building Society Act. The primary reason for the acquisitions was to enhance the strength and stability of the building society sector. The 4 April 2009 Group income statement included acquisition related administrative expenses for the Derbyshire and the Cheshire of £12 million.

The acquisition fair values for these acquisitions are set out below. Further details of the acquisition fair value adjustments are provided in note 49 of the 2009 Annual Report and Accounts.

Acquisitions – the Derbyshire and the Cheshire building societies (continued) 50

Balance Sheet	Derbyshire £m	Cheshire £m
Assets		
Cash and balances with the Bank of England	5	57
Loans and advances to banks	671	138
Investment securities – available for sale	327	631
Derivative financial instruments	120	40
Loans and advances to customers	4,998	3,729
Investments in equity shares	1	-
Intangible assets	23	12
Property, plant and equipment	19	16
Investment properties	-	2
Current tax assets	2	1
Deferred tax assets	63	6
Other assets	1	1
Accrued income and expenses prepaid	3	2
Retirement benefit asset	-	7
Total assets	6,233	4,642
Liabilities		
Shares	4,417	3,255
Deposits from banks	347	292
Due to customers	748	526
Debt securities in issue	409	257
Derivative financial instruments	74	105
Deferred tax liabilities	-	4
Provisions for liabilities and charges	7	6
Other liabilities	13	-
Accruals and deferred income	7	8
Subordinated liabilities	104	63
Subscribed capital	107	37
Total liabilities	6,233	4,553
Net identifiable assets	-	89
Imputed consideration	-	-
Gain on acquisition	-	89

Notes to the Accounts
continued

Capital management 51

The Group is subject to the capital requirements imposed by its regulator the Financial Services Authority (FSA). Capital comprises the Group's general reserve, revaluation reserve, permanent interest bearing shares (PIBS) and subordinated debt, subject to various adjustments required by the capital rules.

During the year the Group complied with the capital requirements set by the FSA. Further details about the Group's capital position can be found in the business review on pages 23 and 24.

Registered office 52

Nationwide is a building society, incorporated and domiciled in the United Kingdom. The address of its registered office is:

Nationwide Building Society
Nationwide House
Pipers Way, Swindon
SN38 1NW

Annual Business Statement

Statutory percentages
For the year ended 4 April 2010

	2010	Statutory limit
	%	%
Lending limit	**15.2**	25.0
Funding limit	**27.8**	50.0

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986 as amended by the Building Societies Act 1997.

The lending limit measures the proportion of business assets not in the form of loans fully secured on residential property and is calculated as (X-Y)/X where:

X = business assets, being the total assets of the Group plus impairment provisions on loans and advances to customers less liquid assets, property, plant and equipment, intangible fixed assets and investment properties as shown in the Group balance sheet.

Y = the principal of, and interest accrued on, loans owed to the Group which are fully secured on residential property.

The funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals and is calculated as (X-Y)/X where:

X = shares and borrowings, being the aggregate of:

i) the principal value of, and interest accrued on, shares in the Society;

ii) the principal of, and interest accrued on, sums deposited with the Society or any subsidiary undertaking of the Society excluding offshore deposits; and

iii) the principal value of, and interest accrued under, bills of exchange, instruments or agreements creating or acknowledging indebtedness and accepted, made, issued or entered into by the Society or any such undertaking, less any amounts qualifying as own funds.

Y = the principal value of, and interest accrued on, shares in the Society held by individuals otherwise than as bare trustees (or, in Scotland, simple trustees) for bodies corporate or for persons who include bodies corporate.

The statutory limits are as laid down under the Building Societies Act 1986 as amended by the Building Societies Act 1997 and ensure that the principal purpose of a building society is that of making loans which are secured on residential property and are funded substantially by its members.

