

Annual Report  
and Accounts 2007



Cover & left image: 'ColourMusic' by Gethin Wyn Jones. Winner of the 2006 Nationwide Mercury Prize Art Competition.  
Photos: JM International.



**proud to be different**

We're different because we're a building society, not a bank. We're run for the benefit of our members rather than shareholders, so we can give you more.

We believe in treating people fairly, which is why we explain our products as clearly as possible, how they work and how much they cost as well as their benefits.

We believe in giving back to the community and protecting the environment, which is why we've kept all our call centres in the UK and get our electricity from renewable resources.

And we believe in giving you the best service we can, which is why we like the fact that with no shareholders, we can really concentrate on making **you** better off.

We're different because we belong to you.

## **Nationwide. Proud to be different**

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# Financial Highlights

Underlying profit before tax up **24%** to **£668.6 million**.

Reported profit before tax up **17%** to **£652.0 million**.

An estimated **£660 million** of pricing benefits delivered to our members.

Cost income ratio improved to **56.6%**.

Net residential mortgage lending up **78%** to **£11.2 billion**.

Net commercial lending up **89%** to **£3.4 billion**.

Planned merger with Portman **approved** by its members.



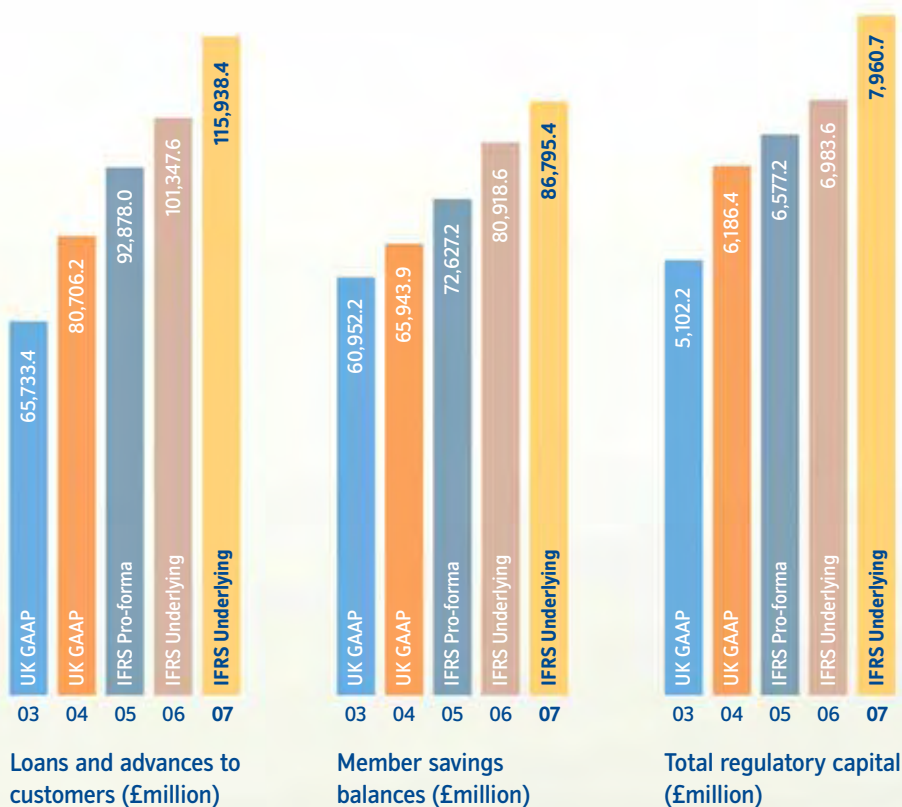
		2003 UK GAAP	2004 UK GAAP	2005 IFRS Pro-forma	2006 IFRS Underlying	2007 IFRS Underlying
Profit before tax	£m	353.3	426.8	467.7	539.4	668.6
Total income net of claims on insurance contracts	£m	1,259.0	1,349.7	1,518.4	1,635.7	1,923.2
Cost income ratio	%	64.1	64.1	61.9	60.6	56.6
Total assets	£m	85,417.7	101,428.4	112,086.1	120,586.0	137,378.5
Loans and advances to customers	£m	65,733.4	80,706.2	92,878.0	101,347.6	115,938.4
Member savings balances	£m	60,952.2	65,943.9	72,627.2	80,918.6	86,795.4
Total regulatory capital	£m	5,102.2	6,186.4	6,577.2	6,983.6	7,960.7

### IFRS 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, to provide a clearer representation of the performance of the Group.

Profit before tax shown on a reported basis and a underlying basis are set out on page 12. Underlying profit before tax of £668.6 million equates to reported profit before tax of £652.0 million adjusted for the deduction of net gains of £0.9 million from derivatives and hedge accounting, the deduction of policyholder tax of £2.0 million and the add back of merger and other similar costs of £19.5 million.

### Nationwide. Proud to be different



# Chairman's Statement



**AN OUTSTANDING PERFORMANCE:** Once again during the past year we demonstrated that as a modern mutual building society we can deliver outstanding value to members by giving them generally better interest rates and lower fees and charges than our competitors. We estimate that last year these benefits amounted to £660 million, in addition to which we retained £463.6 million of profit to support our growing business.

Our underlying profit before tax increased by 24% to £668.6 million and we reported profit before tax of £652 million. In a competitive mortgage market we achieved a net lending market share of 10.1%, and our net commercial lending increased by 89% to £3.4 billion. Our principal efficiency measure, the ratio of underlying costs to income, has improved from 60.6% to 56.6%. Further details of our financial performance can be found elsewhere in the Business Review and in the Annual Report and Accounts.

In a competitive mortgage market we achieved a net lending market share of 10.1%, and our net commercial lending increased by 89% to £3.4 billion

Nationwide is well advanced in its plans to merge with the Portman Building Society, which will create the second largest mortgage lender in the United Kingdom, as well as the second largest taker of retail savings. We are entering into an agreement with Legal & General to sell its life assurance and investment products which we expect will

greatly strengthen our ability to serve our members in those areas.

## Building a better society

We recognise that our responsibilities extend to our impact on the environment and on the communities which we serve. For example, we have launched a pilot scheme in Hampshire which involves providing advice to our members to help them make energy and environmental improvements to their homes. Further details of our community and environmental performance can be found on page 26 and on our website.

In addition to supporting our flagship charity Macmillan Cancer Support, for which employees and members have raised over £4 million since 1993, we have extended our commitment to our road safety campaign, Cats' Eyes for Kids. The campaign has helped reduce child pedestrian casualties by 49% since 2001, and by 2010 we will have distributed 15 million safety reflectors. This year also sees the tenth anniversary of the Nationwide Awards for Voluntary Endeavour, which ensures that volunteers receive recognition for their valiant work in Britain's communities.

In future we intend to donate 1% of our annual pre-tax profits to charity, community and environmental activities. Our members will have the opportunity to vote on this proposal at our Annual General Meeting in July.

### Encouraging voting

The right to vote is a fundamental part of being a member of a mutual building society, and we have always encouraged as many members as possible to make their vote count. Last year we set ourselves a challenging target and pledged that, if one million members voted, we would donate £100,000 to Disability Sport Events (DSE). Our members responded magnificently, enabling us to exceed our target and raise valuable funds for disabled athletes. This year we are hoping that our members will help us raise another £100,000 for DSE by making their vote count again.

We recognise that our responsibilities extend to our impact on the environment and on the communities which we serve

Last year we introduced a Quick Vote option to simplify the process for people who supported the Board's recommendations and this year we are making it possible for members to vote online.

### Board and employees

Mark Rennison, David Rigney and John Sutherland have joined the Board as Group Finance Director, Group Operations Director and Sales & Marketing Director respectively, Mark Rennison from outside Nationwide. Philip Williamson, Bernard Simpson and Jim Willens have

retired from the Board and we thank them for their valuable contributions over many years. I should make a special mention of Philip Williamson, who served as the Society's Chief Executive for five and a half years, for most of which period I had the privilege to be Chairman. Under Philip's leadership, Nationwide has gone from strength to strength and his personal approach to the role won him the admiration of industry experts, members and employees alike. Richard Handover will retire as a non-executive director after the Annual General Meeting and we thank him for contributing his wisdom and experience for the last seven years.

I too will retire after the Annual General Meeting, having completed my five year term as Chairman. I should like to express my thanks to all those in Nationwide, both on the Board and throughout the organisation, who have given me so much help and support during my period of office. On behalf of the members, the Board would wish to express its gratitude to employees for their hard work and dedication, which has made the Society successful. The chairmanship will be taken on by Geoffrey Howe and the new chief executive is Graham Beale. I have every expectation that they, supported by a strong Board and management, will lead Nationwide to even greater success in the future.

**Jonathan Agnew**  
Chairman

16 May 2007

# Chief Executive's Review



**OVERVIEW:** As a Building Society, our strategy is to maximise the value to our members. The value we generate is distributed in one of two ways. It is either distributed to members by offering better deals than our competitors, or it is retained to strengthen our capital position and to allow us to invest in the business. Being a mutual organisation means that all of this value ultimately goes to our members, with no need to divert value to pay dividends to shareholders.

In September 2006 we announced our intention to merge with Portman Building Society, creating an enlarged Society that will become the second largest mortgage provider and second largest savings provider in the UK. We also announced the sale of two of our subsidiary companies, Nationwide Life and Nationwide Unit Trust Managers, to Legal & General together with an agreement to sell Legal & General products. These changes will be of great benefit to our members and will enable us to continue to provide attractive and competitively priced products and services and compete successfully with the retail banks.

## Financial Results

This year, we have generated a record underlying profit before tax of £668.6 million, an increase of 24.0% on last year. This has allowed us to strengthen our financial position, and push ahead with our investment in our product and service offerings. We delivered an estimated

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£660 million to members this year through competitive interest rates and lower fees and charges, which continues to demonstrate our commitment to giving our members a better deal. Improved efficiency led to our underlying cost to income ratio improving from 60.6% to 56.6%.

In order to support our strong growth over the last few years and in anticipation of future growth we raised €300 million of subordinated debt and £350 million of Permanent Interest Bearing Shares (PIBS) to strengthen our capital base. Demand for our capital from institutional investors was high and this was reflected in very attractive pricing.

## RETAIL

### Mortgages and Savings

Borrower demand has been strong throughout the year. We increased Society prime mortgage gross advances by 40.1% to £26.9 billion and net lending by 92.7% to £10.6 billion. In March we launched an innovative 25 year fixed rate mortgage with a borrower option to redeem the mortgage after ten years with no early redemption penalty. This product proved to be very attractive and sold out within five weeks. We also rewarded existing loyal members by offering a substantial discount against the application fee for all mortgage products.

Our growth in savings balances of £5.9 billion represented 8.1% of the market. We introduced a new regular savings

Swimmer image courtesy DSE. © Clara Molden.



product in January 2007 designed to offer a flexible and fair approach to regular savings. Unlike others, Nationwide's regular savings account does not penalise savers for missed payments or withdrawals by closing the account. In direct response to feedback from members, we reduced the qualifying age for our very popular Monthly Income account from 65 to 60.

## Consumer Lending

We have seen strong growth in our current accounts and credit cards. We opened around 580,000 new current accounts and issued over 200,000 credit cards during the year. Our market share of new current accounts is estimated at 9.4%. We believe our current account is one of the best available, with highly competitive interest rates, and our no charge policy for overseas card transactions continues to set us apart from the competition and helps attract new customers. We have adopted a cautious approach to unsecured lending, focusing on credit quality. Our credit

We have seen strong growth in our current accounts and credit cards. We opened around 580,000 new current accounts and issued over 200,000 credit cards

performance remains better than the industry, with arrears on personal loans 25% better than our peer group average and our arrears on credit cards 30% better. However, like other lenders, we have increased our impairment provisions to reflect a more difficult credit environment.

There has been much debate about bank charges and free banking. We offer an excellent current account which is free for day-to-day use and we remain committed to giving our members access to free banking.

## Insurance

Last summer we launched a new home insurance policy with enhanced cover provided as standard. The new policy includes some modern features such as cover for MP3 players and music downloads. There was good news for parents purchasing single trip travel insurance when we widened the cover to include up to four children at no additional cost. As a result of these innovations and our

continued competitive pricing, total policies sold increased by 36.3% to around 545,000.

Building on the successful re-launch of the protection products, our life assurance and investment products also performed well, with Nationwide Life selling over 71,000 life policies during the year, a 9% increase on last year.

## NON - RETAIL

### Commercial Lending

Nationwide Commercial is one of the UK's leading commercial property lenders. It has been another record breaking year for the business which has seen its loan book grow by 23% to £17.9 billion. Gross advances for the year were £7.4 billion, up 34.5% on last year, and net advances were £3.4 billion, up 88.9% on last year. This has been achieved whilst maintaining credit quality across all loan portfolios. Just 0.07% of commercial accounts are 3 or more months in arrears (2006 – 0.05%).

The business funds major acquisitions and re-financing of income generating property for commercial property investors, and supports Private Finance Initiative (PFI) and Public Private Partnership (PPP) projects. It is the UK's number one lender to social housing providers and in 2007 became the first lender to commit over £8.5 billion to the sector. The year also saw an increase in Nationwide Commercial's European lending as property investors expanded their activities, particularly in Germany. This lending is carefully managed to ensure its quality matches that of the rest of the Commercial book.

### UCB Home Loans Corporation Ltd

UCB is our specialist lending subsidiary providing loans primarily to self-employed borrowers and private landlords. Gross lending increased by 12.4% to £2.2 billion with the emphasis on the buy-to-let market. Over the year the proportion of accounts more than three months in arrears reduced to below 1% and the bad debt charge fell by 17%, in contrast to industry trends.

Our plans for specialist lending include a controlled expansion of the product range to include mortgage products for borrowers with an impaired credit history. The first products from this new range were launched in March of this year.

## STRATEGY

### Planned merger with Portman

The merger between Nationwide and Portman was approved by Portman members at their Annual General

Meeting on 23 April 2007, and subject to FSA approval is expected to be effective from 28 August 2007. It will be the biggest ever building society merger, creating an enlarged Society with total assets of over £160 billion. The merger will deliver significant strategic, operational and financial benefits to the enlarged Society.

First and foremost, we will continue to operate as a mutual building society, owned by and run for the benefit of our members. If we are to compete successfully with the retail banks we will need to achieve comparable economies of scale. The merger will make us the second largest mortgage lender in the UK and reinforce our current position as the second largest savings provider in the UK.

We remain committed to a comprehensive branch structure and it is intended that every location that is currently served by a Nationwide or a Portman branch or agency will continue to be served by a Nationwide branch or agency after the merger.

### Legal & General

In February we announced that together with Legal & General we are entering into a new strategic distribution agreement for the supply of life insurance, investment and pension products. Under the terms of the agreement, Legal & General will purchase our wholly owned subsidiaries Nationwide Life and Nationwide Unit Trust Managers, and we will sell Legal & General products via our 2,000 strong team of advisers and consultants. This arrangement will provide an excellent opportunity for our members to choose from a broader range of competitively priced products from one of the UK's top financial services companies and enjoy an enhanced service.

### Stolen laptop

The past year was not without its challenges, not least when one of our laptop computers was stolen from an employee's home in a domestic burglary resulting in a public censure and fine of £980,000 from the FSA. The laptop contained some customer information to be used mainly for marketing purposes but not any PINs, passwords, account information or memorable data. Whilst our security procedures are robust, we took steps to improve them further and to provide additional protection to our members. We have also apologised to those members affected by this incident and confirmed that there was no loss of money from their accounts as a result of this incident.

### Improving access

A common theme in the feedback we collect from members is ease of access to our services. In 2004 we pledged to invest £300 million over six years to make it easier and more pleasant for our customers to do business with us – whether by telephone, post, online or via our branch network. Since then, over 415 branches and agencies have benefited from the investment, including 145 branches refurbished or re-sited this year.

### Our people

I would like to thank our employees for their contribution to our success. They go to great lengths to deliver an excellent service and are the biggest advocates of Nationwide. Our internal employee satisfaction index is amongst the highest in our peer group and externally we were placed 9th in *The Sunday Times* 20 Best Big Companies to Work For survey.

I echo the Chairman's comments about my predecessor, Philip Williamson. He has been an outstanding Chief Executive for the last five years and he will be a hard act to follow.

### Outlook

We expect the economy in the UK to remain stable and provide good opportunities for growth across the Group. The economic drivers are sound and we expect UK growth to remain robust. Rising interest rates have started to have an impact, but we still expect the housing market to remain strong. Demand from buy-to-let investors has supported housing demand. Continuing issues of under-supply of housing, especially in the South East of England, will continue to be a supportive factor and will counteract some of the slowing effect of increasing interest rates. Our forecast for house price growth is 5% to 8% in 2007 reflecting a cooling in the second half of the year as increased interest rates filter through.

In conclusion we remain committed to delivering our mutual agenda; providing fair and competitively priced products on a consistent basis. We have created considerable momentum as the UK's largest mutual building society and intend to continue to grow and deliver more value to our current and future members.

**Graham Beale**  
Chief Executive

16 May 2007

# Business Review



**OVERVIEW:** We have delivered another strong performance this year and have continued to put members first by providing consistently good value products and services. Our core products; mortgages, retail savings, consumer lending and insurance all performed well as did our non-retail activities; specialist and commercial lending. Underlying profit was up 24% to a record £668.6 million and because we have no shareholders, only customers, this will be used to support further growth and investment in the business. We provided an estimated £660 million benefit to members over the year through competitive interest rates and lower fees and charges.

Our core product performance has been very strong, and our net interest receivable has increased by 19.8% to £1,479.3 million. Strong growth in our mortgage and savings balances reflects the excellent value and fair treatment that we provide to our members. Net residential mortgage lending increased substantially to £11.2 billion, with retail savings balances growing by £5.9 billion. Members have also benefited from our continuing refurbishment of the branch network. Since 2004, we have improved over 300 branches, which is almost half of our network.

Our other products continue to perform well, with around 580,000 new current accounts opened and 200,000 new credit cards issued. We wrote over 545,000 new general insurance covers, assisted by our much improved Home Insurance product. We have adopted a cautious approach in a challenging personal loan market, with gross lending of £0.9 billion compared to £1.3 billion last year.

We continue to grow our balance sheet in a controlled way, to provide us with the financial strength necessary to support our objectives. The balance sheet grew by 13.9% to in excess of £137 billion, with regulatory capital increasing by 14.0% to £8.0 billion, and a strong solvency ratio of 11.0%. Credit quality remains excellent, with only

0.24% of mortgage accounts being three months or more in arrears, compared to the industry average of 0.87%. We also perform better than the industry in respect of unsecured credit quality. The proportion of credit card accounts which are 30 or more days in arrears is 30% better than the average, and the equivalent figure for personal loans is approximately 25% better than the industry average.

Strong growth in our mortgage and savings balances reflects the excellent value and fair treatment that we provide to our members

To support this balance sheet growth we have supplemented our retail funding with an increase in wholesale funding. This increase includes further Covered Bond issues, raising €6 billion. Our levels of wholesale funding continue to be low compared to organisations of comparable size, giving us flexibility for additional funding in the future.



In the year we raised additional capital in the form of a subordinated debt issue of €300 million, and an issue of £350 million Permanent Interest Bearing Shares (PIBS). The PIBS issue was six times over subscribed, a testament to the

strength of the Nationwide brand with our institutional investor base. We also introduced an innovative flexible structure for the PIBS to allow us to reduce the capital base as the benefits of Basel II emerge over time.

## Profit before tax

Profit before tax shown on a reported basis and on an underlying basis is set out as follows:

2007	As reported £m	Derivatives and hedge accounting £m	Policyholder tax £m	Merger and other costs(*) £m	Underlying £m
Net interest income	1,479.3	-	-	-	1,479.3
Other income net of claims on insurance contracts	445.9	-	(2.0)	-	443.9
Gains from derivatives and hedge accounting	0.9	(0.9)	-	-	-
<b>Total income net of claims on insurance contracts</b>	<b>1,926.1</b>	<b>(0.9)</b>	<b>(2.0)</b>	<b>-</b>	<b>1,923.2</b>
Administrative expenses	984.5	-	-	(14.1)	970.4
Depreciation and amortisation	124.4	-	-	(5.4)	119.0
Impairment losses on loans and advances to customers	133.6	-	-	-	133.6
Provisions for liabilities and charges	36.5	-	-	-	36.5
Impairment gains on investment securities	(4.9)	-	-	-	(4.9)
<b>Profit before tax</b>	<b>652.0</b>	<b>(0.9)</b>	<b>(2.0)</b>	<b>19.5</b>	<b>668.6</b>

2006	As reported £m	Derivatives and hedge accounting £m	Policyholder tax £m	Merger and other costs(*) £m	Underlying £m
Net interest income	1,234.3	-	-	-	1,234.3
Other income net of claims on insurance contracts	410.3	-	(8.9)	-	401.4
Gains from derivatives and hedge accounting	10.9	(10.9)	-	-	-
<b>Total income net of claims on insurance contracts</b>	<b>1,655.5</b>	<b>(10.9)</b>	<b>(8.9)</b>	<b>-</b>	<b>1,635.7</b>
Administrative expenses	873.7	-	-	-	873.7
Depreciation and amortisation	117.5	-	-	-	117.5
Impairment losses on loans and advances to customers	76.6	-	-	-	76.6
Provisions for liabilities and charges	32.1	-	-	-	32.1
Impairment gains on investment securities	(3.6)	-	-	-	(3.6)
<b>Profit before tax</b>	<b>559.2</b>	<b>(10.9)</b>	<b>(8.9)</b>	<b>-</b>	<b>539.4</b>

(\*) Merger and other costs include £10.8 million merger costs and £8.7 million of costs and asset write-downs relating to the disposal of Nationwide's life, investment and pensions subsidiaries.

## Performance by Business Stream

Nationwide operates three main business streams as follows:

- **Personal Financial Services** – Mortgages, savings, banking, consumer lending, general insurance, life insurance and investment business.
- **Commercial** – Commercial lending and Treasury income generation activities.
- **Group** – Treasury group operations, capital and items classified as being non-attributable to our core business areas.

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

	Contribution before tax		Growth %
	2007 Underlying £m	2006 Underlying £m	
Personal Financial Services	324.1	270.9	19.6
Commercial	224.8	194.2	15.8
Group	119.7	74.3	61.1
<b>Total</b>	<b>668.6</b>	<b>539.4</b>	<b>24.0</b>

From 2007/08, Nationwide will reclassify its business streams, with all customer facing activities classed as either Retail or Non-Retail. The Retail business stream will be the same as the Personal Financial Services stream described above, except for the specialist lending activity which is carried out by UCB. This specialist lending, plus commercial lending, will comprise the Non-Retail stream.

#### Personal Financial Services (PFS)

	2007 Underlying £m	2006 Underlying £m	Growth %
Net interest income	1,102.1	921.3	19.6
Other income	386.7	351.8	9.9
<b>Total income</b>	<b>1,488.8</b>	<b>1,273.1</b>	<b>16.9</b>
Expenses	994.8	896.2	11.0
Impairment and other provisions	169.9	106.0	60.3
<b>Contribution from PFS</b>	<b>324.1</b>	<b>270.9</b>	<b>19.6</b>

The underlying contribution from the PFS business stream increased by 19.6% to £324.1 million which represents just under half of the Group's total contribution. All of the pricing benefit given to our members is delivered through this business stream. The total number of PFS sales remains strong with performance in non-mortgage and savings sales matching that achieved last year despite lower personal loan sales, reflecting our cautious approach in this market.

Expenses increased by 11.0% reflecting growth in volumes, particularly in high transaction products such as our current account and credit card. Unsecured loan impairment losses increased to £133.1 million (2006 – £73.7 million) as a result of significant growth in the book in previous years and a worsening credit environment which led to an increase in delinquency. Secured loan impairment charges are minimal for the current and previous year.

Arrears across all products remain significantly better than industry averages. A provision of £36.5 million has

been raised for the cost of various customer claims (2006 – £32.1 million).

#### Lending

Loans and advances to customers total £115.9 billion of which £98.1 billion, (85%) relates to retail lending activity.

The composition of our PFS lending continues to be low risk. At 4 April 2007, 94% of our PFS lending was residential mortgages, 3% was buy-to-let mortgages, 2% was unsecured personal loans with the balance of 1% lending on overdrafts and credit cards. This mix has not changed significantly from last year and is not expected to change significantly going forward.