Annual Business Statement

continued

Other percentages
For the year ended 4 April 2010

	2010	2009
	%	%
As a percentage of shares and borrowings:		
• Gross capital	**5.4**	4.3
• Free capital	**4.8**	3.9
• Liquid assets	**16.8**	18.5
Profit for the financial year as a percentage of mean total assets	**0.13**	0.08
Management expenses as a percentage of mean total assets	**0.68**	0.72

The above percentages have been prepared from the Society's consolidated accounts and in particular:

- 'Shares and borrowings' represent the total of shares, deposits from banks, other deposits, amounts due to customers and debt securities in issue.
- 'Gross capital' represents the aggregate of general reserve, revaluation reserve, available for sale reserve, cash flow hedge reserve, subscribed capital and subordinated liabilities.
- 'Free capital' represents the aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment and intangible fixed assets.
- 'Liquid assets' represent the total of cash in hand and balances with the Bank of England, loans and advances to banks and investment securities.
- 'Mean total assets' represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
- 'Management expenses' represent the aggregate of administrative expenses, depreciation and amortisation.

Information relating to directors and other officers
For the year ended 4 April 2010

Directors

Name and date of birth	Occupation	Date of appointment	Other directorships
G M T Howe MA (Cantab) Chairman 3 September 1949	Company Director	1 January 2005	Gateway Electronics Components Ltd Investec Ltd, South Africa Investec plc Jardine Lloyd Thompson Group plc, Chairman The Cavendish School Charitable Trust Ltd
G J Beale BSc, ACA 19 October 1958	Chief Executive Officer	5 April 2003	Visa Europe Ltd Visa Europe Services Incorporated, United States
R P Walther MA, FIA Joint Deputy Chairman 31 July 1943	Company Director	1 July 2002	Derbyshire Building Society Staff Pension Scheme Trustee Co Ltd Fidelity European Values plc, Chairman
W Tudor John MA (Cantab), D.L. Joint Deputy Chairman 26 April 1944	Company Director	28 August 2007	Grainger plc The Grainger Trust Employee Trustee Ltd Lehman Brothers European Mezzanine 2004 SICAV NFTS Foundation Wales in London Ltd
T P Prestedge 12 February 1970	Group Development Director	28 August 2007	
M M Rennison BA, FCA 9 August 1960	Group Finance Director	1 February 2007	Confederation Mortgage Services Ltd Exeter Trust Ltd First Nationwide LBS Mortgages Ltd Nationwide Anglia Property Services Ltd Nationwide BES Fund Managers Ltd Nationwide Housing Trust Ltd Nationwide Investments (No.1) Ltd Nationwide Lease Finance Ltd Nationwide Mortgage Corporation Ltd Nationwide Syndications Ltd Staffordshire Financial Services Ltd The Mortgage Works (UK) plc UCB Home Loans Corporation Ltd
C S Rhodes ACA 17 March 1963	Group Product & Marketing Director	20 April 2009	at.home nationwide ltd Derbyshire Home Loans Ltd E-Mex Home Funding Ltd Jubilee Mortgages Ltd The Mortgage Works (UK) plc UCB Home Loans Corporation Ltd
D J Rigney ACMA, MBA 1 June 1963	Group Operations Director	1 October 2006	Dunfermline BS Nominees Ltd Monument (Sutton) Ltd Nationwide Anglia Property Services Ltd NBS Fleet Services Ltd Staffordshire Leasing Ltd The Derbyshire (Premises) Ltd

Annual Business Statement
continued

Information relating to directors and other officers (continued)
For the year ended 4 April 2010

Directors

Name and date of birth	Occupation	Date of appointment	Other directorships
M P V Wyles ACII 25 August 1958	Group Distribution Director	28 August 2007	Confederation Mortgage Services Ltd Exeter Trust Limited Jubilee Mortgages Ltd LBS Mortgages Ltd Staffordshire Financial Services Ltd The Mortgage Works (UK) plc UCB Home Loans Corporation Ltd
Mrs S J David MA (Cantab) 20 November 1962	Company Director	16 April 2003	William Grant & Sons Holdings Limited William Grant & Sons Limited William Grant & Sons Distillers Limited New Look Retail Group Limited
M K Jary MA (Oxon), MBA 15 June 1963	Management Consultant	1 January 2009	Duchy Originals Ltd Duchy Originals Foods Ltd OC&C Peleus Advisors LLP OC&C Strategy Consultants Limited Partnership (Guernsey) OC&C Resources Ltd OC&C Strategy Consultants LLP OC&C Strategy Consultants International (Netherlands) The Prince's Social Enterprises Limited
K Loosemore 30 January 1959	Company Director	1 January 2009	Farnham Castle Micro Focus International plc Morse plc
D A Ross BSc, LLB, FCA, ACMA, CTA (Fellow), FCT 1 August 1950	Building Society Director	1 December 2004	Access Bank (UK) Ltd European Central Counterparty Ltd Friends Provident (UK) Holdings Ltd Friends Provident Group Ltd
Ms S Taverne 3 February 1960	Company Director	16 November 2005	FCE Bank plc One Parent Families|Gingerbread, Chair The Design Museum Vlessing & Taverne Ltd Good Governance Network Consumer Credit Counselling Service

Documents may be served on any of the directors at Burges Salmon LLP, Narrow Quay House, Narrow Quay, Bristol, BS1 4AH.

Directors' Service Contracts
The standard terms for new executive director appointments include a contractual notice period of 12 months. Seven executive directors had or have contracts on this basis; they are (with the date of their contract), G J Beale (3 March 2003), D J Rigney (1 October 2006), M M Rennison (1 February 2007), T P Prestedge (28 August 2007), M P V Wyles (28 August 2007) and C S Rhodes (20 April 2009).

Directors' Share Options
No director or other officer, including connected persons, has any rights to subscribe for shares in, or debentures of, any connected undertaking of the Society.

Information relating to directors and other officers (continued)
For the year ended 4 April 2010

Officers

Name	Occupation	Directorships
L J Coleman BA (Hons), MBA, ACIB, AMCT	Group Director (Treasury)	First Nationwide Nationwide Investments (No.1) Ltd Nationwide Lease Finance Ltd Moulton Finance Overseas BV Great Western Hospitals NHS Foundation Trust
A J Alexander ACA	Divisional Director (Finance)	Confederation Mortgage Services Ltd Derbyshire Building Society Staff Pension Scheme Trustee Co Ltd Exeter Trust Ltd Jubilee Mortgages Ltd Nationwide Healthcare Trustee Ltd Nationwide Pension Fund Nominee Ltd Nationwide Pension Fund Trustee Ltd NBS Fleet Services Ltd Portman Pension Trustees Ltd Staffordshire Financial Services Ltd Ethos Independent Financial Services Ltd
R T Bailey DMS	Divisional Director (Savings & Investments)	Nationwide Independent Financial Services Ltd The New Swindon Company Ltd
J Boulton BSc (Soc Sci) Economics and Accounting	Divisional Director (Customer Strategy & Marketing)	
M J Gibbard BSc, FCA, MCT	Divisional Director (Risk Management)	LBS Mortgages Ltd The Mortgage Works (UK) plc UCB Home Loans Corporation Ltd
B P Glover LLB, ACIB	Divisional Director (Commercial)	at.home nationwide ltd Derbyshire Home Loans Ltd E-Mex Home Funding Ltd Longwide Ltd Nationwide BES Fund Managers Ltd Nationwide Housing Trust Ltd Nationwide Lease Finance Ltd Nationwide Mortgage Corporation Ltd Nationwide Syndications Ltd
G P Hughes MBA, DMS, ACIB	Divisional Director (Branch Network)	
T K Kaye MBA	Divisional Director (Transformation Delivery)	

Annual Business Statement

continued

Information relating to directors and other officers (continued) For the year ended 4 April 2010