#### Residential mortgages

The UK housing and mortgage markets performed strongly in 2006/07. House prices increased by 9.5% in the year to March boosted by stronger GDP growth, buoyant demand from the buy-to-let sector and continued

Our commitment to competitively priced mortgage deals and service standards has delivered a very strong gross lending performance

problems with the slow response of housing supply. Interest rates increased three times during the financial year but the housing market took longer to respond than in earlier cycles. Total gross lending was 16% higher than in 2005/06.

In contrast, UK remortgage activity was relatively flat, with the total value of lending 6% higher than last year, supported by continued equity withdrawal on the back of debt consolidation.

Total net lending was robust and ended the year 20% higher than 2005/06. The buy-to-let sector continues to contribute strongly to market growth, accounting for 9% of outstanding balances at the end of December 2006.

Our commitment to competitively priced mortgage deals and service standards has delivered a very strong gross lending performance for the Group during 2007 at £29.1 billion (2006 – £21.1 billion). Our share of the gross new lending market rose from 7.0% in 2006 to 8.3% in 2007. In addition, we continued to be highly successful in retaining borrowers and this has made a significant contribution to net lending this year. Our 7.6% market share of principal repaid in the Group was below our mortgage par share of 8.9%. As a result, net lending was £11.2 billion (2006 – £6.3 billion) which represents a market share of 10.1%.

This excellent performance was partly driven by our policy of charging between 0.5% – 0.75% less interest on our standard variable rate mortgage compared with our major competitors, as well as having competitively priced fixed and tracker products available to both new and existing borrowers on the same terms. In addition, good service and an active policy of customer contact enabled us to retain borrowers with maturing fixed rate and tracker rate mortgage products.

The quality of our residential mortgage book continues to be excellent, with very low levels of arrears and a minimal impairment charge arising. The average loan to value (LTV)

ratio of the Group's retail loan portfolio is estimated as 39%, with the LTV of new residential mortgage lending being 58%.

During 2007 we successfully launched our Intermediary website to complement the existing mortgage trading exchange. The launch has been very well received by our introducer partners and led to a record surge of business during January.

Following a successful 12 month pilot, our legal service for homebuyers was launched across our entire retail network. This has delivered more value to our members who take out a mortgage with Nationwide and move home within England, Wales & Northern Ireland.

Nationwide is proud to participate in the government's Open Market HomeBuy Scheme launched in October assisting key workers to buy their own property. This, along with the launch of our 25 year fixed rate mortgage, demonstrates our commitment to delivering innovative products that offer good value, long term security and flexibility for a changing competitive environment. We achieved this whilst maintaining a low appetite for risk and strong asset quality.

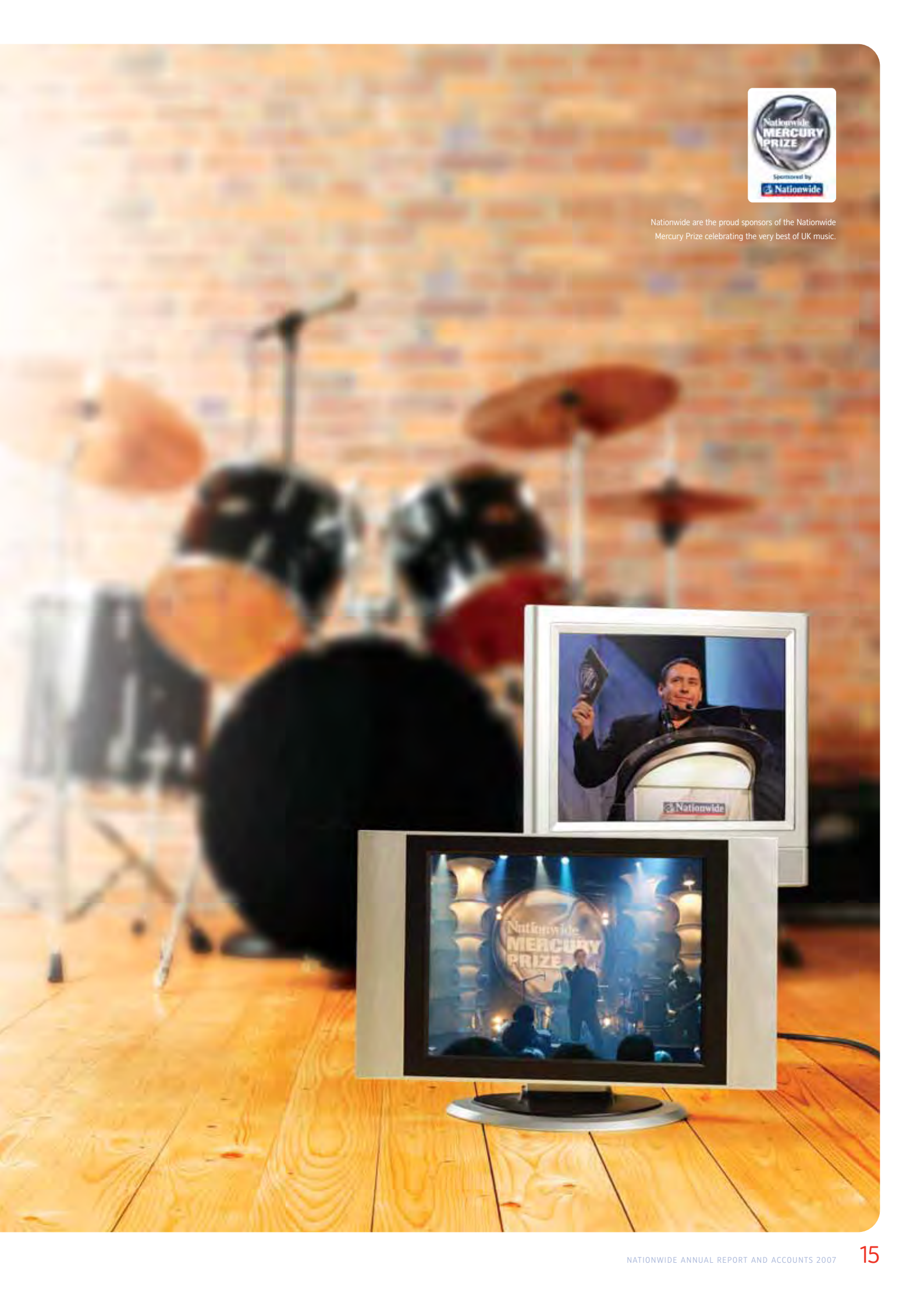
Looking forward, we expect slower house price growth in 2007/08, but we expect a generally favourable outlook for gross lending given the expectation of a fairly positive macro economy. Remortgage lending is expected to recover next year, driven largely by higher levels of deal maturities. UK gross lending is expected to be fairly similar to 2006/07 and net lending is expected to increase slightly to £115 billion.

### *Current accounts*

The Society's current account, FlexAccount, is a pivotal product in developing and retaining lasting customer relationships. We remain committed to giving our members access to free banking, and the product offers a highly competitive banking proposition to both existing and potential customers in offering a competitive rate of interest of up to 4.25% on credit balances and a market leading authorised overdraft rate of 7.75%. In addition, our no charge policy for overseas card transactions sets us apart from the competition and helps attract new customers. Around 48% of FlexAccount customers now regularly use our internet banking service, and just under three million members are registered to use this service.



Nationwide are the proud sponsors of the Nationwide Mercury Prize celebrating the very best of UK music.



The total number of Nationwide current accounts has grown by around 440,000 (2006 – 500,000) to just under 4.1 million. Our market share of new accounts is estimated at 9.4% (based on CACI's Current Account and Savings Database). Credit quality remains strong, with the percentage of delinquent balances as a proportion of the overdrawn book falling to 13.9% (2006 – 14.0%).

## *Credit cards*

The Society continues to differentiate its credit card from others in the UK by not charging for international use and by our positive order of payments, in that we allocate payments to clear the most expensive debt first. We continue to provide first class customer service for our members, and were winners of the Best Achievement in Customer Service at The Credit Card Awards 2007.

Whilst the UK credit card market as a whole has seen a fall of 5% in gross lending in the year to December 2006 compared to the previous year we continue to see growth, primarily driven by year on year increases in merchant spend. We have recently refreshed our introductory offer to maintain our competitive position with an interest free balance transfer proposition (subject to a handling fee).

Despite industry levels of new credit card volumes being at their lowest point for five years (based on GfK's Financial Research Survey, January 2002 – 2007) we have opened 204,000 accounts this financial year (2006 – 252,000). This brings our total cards in issue to 1,426,000 (2006 – 1,222,000) and balances outstanding on credit cards at the end of the year were £726 million (2006 – £670 million).

Our overall delinquent balances as a percentage of outstanding balances remained largely stable during the year, and are approximately 30% better than the industry benchmark. As with others in the industry, there has been an increase in the impairment charge, largely driven by book growth in previous years.

## *Personal loans*

Personal loans are offered through Nationwide Trust Limited, a wholly owned subsidiary of the Society. Loans are sold through the branch network, over the telephone and via the internet. We adopted a cautious approach to unsecured lending in the year, focusing on credit quality. Gross unsecured lending for 2007 decreased by 29% to £922 million (2006 – £1.3 billion).

Strong asset quality is demonstrated by the value of accounts 30+ days in arrears, which at 6.1% is approximately 25% better than the average for the industry of 8.1% (based on data as at February 2007 – Finance & Leasing Association). Provision cover has been increased to reflect a deterioration in delinquency during the year, arising from challenging market conditions.

The business has now increased its focus on the quality of lending. A prudent approach is taken to lending decisions and credit acceptance criteria have been tightened during the year. Approximately three out of every five unsecured personal loan applications are declined, with over three quarters of new loans being to existing members or customers of the Group.

We generated an estimated £660 million in the form of pricing benefit to our members by offering better rates and by charging lower fees and charges than our competitors

## *Savings and investments*

Overall savings balances in the UK market grew by 11% over the last year, returning to trend after weaker growth of only 8% in 2006. Estimates of market net receipts show annual growth significantly higher than that witnessed in 2006. Higher levels of equity withdrawal, enabled by strong house price growth, are likely to have contributed to this. In contrast the cash Individual Savings Account (ISA) market was weaker than last year, down 9% at £12 billion. This is likely to have been caused by healthier stock market performance which also encouraged further growth in equity ISAs with net flows 26% higher than last year.

The Group's total retail member deposits as at 4 April 2007 amounted to £86.8 billion (2006 – £80.9 billion) and represent our primary source of funding. Despite a fiercely competitive savings market, we achieved an 8.1% (2006 – 12.8%) share of the overall increase in UK retail savings, representing £5.9 billion (2006 – £8.3 billion). The largest increases were in our e-Savings and ISA products.

As a result we have consolidated our position as the second largest savings provider in the UK.

During the year several important product launches were made, most notably the Fixed Rate ISA in December 2006, which has captured balances of £650 million in the first three months of operation. In addition Regular Savings, the new flexible, instant access card based account was launched in January 2007, backed by a guarantee to track the Bank of England base rate until 1 January 2010. The total number of accounts opened since its launch was nearly 62,000.

A further product innovation in March 2007 saw the Monthly Income 65+ (MI 65+) product re-branded as MI 60+, broadening its appeal to a wider segment of the savings market (over 60's). This product has continued to perform strongly, attracting nearly £1.7 billion in the year (51,000 accounts).

The Society, through its wholly owned subsidiary Nationwide Unit Trust Managers Limited (NUTM), currently writes a range of investment contracts including unit trusts and ISAs. At 4 April 2007 our range of unit trust investment products held by our customers had a market value of over £2.7 billion (2006 – £2.5 billion). On the 7 February 2007 the Society announced its intention to sell both NUTM and Nationwide Life Limited (NL) and enter into a distribution agreement with Legal & General. Further details are provided in the section on Life Assurance and Investments.

### General insurance

During the year over 545,000 (2006 – 400,000) new general insurance covers were sold, an increase of 36.3% on last year. The primary general insurance products offered by the Group are buildings and contents insurance, payment protection policies, motor insurance and travel insurance. Sales of general insurance products are often linked to, and therefore can be largely dependent upon, other product sales such as mortgages, personal loans and credit cards.

The increase in the number of general insurance covers sold in the year reflects the successful launch of a new Home Insurance product combined with two new add-on products (Legal Assistance and Home Emergency) in July 2006. The initial launch was supported by a multi-media marketing campaign and a variety of customer propositions have continued since launch to sustain the positive momentum.

The re-entry into the over 65 annual travel insurance market (Europe only) and our 'Kids go Free' travel campaign were great successes and feedback from members has been complimentary.

We have continued to use leading insurers as third-party underwriters and the commission and profit share we receive is an important source of non-interest income. Both commission income and profit share are slightly up on 2006 although profit share on the Home Insurance scheme was impacted by the less benign weather conditions this year and the consequent increase in insurance claims.

### Life assurance and investments

The Society, through its wholly owned subsidiary, Nationwide Life Limited, currently writes a range of investment and protection products. These include two types of insurance product: term life assurance and critical illness cover. Over 71,000 life policies were sold during the year (2006 – 65,000 policies). NL also provides pension contracts and guaranteed equity bonds.

On 7 February 2007 the Society announced its intention to sell both NL and NUTM and enter into a distribution agreement with Legal & General. The sale is conditional on the consent of the Financial Services Authority to the change of control of the companies and other customary conditions. The new arrangement will provide an excellent opportunity for Society customers to choose from a broader range of competitively priced products and enjoy an enhanced service. The plans include expanding the range by introducing an Ethical Investment Fund and new family life insurance policies.

### Pricing benefit

The estimated pricing benefit is calculated by comparing the price of each of our products (including interest rates, fees and charges) with the equivalent products offered by our main competitors. During the year we generated an estimated £660 million in the form of pricing benefit to our members by offering better rates and by charging lower fees and charges than our competitors. This demonstrates our continued intention to distribute significant value to our members whilst ensuring that sufficient profit is retained in the business for its future growth and development.

## Distribution channels

We are committed to allowing our customers to do business with us when and how they wish. We are continuing the £300 million, six year investment programme announced in 2004 to develop a modern business and to ensure that our branch, telephone, internet and other access channels are maintained at the high standards expected by our members. This programme continues to progress very well with a number of technology investments having already been successfully deployed and over 300 branches and 115 agencies refurbished or re-sited since its inception. The additional space created is equivalent to that from an extra 100

branches. We have continued our investment in UK call centres and have added 125 jobs into our facility in Wakefield.

We have made a commitment that all of our call centres will remain in the UK. In addition to the investment in physical infrastructure we are also progressing well with our investment in customer facing branch employees with an extra 100 people being deployed to strengthen our sales and service proposition. The Portman Building Society branches will be incorporated into our network during 2008. Following the planned merger, it is anticipated that the combined Society will have a network of around 900 branches and agencies.

## Commercial

	2007 Underlying £m	2006 Underlying £m	Growth %
Net interest income	216.8	199.6	8.6
Other income	45.2	37.3	21.2
<b>Total income</b>	<b>262.0</b>	<b>236.9</b>	<b>10.6</b>
Expenses	41.9	43.6	(3.9)
Impairment and other provisions	(4.7)	(0.9)	422.2
<b>Contribution from Commercial</b>	<b>224.8</b>	<b>194.2</b>	<b>15.8</b>

The underlying contribution from the commercial business stream increased by 15.8% to a record £224.8 million. Commercial is an important contributor to the Group's total return, representing approximately 33% of the Group's profit from only 16.7% of the Group's total assets. Despite a very competitive market, we achieved record levels of gross lending in the year while preserving the high quality of the book. Underlying contribution from investment assets held by Treasury was £40.4 million (2006 – £29.8 million), an increase of 35.6%. The contribution from at.home nationwide limited (at.home) was £10.5 million (2006 – £13.1 million), a decrease of 19.8% on the previous year. This is due to the disposal of the majority of at.home's property portfolio in the current financial year.

## Commercial lending

Commercial Division, which undertakes lending in respect of commercial property, social housing providers and Private Finance Initiatives, has had another outstanding year:

- Gross commercial lending in the year totalled £7.4 billion (2006 – £5.5 billion);

- Net lending reached £3.4 billion (2006 – £1.8 billion); and
- Balances outstanding have risen to £17.9 billion (2006 – £14.5 billion).

Commercial lending is a significant part of our business accounting for 15.4% of total Group loan assets. The commercial portfolio at 4 April 2007 comprised loans in respect of commercial property (64%), social housing (31%) and Private Finance Initiatives (5%).

Commercial property loans are fully secured against properties supported by strong cash flows and tenant covenants. Loans to social housing providers, largely Registered Social Landlords (RSL's), are secured on residential portfolios. Loans advanced under Private Finance Initiatives are secured on cash flows from government backed contracts.

The commercial portfolio is well diversified by industry type and geographic location. In terms of counterparty concentration, the largest single borrower represents only 1.7% of the total commercial book. Asset quality is high as evidenced by just 84 accounts being three or more months in arrears (2006 – 69 accounts).

We remain the lender with the largest value of funding commitments to the social housing sector. There have been several re-financings and increases in borrowing as social housing providers merge in response to government initiatives to increase both efficiency and output from their public subsidies. Our lending during the year included some significant facilities to new customers and the acquisition of a £320 million RSL loan book from the Derbyshire Building Society.

### Treasury investment assets

Treasury holds certain assets in order to generate income for the Group. The underlying contribution from

Treasury investment assets was £40.4 million (2006 – £29.8 million), an increase of 35.6%. Treasury investment assets comprise the asset backed, corporate bond and equity portfolios. The primary reason for the increase on last year was a large dividend from the equity portfolio.

### at.home nationwide limited

at.home conducted the Society's residential letting operations. The subsidiary represented a non strategic activity and it was decided to dispose of the business. The disposal of the majority of at.home's property portfolio was completed in July 2006.

Group	2007 Underlying £m	2006 Underlying £m	Growth %
Net interest income	160.4	113.4	41.4
Other income	12.0	12.3	(2.4)
<b>Total income</b>	<b>172.4</b>	<b>125.7</b>	<b>37.2</b>
Expenses	52.7	51.4	2.5
<b>Contribution from Group</b>	<b>119.7</b>	<b>74.3</b>	<b>61.1</b>

Contribution from the Group business stream includes the contribution derived from capital held for regulatory purposes, in excess of that allocated to other business streams on the basis of an economic capital assessment, together with other elements of contribution that cannot be allocated directly to business streams. It also includes contribution from the Group's treasury operations, excluding the contribution from assets held solely for investment purposes, the later being included in the contribution from the Commercial business stream.

The increase in net interest income allocated to the Group business stream is primarily due to the increase in net interest margin, caused by wider LIBOR to base rate spreads.

### Liquid balances

Liquid balances totalled £17.5 billion at 4 April 2007 (2006 – £14.7 billion) representing a prudential liquidity ratio of 10.4% (2006 – 10.0%). 97% of our Treasury investment portfolio comprised assets which are rated single A or better. We continue to have no exposure to emerging markets and minimal exposure to non investment grade debt.

We remain the lender with the largest value of funding commitments to the social housing sector

### Wholesale funding

At 4 April 2007, wholesale balances stood at £38.5 billion (2006 – £29.2 billion) representing a funding ratio of 28.4% (2006 – 26.6%). This is one of the lowest levels of wholesale funding of organisations of comparable size and provides significant headroom for additional funding in the future in addition to our retail deposit taking activities.

Over the course of the year, we have increased the overall duration of the Treasury funded programme from 2.0 to 2.3 years whilst at the same time reducing the average cost of funding by between 2 and 3 basis points.

During the year our long term funding focused on extending our covered bond presence. We issued €2 billion in November 2006 which was followed with a dual tranche offering in February 2007. The deal offered both €2 billion five and €2 billion fifteen year bonds, making history as the largest ever order book for a UK covered bond and the largest issue of its kind from a British issuer.

Additionally we issued two capital transactions. In December 2006 we issued €300 million of subordinated debt which was followed in January 2007 with an innovative Permanent Interest Bearing Share (PIBS) issue of £350 million. The latter achieved the tightest ever pricing for such an issue and was six times over subscribed, further

evidence of the continuing demand and interest in the Nationwide name from professional investors.

Our short and long-term credit ratings from the major rating agencies have remained stable during the year, with the exception of the Moody's long term rating which was upgraded from Aa3 to Aa2. The ratings are as follows:

	Short term	Long term
Fitch Ratings	F1+	AA-
Moody's	P-1	Aa2
S&P	A-1	A+

## Performance by Income Statement Category

### Profit

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

	2007 Underlying £m	2006 Underlying £m	Growth %
Net interest income	1,479.3	1,234.3	19.8
Other income	443.9	401.4	10.6
<b>Total income</b>	<b>1,923.2</b>	<b>1,635.7</b>	<b>17.6</b>
Expenses	1,089.4	991.2	9.9
Impairment and other provisions	165.2	105.1	57.2
<b>Profit before tax</b>	<b>668.6</b>	<b>539.4</b>	<b>24.0</b>

The Group has seen a strong growth in underlying profit before tax of 24.0%, to £668.6 million compared with 2006 results. Reported profit before tax was a record £652.0 million, up 16.6% on 2006 (see consolidated income statement on page 46). The increase in profit was consistent with our strategy of retaining sufficient profit to allow continued investment in the business and to support its future growth.

### Net interest income

Net interest income is earned on a combination of our PFS and Commercial products together with interest income from activity within Treasury.

Net interest income increased by 19.8% to £1,479.3 million compared with last year. The net interest margin for the year also increased to 1.15%, 9 basis points higher than last year, due to effective margin management and

wider LIBOR to base rate spreads in the rising interest rate environment. The Society's LIBOR denominated net asset exposure has averaged approximately £28 billion over the year. Through this exposure we have benefited from LIBOR being an average of 24 basis points higher than base rate over the course of the year. This differential contributed around 7 basis points to the Group's net interest margin, compared with last year where an average LIBOR to base

Net interest income increased by 19.8% to £1,479.3 million compared with last year. The net interest margin for the year also increased to 1.15%

rate differential of 9 basis points contributed approximately 2 basis points to the net interest margin.

#### Other income

Other income continues to primarily comprise income earned from the sale and manufacture of insurance products together with administration fees not included within interest margin. During the year underlying other income increased by 10.6% to £443.9 million, reflecting the general growth in the business. Credit card default

fees were reviewed in June 2006 following the industry-wide Office of Fair Trading review.

#### Expenses

Total underlying expenses amounted to £1,089.4 million representing an increase of 9.9% over 2006. This increase compares favourably with an increase in total assets of 13.9% over the year and a rise in underlying total income of 17.6%. As a result, our underlying cost to income ratio improved to 56.6% (2006 – 60.6%).

#### Impairment losses on loans and advances

	2007 £m	2006 £m	Growth %
Secured lending	0.5	2.9	(82.8)
Unsecured lending	133.1	73.7	80.6
Customer redress	36.5	32.1	13.7
Treasury investments	(4.9)	(3.6)	36.1
	165.2	105.1	57.2

The excellent asset quality of our mortgage book has again resulted in a minimal impairment charge arising from secured lending.

The increase in the unsecured lending impairment charge has arisen from higher levels of write offs and delinquent accounts. This reflects the difficult market conditions being experienced by the industry and asset growth in previous years.

The charge for customer redress relates to various customer claims.

Following an improvement in the credit quality of a particular treasury investment security an impairment gain has been recognised resulting in a £4.9 million credit from treasury investments.

#### Taxation

The effective rate of tax was 28.9% (2006 – 29.0%) compared with the standard rate of corporation tax of 30%.

The lower rate arises principally because of the reduction in the level of provisions held against uncertain tax positions, partially offset by the additional tax costs in repatriating to the UK the profits of an offshore business which ceased to trade in the year.

We estimate that the Group's effective tax rate going forward will be around the standard UK statutory rate.

#### Derivatives and hedge accounting

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

The fair value accounting volatility pre-tax gain of £0.9 million (2006 – £10.9 million pre-tax gain) represents the net fair value gain on derivative instruments that are matching risk exposure on an economic basis. Some accounting volatility arises on these items due to accounting ineffectiveness of designated hedges, or because hedge accounting has not been adopted or is not achievable on certain items. The gain is primarily due to timing differences in income recognition between the derivative instruments and the hedged assets and liabilities. The impact can be volatile, but will trend to zero over time and has been excluded in reporting the Group's underlying performance.

## Capital Structure

Regulatory capital stood at £8.0 billion (2006 – £7.0 billion) with the Group's total solvency ratio remaining strong at 11.0% (2006 – 11.0%). The Tier 1 solvency ratio stood at 8.7% (2006 – 8.8%). Both ratios remain well in excess of the minimum established by the Society's Regulator.