Officers

Name	Occupation	Directorships
A McQueen	Divisional Director (Mortgages & General Insurance)	Confederation Mortgage Services Ltd Derbyshire Home Loans Ltd E-Mex Home Funding Ltd Exeter Trust Ltd Jubilee Mortgages Ltd LBS Mortgages Ltd Staffordshire Financial Services Ltd The Mortgage Works (UK) plc UCB Home Loans Corporation Ltd
S G Nowell	Divisional Director (Business Protection)	
G Pilkington	Divisional Director (Banking)	
Miss A J Robb BSc (Hons), FCA	Divisional Director (Strategy & Planning)	
P Stafford	Divisional Director (Information Technology)	Nationwide International Ltd, Isle of Man Mid Devon Citizen's Advice Bureau (Trustee)
Mrs M M Taylor	Divisional Director (Corporate Affairs)	The Nationwide Foundation
J R Wood	Divisional Director (Member Account Administration)	Aldbury Housing Association Derbyshire Building Society Staff Pension Scheme Trustee Co Ltd HFL Management Company Ltd Nationwide Pension Fund Nominee Ltd Nationwide Pension Fund Trustee Ltd Nationwide Trust Ltd Portman Pension Trustees Ltd The Cheshire Building Society Pension and Life Assurance Scheme Visa UK Ltd
J D Wrighthouse BSc (Hons), MA, CFCIPD	Divisional Director (Human Resources)	Derbyshire Building Society Staff Pension Scheme Trustee Co Ltd Nationwide Healthcare Trustee Ltd Nationwide Pension Fund Nominee Ltd Nationwide Pension Fund Trustee Ltd Portman Pension Trustees Ltd

Glossary

The following glossary defines terminology used within the Annual Report and Accounts to assist the reader and to facilitate comparison with publications by other financial institutions:

Alt A	A US description for loans regarded as lower risk than sub prime, but with higher risk characteristics than lending under normal criteria.
Arrears	A customer is in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan commitment is overdue. Such a customer can also be said to be in a state of delinquency.
Asset backed securities (ABS)	Securities that represent an interest in an underlying pool of referenced assets. The referenced pool can comprise any assets which attract a set of associated cash flows, including credit card assets, but are commonly pools of residential or commercial mortgages. Investors in these securities have the right to cash received from future payments (interest and/or principal) on the underlying asset pool.
Basel II	The Basel Committee on Banking Supervision's statement of best practice that defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive, and was implemented in the UK via the FSA Handbook.
BIPRU	The prudential sourcebook for banks, building societies and investment firms which sets out the FSA's capital requirements.
Collateralised debt obligations (CDO)	Securities issued by a third party which reference ABS and/or certain other related assets purchased by the issuer. Nationwide has not established any programmes creating CDOs but has invested in instruments issued by other banking groups. These are primarily CLOs.
Collateralised loan obligations (CLO)	A cash collateralised debt obligation (CDO) backed by leveraged loans provided by banks.
Commercial lending	Loans secured on commercial property, loans to Registered Social Landlords and loans undertaken under Private Finance Initiatives.
Commercial mortgage backed securities (CMBS)	Securities that represent interests in a pool of commercial mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal).
Commercial paper (CP)	An unsecured promissory note issued to finance short term credit needs. It specifies the face amount paid to investors on the maturity date.
Commercial real estate	Includes office buildings, industrial property, medical centres, hotels, malls, retail stores, shopping centres, multifamily housing buildings, warehouses, garages and industrial properties.
Consumer banking	Consumer banking comprises credit card, unsecured personal lending and our FlexAccount (current account) product.
Contractual maturity	The final payment date of a loan or other financial instrument, at which point all the remaining outstanding principal and interest is due to be repaid.
Core tier 1 capital	Defined by the FSA as tier 1 capital less hybrid capital instruments (innovative tier 1 securities and permanent interest bearing shares for building societies) and certain regulatory adjustments.
Cost income ratio	A ratio that represents the proportion of administrative expenses plus depreciation and amortisation to total income. The Group calculates cost income ratio on an underlying basis.
Covered bonds	Debt securities backed by a portfolio of mortgages that is segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds. The Group issues covered bonds as part of its funding activities.
Credit default swap	An arrangement whereby the credit risk of an asset (the reference asset) is transferred from the buyer to the seller of protection. A credit default swap is a contract where the protection seller receives premium or interest-related payments in return for contracting to make payments to the protection buyer upon a defined credit event. Credit events normally include bankruptcy, payment default on a reference asset or assets, or downgrades by a rating agency.
Credit risk	Risk of financial loss if a customer or counterparty fails to meet an obligation under a contract.
Credit valuation adjustment (CVA)	An adjustment that represents an estimate of the change to fair value that a market participant would make to incorporate the credit risk inherent in counterparty derivative exposures.
Debt restructuring	The changing of the terms and provisions of outstanding debt agreements. Restructuring may be done in order to improve cash flow and the ability of the borrower to repay the debt. It can involve altering the repayment schedule as well as debt or interest charge alteration.
Debt securities in issue	Transferable certificates of indebtedness of the Group to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit.
Delinquency	See 'Arrears'.

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continued

Economic capital	An internal assessment of the amount of capital required to protect against potential unexpected future losses arising from business activities, across a defined time horizon and confidence interval.
Effective interest rate method (EIR)	The method used to measure the carrying value of a financial asset or a liability and to allocate associated interest income or expense over the relevant period.
Expected loss (EL)	A Basel II calculation under the IRB approach to estimate the potential losses on current exposures due to potential defaults over a one-year time horizon. It is the product of PD, LGD and EAD.
Exposure	The maximum loss that a financial institution might suffer if a borrower, counterparty or group fails to meet their obligations or assets and off-balance sheet positions have to be realised.
Exposure at default (EAD)	A Basel II parameter used in IRB approaches to estimate the amount outstanding at the time of default.
Financial Services Compensation Scheme (FSCS)	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every firm authorised by the FSA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.
Foundation IRB approach	A method of calculating credit risk capital requirements using internal PD models but with supervisory estimates of LGD and conversion factors for the calculation of EAD.
Free capital	The aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment and intangible assets.
Funding limit	Measures the proportion of shares and borrowings not in the form of shares held by individuals. The calculation of the funding limit is explained in the Annual Business Statement.
Gross capital	The aggregate of general reserve, revaluation reserve, available for sale reserve, cash flow hedge reserve, subscribed capital and subordinated liabilities.
Impaired loans	Loans where the Group does not expect to collect all the contractual cash flows or expects to collect them later than they are contractually due.
Impairment allowances	Provisions held against assets on the balance sheet as a result of the raising of a charge against profit for the incurred loss inherent in the lending book. The allowance represents management's best estimate of losses incurred in the loan portfolio at the balance sheet date.
Individually/ collectively assessed	Impairment is measured individually for assets that are individually significant, and collectively where a portfolio comprises homogenous assets and where appropriate statistical techniques are available.
Internal capital adequacy assessment process (ICAAP)	The Group's own assessment, as part of Basel II requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements (for credit, market and operational risks) and for other risks including stress events.
Internal ratings-based approach (IRB)	A Basel II approach for measuring exposure to credit risks. IRB approaches are more sophisticated and risk-sensitive than the Standardised Approach and may be Foundation or Advanced. IRB approaches may only be used with FSA permission.
International Swaps and Derivatives Association (ISDA) master agreement	A standardised contract developed by ISDA and used to enter into bilateral derivatives transactions.
Investment/debt securities	Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings excluding those issued by central banks.
Lending limit	Measures the proportion of business assets not in the form of loans fully secured on residential property. The calculation of the lending limit is explained in the Annual Business Statement.
Leveraged loans	Loans or other financing agreements provided to companies whose overall level of debt is high in relation to their cash flow (net debt : EBITDA (earnings before interest, tax, depreciation and amortisation)) typically arising from private equity sponsor led acquisitions of the businesses concerned.
Liquid assets	Total of cash in hand and balances with the Bank of England, loans and advances to banks and investment securities.
Liquidity risk	The risk that the Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows.
Loan to deposit ratio	Represents loans and advances to customers divided by the aggregate of shares, other deposits and amounts due to customers.
Loan to value ratio (LTV)	A ratio which expresses the amount of a mortgage as a percentage of the value of the property. The Group calculates residential mortgage LTV on an indexed basis (the value of the property is updated on a quarterly basis to reflect changes in the house price index (HPI)).