	2007 £m	2006 £m
<b>Tier 1</b>		
General reserve	5,295.8	4,825.6
Permanent interest bearing shares (Note 1)	1,045.4	700.0
Pension fund deficit add back (Note 2)	106.0	126.0
Intangible fixed assets	(106.1)	(80.5)
Deductions from Tier 1 capital (Note 3)	(20.2)	-
	<b>6,320.9</b>	<b>5,571.1</b>
<b>Tier 2</b>		
Revaluation reserve	128.2	117.0
Subordinated debt (Note 1)	1,617.0	1,484.0
Collective impairment allowance	184.0	145.2
Deductions from Tier 2 capital (Note 3)	(20.2)	-
	<b>1,909.0</b>	<b>1,746.2</b>
Deductions	(269.2)	(333.7)
<b>Total capital</b>	<b>7,960.7</b>	<b>6,983.6</b>
Risk weighted assets (£ billion)	72.5	63.6
Tier 1 ratio (%)	8.7	8.8
Total capital (%)	11.0	11.0
Tier 2 to Tier 1 ratio (%)	30.3	31.3

### Notes:

1. For 2007, 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. For 2006, these adjustments are excluded. This change in treatment reflects a change in the calculation of regulatory capital effective from 1 January 2007, as part of the migration to Basel II.
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. For 2007, certain deductions from capital are required to be allocated, 50% to Tier 1 and 50% to Tier 2 capital, whereas in 2006 they were deducted from total capital. As in note 1, this change in treatment is part of the migration to Basel II.

In the year we raised additional capital in the form of a subordinated debt issue of €300 million and an issue of £350 million Permanent Interest Bearing Shares

In the year we raised additional capital in the form of a subordinated debt issue of €300 million and an issue of £350 million Permanent Interest Bearing Shares (PIBS). These issues supported the strong growth of the business achieved during the year and our future plans. The PIBS incorporated an innovative flexible structure to allow us to reduce the capital base as the benefits of Basel II emerge over time. The planned sale of Nationwide Life Limited will also allow us to release the £269.2 million deduction from capital shown above.

## Basel

Nationwide has applied for a waiver to use an Internal Ratings Based (IRB) approach under the Capital Requirements Directive. A decision on the application is anticipated from the FSA later this year. Given the nature of our portfolios, we would expect to benefit from a reduction in our minimum capital requirements under Pillar 1. We are in discussion with the FSA regarding our overall assessment under Pillar 2.

## Pension Fund (Retirement Benefit Obligations)

The majority of Group employees are members of the Nationwide Pension Fund (the Fund). The Group operates both Final Salary and Career Average Revalued Earnings (CARE) defined benefit arrangements.

The valuation of the Fund at 4 April 2007 resulted in a deficit of £163.0 million (2006 – £283.0 million) using the methodology set out in IAS 19. Our total retirement benefit liability under IAS 19, including other schemes, is £172.4 million (2006 – £294.2 million). We have been actively managing our retirement benefit liability and have taken a number of steps to contain and reduce the deficit over time:

- Final Salary arrangements closed to new members since December 2001;
- Employee contributions (Final Salary arrangements) increased from 5% to 7%;
- Special contributions of £150 million paid in the period 2005/06 – 2006/07; and
- The Fund's Trustees have worked closely with their advisors to optimise the investment strategy for the Fund's assets.

We will continue to review our options to manage the Fund in a timely and responsible way. A full triennial valuation of the Fund as at 31 March 2007 is to be undertaken. The results will not be available until later in 2007, after which a plan will be agreed with the Trustees to manage the ongoing funding of the scheme.

## 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, market risk, liquidity risk and operational risk. In addition, insurance risk arises within our life insurance subsidiary.

We have a formal structure for managing these risks within the Group. This structure consists of three key elements:

Firstly, we have documented our approach to the management of risk in our detailed risk policy statements. These statements cover all of the risks mentioned above and they are reviewed annually by the management committees mentioned below. In addition, risk appetite is implemented through risk limits and the allocation of economic capital.

Secondly, we have well established risk functions within the Group. These functions sit within our Risk Management Division. The role of these functions is to set limits which are consistent with our risk appetite, to monitor and report on compliance with those limits and generally to provide an oversight role in relation to the management of risk. However, prime responsibility for managing risk, and for ensuring controls are put in place in respect of risk, lies with the business units within the Group. This division of responsibility is in accordance with best practice recognised within the industry and by our regulator, the FSA.

Finally, we have a committee structure which supports the management of risk within the Group. During the last financial year we have operated a committee structure consisting of four key management committees. These were:

- Credit Committee (Retail) and Credit Committee (Commercial and Treasury), which have responsibility for credit risk;
- Assets and Liabilities Committee (ALCO), which has responsibility for market and liquidity risk; and
- Chief Executive's Committee, which has responsibility for operational risk.

With effect from 1 April 2007, a new risk committee structure has been put in place to strengthen further our management and oversight of risk within the Group. The new structure introduces a new Group Risk Committee, which will have responsibility for ensuring a co-ordinated approach across all risks, and a new committee to deal specifically with operational risk management.

Insurance risk was managed by the board of our life insurance subsidiary. All of the management committees mentioned above, and the board of our life company, included appropriate representation from amongst our executive and divisional directors, as well as from our risk functions. In addition to these committees, oversight of the risk management framework and control systems was provided by the Audit Committee on behalf of the Board.

## Credit Risk

Credit risk is the risk that a customer or counterparty will fail to meet their obligations to us as they become due. Credit risk arises primarily from loans and other credit based products (such as current account facilities and credit cards) available to our retail customers, loans to our commercial customers and from the liquid and investment assets held by our Treasury Division.

Retail credit risk is managed centrally from within the Retail Credit Risk function in Risk Management Division. We have sought to distance the credit decision from our sales force and to make these decisions within the central team. We have accomplished this by developing and maintaining automated decision systems that differentiate credit risks for residential mortgage loans and other consumer products and services. A specialist retail underwriting unit considers those loan applications which require individual underwriting, but this unit sits within Risk Management Division, not within the sales force. The policy in respect of retail credit risk is maintained by the Retail Credit Risk function and is set by the Credit Committee (Retail). This committee receives regular reports from Retail Credit Risk on the performance of all retail credit portfolios.

Commercial credit risk is managed by our Commercial Division, which is responsible for all commercial lending activities, and the Commercial Credit Risk function within Risk Management Division. The Commercial Credit Risk team underwrite all new loans and monitor existing loans. Loans above certain levels also require approval from the appropriate management committee. The Commercial Credit Risk team also maintain the policy and limits in respect of commercial credit risk and monitor compliance with the limits, providing reports to the Credit Committee (Commercial and Treasury) on performance of the commercial portfolios.

Credit risk within our Treasury Division arises from the investments held by Treasury in order to meet our liquidity requirements and for general business purposes. This aspect of credit risk is managed by Treasury Division and the Treasury Credit Risk function within Risk Management Division. The Treasury Credit Risk team underwrite all new facilities and monitor existing facilities. They also set and monitor compliance with policy and limits, reporting to the Credit Committee (Commercial and Treasury) in the same way as the Commercial Credit Risk function does in relation to commercial credit risk.

## Market Risk

Market risk incorporates a range of risks, but the principal elements are interest rate risk and foreign currency risk. Market risk is the risk that the value of, or income arising from, the Group's assets and liabilities changes as a result of changes in interest rates or exchange rates.

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

Retail credit risk is managed centrally from within the Retail Credit Risk function in Risk Management Division

Whilst an increasing volume of Commercial's loans and advances to customers are denominated in Euros, the majority of currency balances arise from transactions instigated by Treasury Division, to manage wholesale funding costs and returns on liquid assets and to provide diversity in funding and asset markets. Currency risk is managed primarily through the use of currency swaps and forward foreign exchange contracts. The risk is also managed, where appropriate, by foreign currency liabilities being matched with assets denominated in the same foreign currency.

Treasury Division is responsible for managing our exposure to all aspects of market risk within the operational limits set out in the Group's market risk policies. Oversight is provided by the Market Risk team within the Risk Management Division and by ALCO, which includes representation from the Treasury Division and Risk Management Division. ALCO approves the market risk policy and receives regular reports on all aspects of market risk, including interest rate risk and foreign currency risk.

Our Treasury Division uses derivative instruments in managing various aspects of market risk. However, in doing so it complies with the Building Societies Act 1986 which limits our use of derivatives to the management of changes in interest rates, exchange rates or other factors defined by the Act.

Our liquidity risk policy is monitored by ALCO, which receives regular reports on our liquidity position, and the Market Risk team within the Risk Management Division

#### Liquidity Risk

Liquidity risk is the risk that the Group is not able to meet its financial obligations as they fall due, or can do so only at excessive cost. The objective of our liquidity policy is therefore to enable us to maintain sufficient liquid assets to cover cash flow imbalances and fluctuations in funding, to maintain full public confidence in our business and to enable us to meet all our financial obligations.

The day-to-day management of liquidity is the responsibility of Treasury Division, which manages our portfolio of liquid assets and our contingency funding plans. Our liquidity risk policy is monitored by ALCO, which receives regular reports on our liquidity position, and the Market Risk team within the Risk Management Division. We also comply with regulatory guidelines which govern the scope and nature of the Group's holdings of liquid assets.

#### Operational Risk

Operational risk is the risk of a loss arising from inadequate or failed internal processes or systems, human error or external events. For the purposes of managing operational risk, we divide it into a number of discrete areas of risk which include, for example, process management, systems failure and fraud risk.

We manage operational risk through the Group's business units, with senior management having responsibility for understanding how operational risk impacts on their business unit and for putting in place the appropriate

controls or other mitigation actions, for example, insurance. The business units are supported by a central Operational Risk team within the Risk Management Division, which coordinates activity across a network of operational risk officers who work within the business units.

Our Chief Executive's Committee has, over the last financial year, had primary responsibility for operational risk, ensuring effective management of the Group's operational risk profile. With effect from 1 April 2007 a new operational risk committee has taken over primary responsibility to provide strengthened oversight of the effective and consistent implementation of the operational risk management strategy, policy and approach across the Group.

**Mark Rennison**

Group Finance Director

16 May 2007

# Community and Environmental Affairs

**INTRODUCTION:** Nationwide's community and environmental affairs programme is increasingly a key component of our corporate values, our brand and our reputation. It helps to define our corporate personality, and differentiates us from our competitors. Last but not least, research has shown that it helps to attract and retain employees and members – the lifeblood of any successful organisation.

The Community and Environmental Affairs team works to support the communities in which Nationwide operates and to manage our approach to sustainability. For us, this entails operating and growing the business in such a way as to meet the needs of the present while conserving resources for future generations. It is based on our core values of fairness, honesty, integrity and transparency.

Sustainability is widely considered to have three elements: economic, social and environmental. For Nationwide, economic considerations are important in order to ensure that we have a sustainable business for our members and employees. As an integral part of our stance on mutuality, we play a strong and active role in supporting communities across the UK. Nationwide is not a major polluter and strong financial performance enables us to play an important role in protecting the environment. It also allows us to make appropriate fiscal contributions and during the year we paid taxes in excess of £790 million on behalf of the Nationwide Group of companies, employees and members.

Further details of our economic policies, objectives and performance can be found elsewhere in this document.

## Governance and accountability

Our Sustainability Committee, chaired by Stuart Bernau, Group Retail Director, meets quarterly to review strategy and activities. The Committee comprises senior managers from across the business.

Coordination of management activities is the responsibility of the Head of our Community and Environmental Affairs department. The Community and Environmental Affairs team strives to ensure that Nationwide makes an active contribution to and positive impact upon the communities and environments in which it operates. Our employees are also encouraged to take personal responsibility to create a more sustainable Society.

## Sustainability strategy

In November 2006, the Board reviewed and approved our strategy for 2007/08. The strategy includes seeking our members' approval to achieve the Business in the Community PerCent Standard (formerly PerCent Club). This

is a voluntary benchmark run by Business in the Community which measures the contributions made by companies through cash donations, staff time, gifts in kind and management time, shown as a percentage of pre-tax profits. Our members will have the opportunity to indicate their views on this when they vote at the Annual General Meeting in July.

Other priorities for the year include:

- developing network-wide management strategies relating to climate change, water, waste and transport;
- building on existing activity, develop a more formal volunteering policy, aligned with business need and supporting employees' personal and professional development; and
- continuing to develop an approach to integrate sustainable/ethical elements into new and existing products.

## BITC Corporate Responsibility Index 2006

In our second submission to the Business in the Community Corporate Responsibility Index in 2005 we improved our ranking from 74th to 68th in the Top 100 Companies that Count. This year the ranking has been changed to a bronze, silver, gold and platinum banding within the top 100 companies. Nationwide has been placed in the silver band. This has again confirmed that in some areas, such as employee policies and practices, we are performing strongly but in others we have room for improvement. For instance, we need to report publicly on performance against targets. We will also ensure that we continue to improve our risk management processes and engage more comprehensively with all stakeholders.

We are developing network-wide management strategies relating to climate change, water, waste and transport

## Reporting

Our Better Society report sets out our approach to our members, employees, communities, the environment and our partners. It also details our performance in these areas, shows our targets for improvements and identifies the challenges that we face. Further information can be found on our Better Society website, at [www.nationwide.co.uk/bettersociety](http://www.nationwide.co.uk/bettersociety)

## Diversity

We are committed to promoting a supportive and inclusive culture for all our employees, members and business partners. We seek to harness the strengths and talents of each of our employees to create a productive workforce

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that puts members first and which generates ever greater value for them. Diversity is important to business plans throughout Nationwide, and increased awareness of it helps maximise productivity and value.

We strive for equal opportunities at all levels of our business and we encourage employee diversity in order to eliminate discrimination and to reflect and understand the communities in which we operate. This is supported by our Diversity and Equality of Opportunity Committee (DEOC) chaired by the Divisional Director for Customer Service and Communications. The DEOC is comprised of senior managers from across the business along with the General Secretary of the Nationwide Group Staff Union. It is responsible for developing actions relating to diversity and taking them forward as part of their business plans. These include:

- identifying ways of overcoming barriers to greater diversity, as well as setting clear and measurable goals for doing so;
- evaluating the workforce with external benchmarking data and recommending changes as necessary;
- maintaining action plans, best practice bulletins and case studies on the diversity intranet site according to an agreed communications strategy; and

- sponsoring the Disability Action Group which leads our discussions on disability issues for members and employees.

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

- Employers Forum on Age: Nationwide was a founding member of the EFA and has been a member of its Executive Steering Committee for ten years, enabling us to influence age legislation and age diversity in the UK;
- Business in the Community's Race for Opportunity programme: in 2005 and 2006 we achieved Gold status in their national benchmarking survey;
- Employers' Forum on Disability: as a member we have the opportunity to work closely with Government and other stakeholders, sharing best practice to make it easier to employ disabled people and to serve disabled customers;
- Business in the Community's Opportunity Now Programme: through this programme we have been recognised externally for our work on gender equality and best practices in the workplace; and
- Stonewall: Nationwide is a Stonewall Diversity Champion and was ranked the third best financial services organisation in their Corporate Equality Index in 2007.

## Employee commitment

We look carefully at how we engage with our employees and how their commitment impacts positively upon our members. Over the last four years we have established through our Viewpoint employee survey that satisfaction with leadership, reward and recognition, training and development and resourcing all play a key part in driving up employee engagement, as does alignment with our corporate values, PRIDE.

The relationship between employee commitment, member advocacy and business performance has been quantified in our "service profit chain" research which we call Project Genome.

In addition to conducting our own research in this area, we also collaborate with the University of Bath. They have not only confirmed our findings but also established that our employees' opinions on sustainability and fairness (both internal and external) have a major positive impact on their commitment.

Research will continue over the course of the coming year to enable us to gain greater insight into our employees' commitment.

## Community

We have over 150 years' experience of working in positive partnership with the community. Our commitment today remains as strong as ever. With more than 12 million members and over 16,000 employees, we have a physical presence in almost 1,000 locations across the UK. To reinforce our commitment to this local presence, we go to great lengths to ensure that our community activities reach every corner of the UK, are relevant to our members, to our employees and to the communities in which they take place.

We focus very clearly on projects which are of lasting benefit, which involve the broadest possible cross-section of the community and which help the most marginalised communities in the UK.

Recent highlights include:

- enhancing and extending our partnership with Disability Sport Events (DSE) to 2012, through a programme worth £1 million. For the second year, we will donate 10p to DSE for every vote cast at this year's AGM, up to £100,000;
- sponsoring the Nationwide Achievement Awards at the 2007 VISA Paralympic World Cup in Manchester in May;

We focus very clearly on projects which are of lasting benefit, which involve the broadest possible cross-section of the community

- contributing to a 49% reduction in UK child pedestrian casualties through our Cats' Eyes for Kids scheme, which has distributed 11 million safety reflectors to primary schoolchildren (as of October 2006). The scheme won a Big Tick award for excellence from Business in the Community;
- being rated a 'socially responsible company' by 89% of our employees, many of whom were involved in community activities during the year;
- receiving *The Sunday Times* 'Giving Something Back' award in recognition of our support for communities;
- raising over £25,000 for Macmillan Cancer Support from the World's Biggest Coffee Morning fundraising event. Macmillan has been our flagship charity for over 14 years and we have raised more than £4.3 million for people living with cancer since the partnership began; and

- recognising more than 1,300 individuals and groups engaged in community volunteering via our Nationwide Awards for Voluntary Endeavour.

We are constantly inspired by the boundless generosity, creativity and sense of fun of our employees across the UK. We aim to support and encourage employees who decide to get involved – where there is measurable value not only for the community, but to Nationwide and our members. And our employees can benefit personally too, in terms of self development and personal fulfilment.

Employees can recognise their colleagues' contributions by nominating them for our Community and Environment Awards, held twice a year.

## Environment

Everything we do leads to environmental impacts – from our internal operations to our products and services. We have been working to improve our understanding and measurement of these impacts and how we consider them in decision making. Wherever possible we work to reduce the negative impacts whilst delivering our business objectives.

We do not have a major direct impact on the environment when compared, for example, to businesses in the manufacturing sector. But even though our impacts are relatively small, we believe that we can make a difference in solving the very real issues the world is facing. By far the biggest of these is climate change, associated with increased levels of carbon dioxide (CO<sub>2</sub>) in the atmosphere resulting from the use of fossil fuels.

We are also looking at how we can deal with our indirect impacts by, for example, giving advice to our members about how they can improve the energy efficiency of their homes.

## Climate change

Nationwide believes that there is more than enough evidence to support the strategic decision that we must take measures to reduce our CO<sub>2</sub> emissions. One of our most significant environmental impacts is the CO<sub>2</sub> emissions resulting from the energy use in our buildings – about 38,000 tonnes each year.

In October 2005 we entered into a one year contract to buy electricity from renewable energy sources, such as wind, new hydroelectric and biomass. In October 2006 a new contract was negotiated for a further period of two years for all our branches to be supplied from a similar mix of renewable sources. A separate one year contract was awarded for our head-office buildings, again supplied

## Community and Environmental Affairs

from a mix of hydroelectric, wind and biomass. As a result, when the electricity Nationwide uses in its branch network and other buildings is generated, it will not add to greenhouse gas emissions.

### Waste and paper

We intend to consider the environmental impact of all the materials and consumables we use, but at present paper use remains our priority. We use a significant amount in marketing, and also in correspondence with more than 12 million members. We use biodegradable material for the windows of our direct mailing envelopes, and are reducing the amount of plastics used in our marketing materials (for example, paper over board instead of laminated paper).

As part of our Paperwatch initiative, members using our Internet Bank can now choose to download images of their statements. This option is available to all FlexAccount, card-based savings accounts and credit card statements. By opting for paperless statements, our members are actively helping us to manage our impact on the environment. Approximately 310,000 fewer paper statements are now sent each month representing a significant cost saving to the business. We are donating a proportion of the money we save to the charity CSV's Action Earth campaign. Its objective is to empower and support people at grass roots level to improve the quality of their lives and their environment.

The proportion of general waste we recycle from our two main administration buildings has increased from 73% to 76% over the last year. One way we recycle is to support Green Standards, a charity near our Swindon headquarters, by donating corporate furniture and equipment that is no longer required. Green Standards redistributes these donations to local schools and charities, as well as to communities further afield.

We have entered into contracts to buy all our electricity from renewable energy sources, such as wind, new hydroelectric and biomass



### Transport

Our main transport impacts come from business travel and employee travel to and from work. We have several initiatives in place to improve our understanding of and to reduce our transport impacts.

Our transport awareness campaign has been running since April 2005. The programme promotes and encourages sustainable transport. It is part of Nationwide's workplace travel plan, which includes cycle facilities, bus timetable information, free lunchtime buses, car sharing and videoconferencing facilities.

### Partners

As a thriving business with a presence throughout the country, we have over 5,000 active suppliers accounting for an annual spend of over £600 million. We recognise that working with our suppliers and other partners can have a positive impact on our sustainability performance.

We are one of 59 organisations to have been accredited by the Chartered Institute of Purchasing and Supply (CIPS) under its scheme of certification in best practice and policy for purchasing. In dealing with our suppliers, we subscribe to the recognised ethical code of conduct set out by CIPS which mirrors the Society's own values.

Aramark Ltd is one of the largest suppliers to Nationwide, providing catering services across nine buildings including the two main administration buildings at Swindon and Northampton. The team is committed to quality and to supporting Nationwide in improving its environmental performance. In 2006 it attained Quality and Environmental Management System accreditation (ISO 9001 and 14001).

We recycle used and obsolete clothing through Wilcox Industrial Supply. With a new collection of corporate clothing every two years appropriate disposal of obsolete garments is crucial, and another way in which we support communities in need.

# Nationwide Foundation

In 2007, the Nationwide Foundation celebrates its 10th anniversary. Since it was set up in 1997, it has received over £26 million from Nationwide Building Society, which has been distributed to more than 2,200 charities across the United Kingdom.

The Nationwide Foundation is a registered charity (no 1065552) and company limited by guarantee which makes donations to registered charities, and is funded principally from contributions from Nationwide Building Society. It is a separate legal entity from the Society and is run by its own Board of Trustees. The Foundation's membership consists of those who became Society members on or after 3 November 1997. These members agreed to assign to the Foundation any potential windfall benefit to which they might be entitled in the event of the Society undergoing conversion or takeover. Some longer standing Society members have chosen to make this assignment as well. Currently there are over five and a half million members of the Foundation.

The Foundation works towards a just and caring society by enabling people to take part in building better futures in their communities, and its trustees are committed to ensuring that its funds are deployed for maximum benefit.

The current grant making strategy is called Supporting Families and is designed to help people in need and, importantly, to help break the drivers of social exclusion by offering support to those who are on its margins. The strategy incorporates two grants programmes, the Small Grants Programme and the Investor Programme. Both programmes encompass the following three aims:

1. to promote the well-being of young men, women and children whose lives have been affected by domestic violence and to reduce the prevalence of domestic violence through increased service provision, education and awareness raising;

To promote the well-being of young men, women and children whose lives have been affected by domestic violence

2. to improve the quality of life of families with a member or members in prison, through the provision of services responsive to their needs; and
3. to provide young people who are or have been involved with the criminal justice system with a rehabilitation programme designed to obtain the skills, confidence and personal support networks to enable them to lead fulfilled and successful lives.

The aims are designed to:

- support the 1 in 4 women and 1 in 6 men who experience domestic violence at some point in their lives;
- prevent re-offending. Offenders are six times less likely to re-offend if they maintain strong family ties whilst in prison; and
- support the rehabilitation of young people in or leaving custody to prevent them re-offending. Research shows that 70% of young offenders re-offend within 12 months of release.

The Investor Programme was designed to offer long term support and core funding to a selected number of charities, over three years, whilst encouraging partnership working among them. The Foundation recognises and places great importance on the increased potential benefits that can be achieved from partnership working, which can help charities to improve their services, avoid duplication of effort and resource, and enable them to share learning.

Each aim of the Investor Programme has a budget of £1.25 million and is supporting six charities over a three year period. This includes grant funding of £150,000 to each charity, £250,000 to fund partnership working activities identified by each group of six charities and £100,000 to evaluate the work to ensure it is making a difference.

The charities chosen for support under the first aim were agreed in March 2006 and those supported under the second and third aims were agreed in October 2006 and February 2007, respectively. The charities receive proactive and regular support from the Foundation's staff team to ensure the grants are being used as effectively as possible

continued

and a small number of the charities are being supported by a 'Trustee Buddy' from the Foundation to help enhance the funding relationship further whilst mutually sharing knowledge and skills.

The Small Grants Programme offers one-off grants of up to £5,000 to registered charities with an income of under £500,000. The programme commenced in 2005 making grants under the first aim, supporting those affected by domestic violence. In 2006, the criteria were expanded to include aims two and three relating to the support of prisoners' families and young offenders. For the year ended 31 March 2007, 182 small grants were made to charities across the UK, totalling over £800,000.