Loans past due/past due loans	Loans on which payments are overdue including those on which partial payments are being made.
Loss given default (LGD)	A Basel II parameter used in IRB approaches to estimate the difference between EAD and the net amount of the expected recovery expressed as a percentage of EAD.
Management expenses	The aggregate of administrative expenses, depreciation and amortisation.
Market risk	The risk that movements in market risk factors, including foreign exchange rates, interest rates, credit spreads and customer-driven factors will reduce income or portfolio values.
Mean total assets	Represents the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
Medium term notes (MTN)	Corporate notes continuously offered by a company to investors through a dealer. Investors can choose from differing maturities, ranging from nine months to 30 years.
Member	A person who has a share investment or a mortgage loan with the Society.
Monoline	An entity which specialises in providing credit protection to the holders of debt instruments in the event of default by the debt security counterparty. This protection is typically held in the form of derivatives such as credit default swaps referencing the underlying exposures held.
Mortgage backed securities	Assets which are referenced to underlying mortgages.
Negative equity mortgages	Negative equity occurs when the value of the property purchased using the mortgage is less than the balance outstanding on the loan. Negative equity is the difference between the value of the property and the outstanding balance on the loan.
Net interest income	The difference between interest received on assets and interest paid on liabilities after taking into account the effect of derivatives.
OECD	Used to refer to member countries of the OECD (Organisation for Economic Co-operation and Development). The OECD is an international organisation of countries with highly developed economies and democratic governments. The OECD has 31 member countries, including (but not limited to) key European countries, the United States, Canada and Japan.
Operational risk	The risk of loss arising from inadequate or failed internal processes, people and systems or from external incidents.
Over-the-counter (OTC)	A bilateral transaction (e.g. derivatives) that is not exchange traded and valued using valuation models.
Permanent interest bearing shares (PIBS)	Unsecured, deferred shares that are a form of tier 1 capital. PIBS rank behind the claims of all subordinated debt holders, depositors and creditors of Nationwide.
Prime	Prime mortgages are mainstream residential loans, which typically have a higher credit quality and fit standard underwriting processes. As such, they are likely to have a good credit history, and pass a standard affordability assessment at the point of origination.
Private equity investments/ holdings	Equity securities in operating companies not quoted on a public exchange.
Probability of default (PD)	A Basel II parameter used in IRB approaches to estimate the probability that a borrower will default on their credit obligations in next 12 months.
Protected equity bond (PEB)	A deposit account with the potential for stock market correlated growth linked to the performance of specified stock market indices. The PEB protects an investor's original investment amount, whilst providing potential for upside from movements in the stock markets over a fixed term.
Renegotiated loans	Loans and advances are generally renegotiated either as part of an ongoing customer relationship or in response to an adverse change in the circumstances of the borrower. In the latter case renegotiation can result in an extension of the due date of payment or repayment plans under which the Group offers a concessionary rate of interest to genuinely distressed borrowers. This will result in the asset continuing to be overdue and will be individually impaired where the renegotiated payments of interest and principal will not recover the original carrying amount of the asset. In other cases, renegotiation will lead to a new agreement, which is treated as a new loan.
Repo/Reverse repo	A repurchase agreement that allows a borrower to use a financial security as collateral for a cash loan at a fixed rate of interest. In a repo, the borrower agrees to sell a security to the lender subject to a commitment to repurchase the asset at a specified price on a given date. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or reverse repo.
Residential mortgage backed securities (RMBS)	A category of ABS that represent interests in a group of residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal).
Retail IRB approach	A method of calculating credit risk capital requirements using internal PD, LGD and EAD models.