The Small Grants Programme offers one-off grants of up to £5,000 to registered charities with an income of under £500,000

The Supporting Families strategy and its two grant programmes are being independently monitored and evaluated by consultants Rocket Science UK Ltd, who were appointed in September 2006 and whose work will conclude a year after the grant support has finished, so that any long term benefits achieved with the grants can be captured.

The current grant making strategy was developed following experiences and lessons learned from the New Generation Initiative (NGI), a major grant making programme which the Foundation operated from 2000 – 2005. The NGI supported five charities, working to address issues of parenting, with long term, flexible funding for core and development work. Grants totalling over £2 million enabled the charities to expand their activities and organisational capacity significantly, thereby benefiting thousands of families in need. The work was independently monitored and evaluated by consultants Shared Intelligence and the results were developed into a CD Rom and booklet called the Virtual Town. The Virtual Town was launched at the House of Commons in 2005 and disseminated to funders and policy makers throughout 2006.

## Nationwide Foundation

In recognition of the innovation and achievements of the NGI, The Foundation won the Grant Making Category at the Charity Awards in June 2006, one of the most prestigious accolades in the charity sector.



The Foundation was also nominated in the Overall Strategy Category of the Third Sector Excellence Awards for the same work and the Virtual Town was recognised with an IVCA award (International Visual Communication Association) in September 2006.

The Nationwide Foundation is continuing to explore ways of working with other funders and organisations, which have similar aims and ideologies, in order to give maximum support to the charitable sector.

More information about the Foundation is available from:

The Nationwide Foundation  
Nationwide House, Pipers Way  
Swindon SN38 2SN

Telephone: 01793 655113; Fax: 01793 652409  
Email: [enquiries@nationwidefoundation.org.uk](mailto:enquiries@nationwidefoundation.org.uk)  
Website: [www.nationwidefoundation.org.uk](http://www.nationwidefoundation.org.uk)



*Supporting communities  
nationwide*

# Board of Directors

## As at 4 April 2007



### 1 Jonathan Agnew (65)

Chairman

Jonathan Agnew was appointed to the Board in 1997 and became Chairman in 2002. He has considerable experience in financial services businesses. During his career he has been a Managing Director of Morgan Stanley, Group Chief Executive of Kleinwort Benson and Chairman of Limit and of Gerrard Group. He is currently Chairman of Beazley Group, LMS Capital plc and The Cayenne Trust plc and senior independent director of Rightmove plc.

### 2 Graham Beale (48)

Chief Executive

Graham Beale was appointed to the Board on 5 April 2003 as Group Finance Director and became Chief Executive on 1 April 2007. He is a chartered accountant and first joined the Society in 1985. He worked extensively in the Finance function before undertaking more general management responsibilities including Managing Director of a wholly owned property company and Divisional Director of Commercial Lending. As Group Finance Director he was responsible for running the Finance, Legal Compliance, Risk Management and Treasury Divisions and the Strategy and Planning function.

**3 Stuart Bernau (55)****Group Retail Director**

Stuart Bernau joined the Society in June 1990 and was appointed to the Board in 1996. He has served as Retail Operations Director, Marketing & Commercial Director, Commercial & Treasury Director and Commercial & Communications Director. Under the new Group structure Stuart takes up the role of Group Retail Director, with responsibilities for all aspects of the retail facing side of the business, including Sales & Marketing. He was appointed Chairman of the Financial Services Skills Council in February 2006 and was Chairman of the Council of Mortgage Lenders in 2005.

**4 Mark Rennison (46)****Group Finance Director**

Mark Rennison was appointed to the Board on 1 February 2007. His responsibilities are Finance and Planning, Risk Management, Legal Compliance, Internal Audit and Treasury. Prior to his appointment he 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. He is a director of various Society subsidiaries.

**5 David Rigney (43)****Group Operations Director**

David Rigney joined the Society in 1999 as Head of Nationwide Direct and was appointed to the Board on 1 October 2006. He has executive responsibility for Technology, Member Account Administration, Business Services and Group Purchasing. Prior to his appointment to the Board, he held roles as Divisional Director Central Retail Operations and Personnel & Development. He is a director of several of the Society's subsidiaries and a non-executive director of HM Land Registry.

**6 Richard Handover (60)****Non-executive director**

Richard Handover joined the Board on 1 May 2000 and has extensive knowledge of and experience in, the management of businesses within the retail sector. He is Chairman of The Community Foundation for Wiltshire and Swindon, Chairman of the Governors of Dauntsey's School, a non-executive director of Royal Mail, and was Chairman of the Adult Learning Inspectorate until April 2007.

**7 Suzanna Taverne (47)****Non-executive director**

Suzanna Taverne joined the Board on 16 November 2005. Her experience is in management, strategy and finance. Prior to her appointment she held various positions in the public sector and industry and was formerly a director of

Imperial College London, Managing Director of the British Museum, Director of Strategy at Pearson plc, a consultant at Saatchi & Saatchi plc, Finance Director of The Independent and a senior manager at S.G.Warburg & Co Ltd. She is currently Chair of the National Council for One Parent Families.

**8 Stella David (44)****Non-executive director**

Stella David joined the Board on 16 April 2003 and is also Chairman of the Remuneration Committee. She brings considerable expertise in general management as well as branding, marketing and the management of consumer goods. She is Senior Vice President and Chief Marketing Officer for the international drinks group Bacardi Ltd and prior to this she was Vice President of their Global Operations.

**9 Robert Walther (63)****Non-executive director**

Robert Walther joined the Board on 1 July 2002 and became Deputy Chairman in 2006. He is also a director of the Society's life insurance and unit trust subsidiaries. His background in investment and insurance was mainly built within a mutual organisation. He was Chief Executive of Clerical Medical from 1995 to 2001, which he joined in 1965. He is currently Chairman of Fidelity European Values plc, and a non-executive director of BUPA.

**10 Geoffrey Howe (57)****Non-executive director**

Geoffrey Howe joined the Board on 1 January 2005. He brings considerable legal, regulatory and management experience to the Board. He is currently Chairman of Jardine Lloyd Thompson Group plc and a director of Investec plc and the JPMorgan Overseas Investment Trust plc. He was formerly Chairman of Railtrack Group plc, a director and Group General Counsel of Robert Fleming Holdings Ltd and managing partner of Clifford Chance.

**11 Derek Ross (56)****Non-executive director**

Derek Ross joined the Board on 1 December 2004. He is also Chairman of the Society's Audit Committee. He has extensive experience in audit and financial advisory services, particularly in 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.

**Bernard Simpson (59)****Deputy Chief Executive and Chief Operating Officer**

Retired from the Board on 5 May 2007.

# Directors' Report

## For the year ended 4 April 2007

The directors have pleasure in presenting their Annual Report and Accounts for the year ended 4 April 2007.

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 2007 and 2006 are given in the Business Review on pages 10 to 25.

### Business objectives

The main aim of the Society and its subsidiaries (the Group) is to provide a full range of top value, quality financial services that are widely available and delivered with speed, courtesy and reliability. This aim is backed by the key values of fairness, honesty, employee importance and corporate responsibility.

### 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 25.

### Profits and capital

Profit before tax was £652.0 million (2006 – £559.2 million). The profit after tax transferred to the general reserve was £463.6 million (2006 – £397.2 million).

Total Group reserves at 4 April 2007 were £5,464.4 million (2006 – £5,031.4 million) after taking into account the revaluation reserve of £128.2 million (2006 – £117.0 million) and the available for sale reserve of £40.4 million (2006 – £88.8 million).

Gross capital at 4 April 2007 was £8,126.8 million (2006 – £7,218.9 million) including £1,617.0 million (2006 – £1,446.3 million) of subordinated debt and £1,045.4 million (2006 – £741.2 million) of subscribed capital. The ratio of gross capital as a percentage of shares and borrowings at 4 April 2007 was 6.5% (2006 – 6.6%) and the free capital ratio was 6.0% (2006 – 6.0%). (See the Annual Business Statement on page 100 for an explanation of these ratios.)

### Mortgage arrears

The Group mortgage portfolios at 4 April 2007 included 389 mortgage accounts (2006 – 466), including those in possession, where payments were more than 12 months in arrears. The total amount of principal loans outstanding in these cases was £47.5 million (2006 – £41.2 million). The total amount of arrears in these cases was £5.4 million (2006 – £5.4 million) or 0.01% (2006 – 0.01%) of total mortgage balances.

### Charitable and political donations

During the year the Group made charitable donations of £2,380,565 (2006 – £2,324,287) including £2,000,000 (2006 – £2,000,000) to the Nationwide Foundation, a report on which is given on pages 30 and 31. 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 23 days at 4 April 2007 (2006 – 36 days).

### Risk management

The financial management objectives and policies of the Group are shown in the Business Review on pages 23 to 25 and in Note 48 on pages 86 to 96.

### Employees

During the financial year the Society has maintained and developed systems for the provision of information to employees. The Society has continued to consult actively with the Nationwide Group Staff Union. In addition, meetings, team briefings, circulars, newsletters and the Society's intranet ensure employees are aware of the Society's performance and objectives and the business environment in which it operates.

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.

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

This statement, which should be read in conjunction with the Statement of the Auditors on page 45 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.

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.

### 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.

### Going concern

The directors are satisfied that the Group has adequate resources to continue in business for the foreseeable

future and that it is, therefore, appropriate to adopt the going concern basis in preparing the Annual Accounts.

### Directors

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

**J G W Agnew** MA (Chairman)

**R P Walther** MA, FIA (Deputy Chairman)

**B A Walsh** MSc (Econ), FCMA, CCMl  
(Retired from the Board on 20 July 2006)

**G J Beale** BSc, ACA (Chief Executive)

**P F Williamson** BA (Econ), FCIB, FRSA  
(Retired from the Board on 31 March 2007)

**S D M Bernau** BSc (Econ), FCIB, MCT (Group Retail Director)

**M M Rennison** BA, FCA (Group Finance Director)  
(Appointed to the Board on 1 February 2007)

**D J Rigney** ACMA, MBA (Group Operations Director)  
(Appointed to the Board on 1 October 2006)

**B K Simpson** MIMIS, FRSA

**J H Willens** MBA, DMS, ACIB  
(Retired from the Board on 30 September 2006)

**Mrs S J David** MA (Cantab)

**J Engstrom** MBA  
(Retired from the Board on 20 July 2006)

**R G Handover**

**G M T Howe** MA (Cantab)

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

**Ms S Taverne**

B K Simpson retired from the Board on 5 May 2007, during the following financial year.

J A Sutherland was appointed to the Board on 5 April 2007, during the following financial year.

J G W Agnew, G J Beale, Mrs S J David and R G Handover will retire at the Annual General Meeting on 19 July 2007. G J Beale and Mrs S J David will stand for re-election and M M Rennison and D J Rigney will stand for election.

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.

**J G W Agnew**  
Chairman

16 May 2007

# Report of the Directors on Corporate Governance

## For the year ended 4 April 2007

The Board of Directors (the 'Board') is committed to best practice in corporate governance. This Report on Corporate Governance explains how the Society applies the principles in the 2006 Combined Code on Corporate Governance (the 'Code') issued by the Financial Reporting Council as well as meeting guidance for building societies issued by the Financial Services Authority (the 'FSA'). The Board considers that the Society complies with all the Code provisions unless the contrary is stated.

### Directors

#### The Board

**Code Principle:** Every company should be headed by an effective Board, which is collectively responsible for the success of the company.

**Board comment:** The Board's terms of reference are published on the Society's website. The principal functions of the Board are to determine the strategy and policies of the Group, to set out the guidelines within which the business is managed and to review business performance. The Board has a general duty to ensure that the Group operates within the Society's constitution and relevant legislation and regulation and that proper accounting records and effective systems of business control are established, maintained, documented and audited. The Board's terms of reference include a list of specific matters reserved to the Board and a High Level Business Control Manual sets out the structure of delegation of authority by the Board to management.

The Board has three main committees. These are Audit Committee, Nomination Committee and Remuneration Committee. Each committee comprises only non-executive directors and each committee has a different chairman. A non-executive director also attends the Assets and Liabilities Committee. The terms of reference of each committee are published on the Society's website. The composition of the committees is shown on page 39. Brian Walsh was the Senior Independent Director until his retirement on 20 July 2006; thereafter Robert Walther assumed this responsibility. Members may contact the Senior Independent Director if they have concerns that have not been resolved (or which it would not be appropriate to raise) within the business.

The Board meets as often as necessary for the proper conduct of business, and there are usually ten formal Board meetings each year. In addition the non-executive directors meet without executive directors present at least once a year. Other non-executive directors meet without the Chairman once a year. The attendance record during the year of members at formal meetings of the Board and its committees is shown on page 39.

All Board members have the benefit of appropriate liability insurance at the Society's expense. All Board members have access to independent legal advice at the Society's expense, if required.

#### Chairman and Chief Executive

**Code Principle:** There should be a clear division of responsibilities at the head of the company between the running of the Board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.

**Board comment:** The offices of Chairman and Chief Executive are distinct and held by different people. The role of each is set out in their terms of appointment or contract respectively and in their individual performance agreement. The Chairman is responsible for leading the Board and communicating with the Society's members on behalf of the Board. The Chief Executive is responsible for managing the Society's business within the parameters set by the Board.

#### Board Balance and Independence

**Code Principle:** The Board should include a balance of executive and non-executive directors (and in particular independent non-executive directors) such that no individual or small group of individuals can dominate the Board's decision taking.

**Board comment:** The Board currently comprises five executives and seven non-executives (including the Chairman). Apart from the Chairman, for whom the ongoing test of independence is considered inappropriate, all non-executive directors are considered by the Board to be independent in character and judgement and free of any relationship or circumstances which are likely to affect, or could appear to affect, the directors' judgement. The executive members of the Board are satisfied that the sound judgement and challenging approach of its highly experienced, independent non-executive directors make a significant contribution to the Society.

#### Appointment to the Board

**Code Principle:** There should be a formal, rigorous and transparent procedure for the appointment of new directors to the Board.

**Board comment:** The Nomination Committee evaluates the balance of skills and experience on the Board and the requirements of the business. A description of the role and capabilities required for a particular appointment is prepared in the light of that evaluation. The Board has an agreed Board Composition and Succession Policy which is published on the Society's website. Appointments to the Board are made on merit and against objective criteria. Candidates for non-executive directorship are identified in a variety of ways, including the use of external search consultants by the Board, and in addition members of the Society have the right under the Society's Rules to nominate candidates for election to the Board. The Chairman did not chair the Nomination Committee when it dealt with the appointment of his successor to the chairmanship. All directors must meet the tests of fitness and propriety laid down by the FSA and all directors are required to be registered with the FSA as an Approved Person in order to fulfil their Controlled Function as a director.

The Chairman is also chairman of the boards of Beazley Group plc, Beazley Furlonge Ltd, LMS Capital plc and The Cayenne Trust plc, senior independent director of Rightmove plc, non-executive director of Thos Agnew & Sons Ltd and a governor of St Mary's School Ascot.

The service contracts of executive directors and the letters of appointment of non-executive directors are available for inspection on request from the Secretary.

In accordance with the Board's Composition and Succession Policy, executive appointments to the Board and other senior positions are part of continuous processes, involving

# Report of the Directors on Corporate Governance

consideration from time to time of potential external candidates. During the year under review the Nomination Committee employed executive search consultants to help it find possible external candidates for the succession to the Chief Executive position and to compare them with internal candidates. A number of internal and external candidates were interviewed as part of the selection process. A similar but more restricted selection process was used to provide succession to the Group Finance Director position. The outcome of these search processes is the promotion of Graham Beale to Chief Executive (effective 1 April 2007) and the appointment of Mark Rennison as Group Finance Director (effective 1 February 2007). The Chairman is due to retire at the 2007 AGM and will be succeeded by Geoffrey Howe.

The Society announced on 12 September 2006 its intention to merge with the Portman Building Society. The merger is expected to become effective by the end of August 2007 and, at that time, two executive directors and three non-executive directors of the Portman will join the enlarged Board.

## Information and Professional Development

**Code Principle:** The Board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. All directors should receive an induction on joining the Board and should regularly update and refresh their skills and knowledge.

**Board comment:** The Chairman ensures that the Board receives information sufficient to enable it to fulfil its responsibilities. All new directors receive a full, formal and tailored induction on joining the Board. Any training or development needs are identified during this process and in the course of subsequent annual evaluations of the Board's and individual director's performance and effectiveness.

## Performance Evaluation

**Code Principle:** The Board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

**Board comment:** The Board has adopted a questionnaire and feedback-based methodology to evaluate the performance and effectiveness of individual directors and of the Board as a whole and its committees. Each director has a Performance Agreement and (as needed) a Personal Development Plan tailored to their individual circumstances (e.g. as Chairman, other non-executive director, or executive director). The non-executive directors are evaluated by the Chairman, taking into account the views of other directors; the Chairman is evaluated by the non-executive directors facilitated by the Senior Independent Director and taking into account the views of the executive directors; and the Board evaluates its own overall performance. Executive directors are evaluated within the performance evaluation framework for employees generally and by the Remuneration Committee in the context of their remuneration.

## Re-election

**Code Principle:** All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance. The Board should ensure planned and progressive refreshing of the Board.

**Board comment:** The Society's Rules require that all directors are submitted for election at the Annual General Meeting (the 'AGM') following their first appointment to the Board, except where their appointment occurs in the period between the end of the Society's financial year and the AGM itself, in which case they must seek election at the AGM in the following year, and all directors are required to seek re-election every three years after first being elected.

The Board's general policy is that non-executive directors should not expect to serve more than two full three-year terms. The Nomination Committee makes recommendations to the Board about appointments to the Board and its Committees in accordance with the Board Composition and Succession Policy, a copy of which is published on the Society's website. Any term lasting beyond the normal six years will be subject to particularly rigorous review and any term lasting beyond nine years will be approved by the Board only in exceptional circumstances and then only on the basis of annual re-election.

During the year, four non-executive directors served more than two full three-year terms. Brian Walsh and John Engstrom both retired at the 2006 AGM. Richard Handover and Jonathan Agnew will retire at the 2007 AGM.

## Remuneration

Please refer to the Report of the Directors on Remuneration on pages 40 to 44.

## Accountability and audit

### Financial Reporting

**Code Principle:** The Board should present a balanced and understandable assessment of the company's position and prospects.

**Board comment:** The responsibilities of the directors in relation to the preparation of the Society's accounts and a statement that the Society's business is a going concern are to be found within the Directors' Report (on pages 34 to 35).

### Internal Control

**Code Principle:** The Board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.

**Board comment:** The Board is responsible for determining strategies for risk management and control. Senior management is responsible for designing, operating and monitoring risk management and internal control processes, and the Audit Committee, on behalf of the Board, is responsible for reviewing the adequacy of these processes. The system of internal control is designed to enable the Society to achieve its corporate objectives within a managed risk profile, not to eliminate risk and the Audit Committee regularly reviews the effectiveness of internal systems and controls on behalf of the Board. The Risk Management Division ensures that appropriate risk management systems exist across the spectrum of the Group's operations, and that there is an ongoing process for identifying, evaluating and managing significant risks faced by the Group. This process has operated throughout the year and the process is regularly reviewed at Board level. The Group Internal Audit function provides independent and objective assurance that these processes are appropriate and effectively applied.

The Board has approved a Group Risk Appetite Statement and the Audit Committee regularly reviews the operational risk profile in the context of the Group's risk appetite. The operational risk profile is compiled by the Risk Management Division based on risk assessment submissions from divisional directors and other senior executives throughout the Group in relation to the areas of the Group's business for which they are responsible. The key risk categories are identified together with the ongoing status in relation to each risk and any actions deemed necessary being taken or planned to mitigate such risks.

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 pages 23 to 25) together with an explanation of the structure adopted within the Group for managing financial risk (including the roles of the Credit Committees and the Assets and Liabilities Committee). Prior to April 2007 the Chief Executives's Committee was the principal risk management committee. With effect from 1 April 2007, a new risk committee structure was put in place to strengthen further the Society's management and oversight of risk. The revised structure introduces a new Group Risk Committee, which will have responsibility for ensuring a coordinated approach across all risks, and a new committee to deal specifically with operational risk management.

The Board has ultimate responsibility for ensuring the maintenance of sound systems of risk management and internal control, and following review by the Audit Committee it is satisfied that the Society's systems are appropriate and meet the requirements of the Code and the revised supplementary Turnbull guidance. The Board confirms that any significant failings or weaknesses identified from their review of the effectiveness of the internal control system are being remedied. The Board recognises the importance of exercising satisfactory oversight of the management of risk and has created the new Group Risk Committee with delegated responsibility for oversight of the Commercial and Treasury Credit Committees, the Assets and Liabilities Committee and a newly-created Operational Risk Committee.

## Audit Committee and auditors

**Code Principle:** The Board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors.

**Board comment:** The Board has an Audit Committee comprising four non-executive directors all of whom are independent. The Chairman of the Board is not a member of the Committee although he usually attends meetings of the Committee by invitation. The Board is satisfied that at least one member of the Committee has recent and relevant financial experience. The Chairman and all members of the Audit Committee receive supplementary fees in recognition of their additional responsibilities. The terms of reference of the Audit Committee are available on request from the Secretary and are published on the Society's website.

The role of the Audit Committee is to review the integrity of the financial statements, to review the effectiveness of

internal controls and risk management systems, to monitor and review the effectiveness of the internal audit function, to consider and recommend to the Board (for approval by the members) the appointment or re-appointment of the external auditors and to oversee the relationship with the external auditors, including the monitoring of the policy on the engagement of the external auditors for non-audit services.

The policy developed by the Committee on the engagement of the external auditors for non-audit services includes a requirement that the engagement of the auditors for non-audit services requires prior approval of the Committee where the proposed fee for non-audit work exceeds a certain amount or the level of fees payable for non-audit services would exceed set threshold proportions of the audit fee, differentiating between non-discretionary services (i.e. those required by external rules to be carried out by the auditors) and discretionary services (i.e. any other services). The Committee is unlikely to sanction any engagement of the auditors for discretionary services where the aggregate fees for all non-audit services would exceed a limit set from time to time as a proportion of the audit fee but the level of non-audit fees is kept under review.

The Committee is also responsible for ensuring that there are effective whistleblowing arrangements to enable employees to raise, in confidence, any concerns about possible improprieties in matters of financial reporting or other matters and effective arrangements for investigation and appropriate follow-up of any such concerns raised.

The Audit Committee has met six times over the course of this year. The Committee usually excludes all executives from part of its meetings and the Committee annually meets with only the external auditors. By invitation of the Committee, executives and others regularly attending its meetings include the Divisional Director Audit, the Group Finance Director, the Divisional Director Risk Management, the Divisional Director Legal Compliance and the external auditors. Minutes of the Committee's meetings are routinely distributed to all Board members and the Chairman of the Committee reports to the Board following each Audit Committee meeting.

The Audit Committee has adopted a methodology to evaluate annually the performance and effectiveness of the Committee and its compliance with the requirements of the Code and the supplementary Smith guidance. The evaluation process includes the completion of a standard review proforma by members of the Committee, the Divisional Director Audit, the Group Finance Director and the external auditor. A report is then prepared for consideration by the Committee and submission to the Board.

## Relations with shareholders

### Dialogue with Institutional Shareholders

**Code Principle:** There should be a dialogue with shareholders based on the mutual understanding of objectives. The Board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.

**Board comment:** As a mutual body, the Society has a membership composed almost exclusively of (currently over

# Report of the Directors on Corporate Governance

12 million) individuals (rather than institutions), all of whom are the Society's customers. The Society proactively seeks the view of members in a variety of ways. Member TalkBack events (both face-to-face and via the internet) give members an opportunity to put questions or points to a director or senior executive. The Member Suggestion Scheme enables members to express their views on an ongoing basis, and a Feedback Log allows employees to record immediately any ad hoc comments from members on any aspect of its business.

In addition, members' participation in its Usability Centre enables the Society to obtain comments on a range of practical measures and initiatives. The Society's Customer Experience Tracker, involving an external accredited research company telephoning around 2,000 members on its behalf every month, helps pinpoint where the Society is doing well, not so well and what is important to members.

## Constructive use of the AGM

**Code Principle:** The Board should use the AGM to communicate with investors and to encourage their participation.

**Board comment:** Each year the Society sends details of the AGM and the postal ballot for the election of directors to (currently over 6.5 million) members who are eligible to vote. Members are sent voting forms and are encouraged to vote in

the postal ballot and to appoint a proxy to vote for them at the AGM if they cannot, or choose not to, attend the AGM. All postal ballot votes and all proxy votes are counted under independent scrutiny. At the AGM the Chief Executive gives a presentation on the main developments in the business and members present have the opportunity to raise questions and put forward their views. A poll is called in relation to each resolution at the AGM and all proxy votes cast are included in the published results of voting.

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

## Board and committee membership attendance record

Against each director's name is shown the number of meetings of the Board and its committees at which the director was present as a member and in brackets the number of such meetings that the director was eligible as a member of the Board or committee to attend during the year. There are normally 10 Board meetings each year but in 2006/07 an additional four Board meetings were held. Two of these meetings were called at short notice and not all Board members were able to attend, which was the cause of the reduced attendance.

Director	Board	Audit Committee	Nomination Committee	Remuneration Committee
J G W Agnew, Chairman of the Board and the Nomination Committee	14(14)	-	7(7)	-
G J Beale	14(14)	-	-	-
S D M Bernau	12(14)	-	-	-
Mrs S J David, Chairman of the Remuneration Committee	12(14)	-	4(7)	10(11)
J Engstrom (retired from the Board 20/7/2006)	4(4)	2(2)	2(2)	3(3)
R G Handover	11(14)	5(6)	6(7)	10(11)
G M T Howe	13(14)	4(4)	6(7)	10(11)
M M Rennison, Group Finance Director (appointed to the Board 1/2/2007)	2(3)	-	-	-
D J Rigney, Group Operations Director (appointed to the Board 1/10/2006)	6(8)	-	-	-
D A Ross, Chairman of the Audit Committee	12(14)	6(6)	-	-
B K Simpson (retired from the Board 5/5/2007)	14(14)	-	-	-
Ms S Taverne	12(14)	1(1)	-	8(8)
B A Walsh (retired from the Board 20/7/2006)	4(4)	2(2)	2(2)	3(3)
R P Walther, Deputy Chairman and Senior Independent Director	13(14)	3(5)	7(7)	11(11)
J H Willens (retired from the Board 30/9/2006)	5(6)	-	-	-
P F Williamson (retired from the Board 31/3/2007)	12(14)	-	-	-

**J G W Agnew**  
Chairman  
16 May 2007

# Report of the Directors on Remuneration

## For the year ended 4 April 2007

As a mutual organisation, Nationwide is run for the benefit of our Members. Our principal objective is to create more value for our Members through fair and competitively priced products and services. We need to ensure that we have high quality people who can deliver our goals and who, in return, are rewarded fairly for running the Society on behalf of our Members.

### How pay is set

The pay of our most senior executives (our executive directors and divisional directors) is set by the Society's Remuneration Committee. The Remuneration Committee is made up of non-executive directors of the Society. The current members of the Remuneration Committee are Stella David (Chairman of the committee), Richard Handover, Geoffrey Howe, Suzanna Taverne and Robert Walther. The committee sets annual performance targets and meets on a regular basis to review performance and decide on how we pay our directors.

To help the Remuneration Committee, an independent external consultant from Hay Group Limited provides advice, for example, by providing information on how other building societies and banks reward their senior people. In addition, certain members of our senior management may also be invited to attend committee meetings although no individual is present at a meeting where their own pay is decided.

### Deciding on pay

The Remuneration Committee considers the following when deciding on pay levels:

- The size and responsibilities of the role;
- Pay levels for similar roles in other financial services organisations; and
- The performance of the individual and of Nationwide.

Nationwide strongly believes in pay for performance. A large portion of the total pay that directors can earn is

based on the performance of the Society and their own personal performance.

### Elements of pay

The reward package for directors consists of the following:

- Base salary
- Annual bonus
- Medium Term Incentive Plan
- Benefits (including pensions)

### Base salary

Base salary reflects the size of the role and what other similar companies would pay, as well as the individual's skills, experience and performance.

Base salary is designed to ensure we pay the median market rate for the job and our aim is to be neither the highest nor the lowest payer. The Remuneration Committee reviews directors' salaries every year. The principal way in which we reward performance is through our bonus plans.

### Annual bonus plan

The annual bonus plan provides an opportunity to set **challenging performance targets** for the year and rewards directors for meeting these.

Bonuses are only paid if targets are met. The committee sets annual performance targets and then meets on a regular basis to review performance against those targets.

The five measures which are used for the annual bonus plan are outlined below. Meeting the targets set for these measures means that we are performing strongly and delivering value to our Members. If minimum targets are not met we will not pay a bonus.

Measure	What does it mean?	Why is it used?
Profit	The profit made before tax.	We do not have shareholders. The bigger we get the more we have to set aside to invest in our future and provide the best value to our Members.
Cost	The cost of running the business: branches, salaries, technology.	By being efficient and controlling our costs we have more money to offer better value products to our Members.

## Report of the Directors on Remuneration

Measure	What does it mean?	Why is it used?
Net Mortgage Lending	The money lent, less what has been repaid.	Lending money to people to buy a home is at the heart of our business.
Non-mortgage and Non-savings Sales	These are sales of products such as insurance policies, loans, credit cards etc.	By offering competitive financial products we can meet more of our Members' needs.
Individual Performance Targets	Targets for group efficiency and leadership.	We want to encourage the best performance from our people.

The maximum bonus that could be earned during the year by the Chief Executive based on these measures is 94% and for other executive directors it is 73% of salary. The

maximum bonus will only be paid if the Society out-performs against the demanding targets set by the Remuneration Committee for each of these measures.

### Medium Term Incentive Plan

The Medium Term Incentive Plan (MTIP) rewards our directors for **sustained performance** and achieving challenging financial targets over a three year

performance cycle. A new three year performance cycle starts each year.

The bonus paid to directors in 2007 is in respect of achievement against the financial targets in the following areas:

Measure	What does it mean?	Why is it used?
Accumulated Total Member Value	This is a mixture of profit and pricing benefit given to Members.	We need to ensure that the business is financially strong and Members receive the benefits of mutuality.
Cost Income Ratio	This measures how efficiently we run the business.	Improving our efficiency and lowering our costs enables us to give more value to our Members.

The maximum incentive that could be paid during the year to the Chief Executive is 70% of salary and for other executive directors it is 60%. Like the annual bonus, the maximum can only be paid if the Society out-performs against the demanding targets set by the Remuneration Committee. If our performance falls below the minimum acceptable performance, then no bonus will be paid. The Remuneration Committee reviews performance against targets each year.

The MTIP has been operating for a number of years. It has been highly successful in helping to focus and reward our directors in delivering sustained value and benefits to our Members.

### Pensions and benefits

Executive directors (apart from M M Rennison) are members of the executive section of the Nationwide Pension Fund and they have been able to accrue a pension

of 1/30th of pensionable salary for each year of service, up to a maximum of two-thirds of pensionable salary. Pension entitlements from the executive section 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.

Following changes in pension legislation, from 5 April 2006, there have been no further contributions into the Group's funded unregistered pension scheme. Also from 5 April 2006, executive directors on a 1/30th accrual rate have been eligible to receive pension allowances in compensation for restricting pension accrual. Five executive directors have elected for this option and details can be found in the notes to the Directors' Remuneration tables below.

M M 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

# Report of the Directors on Remuneration

continued

accrual under our 1/54th Career Averaged Re-valued Earnings Pension Scheme and a monthly pension allowance.

In addition, executive directors receive other benefits including a car allowance, healthcare and mortgage allowance. All current executive directors have a contractual notice period of 12 months.

## Directors leaving the Society

In accordance with our succession planning arrangements, and taking account of the planned merger between Nationwide and Portman Building Society, three of our executive directors have left the Society before their normal retirement dates, namely P F Williamson, B K Simpson and J H Willens. To meet our legal obligations we made payments to those directors who left. The Remuneration Committee is satisfied that these payments were in accordance with contractual obligations and the Society's employment policies.

P F Williamson retired from the Board on 31 March 2007, B K Simpson retired from the Board on 5 May 2007 and J H Willens retired from the Board on 30 September 2006.

Leaving payments in respect of annual bonus and MTIP plans take account of the performance of the individuals and of the Society and their leaving dates. More details of these payments are provided in the notes to the Directors' Remuneration tables below.

## Fees for non-executive directors

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

Current non-executive directors do not take part in any of our bonus or incentive schemes or in any pension arrangement.

Table 1 Directors' emoluments

	2007			2006		
	Society Fees £000	Subsidiary Fees £000	Total £000	Society Fees £000	Subsidiary Fees £000	Total £000
<b>Non-executive Directors</b>						
J G W Agnew (Chairman)	200	-	200	200	-	200
Mrs S J David	53	-	53	45	-	45
J Engestrom (Note 1)	18	5	23	61	16	77
R G Handover	51	-	51	49	-	49
G M T Howe	50	-	50	43	-	43
D A Ross	65	-	65	51	-	51
Ms S Taverne (Note 2)	43	-	43	15	-	15
B A Walsh (Note 3)	27	-	27	90	-	90
R P Walther (Deputy Chairman)	65	18	83	49	16	65
	<b>572</b>	<b>23</b>	<b>595</b>	<b>603</b>	<b>32</b>	<b>635</b>
Pension payments to past Directors in respect of services as Directors			<b>409</b>			<b>463</b>

### Notes:

1. J Engestrom retired from the Board on 20 July 2006.
2. Ms S Taverne was appointed to the Board on 16 November 2005.
3. B A Walsh retired from the Board on 20 July 2006.

Subsidiary fees relate to fees payable as a Director of Nationwide Life Ltd and Nationwide Unit Trust Managers Ltd.

## Executive Directors

The table below shows the remuneration received for the year ended 4 April 2007. The contractual settlement is made up of salary and annual bonus for the balance of the notice period for each departing director, earned MTIP 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 each director is entitled to. Further details are provided in the notes to the table.

continued

## Report of the Directors on Remuneration

Executive Directors	Salary	Pension allowances	Annual bonus	Benefits	3-year medium term bonus	Increase in accrued pension	Total before contractual/other settlements	Contractual/other settlements	Total
2007	£000	£000	£000	£000	£000	£000	£000	£000	£000
G J Beale (Note 1)	374	6	181	24	178	21	784	-	784
S D M Bernau	368	-	179	24	175	19	765	-	765
M M Rennison (Note 2)	67	17	32	5	32	1	154	-	154
D J Rigney (Notes 1 & 3)	153	6	73	13	72	14	331	-	331
P F Williamson (Notes 4 & 5)	605	242	374	24	342	24	1,611	1,608	3,219
B K Simpson (Notes 4 & 6)	445	178	216	24	211	6	1,080	890	1,970
J H Willens (Notes 4 & 7)	161	64	69	13	120	10	437	926	1,363
	2,173	513	1,124	127	1,130	95	5,162	3,424	8,586
2006									
G J Beale	340	-	168	25	170	29	732		
S D M Bernau	357	-	173	28	179	23	760		
P F Williamson	575	-	338	37	345	34	1,329		
B K Simpson	432	-	210	25	216	27	910		
J H Willens	300	-	144	25	150	20	639		
	2,004	-	1,033	140	1,060	133	4,370		

### Notes:

- £14,040 of the salary of G J Beale and £15,250 of the salary of D J Rigney has been paid in non pensionable form. G J Beale and D J Rigney receive a pension allowance on this non pensionable salary in lieu of an alternative pension benefit.
- M M Rennison was appointed to the Board on 1 February 2007.
- D J Rigney was appointed to the Board on 1 October 2006.
- P F Williamson, B K Simpson and J H Willens each received a pension allowance instead of receiving further benefits that they were entitled to under the Society's pension plans.
- P F Williamson retired from the Board on 31 March 2007. £1,607,681 included in contractual/other settlements represents the amount P F Williamson received as compensation for agreeing to early retirement and is made up of the following:
  - £442,471 in respect of contractual salary entitlement;
  - Earned annual bonus of £251,884 and MTIP of £475,298 which P F Williamson earned in respect of the 2005-2008, 2006-2009 and 2007-2010 cycles. The amount received by P F Williamson was determined by the Society's performance and was reduced to reflect the fact that he left the Society before the end of the MTIP cycles;
  - Pension allowance of £176,989; and
  - £261,039 awarded for Retirement and End of Service and in lieu of other benefits, made in line with the Society's policies.
- B K Simpson retired from the Board on 5 May 2007. £889,809 included in contractual/other settlements represents the amount B K Simpson received as compensation for agreeing to early retirement and is made up of the following:
  - £369,106 in respect of contractual salary entitlement;
  - Earned MTIP of £181,560 which B K Simpson earned in respect of the 2005-2008 and 2006-2009 cycles. The amount received by B K Simpson was determined by the Society's performance and was reduced to reflect the fact that he left the Society before the end of the MTIP cycles;
  - Pension allowance of £147,643; and
  - £191,500 awarded for Retirement and End of Service and in lieu of other benefits, made in line with the Society's policies.
- J H Willens retired from the Board on 30 September 2006. £926,243 included in contractual/other settlements represents the amount J H Willens received as compensation for loss of office on 30 September 2006 which is made up of the following:
  - 12 months contractual salary entitlement of £321,000, plus £80,250 for an additional notice period of 3 months;
  - Earned annual bonus of £34,508 and MTIP of £275,913 which J H Willens earned in respect of the 2005-2008, 2006-2009 and 2007-2010 cycles. The amount received by J H Willens was determined by the Society's performance and was reduced to reflect the fact that he left the Society before the end of the MTIP cycles;
  - Pension allowance of £160,500; and
  - £54,072 in lieu of other benefits.

Directors' emoluments are audited numbers.

# Report of the Directors on Remuneration

continued

Table 2 Directors' pension benefits

Executive Directors	Accrued pension at 4.4.07 £000 (a)	Accrued pension at 4.4.06 £000 (b)	Transfer value at 4.4.07 £000 (c)	Transfer value at 4.4.06 £000 (d)	Change in transfer value £000 (c)-(d)	Additional pensions earned in year £000 (e)	Transfer value of the increase £000 (f)	Directors' contributions in year £000 (g)
G J Beale	183	162	2,128	1,866	262	16	182	25
S D M Bernau	231	212	3,789	3,410	379	11	186	25
M M Rennison (Note 1)	1	-	14	-	14	1	14	3
D J Rigney (Note 2)	42	28	401	274	127	14	135	10
P F Williamson (Note 3)	297	273	5,823	5,197	626	14	278	73
B K Simpson (Note 4)	272	266	5,507	5,031	476	-	-	23
J H Willens (Note 5)	174	164	2,277	2,134	143	4	50	16

## Notes:

1. M M Rennison was appointed to the Board on 1 February 2007.
2. D J Rigney was appointed to the Board on 1 October 2006. Balances for D J Rigney are in respect of the period 1 October 2006 to 4 April 2007.
3. P F Williamson retired from the Board on 31 March 2007.
4. B K Simpson retired from the Board on 5 May 2007.
5. J H Willens retired from the Board on 30 September 2006.

## Explanations:

- (a) and (b) show deferred pension entitlements at 4 April 2007 and 2006 respectively.
- (c) is the transfer value of the deferred pension in (a) calculated at 4 April 2007.
- (d) is the equivalent transfer value at 4 April 2006 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.

**Mrs S J David**

Chairman of the Remuneration Committee

16 May 2007

# 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 2007 which comprise the Group and Society Income Statements, the Group and Society Balance Sheets, the Group and Society Statements of Recognised Income and Expense, the Group and Society Cash Flow Statements and the 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, Community and Environmental

Affairs, Nationwide Foundation, Board Biographies, the remainder of the Report of the Directors on Remuneration and the Report of the Directors on Corporate Governance. 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 2007 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.

**PricewaterhouseCoopers LLP**

Chartered Accountants and Registered Auditors  
London

16 May 2007

# Income Statements

## For the year ended 4 April 2007

	Notes	Group		Society	
		2007 £m	2006 £m	2007 £m	2006 £m
Interest receivable and similar income	3	6,890.9	5,799.9	6,671.3	5,551.3
Interest expense and similar charges	4	5,411.6	4,565.6	5,411.6	4,525.8
<b>Net interest income</b>		<b>1,479.3</b>	<b>1,234.3</b>	<b>1,259.7</b>	<b>1,025.5</b>
Fee and commission income	5	335.4	309.3	299.8	281.0
Fee and commission expense	6	(3.6)	(2.9)	(3.3)	(2.8)
Premiums on insurance contracts and fair value gains on insurance assets	7	224.9	278.9	-	-
Income from investments	8	23.1	7.9	430.2	59.3
Other operating income	9	36.0	25.5	12.4	8.1
Gains from derivatives and hedge accounting	10	0.9	10.9	2.2	9.7
<b>Total income</b>		<b>2,096.0</b>	<b>1,863.9</b>	<b>2,001.0</b>	<b>1,380.8</b>
Insurance claims and change in liabilities	7	169.9	208.4	-	-
<b>Total income net of claims on insurance contracts</b>		<b>1,926.1</b>	<b>1,655.5</b>	<b>2,001.0</b>	<b>1,380.8</b>
Administrative expenses	11	984.5	873.7	936.5	820.2
Depreciation and amortisation		124.4	117.5	123.1	115.0
Impairment losses on loans and advances to customers	13	133.6	76.6	76.2	48.9
Provisions for liabilities and charges	38	36.5	32.1	34.0	28.5
Impairment gains on investment securities	18	(4.9)	(3.6)	(4.9)	(3.6)
<b>Profit before tax</b>		<b>652.0</b>	<b>559.2</b>	<b>836.1</b>	<b>371.8</b>
Taxation	14	188.4	162.0	143.8	109.7
<b>Profit after tax</b>		<b>463.6</b>	<b>397.2</b>	<b>692.3</b>	<b>262.1</b>

The accounting policies and notes on pages 50 to 98 form part of these Accounts.

# Balance Sheets

## At 4 April 2007

	Notes	Group		Society	
		2007 £m	2006 £m	2007 £m	2006 £m
<b>Assets</b>					
Cash and balances with the Bank of England		364.0	368.6	361.1	367.8
Loans and advances to banks	17	1,490.1	1,364.0	1,321.4	1,017.4
Investment securities – available for sale	18	15,600.6	13,007.7	13,723.1	11,421.0
Derivative financial instruments	19	1,071.6	674.2	1,044.4	628.4
Insurance and other financial assets at fair value		-	1,918.2	-	21.3
Fair value adjustment for portfolio hedged risk	20	(619.5)	(52.2)	(619.5)	(52.2)
Loans and advances to customers	21	115,938.4	101,347.6	106,469.1	92,597.9
Investments in equity shares	22	36.7	22.0	10.7	2.2
Investments in group undertakings	23	-	-	15,230.1	10,846.3
Value of in force life insurance contract business	24	-	125.4	-	-
Intangible fixed assets	25	106.1	80.5	106.1	80.5
Property, plant and equipment	26	663.7	648.0	648.4	629.5
Investment properties	27	15.1	279.1	11.9	10.2
Accrued income and expenses prepaid	28	76.3	283.7	176.3	443.5
Deferred tax assets	29	77.2	110.0	73.1	149.5
Other assets	30	161.6	409.2	81.4	65.0
Assets classified as held for sale	16	2,396.6	-	-	-
<b>Total assets</b>		<b>137,378.5</b>	<b>120,586.0</b>	<b>138,637.6</b>	<b>118,228.3</b>
<b>Liabilities</b>					
Shares	31	86,795.4	80,918.6	86,795.4	80,918.6
Deposits from banks	32	3,288.7	2,697.4	2,767.4	1,805.2
Other deposits	33	3,406.7	3,161.4	11,749.2	7,225.1
Due to customers	34	2,926.1	2,608.3	945.0	941.1
Debt securities in issue	35	28,871.7	20,767.6	27,568.1	19,571.7
Fair value adjustment for portfolio hedged risk	20	(30.2)	53.9	(19.9)	53.9
Derivative financial instruments	19	703.2	714.7	564.6	641.3
Insurance contract liabilities	36	-	1,190.5	-	-
Other liabilities	37	516.5	515.8	438.6	350.1
Provisions for liabilities and charges	38	50.3	40.3	37.3	29.0
Accruals and deferred income	39	367.0	230.1	328.4	192.6
Subordinated liabilities	40	1,617.0	1,446.3	1,617.0	1,446.3
Subscribed capital	41	1,045.4	741.2	1,045.4	741.2
Current tax liabilities		93.2	174.3	73.8	141.0
Retirement benefit obligations	42	172.4	294.2	172.1	293.6
Liabilities directly associated with assets classified as held for sale	16	2,090.7	-	-	-
<b>Total liabilities</b>		<b>131,914.1</b>	<b>115,554.6</b>	<b>134,082.4</b>	<b>114,350.7</b>
General reserve	43	5,295.8	4,825.6	4,413.1	3,714.5
Revaluation reserve	44	128.2	117.0	127.9	116.8
Available for sale reserve	45	40.4	88.8	14.2	46.3
<b>Total reserves &amp; liabilities</b>		<b>137,378.5</b>	<b>120,586.0</b>	<b>138,637.6</b>	<b>118,228.3</b>

The accounting policies and notes on pages 50 to 98 form part of these Accounts.

Approved by the Board of Directors on 16 May 2007.

**J G W Agnew** Chairman

**R P Walther** Deputy Chairman

**G J Beale** Director and Chief Executive

**M M Rennison** Group Finance Director

# Statements of Recognised Income and Expense

## For the year ended 4 April 2007

	Notes	Group		Society	
		2007 £m	2006 £m	2007 £m	2006 £m
Available for sale investments - net fair value (loss)/gain	45	(69.0)	55.3	(51.2)	48.9
Property revaluation	44	21.4	24.1	21.3	24.0
Actuarial gain/(loss) on retirement benefit obligations	43	1.6	(6.1)	1.3	(6.1)
Taxation on items through reserves		15.4	(23.4)	13.9	(19.8)
<b>Net (expense)/income recognised directly in reserves</b>		<b>(30.6)</b>	<b>49.9</b>	<b>(14.7)</b>	<b>47.0</b>
<b>Net profit for the year</b>		<b>463.6</b>	<b>397.2</b>	<b>692.3</b>	<b>262.1</b>
<b>Total recognised income and expense for the year</b>		<b>433.0</b>	<b>447.1</b>	<b>677.6</b>	<b>309.1</b>
<b>Impacts arising from changes in accounting policies</b>					
Adoption of IFRS 4 and IAS 39		-	33.3	-	0.9
Tax on adoption of IFRS 4 and IAS 39		-	(12.6)	-	(14.4)
Adoption of IFRS 4 and IAS 39		-	20.7	-	(13.5)

The accounting policies and notes on pages 50 to 98 form part of these Accounts.

# Cash Flow Statements

## For the year ended 4 April 2007

	Notes	Group		Society	
		2007 £m	2006 £m	2007 £m	2006 £m
<b>Cash flows from operating activities</b>					
Profit before tax		652.0	559.2	836.1	371.8
Adjustments for:					
• Non-cash items included in profit before tax	50	272.6	133.1	243.1	123.4
• Changes in operating assets	50	(13,664.1)	(10,110.1)	(17,553.6)	(11,199.5)
• Changes in operating liabilities	50	15,724.3	8,519.8	19,220.9	9,869.5
• Interest paid on subordinated liabilities		(68.2)	(54.8)	(68.2)	(54.8)
• Interest paid on subscribed capital		(44.9)	(46.8)	(44.9)	(46.8)
• Taxation		(178.3)	(149.5)	(129.0)	(99.1)
<b>Net cash flows from operating activities</b>		<b>2,693.4</b>	<b>(1,149.1)</b>	<b>2,504.4</b>	<b>(1,035.5)</b>
<b>Cash flows from investing activities</b>					
Purchase of investment securities		(10,983.8)	(9,989.9)	(10,086.4)	(9,327.7)
Sale and maturity of investment securities		9,268.7	10,286.5	8,815.7	9,823.5
Purchase of property, plant and equipment		(111.2)	(76.9)	(111.2)	(75.2)
Sale of property, plant and equipment		21.7	1.9	16.8	1.9
Purchase of investment properties		(5.4)	(23.1)	-	-
Sale of investment properties		286.6	5.0	-	-
Purchase of intangible fixed assets		(58.6)	(77.6)	(58.6)	(77.6)
<b>Net cash flows from investing activities</b>		<b>(1,582.0)</b>	<b>125.9</b>	<b>(1,423.7)</b>	<b>344.9</b>
<b>Cash flows from financing activities</b>					
Issue of subordinated liabilities		201.8	-	201.8	-
Issue of subscribed capital		347.3	-	347.3	-
<b>Net cash flows from financing activities</b>		<b>549.1</b>	<b>-</b>	<b>549.1</b>	<b>-</b>
<b>Net increase/(decrease) in cash</b>		<b>1,660.5</b>	<b>(1,023.2)</b>	<b>1,629.8</b>	<b>(690.6)</b>
Cash and cash equivalents at start of year		3,962.1	4,985.3	3,379.9	4,070.5
<b>Cash and cash equivalents at end of year</b>	50	<b>5,622.6</b>	<b>3,962.1</b>	<b>5,009.7</b>	<b>3,379.9</b>

# Notes to the Accounts

## 1 Statement of Accounting Policies

### Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union; interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC); and with those parts of the Building Societies (Accounts and Related Provisions) Regulations 1998 applicable to organisations reporting under IFRS. The financial statements have been prepared under the historical cost convention as modified by the revaluation of land and buildings, available for sale investments, derivatives and other financial assets at fair value through the income statement. 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 reporting period. 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.