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continued

Risk appetite	The articulation of the level of risk that the Group is willing to take (or not take) in order to safeguard the interests of the Society's members whilst achieving business objectives.
Risk-weighted asset (RWA)	The value of assets, after adjustment, under Basel II rules to reflect the degree of risk they represent.
Retail loans	Money loaned to individuals rather than institutions, including residential mortgage lending and consumer banking. Residential mortgage lending is secured against residential property. Consumer banking is unsecured lending, including current accounts, credit cards and personal loans, which may be used for various customer uses including car purchases, medical care, home repair and holidays.
Securitisation	A process by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities. A company sells assets to an SPE which then issues securities backed by the assets. This allows the credit quality of the assets to be separated from the credit rating of the original company and transfers risk to external investors. The Group has established securitisation structures as part of its funding and capital management activities. These securitisation structures use retail mortgages as the asset pool.
Shares	Money 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 total of shares, deposits from banks, other deposits, amounts due to customers and debt securities in issue.
Structured investment vehicles (SIVs)	Special purpose entities which invest in diversified portfolios of interest earning assets, generally funded through issues of commercial paper, medium term notes and other senior debt to take advantage of the spread differentials between the assets in the SIV and the funding cost.
Specialist residential lending	Consists of Buy to Let, self-certified and sub prime mortgages.
Special purpose entities (SPE)	Entities that are created to accomplish a narrow and well defined objective. There are often specific restrictions or limits around their ongoing activities. The Group uses a number of SPEs, including those set up under securitisation programmes. Where the Group has control of these entities or retains the risks and rewards relating to them they are consolidated within the Group's results.
Standardised approach	The basic method used to calculate credit risk capital requirements under Basel II. In this approach the risk weights used in the capital calculation are determined by supervisory parameters. The Standardised approach is less risk-sensitive than IRB.
Subordinated debt /liabilities	A form of tier 2 capital that is unsecured and ranks behind the claims of all depositors, creditors, and investing members (other than holders of PIBS).
Sub prime	Loans to borrowers typically having weakened credit histories that include payment delinquencies and potentially more severe problems such as court judgements and discharged bankruptcies. They may also display higher risk characteristics as measured by credit scores, or other criteria indicating heightened risk of default. The definition of sub prime lending varies from lender to lender, but we define sub prime as a borrower with a County Court Judgement (CCJ) or default in excess of £1,000 or more than one missed mortgage payment in the last 12 months. We define near prime as a borrower with a CCJ or default less than or equal to £1,000 or one missed mortgage payment in the last 12 months.
Tier 1 capital	A measure of financial strength. Tier 1 capital is divided into core tier 1 and other tier 1 capital. Core tier 1 capital comprises general reserves from retained profits. The book values of goodwill and intangible assets are deducted from core tier 1 capital and other regulatory adjustments may be made for the purposes of capital adequacy. Qualifying capital instruments such as PIBS are included in other tier 1 capital (i.e. not core tier 1).
Tier 2 capital	Comprises the Group's property valuation reserve, qualifying subordinated notes and collective impairment allowance (for exposures treated on a Basel II standardised basis). Certain regulatory deductions may be made for the purposes of assessing capital adequacy.
Transformation costs	Costs, included within administrative expenses, which are directly related to business combinations or the restructuring of parts of our business. The main costs included within this category are employee severance costs (including redundancy pay and pension enhancement costs), lease cancellation fees and onerous lease costs.
Value at risk (VaR)	A technique that estimates the potential loss that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence. In its day-to-day monitoring, Nationwide uses a 10 day horizon and a 99% confidence level.