### 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. Adjustment is made for individually significant transactions arising between 31 March and the Society's year end. Certain special purpose entities have year ends other than 31 March and are consolidated using internal management accounts prepared to that date.

As the consolidated accounts include partnerships where a Group member is a partner, advantage is taken of the exemption given by Regulation 7 of the Partnerships and Unlimited Companies (Accounts) Regulations 1993 with regard to the preparation and filing of individual partnership accounts.

The Group has applied early the following IFRS and IFRIC interpretation:

- IFRS 7 'Financial Instruments: Disclosures' prospectively from 5 April 2005.
- IFRIC 9 'Reassessment of Embedded Derivatives'.

The Group has not applied early the following amendment, standard and IFRIC interpretation:

- Amendment to IAS 1 'Presentation of Financial Statements: Capital Disclosures'. This amendment requires disclosure on the level of the Group's capital and how this is managed. The Group is currently assessing the impact on the disclosures that the introduction of this amendment will have.
- IFRS 8 'Operating Segments' which is yet to be endorsed by the EU. This standard, which replaces IAS 14 'Segment Reporting', would amend the disclosures of the Group's operating segments, products, services and geographical areas in which it operates.
- IFRIC 10 'Interim Financial Reporting and Impairment', which is yet to be endorsed by the EU. This interpretation addresses the conflict between IAS 34 'Interim Financial Reporting' and other standards on the recognition and reversal of impairment losses on certain financial assets.

### Interest receivable and interest expense

For instruments measured at amortised cost the effective interest 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 investments, derivatives and other financial assets at fair value through the income statement is included in interest receivable and similar income.

## 1 Statement of Accounting Policies (continued)

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

Direct fees and costs incremental to generating a financial instrument are deferred and spread as interest receivable or expense on an effective interest 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

A business segment is defined as a group of assets and operations providing products and services that are subject to different risks and returns from those of other business segments. The Group considers that business segments are its primary reporting format for segment analysis. Business segments are based on the Group's management and internal reporting structures.

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

### Intangibles

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 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 5 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.

### Leases

Leases entered into by the Group are primarily operating leases.

#### (a) As lessee

Operating leases are leases that do not transfer substantially all the risks and rewards incidental to ownership to the 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.

## 1 Statement of Accounting Policies (continued)

Deferred tax related to fair value re-measurement of available for sale investments, which are charged or credited directly to the available for sale reserve, is also credited or charged directly to the available for sale reserve and is subsequently recognised in the income statement together with the deferred gain or loss.

### 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 the revaluation reserve 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 the revaluation reserve for the same asset, in which case the decrease in valuation is recognised in the revaluation reserve.

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.

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	25 to 43 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 of 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.

### 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.

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), which are redeemable at specific dates at the option of the Society, 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 note.

### Financial assets

The Group classifies its financial assets at inception into the following three categories:

## 1 Statement of Accounting Policies (continued)

### (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. Certain of the Group's investment securities, held to meet insurance liabilities, are included in this category, as well as 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 are quoted market prices (where there is an active market), or are based on valuation techniques (where there is no active market or the securities are unlisted). Valuation techniques include the use of recent arm's length transactions, discounted cash flow analysis and other commonly used valuation techniques.

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 method.

### (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 initially measured at fair value. Subsequently, AFS assets are carried at fair value. The fair values are quoted market prices (where there is an active market), or based on valuation techniques (where there is no active market or the securities are unlisted).

Unrealised gains and losses arising from changes in the fair values are recognised directly in the available for sale reserve, 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 the available for sale reserve, are recognised in the income statement.

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 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 note.

## 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 are impaired. Evidence of impairment may include indications that the borrower or group of borrowers are experiencing significant financial difficulty, default or delinquency in interest or principal payments or the 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 have been deducted from the appropriate asset values in the balance sheets.

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.

## 1 Statement of Accounting Policies (continued)

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 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. In the case of investment securities classified as available for sale, a significant or prolonged decline in the fair value of the asset below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available for sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that asset previously recognised – is recognised in the income statement.

If, in a subsequent period, the fair value of an investment debt security classified as available for sale increases 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.

## 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 initially measured at fair value and are subsequently remeasured to fair value at each reporting date with movements recorded in the income statement. Fair values are obtained from quoted prices prevailing in active markets and valuation techniques, including discounted cash flow models, as appropriate. 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.

### (b) Embedded derivatives

A number of complex contracts contain both a derivative and a non-derivative component, in which case the derivative is termed an embedded derivative. If the economic characteristics and risks of embedded derivatives are not closely related to those of the host contract, and the overall contract itself is not carried at fair value, the embedded derivative is accounted for separately and reported at fair value with gains and losses being recognised in the income statement.

### (c) Hedge accounting

When transactions meet the criteria specified in IAS 39, the Group applies fair value hedge accounting so that changes in the fair value of the underlying asset or liability that are attributable to the hedged risk are recorded in the income statement to offset the fair value movement of the related derivative.

To qualify for hedge accounting 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.

## 1 Statement of Accounting Policies (continued)

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.

### Employee benefits

#### (a) Pensions

The Group operates a number of pension arrangements. The majority of the Group's employees are members of the Nationwide Pension Fund ('the Fund'). The Group also operates other arrangements for certain current and former directors and officers and for one subsidiary undertaking.

All of the pension arrangements are 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 the statement of recognised income and expense.

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 immediately 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.

### Long term life insurance

#### (a) Classification of contracts

The Group issues linked contracts that transfer both insurance risk and financial risk, and term and annuity contracts that transfer insurance risk. Contracts that contain significant insurance risk for the Group are accounted for as insurance liabilities. Such contracts may also contain financial risk. Contracts that do not contain significant insurance risk are classified as investment contracts and are accounted for as financial liabilities. Premiums are recognised as revenue when they become payable by the contract holder. Claims and surrenders are recognised when notified and maturities are recognised on the policy maturity date.

#### (b) Recognition and measurement of insurance liabilities

Premiums on term insurance contracts are recognised as revenue when they become due for payment. Single premiums on linked contracts are recognised as revenue when the policy comes into force. A liability for contractual benefits that are expected to be incurred in the future is recognised when the premiums are recognised. Benefits are accounted for on maturity or when the insured event occurs. The increase or decrease in the liability for contractual benefits and benefits paid is included in the income statement.

## 1 Statement of Accounting Policies (continued)

The liability for contractual benefits under term insurance contracts is the discounted value of future benefit payments, allowing for assumptions as to mortality, persistency, future premiums, maintenance expenses and investment income. The liability for linked contracts is adjusted for the changes in the fair value of the underlying assets.

The Group enters into reinsurance contracts in relation to some long term insurance contracts. Insurance liabilities that are reinsured are included gross with corresponding reinsurance assets included in total assets.

A liability adequacy test is performed using current best estimates of future contractual cash flows, claims handling and administrative expenses and investment income from assets backing the liabilities. Any deficiency is immediately charged to the income statement by establishing a provision for losses arising from the liability adequacy test.

### (c) Embedded value

The embedded value method of accounting is used to measure the Group's interest in the long term life insurance contract business. This represents the present value of in force insurance contract business together with the net assets.

The value of in force life insurance contract business is determined using assumed economic parameters (future investment returns and risk discount rate) and mortality, persistency, expense assumptions and future expense inflation. The present value of the in force business is determined on a pre tax basis with changes in the valuation included in the income statement.

### Foreign currency translation

The consolidated financial statements are presented in Sterling, which is the functional currency of the parent undertaking. 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.

Non-monetary assets that are measured at fair value are translated using the exchange rate at the date that the fair value was determined. Exchange differences on equities and similar non-monetary items held at fair value through the income statement, are reported as part of the fair value gain or loss.

### 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.

### 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.

### Provisions and contingent liabilities

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.

Contingent liabilities have not been recognised.

## 2 Judgements in applying accounting policies and critical accounting estimates

The Group has to make judgements in applying its accounting policies which affect the amounts recognised in the accounts. In addition, estimates and assumptions are made that could affect the reported amounts of assets and liabilities within the following financial year. The most significant areas where judgements and estimates are made are as follows:

### Impairment provisions on loans and advances

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 and future conditions. The accuracy of the impairment provision would therefore be affected by unexpected changes in the above assumptions.

To the extent that actual losses incurred differ from that estimated by 10%, the impairment provisions on loans and advances would change by an estimated £20.4 million.

### Impairment of available for sale assets

The Group determines that available for sale investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement the Group evaluates, among other factors, the normal volatility in valuation, evidence of a deterioration in the financial health of the investee, industry and sector performance and operational and financing cash flows.

### Fair value of derivatives and available for sale assets

The fair values of derivative financial instruments and available for sale assets are calculated using valuation techniques, including discounted cash flow models, where market values are not available. Changes in assumptions used in the models could affect the reported fair value of derivatives and available for sale assets.

### Retirement benefit obligations

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 £40 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 £40 million and vice versa.

### Provisions for liabilities and charges

The Group establishes provisions for the estimated cost of making redress payments to customers in respect of past product sales or other administration processes, in those cases where the original processes are found to have been deficient. The ultimate cost is inherently uncertain and in determining the level of provisions required it is necessary for management to exercise significant judgement. The principal assumptions underlying the provisions relate to the number of cases requiring redress and the estimated average cost of redress per case; these will be affected by external factors beyond the control of management, such as regulatory actions and the performance of the financial markets. Therefore over time it is possible that adjustments will be necessary to the level of provisions held.

### Effective interest rates (EIR)

To calculate the appropriate EIR the Group makes assumptions of the expected lives of financial instruments and the anticipated level of early redemption penalty charges. The most critical assumption is the expected lives of the financial instruments.

The impact of a one month increase in the anticipated life of the financial instruments would result in an increase of the value of the loans on the balance sheet of £4.3 million.

### Taxation

Significant estimates are required in determining the provision for corporation tax. There are a number of transactions for which the final tax determination is uncertain at the balance sheet date.

# Notes to the Accounts

continued

## 3 Interest receivable and similar income

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
On loans fully secured on residential property	5,029.7	4,481.8	4,618.0	4,104.7
On other loans:				
• Connected undertakings	-	-	503.9	402.4
• Other	879.8	743.6	742.7	612.9
On investment securities	703.3	548.4	583.9	456.8
On other liquid assets	132.4	64.8	78.3	14.2
Other interest receivable	1.4	1.1	0.3	0.1
Net income/(expense) on financial instruments hedging assets	33.2	(127.8)	33.2	(127.8)
Expected return on pension assets (note 42)	111.1	88.0	111.0	88.0
	<b>6,890.9</b>	<b>5,799.9</b>	<b>6,671.3</b>	<b>5,551.3</b>

Included within interest receivable and similar income is interest accrued on impaired financial assets: Group £17.9 million, Society £15.9 million (2006 – Group £11.7 million, Society £7.9 million) and the unwind of the discount on the impairment provisions: Group £7.0 million, Society £7.0 million (2006 – Group £4.1 million, Society £4.1 million) (note 13).

## 4 Interest expense and similar charges

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
On shares held by individuals	3,489.0	3,125.7	3,489.0	3,125.7
On other shares	0.3	0.3	0.3	0.3
On subscribed capital	51.0	47.1	51.0	47.1
On deposits and other borrowings:				
• Subordinated liabilities	68.8	64.8	68.8	64.8
• Connected undertakings	-	-	244.5	129.9
• Other	488.3	379.8	332.5	258.1
Debt securities in issue	1,155.5	830.0	1,095.4	788.9
Foreign exchange differences	2.6	2.3	2.6	2.4
Net expense on financial instruments hedging liabilities	64.0	35.6	35.5	28.6
Pension interest cost (note 42)	92.1	80.0	92.0	80.0
	<b>5,411.6</b>	<b>4,565.6</b>	<b>5,411.6</b>	<b>4,525.8</b>

## 5 Fee and commission income

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Mortgage related fees	22.2	20.3	18.4	17.1
Banking and savings fees	159.2	144.8	159.0	144.6
General insurance fees	119.7	116.3	96.7	94.7
Other fees and commissions	34.3	27.9	25.7	24.6
	<b>335.4</b>	<b>309.3</b>	<b>299.8</b>	<b>281.0</b>

## 6 Fee and commission expense

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Mortgage related fees	2.0	1.8	2.0	1.8
Other fees and commissions	1.6	1.1	1.3	1.0
	<b>3.6</b>	<b>2.9</b>	<b>3.3</b>	<b>2.8</b>

## 7 Insurance premiums and insurance claims and change in liabilities

	Group	
	2007 £m	2006 £m
Insurance premiums receivable:		
• Gross	189.7	170.9
• Reinsurers' share	(26.1)	(24.0)
Fair value gains on insurance assets	61.3	132.0
Premiums on insurance contracts and fair value gains on insurance assets	224.9	278.9

Fair value gains on insurance assets include a gain of £2.0 million (2006 – gain of £8.9 million) on policyholder assets which are offset by losses included in the taxation charge. Further information is presented in Note 14.

	Group	
	2007 £m	2006 £m
Insurance claims paid:		
• Gross	180.9	193.6
• Reinsurers' share	(14.2)	(10.2)
Change in provisions for insurance liabilities:		
• Gross	3.2	94.2
• Reinsurers' share	-	(69.2)
Insurance claims and change in liabilities	169.9	208.4

## 8 Income from investments

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Income from equity shares	23.1	7.9	0.5	0.4
Income from shares in subsidiary undertakings	-	-	429.7	58.9
	23.1	7.9	430.2	59.3

## 9 Other operating income

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Other operating income includes:				
• Change in value of in force life insurance contract business	8.4	1.5	-	-
• Rental income from investment properties	6.6	16.2	0.8	0.4
• Profit on sale of investment properties	8.5	1.0	-	-
• Profit on revaluation of investment properties	2.2	5.9	1.7	0.9

## 10 Gains from derivatives and hedge accounting

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Gains less losses on derivatives:				
• Derivatives designated as fair value hedges	700.1	(83.3)	784.5	(29.1)
• Adjustment for hedge accounting	(682.9)	54.5	(765.9)	(0.9)
	17.2	(28.8)	18.6	(30.0)
• Other derivatives	86.9	38.6	86.9	38.6
Other	(103.2)	1.1	(103.3)	1.1
	0.9	10.9	2.2	9.7

## 11 Administrative expenses

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Employee costs:				
• Wages and salaries	385.8	348.7	362.3	324.0
• Social security costs	29.1	29.6	27.1	27.4
• Pension costs – defined benefit plans (note 42)	94.2	81.1	88.3	75.2
	509.1	459.4	477.7	426.6
Other administrative expenses	475.4	414.3	458.8	393.6
	984.5	873.7	936.5	820.2
Other administrative expenses include:				
• Property operating lease rental	31.1	28.9	30.0	27.7
• Direct operating expenses on investment properties	0.6	4.5	-	-
• Other property costs	40.9	37.1	38.8	35.8
• Postage and communications	57.8	56.6	57.0	53.7
• Computer costs	42.6	44.5	41.3	39.2
• Marketing and advertising	20.8	23.7	20.1	21.6
• Money transmission and other bank costs	44.0	37.8	43.2	30.2
• Legal and professional	36.1	20.1	28.1	13.8
• Training, education and other staff costs	52.2	42.4	49.5	42.7
• Other	149.3	118.7	150.8	128.9
	475.4	414.3	458.8	393.6

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 remuneration of the auditors, PricewaterhouseCoopers LLP, is set out below:

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Audit fees for Nationwide Building Society statutory audit	0.9	0.8	0.8	0.7
Fees payable for other services:				
• Audit of subsidiaries pursuant to legislation	0.3	0.3	0.1	0.1
• Other services pursuant to legislation	0.1	0.1	0.1	0.1
• All other assurance services	0.4	0.6	0.4	0.5
• Other services relating to taxation	-	0.1	-	0.1
• All other services	1.7	0.2	1.7	0.2
	3.4	2.1	3.1	1.7

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 increase in the fee payable for other services is due to extra work required in respect of the planned merger with Portman Building Society.

## 12 Employees

	Group		Society	
	2007	2006	2007	2006
The average number of persons employed during the year was:				
• Full-time	11,519	11,030	10,743	10,182
• Part-time	5,296	5,187	5,097	4,982
	<b>16,815</b>	<b>16,217</b>	<b>15,840</b>	<b>15,164</b>
Society				
• Central administration	7,592	7,123	7,592	7,123
• Branches	8,248	8,041	8,248	8,041
Subsidiaries	975	1,053	-	-
	<b>16,815</b>	<b>16,217</b>	<b>15,840</b>	<b>15,164</b>

Central administration employee numbers include employees engaged in direct customer-facing operations in administrative centres.

## 13 Impairment provisions on loans and advances to customers

2007	Loans fully secured on residential property		Loans fully secured on land		Other loans		Total	
	Individual £m	Collective £m	Individual £m	Collective £m	Individual £m	Collective £m	Individual £m	Collective £m
Group								
At 5 April 2006	1.8	30.1	9.6	23.2	-	91.9	11.4	145.2
Charge/(credit) for the year	1.0	(0.8)	0.4	(0.1)	-	133.1	1.4	132.2
Amounts written off during the year	(1.4)	(0.9)	(0.5)	-	-	(86.2)	(1.9)	(87.1)
Amounts recovered during the year	0.8	-	(0.2)	-	-	9.0	0.6	9.0
Unwind of discount of provision	(0.2)	-	(1.8)	-	-	(5.0)	(2.0)	(5.0)
<b>At 4 April 2007</b>	<b>2.0</b>	<b>28.4</b>	<b>7.5</b>	<b>23.1</b>	<b>-</b>	<b>142.8</b>	<b>9.5</b>	<b>194.3</b>
2006								
Group								
At 5 April 2005	0.4	30.7	9.7	21.4	-	82.8	10.1	134.9
Charge/(credit) for the year	1.2	(0.3)	0.2	1.8	-	73.7	1.4	75.2
Amounts written off during the year	(0.9)	(0.3)	(0.5)	-	-	(67.6)	(1.4)	(67.9)
Amounts recovered during the year	1.1	-	0.8	-	-	6.5	1.9	6.5
Unwind of discount of provision	-	-	(0.6)	-	-	(3.5)	(0.6)	(3.5)
<b>At 4 April 2006</b>	<b>1.8</b>	<b>30.1</b>	<b>9.6</b>	<b>23.2</b>	<b>-</b>	<b>91.9</b>	<b>11.4</b>	<b>145.2</b>

## 13 Impairment provisions on loans and advances to customers (continued)

2007	Loans fully secured on residential property		Loans fully secured on land		Other loans		Total	
	Individual £m	Collective £m	Individual £m	Collective £m	Individual £m	Collective £m	Individual £m	Collective £m
<b>Society</b>								
At 5 April 2006	1.3	21.4	9.6	23.2	-	55.1	10.9	99.7
Charge/(credit) for the year	-	(1.3)	0.4	(0.1)	-	77.2	0.4	75.8
Amounts written off during the year	(0.8)	(0.5)	(0.5)	-	-	(60.8)	(1.3)	(61.3)
Amounts recovered during the year	0.7	-	(0.2)	-	-	4.2	0.5	4.2
Unwind of discount of provision	(0.2)	-	(1.8)	-	-	(5.0)	(2.0)	(5.0)
<b>At 4 April 2007</b>	<b>1.0</b>	<b>19.6</b>	<b>7.5</b>	<b>23.1</b>	<b>-</b>	<b>70.7</b>	<b>8.5</b>	<b>113.4</b>
<b>2006</b>								
<b>Society</b>								
At 5 April 2005	0.3	22.9	9.7	21.4	-	54.5	10.0	98.8
Charge/(credit) for the year	0.7	(1.3)	0.2	1.8	-	47.5	0.9	48.0
Amounts written off during the year	(0.5)	(0.2)	(0.5)	-	-	(45.7)	(1.0)	(45.9)
Amounts recovered during the year	0.8	-	0.8	-	-	2.3	1.6	2.3
Unwind of discount of provision	-	-	(0.6)	-	-	(3.5)	(0.6)	(3.5)
<b>At 4 April 2006</b>	<b>1.3</b>	<b>21.4</b>	<b>9.6</b>	<b>23.2</b>	<b>-</b>	<b>55.1</b>	<b>10.9</b>	<b>99.7</b>

These provisions have been deducted from the appropriate asset values in the balance sheet.

## 14 Taxation

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Current Tax:				
• UK corporation tax at 30% (2006 – 30%)	138.8	183.7	76.4	124.9
• Corporation tax – adjustment in respect of prior years	(16.0)	4.1	(11.8)	3.9
	122.8	187.8	64.6	128.8
Isle of Man income tax	0.6	0.7	-	-
Total current tax	123.4	188.5	64.6	128.8
Deferred tax (note 29):				
• Current year	59.4	(26.5)	73.1	(19.2)
• Adjustment in respect of prior periods	5.6	-	6.1	0.1
Total deferred taxation	65.0	(26.5)	79.2	(19.1)
	188.4	162.0	143.8	109.7

The Society's tax charge includes receipts for the surrender of tax losses to subsidiary undertakings totalling £12.7 million (2006 – payments for the receipt of tax losses of £0.2 million).

Under IFRS, tax on policyholder investment returns is required to be included in the Group's tax charge rather than being offset against the related income, as it is in the actual distributions made to policyholders. The impact is, therefore, to either increase or decrease profit before tax with a corresponding change in the tax charge.

The tax attributable to policyholder earnings was a charge for the Group of £2.0 million (2006 – £8.9 million).

Further information about deferred tax is presented in note 29.

## 14 Taxation (continued)

The actual tax charge differs from the theoretical amount that would arise using the standard rate of corporation tax in the UK as follows:

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Profit before tax	652.0	559.2	836.1	371.8
Tax calculated at a tax rate of 30% (2006 – 30%)	195.6	167.8	250.8	111.5
Effect of different tax rates in other countries	(2.1)	(1.7)	-	-
Effect of life subsidiary	0.8	6.3	-	-
(Income)/expenses not taxable/deductible for tax purposes:				
• Building depreciation	1.7	2.5	1.5	2.3
• Non taxable UK dividend received	-	-	(105.0)	-
• Other	2.8	(4.1)	2.3	4.8
Adjustments in respect of prior years	(10.4)	4.1	(5.8)	4.0
Utilisation of previously unrecognised tax losses	-	(12.9)	-	(12.9)
	188.4	162.0	143.8	109.7

## 15 Segmental reporting

The Group operates predominately in the UK and the Isle of Man and accordingly no geographical analysis has been presented.

The Group reports through the following three business segments:

- Personal Financial Services includes the provision of mortgages (including UCB our specialist lending subsidiary), banking and savings, credit card, unsecured personal lending (through our subsidiary Nationwide Trust), general insurance products, life insurance and unit trust investments.
- Commercial includes all the costs and income associated with the Group's lending to Registered Social Landlords and other loans to support investment in commercial properties and residential housing. Treasury income generation activities and at.home, Nationwide's subsidiary residential letting agency are also included within this segment.
- Group includes the costs and income associated with managing the Group's capital position and the wholesale funding and liquid asset management of the Group. It also includes rental income and associated property costs on properties surplus to the Society's retail needs and costs which cannot be meaningfully allocated to a business segment.

Income has been attributed to the business segments in which it is generated. Funding costs have been calculated using a funds transfer pricing methodology which reflects the nature of the interest received or paid. The transfer pricing flows are shown as revenues from other segments.

Administrative expenses and depreciation have been allocated to segments based on the resources consumed, except where they cannot be meaningfully allocated in which case they have been included in the Group business segment.

Capital is allocated to each business segment for investment purposes and is based on economic capital principles. No charge has been made for capital.

# Notes to the Accounts

continued

## 15 Segmental reporting (continued)

	Personal Financial Services £m	Commercial £m	Group £m	Consolidation adjustments £m	Total £m
<b>2007</b>					
Net interest income	1,244.5	973.3	(738.5)	-	1,479.3
Revenue from other segments	(142.4)	(756.5)	898.9	-	-
	1,102.1	216.8	160.4	-	1,479.3
Other income net of claims on insurance contracts	388.7	45.2	12.0	-	445.9
<b>Total revenue</b>	<b>1,490.8</b>	<b>262.0</b>	<b>172.4</b>	<b>-</b>	<b>1,925.2</b>
Administrative expenses	880.0	39.2	65.3	-	984.5
Depreciation and amortisation	114.8	2.7	6.9	-	124.4
Impairment losses on loans and advances to customers	133.4	0.2	-	-	133.6
Provisions for liabilities and charges	36.5	-	-	-	36.5
Impairment gains on investment securities	-	(4.9)	-	-	(4.9)
<b>Segment results</b>	<b>326.1</b>	<b>224.8</b>	<b>100.2</b>	<b>-</b>	<b>651.1</b>
Gains from derivatives and hedge accounting					0.9
<b>Profit before tax</b>					<b>652.0</b>
Taxation					188.4
<b>Profit after tax</b>					<b>463.6</b>
Segment assets	187,998.1	22,929.8	18,452.4	(92,126.7)	137,253.6
Unallocated assets					124.9
<b>Total assets</b>					<b>137,378.5</b>
Segment liabilities	190,038.7	20,692.9	40,094.4	(119,172.6)	131,653.4
Unallocated liabilities					260.7
<b>Total liabilities</b>					<b>131,914.1</b>
Capital expenditure	156.5	3.6	2.0	-	162.1

## 15 Segmental reporting (continued)

2006	Personal Financial Services £m	Commercial £m	Group £m	Consolidation adjustments £m	Total £m
Net interest income	1,116.0	898.3	(780.0)	-	1,234.3
Revenue from other segments	(194.7)	(698.7)	893.4	-	-
	921.3	199.6	113.4	-	1,234.3
Other income net of claims on insurance contracts	360.7	37.3	12.3	-	410.3
<b>Total revenue</b>	<b>1,282.0</b>	<b>236.9</b>	<b>125.7</b>	<b>-</b>	<b>1,644.6</b>
Administrative expenses	783.9	39.8	50.0	-	873.7
Depreciation and amortisation	112.3	3.8	1.4	-	117.5
Impairment losses on loans and advances to customers	73.9	2.7	-	-	76.6
Provisions for liabilities and charges	32.1	-	-	-	32.1
Impairment gains on investment securities	-	(3.6)	-	-	(3.6)
<b>Segment results</b>	<b>279.8</b>	<b>194.2</b>	<b>74.3</b>	<b>-</b>	<b>548.3</b>
Gains from derivatives and hedge accounting					10.9
<b>Profit before tax</b>					<b>559.2</b>
Taxation					162.0
<b>Profit after tax</b>					<b>397.2</b>
Segment assets	171,332.4	17,679.2	17,337.7	(85,971.1)	120,378.2
Unallocated assets					207.8
<b>Total assets</b>					<b>120,586.0</b>
Segment liabilities	173,716.9	14,795.7	28,348.0	(102,001.7)	114,858.9
Unallocated liabilities					695.7
<b>Total liabilities</b>					<b>115,554.6</b>
Capital expenditure	148.8	26.4	4.4	-	179.6

### 16 Assets classified as held for sale and associated liabilities

On 7 February 2007 the Group announced the proposed sale of its life, investment and pensions subsidiaries, Nationwide Life Limited and Nationwide Unit Trust Managers Limited to Legal & General. Consequently, the assets and liabilities of these undertakings are disclosed separately as required by IFRS 5 (Non-Current Assets Held for Sale and Discontinued Operations).

The proceeds of disposal are expected to exceed the carrying value of the related net assets and, accordingly, no losses have been recognised.

The major assets and liabilities of these undertakings are as follows:

#### Balance sheet

	Notes	Group	
		2007 £m	2006 £m
<b>Assets</b>			
Loans and advances to banks	17	198.8	-
Insurance assets at fair value		1,909.6	-
Other assets	30	288.2	-
<b>Total assets held for sale</b>		<b>2,396.6</b>	<b>-</b>
<b>Liabilities</b>			
Deposits from banks	32	875.0	-
Insurance contract liabilities	36	1,178.0	-
Other liabilities	37	37.7	-
<b>Total liabilities directly associated with assets classified as held for sale</b>		<b>2,090.7</b>	<b>-</b>

### 17 Loans and advances to banks

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Placements with banks with a maturity on acquisition of:				
• Less than 3 months	1,224.2	1,111.5	1,166.3	878.6
• More than 3 months but less than 1 year	110.8	-	-	-
• More than one year but less than five years	3.0	113.7	3.0	-
	1,338.0	1,225.2	1,169.3	878.6
Mandatory reserve deposits with the Bank of England	152.1	138.8	152.1	138.8
	1,490.1	1,364.0	1,321.4	1,017.4
<b>Assets classified as held for sale (note 16)</b>				
Placements with banks with a maturity on acquisition of:				
• Less than 3 months	198.8	-	-	-
• More than one year but less than five years	-	-	-	-
	198.8	-	-	-

Placements with banks with a maturity on acquisition of less than 3 months are included in the total cash and cash equivalents figure in note 50.

Mandatory reserve deposits with the Bank of England are not available for use in the Group's day to day operations.

## 18 Investment securities – available for sale

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Government investment securities	172.6	842.1	150.4	691.9
Other public sector investment securities	55.2	43.2	-	-
Private sector investment securities:				
• Listed	10,812.8	9,395.2	9,012.7	8,001.7
• Unlisted	4,560.0	2,727.2	4,560.0	2,727.4
	<b>15,600.6</b>	<b>13,007.7</b>	<b>13,723.1</b>	<b>11,421.0</b>
Investment securities have remaining maturities as follows:				
• Accrued interest	103.5	75.5	88.9	68.1
• In not more than one year	6,390.0	4,617.5	6,033.8	4,567.5
• In more than one year	9,107.1	8,314.7	7,600.4	6,785.4
	<b>15,600.6</b>	<b>13,007.7</b>	<b>13,723.1</b>	<b>11,421.0</b>

During the year an impairment gain of Group and Society £4.9 million (2006 – Group and Society £3.6 million) has been recognised in the income statement as a result of an improvement in the credit quality of a particular treasury investment security. As a consequence a cumulative impairment loss at 4 April 2007 of Group and Society £5.6 million (2006 – Group and Society £10.5 million) has been charged to the general reserve.

£183.3 million (2006 – £84.6 million) of investment securities are pledged as collateral under sale and repurchase agreements.

Investment securities include asset backed securities of £1,495.2 million (2006 – £1,169.2 million) owned by a bankruptcy remote special purpose vehicle. The acquisitions of the asset backed securities have been funded primarily through the issue of commercial paper reported in debt securities in issue.

The investment securities portfolio contains some highly liquid instruments which have a life of 3 months or less, these securities are classified as cash equivalents in accordance with IAS 7 'Cash Flow Statements'. In the Group accounts £3,479.4 million (2006 – £2,133.5 million) and in the Society accounts £3,479.3 million (2006 – £2,133.5 million) of investment securities are included in the total cash equivalents figure in note 50.

## 19 Derivative financial instruments

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 below analyses derivatives between those designated as hedging instruments and those which, whilst in economic hedging relationships, are not designated as hedging instruments:

	Contract/ notional amount £m	2007 Fair value		Contract/ notional amount £m	2006 Fair value	
		Assets £m	Liabilities £m		Assets £m	Liabilities £m
<b>Derivatives held for hedging</b>						
<b>a) Society</b>						
Derivatives designated as fair value hedges						
• Interest rate swaps	71,944.3	989.2	202.5	64,204.1	366.5	506.5
Other derivatives						
• Cross currency interest rate swaps	4,885.1	16.5	243.9	4,213.2	226.4	90.3
• Caps, collars and floors	220.3	1.8	-	388.9	0.1	0.1
• Forward foreign exchange	4,775.7	4.2	85.8	2,550.9	2.5	33.8
• Forward rate agreements	14,938.2	1.3	0.7	10,550.0	0.4	0.1
• Interest rate futures	4,881.9	0.1	0.1	6,469.0	0.1	-
• Interest rate swaps	25,604.5	29.7	23.1	15,313.5	26.2	4.2
• Credit default swaps	664.8	1.6	8.5	1,442.6	6.2	6.3
	127,914.8	1,044.4	564.6	105,132.2	628.4	641.3
<b>b) Subsidiary</b>						
Derivatives designated as fair value hedges						
• Interest rate swaps	5,911.6	-	122.3	1,397.0	-	73.4
Other derivatives						
• Cross currency interest rate swaps	5,413.2	27.2	16.3	1,369.2	45.8	-
<b>Group</b>	<b>139,239.6</b>	<b>1,071.6</b>	<b>703.2</b>	<b>107,898.4</b>	<b>674.2</b>	<b>714.7</b>
<b>Group</b>						
	Contract/ notional amount £m	2007 Fair value		Contract/ notional amount £m	2006 Fair value	
		Assets £m	Liabilities £m		Assets £m	Liabilities £m
Derivatives have remaining maturities as follows:						
• In not more than one year	56,636.6	164.0	163.1	44,448.7	76.1	115.8
• In more than one year	82,603.0	907.6	540.1	63,449.7	598.1	598.9
	139,239.6	1,071.6	703.2	107,898.4	674.2	714.7
<b>Society</b>						
	Contract/ notional amount £m	2007 Fair value		Contract/ notional amount £m	2006 Fair value	
		Assets £m	Liabilities £m		Assets £m	Liabilities £m
Derivatives have remaining maturities as follows:						
• In not more than one year	56,636.6	164.0	163.1	44,448.7	76.1	115.8
• In more than one year	71,278.2	880.4	401.5	60,683.5	552.3	525.5
	127,914.8	1,044.4	564.6	105,132.2	628.4	641.3

Contract/notional amount indicates the amount outstanding at the balance sheet date and does not represent amounts at risk.

## 20 Fair value adjustment for portfolio hedged risk

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.

## 21 Loans and advances to customers

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Loans fully secured on residential property	101,883.3	89,587.4	94,592.7	82,821.4
Loans fully secured on land	10,072.2	8,050.2	9,852.0	7,771.7
Other loans	4,084.1	3,592.3	2,125.6	1,887.1
	116,039.6	101,229.9	106,570.3	92,480.2
Fair value adjustment for micro hedged risk	(101.2)	117.7	(101.2)	117.7
	115,938.4	101,347.6	106,469.1	92,597.9

Under the Building Societies Act 1997, loans to corporate bodies and Registered Social Landlords already existing at the date of adoption may not be reported as loans fully secured on residential property. Accordingly, the reported loans fully secured on land include Group £524.2 million (2006 – £578.7 million) of loans which are fully secured on residential property, and Society £304.0 million (2006 – £300.3 million) of loans which are fully secured on residential property.

### Maturity analysis

Loans and advances to customers have remaining maturities as follows:

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Repayable on demand	1,350.0	967.6	1,341.4	833.3
Other loans and advances by residual maturity repayable:				
• In not more than three months	725.7	794.4	720.7	793.2
• In more than three months but not more than one year	2,920.5	2,545.9	2,411.5	2,058.4
• In more than one year but not more than five years	16,836.6	13,892.0	15,405.2	12,631.0
• In more than five years	94,410.6	83,186.6	86,813.4	76,274.9
	116,243.4	101,386.5	106,692.2	92,590.8
Impairment provision on loans and advances (note 13)	(203.8)	(156.6)	(121.9)	(110.6)
Fair value adjustment for micro hedged risk	(101.2)	117.7	(101.2)	117.7
	115,938.4	101,347.6	106,469.1	92,597.9

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 not actual redemption levels experienced by the Group or Society.

### Covered bonds

Loans and advances to customers include £11,435.1 million (2006 – £1,742.1 million) for both the Group and Society which have been transferred from the Society to Nationwide Covered Bonds LLP, a bankruptcy remote special purpose vehicle which is consolidated by the Group. The loans secure £5,913.2 million (2006 – £1,401.9 million) of covered bonds issued by the Society. The covered bonds are included in debt securities in issue (note 35). The loans are retained on the Society's balance sheet as the Society substantially retains the risks and rewards relating to the loans.

## 22 Investments in equity shares

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
At 5 April 2006	22.0	14.9	2.2	1.9
Movements	14.7	7.1	8.5	0.3
<b>At 4 April 2007</b>	<b>36.7</b>	<b>22.0</b>	<b>10.7</b>	<b>2.2</b>

## 23 Investments in group undertakings

	Shares £m	Loans £m	Total £m
At 5 April 2006	1,120.9	9,725.4	10,846.3
Additions	3.2	5,145.3	5,148.5
Redemptions/repayments	(412.1)	(352.6)	(764.7)
<b>At 4 April 2007</b>	<b>712.0</b>	<b>14,518.1</b>	<b>15,230.1</b>

The interests of the Society in its principal subsidiary undertakings, all of which are consolidated, as at 4 April 2007 are set out below:

100% held subsidiary undertaking	Nature of business
at.home nationwide ltd	Property rental
First Nationwide	Investment company
Foundation Insurance Limited	Mortgage indemnity insurance
Moulton Finance Overseas BV	Investment company
Nationwide International Limited*	Offshore deposit taker
Nationwide Investments (No.1) Limited	Investment company
Nationwide Life Limited*	Life insurance
Nationwide Syndications Limited	Syndicated lending
Nationwide Trust Limited	Consumer finance
Nationwide Unit Trust Managers Limited*	Unit trust management
UCB Home Loans Corporation Limited*	Centralised mortgage lender

\*Regulated entities which are subject to regulations which require them to maintain capital at agreed levels and so governs the availability of funds for distribution as dividends.

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 and Foundation Insurance Limited which are registered and operate in the Isle of Man and Moulton Finance Overseas BV which is registered and operates in Holland.

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 2007 are set out below:

Other subsidiary undertakings	Nature of business	Country of registration	Country of operation
Great Eastern Investment Partnership	Investment company	England and Wales	UK
Nationwide Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds	England and Wales	UK
Cobbler Funding Limited	Investment company and issuer of commercial paper	Jersey	Jersey

## 24 Value of in force life insurance contract business

The value of in force life insurance business has been derived by using the following key assumptions:

- Expected future profits after tax from business currently in force have been discounted at a rate of 7.75% (2006 – 7.5%) per annum, increased in line with the rise in interest rates during the year.
- Future investment returns of 4.5% (2006 – 4.25%) gross per annum for fixed interest investments and 6.5% (2006 – 6.25%) for equity investments, again increased in line with the rise in interest rates during the year. The investment return for guaranteed return products is linked to the matching assets.
- Expense inflation rate of 3.5% (2006 – 3.5%) gross is unchanged in line with industry expectations of salary and price inflation.
- Mortality and morbidity for the future based on the Group's and general industry experience and expectation of future trends of the type of business concerned.
- Expenses and withdrawals for the future based on own recent experience of the type of business concerned.

## 25 Intangible fixed assets

2007	Computer software		Total
	Externally acquired £m	Internally developed £m	£m
<b>Group and Society</b>			
<b>Cost</b>			
At 5 April 2006	142.3	30.2	172.5
Additions	44.0	15.6	59.6
Disposals	(2.4)	-	(2.4)
<b>At 4 April 2007</b>	<b>183.9</b>	<b>45.8</b>	<b>229.7</b>
<b>Amortisation</b>			
At 5 April 2006	77.1	14.9	92.0
Charge for the year	29.5	3.5	33.0
Disposals	(1.4)	-	(1.4)
<b>At 4 April 2007</b>	<b>105.2</b>	<b>18.4</b>	<b>123.6</b>
<b>Net book value</b>			
<b>At 4 April 2007</b>	<b>78.7</b>	<b>27.4</b>	<b>106.1</b>

2006	Computer software		Total
	Externally acquired £m	Internally developed £m	£m
<b>Group and Society</b>			
<b>Cost</b>			
At 5 April 2005	112.3	20.7	133.0
Additions	69.2	9.5	78.7
Disposals	(39.2)	-	(39.2)
<b>At 4 April 2006</b>	<b>142.3</b>	<b>30.2</b>	<b>172.5</b>
<b>Amortisation</b>			
At 5 April 2005	80.2	8.6	88.8
Charge for the year	36.1	6.3	42.4
Disposals	(39.2)	-	(39.2)
<b>At 4 April 2006</b>	<b>77.1</b>	<b>14.9</b>	<b>92.0</b>
<b>Net book value</b>			
<b>At 4 April 2006</b>	<b>65.2</b>	<b>15.3</b>	<b>80.5</b>

# Notes to the Accounts

continued

## 26 Property, plant and equipment

2007	Branches and non specialised buildings	Specialised administration buildings	Short leasehold buildings	Total land and buildings	Plant and machinery	Equipment, fixtures, fittings and vehicles	Total
Group	£m	£m	£m	£m	£m	£m	£m
<b>Cost or valuation</b>							
At 5 April 2006	313.3	103.5	25.1	441.9	119.8	819.7	1,381.4
Additions	5.5	0.2	3.7	9.4	13.5	79.7	102.6
Revaluation	22.9	-	-	22.9	-	-	22.9
Disposals	(10.1)	-	-	(10.1)	(16.6)	(297.7)	(324.4)
<b>At 4 April 2007</b>	<b>331.6</b>	<b>103.7</b>	<b>28.8</b>	<b>464.1</b>	<b>116.7</b>	<b>601.7</b>	<b>1,182.5</b>
<b>Depreciation</b>							
At 5 April 2006	-	45.0	16.7	61.7	89.0	582.7	733.4
Charge for the year	-	4.2	1.9	6.1	11.0	74.3	91.4
Disposals	-	-	-	-	(16.5)	(289.5)	(306.0)
<b>At 4 April 2007</b>	<b>-</b>	<b>49.2</b>	<b>18.6</b>	<b>67.8</b>	<b>83.5</b>	<b>367.5</b>	<b>518.8</b>
<b>Net book value</b>							
<b>At 4 April 2007</b>	<b>331.6</b>	<b>54.5</b>	<b>10.2</b>	<b>396.3</b>	<b>33.2</b>	<b>234.2</b>	<b>663.7</b>

2006	Branches and non specialised buildings	Specialised administration buildings	Short leasehold buildings	Total land and buildings	Plant and machinery	Equipment, fixtures, fittings and vehicles	Total
Group	£m	£m	£m	£m	£m	£m	£m
<b>Cost or valuation</b>							
At 5 April 2005	282.5	103.0	37.5	423.0	103.9	769.6	1,296.5
Additions	5.7	0.5	1.2	7.4	15.9	54.5	77.8
Revaluation	25.1	-	-	25.1	-	-	25.1
Disposals	-	-	(13.6)	(13.6)	-	(4.4)	(18.0)
<b>At 4 April 2006</b>	<b>313.3</b>	<b>103.5</b>	<b>25.1</b>	<b>441.9</b>	<b>119.8</b>	<b>819.7</b>	<b>1,381.4</b>
<b>Depreciation</b>							
At 5 April 2005	-	41.4	29.1	70.5	78.4	527.6	676.5
Charge for the year	2.4	3.6	1.2	7.2	10.6	57.3	75.1
Revaluation	(2.4)	-	-	(2.4)	-	-	(2.4)
Disposals	-	-	(13.6)	(13.6)	-	(2.2)	(15.8)
<b>At 4 April 2006</b>	<b>-</b>	<b>45.0</b>	<b>16.7</b>	<b>61.7</b>	<b>89.0</b>	<b>582.7</b>	<b>733.4</b>
<b>Net book value</b>							
<b>At 4 April 2006</b>	<b>313.3</b>	<b>58.5</b>	<b>8.4</b>	<b>380.2</b>	<b>30.8</b>	<b>237.0</b>	<b>648.0</b>

## 26 Property, plant and equipment (continued)

2007	Branches and non specialised buildings £m	Specialised administration buildings £m	Short leasehold buildings £m	Total land and buildings £m	Plant and machinery £m	Equipment, fixtures, fittings and vehicles £m	Total £m
<b>Society</b>							
<b>Cost or valuation</b>							
At 5 April 2006	300.7	103.5	24.6	428.8	118.0	788.4	1,335.2
Additions	5.5	0.2	3.7	9.4	13.5	79.4	102.3
Revaluation	22.4	-	-	22.4	-	-	22.4
Disposals	(10.1)	-	-	(10.1)	(16.5)	(287.3)	(313.9)
<b>At 4 April 2007</b>	<b>318.5</b>	<b>103.7</b>	<b>28.3</b>	<b>450.5</b>	<b>115.0</b>	<b>580.5</b>	<b>1,146.0</b>
<b>Depreciation</b>							
At 5 April 2006	-	45.0	16.3	61.3	87.8	556.6	705.7
Charge for the year	-	4.2	1.9	6.1	10.9	73.1	90.1
Disposals	-	-	-	-	(16.4)	(281.8)	(298.2)
<b>At 4 April 2007</b>	<b>-</b>	<b>49.2</b>	<b>18.2</b>	<b>67.4</b>	<b>82.3</b>	<b>347.9</b>	<b>497.6</b>
<b>Net book value</b>							
<b>At 4 April 2007</b>	<b>318.5</b>	<b>54.5</b>	<b>10.1</b>	<b>383.1</b>	<b>32.7</b>	<b>232.6</b>	<b>648.4</b>
<b>2006</b>							
2006	Branches and non specialised buildings £m	Specialised administration buildings £m	Short leasehold buildings £m	Total land and buildings £m	Plant and machinery £m	Equipment, fixtures, fittings and vehicles £m	Total £m
<b>Society</b>							
<b>Cost or valuation</b>							
At 5 April 2005	271.2	103.0	37.0	411.2	102.4	739.5	1,253.1
Additions	5.7	0.5	1.2	7.4	15.6	53.1	76.1
Revaluation	23.8	-	-	23.8	-	-	23.8
Disposals	-	-	(13.6)	(13.6)	-	(4.2)	(17.8)
<b>At 4 April 2006</b>	<b>300.7</b>	<b>103.5</b>	<b>24.6</b>	<b>428.8</b>	<b>118.0</b>	<b>788.4</b>	<b>1,335.2</b>
<b>Depreciation</b>							
At 5 April 2005	-	41.4	28.7	70.1	77.4	503.3	650.8
Charge for the year	2.1	3.6	1.2	6.9	10.4	55.3	72.6
Revaluation	(2.1)	-	-	(2.1)	-	-	(2.1)
Disposals	-	-	(13.6)	(13.6)	-	(2.0)	(15.6)
<b>At 4 April 2006</b>	<b>-</b>	<b>45.0</b>	<b>16.3</b>	<b>61.3</b>	<b>87.8</b>	<b>556.6</b>	<b>705.7</b>
<b>Net book value</b>							
<b>At 4 April 2006</b>	<b>300.7</b>	<b>58.5</b>	<b>8.3</b>	<b>367.5</b>	<b>30.2</b>	<b>231.8</b>	<b>629.5</b>

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 2007 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.

## 27 Investment properties

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
At 5 April 2006	279.1	242.6	10.2	9.3
Additions from acquisitions	4.0	18.8	-	-
Additions from subsequent expenditure	1.4	4.3	-	-
Revaluation	7.0	17.7	1.7	0.9
Disposals	(276.4)	(4.3)	-	-
<b>At 4 April 2007</b>	<b>15.1</b>	<b>279.1</b>	<b>11.9</b>	<b>10.2</b>

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.

In July 2006 the Group completed the sale of the majority of the investment property portfolio of at.home nationwide limited, the Group's wholly owned residential letting subsidiary.

## 28 Accrued income and expenses prepaid

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Amounts owed by subsidiary undertakings	-	-	111.3	201.7
Other	76.3	283.7	65.0	241.8
	<b>76.3</b>	<b>283.7</b>	<b>176.3</b>	<b>443.5</b>

## 29 Deferred tax assets

Deferred tax is provided in full on temporary differences under the liability method at the standard UK corporation tax rate of 30% (2006 – 30%).

The movements on the deferred tax account are as follows:

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
At 4 April 2005		81.9		127.1
Adoption of IFRS 4 and IAS 39		(1.3)		(3.2)
At 5 April 2006	110.0	80.6	149.5	123.9
Income statement (charge)/income	(65.0)	26.5	(79.2)	19.1
Future consortium relief	4.3	11.6	4.3	11.6
Available for sale investments – net fair value gain	5.3	(0.4)	3.7	3.2
Property revaluation	(4.8)	(10.1)	(4.8)	(10.1)
Retirement benefit obligations	(0.4)	1.8	(0.4)	1.8
Taxation on items through reserves	0.1	(8.7)	(1.5)	(5.1)
Deferred tax asset	49.4	110.0	73.1	149.5
Excluding liabilities directly associated with assets classified as held for sale	27.8	-	-	-
<b>At 4 April 2007</b>	<b>77.2</b>	<b>110.0</b>	<b>73.1</b>	<b>149.5</b>

## 29 Deferred tax assets (continued)

Deferred tax assets and liabilities are attributable to the following items:

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Retirement benefit obligations	61.4	108.2	61.3	108.2
Provisions for loan impairment	35.0	35.4	16.9	20.1
Life insurance business	-	(32.4)	-	-
Other provisions	46.2	61.0	56.5	65.7
Accelerated tax depreciation	5.8	8.7	5.7	8.8
Available for sale investments	(17.4)	(22.7)	(13.2)	(17.0)
Property revaluation	(53.8)	(60.5)	(54.1)	(48.6)
Tax losses carried forward	-	12.3	-	12.3
	<b>77.2</b>	<b>110.0</b>	<b>73.1</b>	<b>149.5</b>

Deferred tax assets are all anticipated to be recoverable after 1 year.

As at the balance sheet date there are no unused tax losses for which no deferred tax asset is recognised (2006 – Group and Society £16.0 million).

The aggregate amount of the temporary differences associated with undistributed earnings of overseas subsidiaries for which deferred tax liabilities have not been recognised is Group and Society £60.6 million (2006 – Group and Society £51.9 million). No liability has been recognised in respect of these differences because the Group is in a position to control the timing of the reversal of these temporary differences and it is probable that such differences will not reverse in the future.

The deferred tax charge/(credit) in the income statement comprises of the following temporary differences (note 14):

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Accelerated tax depreciation	2.9	(10.0)	3.1	(9.4)
Retirement benefit obligations	46.8	12.4	46.9	12.3
Provisions for loan impairment	0.4	(3.0)	3.2	(0.3)
Other	2.6	(13.6)	13.7	(9.4)
Tax losses carried forward	12.3	(12.3)	12.3	(12.3)
	<b>65.0</b>	<b>(26.5)</b>	<b>79.2</b>	<b>(19.1)</b>

The government has announced the rate of standard UK corporation tax will reduce to 28% effective from 1 April 2008, however legislation has yet to be enacted. In accordance with the IFRS provisions, the rate of 30% is still used as a basis for the calculation of the deferred taxes as stated. This new rate, if enacted would result in a release of deferred tax assets in the year ended 4 April 2008, and a consequential charge to the income statement of £5.1 million and £4.9 million in the Group and Society respectively.

## 30 Other assets

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Reinsurance assets (note 36)	-	245.0	-	-
Other	161.6	164.2	81.4	65.0
	<b>161.6</b>	<b>409.2</b>	<b>81.4</b>	<b>65.0</b>
<b>Assets classified as held for sale (note 16)</b>				
Reinsurance assets (note 36)	245.5	-	-	-
Other	42.7	-	-	-
	<b>288.2</b>	<b>-</b>	<b>-</b>	<b>-</b>

# Notes to the Accounts

continued

## 31 Shares

	Group & Society	
	2007 £m	2006 £m
Held by individuals	86,789.0	80,910.2
Other shares	6.4	8.4
	<b>86,795.4</b>	<b>80,918.6</b>
Shares are repayable from the balance sheet date in the ordinary course of business as follows:		
Accrued interest	575.7	549.4
Repayable on demand	82,092.6	76,008.7
Other shares by residual maturity repayable:		
• In not more than three months	756.0	934.6
• In more than three months but not more than one year	1,864.5	2,125.8
• In more than one year but not more than five years	1,506.6	1,300.1
	<b>86,795.4</b>	<b>80,918.6</b>

## 32 Deposits from banks

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Deposits from banks are repayable from the balance sheet date in the ordinary course of business as follows:				
Accrued interest	36.5	13.5	21.0	13.5
Repayable on demand	750.5	470.2	745.4	468.4
Other amounts owed to banks with residual maturity repayable:				
• In not more than three months	1,241.6	953.3	1,241.6	882.5
• In more than three months but not more than one year	659.4	427.8	659.4	306.0
• In more than one year but not more than five years	500.0	732.6	-	34.8
• In more than five years	100.7	100.0	100.0	100.0
	<b>3,288.7</b>	<b>2,697.4</b>	<b>2,767.4</b>	<b>1,805.2</b>

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
<b>Liabilities directly associated with assets classified as held for sale (note 16)</b>				
Deposits from banks are repayable from the balance sheet date in the ordinary course of business as follows:				
Amounts owed to banks with residual maturity repayable:				
• In not more than three months	874.6	-	-	-
• In more than three months but not more than one year	0.4	-	-	-
	<b>875.0</b>	<b>-</b>	<b>-</b>	<b>-</b>

Deposits from banks include £183.3 million (2006 – £84.6 million) in respect of sale and repurchase agreements.

## 33 Other deposits

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Amounts owed to subsidiary undertakings	-	-	8,405.1	4,063.7
Other	3,406.7	3,161.4	3,344.1	3,161.4
	<b>3,406.7</b>	<b>3,161.4</b>	<b>11,749.2</b>	<b>7,225.1</b>
Other deposits are repayable from the balance sheet date in the ordinary course of business as follows:				
Accrued interest	41.0	26.3	45.7	31.3
Repayable on demand	63.6	0.8	8,216.7	3,880.9
Other amounts owed to depositors with residual maturity repayable:				
• In not more than three months	2,127.2	1,907.4	2,194.8	1,929.4
• In more than three months but not more than one year	1,138.6	1,180.2	1,195.9	1,236.4
• In more than one year but not more than five years	36.3	46.7	96.1	147.1
	<b>3,406.7</b>	<b>3,161.4</b>	<b>11,749.2</b>	<b>7,225.1</b>

## 34 Due to customers

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Amounts due to customers are repayable from the balance sheet date in the ordinary course of business as follows:				
Accrued interest	18.2	11.5	7.2	4.4
Repayable on demand	2,444.9	2,069.6	937.8	936.7
Other amounts owed to customers with residual maturity repayable:				
• In not more than three months	339.2	354.3	-	-
• In more than three months but not more than one year	72.0	122.6	-	-
• In more than one year but not more than five years	51.8	50.3	-	-
	<b>2,926.1</b>	<b>2,608.3</b>	<b>945.0</b>	<b>941.1</b>

## 35 Debt securities in issue

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Certificates of deposit	12,557.0	6,780.9	10,979.2	5,528.6
Fixed and floating rate notes	16,263.6	13,937.4	16,416.5	13,937.4
Other debt securities	230.4	223.6	230.4	223.6
	<b>29,051.0</b>	<b>20,941.9</b>	<b>27,626.1</b>	<b>19,689.6</b>
Fair value adjustment for micro hedged risk	(179.3)	(174.3)	(58.0)	(117.9)
	<b>28,871.7</b>	<b>20,767.6</b>	<b>27,568.1</b>	<b>19,571.7</b>
Debt securities in issue are repayable from the balance sheet date in the ordinary course of business as follows:				
Accrued interest	202.9	154.6	200.8	154.6
Other debt securities in issue with residual maturity repayable:				
• In not more than one year	16,431.8	11,063.9	14,855.0	9,897.1
• In more than one year	12,416.3	9,723.4	12,570.3	9,637.9
	<b>29,051.0</b>	<b>20,941.9</b>	<b>27,626.1</b>	<b>19,689.6</b>
Fair value adjustment for micro hedged risk	(179.3)	(174.3)	(58.0)	(117.9)
	<b>28,871.7</b>	<b>20,767.6</b>	<b>27,568.1</b>	<b>19,571.7</b>

Debt securities in issue include Group and Society £5,913.2 million (2006 – £1,401.9 million) of covered bonds secured on certain loans and advances to customers (note 21).

## 36 Insurance contract liabilities

	Group	
	2007 £m	2006 £m
Insurance contract liabilities:		
• Gross	1,178.0	1,190.5
• Reinsurers' share (note 30)	(245.5)	(245.0)
Net insurance contract liabilities	932.5	945.5

At 4 April 2007 all net insurance contract liabilities are directly associated with assets classified as held for sale (note 16).

The Group offers various insurance products including critical illness and term assurance. Certain liabilities are reinsured.

Under the terms of a Memorandum of Understanding entered into between leading members of the life insurance and bancassurance sectors, the Association of British Insurers and the UK Accounting Standards Board, insurers are encouraged to provide certain disclosures that would have been required by UK GAAP in their financial statements. The Group is providing these additional disclosures.

## Regulatory capital requirements of insurance contract business

The Society's life insurance subsidiary, Nationwide Life, is regulated by the Financial Services Authority (FSA) and as a condition of being able to transact business as a life insurer, is required to hold a minimum level of capital which is calculated with respect to the mix of business written. In calculating these capital requirements, the FSA requires certain adjustments to be made in the valuation of assets and liabilities in comparison to those used in the financial statements.

Nationwide Life also regularly prepares an Individual Capital Assessment (ICA) which is an assessment of the amount of capital required to ensure that it can cover its liabilities to policyholders to a given level of confidence. Resources are maintained to cover the higher of the ICA and FSA requirements.

Details of the life insurance subsidiary's regulatory capital are as follows:

	2007 £m	2006 £m
Shareholder's funds	269.2	303.9
Adjustments to assets	(102.7)	(94.5)
Available capital to meet regulatory requirements	166.5	209.4

The numbers quoted in the above table for the current year are based on management's current expectations in advance of completion of the annual financial return to the FSA. The 2006 numbers have been restated to reflect the final position as reported in the prior year annual financial return to the FSA.

The relevant capital requirement is the minimum solvency requirement determined in accordance with FSA Regulations. The available capital has been calculated after deducting liabilities that include additional prudential margins. At 31 March 2007, the available capital of £166.5 million (2006 – £209.4 million) was 213% (2006 – 284%) of the capital requirement of £78.1 million (2006 – £73.8 million) in comparison to management's target minimum of 200%. The level of available capital is sensitive to certain key assumptions used in the calculation of life insurance contract liabilities, the most significant of which are mortality risk (in respect of term assurances) and morbidity risk (in respect of critical illness policies or term assurances with critical illness acceleration).

## Options and guarantees

The Group's life insurance products contain certain options and guarantees.

A significant proportion of insurance contract business is represented by guaranteed equity bonds. These bonds, which are normally offered for a fixed period of five or six years, offer the policyholder the opportunity to invest in equity markets with the added benefit of a guarantee that, on maturity of the bond, it will return at least the minimum of the premium invested plus a pre-defined portion of the growth in the relevant equity index. On death of the policyholder, the contract guarantees to return the higher of the premium received or the premium plus relevant equity growth, plus a death benefit of 1%. The exposure to the market risk is matched by an asset designed specifically for the guaranteed equity bond. As a result there is little sensitivity to market movements.

In order to minimise exposure to the underlying investment or liquidity risk, the life insurance subsidiary purchases bespoke structured products which are designed to deliver, at maturity, a return which exactly matches the benefits payable to the policyholder. It further reduces its exposure to credit risk (i.e. the failure of the counterparty to deliver the appropriate funds) by use of a collateral arrangement.

The life insurance subsidiary measures its liabilities under these contracts based on the fair value of the underlying investments together with a provision in respect of margins for mortality, expenses, tax and counterparty risk.

**37 Other liabilities**

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Third party income tax withheld	234.3	204.6	233.7	204.5
Consortium relief	6.2	11.6	6.2	11.6
Other liabilities	276.0	299.6	198.7	134.0
	<b>516.5</b>	<b>515.8</b>	<b>438.6</b>	<b>350.1</b>
<b>Liabilities directly associated with assets classified as held for sale (note 16)</b>				
Other liabilities	37.7	-	-	-
	<b>37.7</b>	<b>-</b>	<b>-</b>	<b>-</b>

**38 Provisions for liabilities and charges**

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
At 5 April 2006	40.3	49.0	29.0	41.1
Provisions utilised	(26.5)	(40.8)	(25.7)	(40.6)
Charge for the year	36.5	32.1	34.0	28.5
<b>At 4 April 2007</b>	<b>50.3</b>	<b>40.3</b>	<b>37.3</b>	<b>29.0</b>

Provisions have been made in respect of various customer claims. It is expected that the liability will predominately crystallise over the next 12-24 months.

**39 Accruals and deferred income**

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Deferred income recognition on unit trust products	2.1	3.9	-	-
Interest accrued on subordinated liabilities	18.7	18.4	18.7	18.4
Interest accrued on subscribed capital	9.0	5.2	9.0	5.2
Accruals relating to investment properties	1.2	11.4	-	-
Other	336.0	191.2	300.7	169.0
	<b>367.0</b>	<b>230.1</b>	<b>328.4</b>	<b>192.6</b>

**40 Subordinated liabilities**

	Group & Society	
	2007 £m	2006 £m
Subordinated Floating Rate Notes due 2013 (€400m)	270.6	279.4
5 1/4% Subordinated Notes due 2014 (\$225m)	113.8	128.0
3 3/8% Subordinated Notes due 2015 (€750m)	507.4	523.9
5% Subordinated Notes due 2015 (\$400m)	202.4	227.7
Subordinated Floating Rate Notes due 2016 (€300m)	202.9	-
5 1/4% Subordinated Notes due 2018 (£)	200.0	200.0
8 5/8% Subordinated Notes due 2018 (£)	125.0	125.0
	<b>1,622.1</b>	<b>1,484.0</b>
Fair value adjustment for micro hedged risk	2.2	(30.7)
Unamortised premiums and issue costs	(7.3)	(7.0)
	<b>1,617.0</b>	<b>1,446.3</b>

All of the Society's subordinated liabilities are unsecured. The Society may, with the prior consent of the FSA, redeem some of the subordinated notes early as follows:

- All (but not some only) of the Floating Rate Notes due 2013 at par (100%) on 11 April 2008, 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 11 April 2008 the initial interest margin of 0.6% over Euribor will increase by a further 0.5%.

#### 40 Subordinated liabilities (continued)

- All (but not some only) of the 3<sup>3</sup>/<sub>8</sub>% 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 (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%. The Floating Rate Notes due 2016 were issued on 21 December 2006. Total net proceeds of the issue were €299.2 million.
- All (but not some only) of the 5<sup>1</sup>/<sub>4</sub>% Notes due 2018 at par (100%) on 12 February 2013, by giving not less than 15 nor more than 30 days notice to the holders. In the event the Society does not redeem the notes on 12 February 2013 the fixed rate of interest will become an aggregate of 1.98% and the then current 5 year benchmark Gilt rate.
- All or some of the 8<sup>5</sup>/<sub>8</sub>% Notes at the higher of par (100%) or the benchmark 8<sup>3</sup>/<sub>4</sub>% 2017 Gilt, by giving not less than 30 nor more than 60 days notice to the holders.

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.

#### 41 Subscribed capital

	Group & Society	
	2007 £m	2006 £m
6.024% Permanent Interest Bearing Shares	350.0	-
7.971% Permanent Interest Bearing Shares	200.0	200.0
5.769% Permanent Interest Bearing Shares	400.0	400.0
7.859% Permanent Interest Bearing Shares	100.0	100.0
	<b>1,050.0</b>	<b>700.0</b>
Fair value adjustment for micro hedged risk	5.9	49.4
Unamortised premiums and issue costs	(10.5)	(8.2)
	<b>1,045.4</b>	<b>741.2</b>

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 in March 2015 or any fifth anniversary thereafter.
- The 5.769% PIBS are repayable, at the option of the Society, in whole in February 2026 or any fifth anniversary thereafter.
- The 7.859% PIBS are repayable, at the option of the Society, in whole in March 2030 or any fifth anniversary thereafter.

If the above three 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 5 year benchmark Gilt rate.

- The 6.024% PIBS were issued on 30 January 2007. Total net proceeds of the issue were £347.3 million. The 6.024% PIBS are repayable, at the option of the Society, in whole in February 2013 or any interest coupon date thereafter. If the 6.024% PIBS are not repaid on their first call date then the interest rate is reset at a margin of 50 basis points over 3 month Libor. If 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.

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.

## 42 Retirement benefit obligations

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Present value of funded obligations	1,944.7	1,826.4	1,942.0	1,824.0
Fair value of plan assets	(1,781.4)	(1,542.8)	(1,779.0)	(1,541.0)
	163.3	283.6	163.0	283.0
Present value of unfunded obligations	6.2	7.0	6.2	7.0
Total pension liabilities	169.5	290.6	169.2	290.0
Post retirement healthcare	2.9	3.6	2.9	3.6
	172.4	294.2	172.1	293.6

The principal pension arrangement is the Nationwide Pension Fund. This is a contributory defined benefit arrangement, with two main sections. The final salary section was closed to new entrants with effect from 1 January 2002. The career average revalued earnings (CARE) section has applied to new entrants with effect from 1 January 2002. The Group also operates other pension arrangements for certain current and former directors and officers, as well as for one subsidiary company.

The amounts recognised in the income statement are as follows:

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Current service cost	95.2	83.3	89.3	77.4
Past service cost	1.5	-	1.5	-
	96.7	83.3	90.8	77.4
Capitalised as intangible fixed assets	(2.5)	(2.2)	(2.5)	(2.2)
Included in employee costs (note 11)	94.2	81.1	88.3	75.2
Expected return on pension assets (note 3)	(111.1)	(88.0)	(111.0)	(88.0)
Pension interest cost (note 4)	92.1	80.0	92.0	80.0
	75.2	73.1	69.3	67.2

Changes in the present value of defined benefit pension obligations are as follows:

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
At 5 April 2006	1,833.4	1,478.4	1,831.0	1,476.6
Current service cost	95.2	83.3	89.3	77.4
Past service cost	1.5	-	1.5	-
Pension interest cost	92.1	80.0	92.0	80.0
Employee contributions	1.0	2.0	1.0	2.0
Subsidiary undertakings contributions	-	-	5.7	5.8
Actuarial (gains)/losses	(32.7)	212.3	(32.7)	211.8
Benefits paid	(39.6)	(22.6)	(39.6)	(22.6)
<b>At 4 April 2007</b>	<b>1,950.9</b>	<b>1,833.4</b>	<b>1,948.2</b>	<b>1,831.0</b>

The Group does not charge the net defined benefit cost to the subsidiary undertakings that participate in the Nationwide Pension Fund. The pension cost to the subsidiary undertakings equals the contributions payable to the Fund.

## 42 Retirement benefit obligations (continued)

Changes in the fair value of plan assets are as follows:

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
At 5 April 2006	1,542.8	1,131.2	1,541.0	1,130.0
Expected return on assets	111.1	88.0	111.0	88.0
Actuarial (losses)/gains	(31.8)	205.4	(32.1)	204.9
Contributions by employer	197.9	138.8	192.0	132.9
Employee contributions	1.0	2.0	1.0	2.0
Subsidiary undertakings contributions	-	-	5.7	5.8
Benefits paid	(39.6)	(22.6)	(39.6)	(22.6)
<b>At 4 April 2007</b>	<b>1,781.4</b>	<b>1,542.8</b>	<b>1,779.0</b>	<b>1,541.0</b>

The actual return on assets was 5.0% (2006 – 25.7%).

The major categories of plan assets for the pension funds are as follows:

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
UK equities	920.1	571.6	919.0	570.1
Non-UK equities	389.5	592.1	389.0	592.1
Bonds	319.2	312.8	319.0	312.7
Property and cash	152.6	66.3	152.0	66.1
	<b>1,781.4</b>	<b>1,542.8</b>	<b>1,779.0</b>	<b>1,541.0</b>

None of the Funds' assets are invested in the Nationwide Group (2006 – nil).

The amounts recognised in respect of pension obligations in the statement of recognised income and expense are as follows:

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
Cumulative actuarial gains at 5 April 2006	97.5	104.4	97.4	104.3
Actuarial gains/(losses) in the year*	0.9	(6.9)	0.6	(6.9)
<b>Cumulative actuarial gains at 4 April 2007</b>	<b>98.4</b>	<b>97.5</b>	<b>98.0</b>	<b>97.4</b>

\*In addition an actuarial gain of Group and Society £0.7 million (2006 – £0.8 million) was recognised in respect of post retirement healthcare.

Experience gains and losses in respect of pension obligations for the current and the previous years are as follows:

	Group			Society		
	2007 £m	2006 £m	2005 £m	2007 £m	2006 £m	2005 £m
Experience (losses)/gains on plan liabilities	(6.7)	8.0	23.0	(6.7)	8.0	23.0
Changes in actuarial assumptions	39.4	(220.3)	52.9	39.4	(219.8)	52.9
Actuarial gains/(losses) on plan liabilities	32.7	(212.3)	75.9	32.7	(211.8)	75.9
Experience (losses)/gains on plan assets	(31.8)	205.4	28.5	(32.1)	204.9	28.4
	<b>0.9</b>	<b>(6.9)</b>	<b>104.4</b>	<b>0.6</b>	<b>(6.9)</b>	<b>104.3</b>

## 42 Retirement benefit obligations (continued)

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		
	2007 £m	2006 £m	2005 £m	2007 £m	2006 £m	2005 £m
Present value of defined benefit obligation	1,953.8	1,837.0	1,482.8	1,951.1	1,834.6	1,481.0
Fair value of plan assets	1,781.4	1,542.8	1,131.2	1,779.0	1,541.0	1,130.0
Total deficit	172.4	294.2	351.6	172.1	293.6	351.0

The principal actuarial assumptions used were as follows:

	Group & Society	
	2007 %	2006 %
Discount rate	5.4	5.0
Expected return on plan assets	7.5	7.0
Future salary increases	4.8	4.6
Future pension increases	2.9	2.7
Inflation	3.0	2.8

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. The expected overall return was then calculated based on the asset allocation at 4 April 2007. This resulted in the selection of the 7.5% assumption as at 4 April 2007 (2006 – 7.0%). A deduction is made for the expenses of the fund.

The assumptions on mortality are determined by the following actuarial tables:

	2007	2006
Retired members	PXA 92 BY SC	PXA 92 C2006 SC
Non-retired members	PXA 92 BY SC	PXA 92 C2016 SC

The assumptions are illustrated by the following years of life expectancy at age 60:

	2007	2006
Retired members		
• Males	26.0	24.6
• Females	28.9	27.5
Non-retired members		
• Males	27.2	25.6
• Females	30.0	28.4

The Group estimates that its contributions to the pension funds during the year ended 4 April 2008 will be £103 million.

This is subject to a full triennial valuation of the Nationwide Pension Fund as at 31 March 2007. The result of this valuation will not be known until later in 2007.

# Notes to the Accounts

continued

## 43 General reserve

Movements in general reserves were as follows:

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
At 4 April 2005		4,460.6		3,479.1
Effective interest basis		(8.7)		(5.3)
Available for sale assets		16.0		12.4
Derivatives and hedging		(94.4)		(94.4)
Derecognition of financial liabilities		(33.1)		(33.1)
Insurance		(3.3)		-
Loan impairment and suspended interest		86.0		92.2
Tax		9.6		5.8
At 5 April 2006	4,825.6	4,432.7	3,714.5	3,456.7
Profit for the year	463.6	397.2	692.3	262.1
Actuarial gains/(losses) on retirement benefit obligations	1.6	(6.1)	1.3	(6.1)
Tax on actuarial gains/(losses) on retirement benefit obligations	(0.4)	1.8	(0.4)	1.8
Transfer from revaluation reserve	5.4	-	5.4	-
<b>At 4 April 2007</b>	<b>5,295.8</b>	<b>4,825.6</b>	<b>4,413.1</b>	<b>3,714.5</b>

The above adjustments between 4 April 2005 and 5 April 2005 were made in accordance with the transitional rules of IFRS, whereby adjustments necessary to comply with IAS 32, IAS 39 and IFRS 4 were made as at 5 April 2005.

## 44 Revaluation reserve

Movements in revaluation reserves were as follows:

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
At 5 April 2006	117.0	103.0	116.8	102.9
Revaluation increase on land and buildings	21.4	24.1	21.3	24.0
(Increase) in deferred tax liability on the revaluation of land and buildings	(4.8)	(10.1)	(4.8)	(10.1)
Transfer to general reserve	(5.4)	-	(5.4)	-
<b>At 4 April 2007</b>	<b>128.2</b>	<b>117.0</b>	<b>127.9</b>	<b>116.8</b>

## 45 Available for sale reserve

Movements in available for sale reserves were as follows:

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
At 4 April 2005		-		-
Available for sale assets on adoption of IAS 39		70.8		29.1
Tax on adoption of IAS 39		(22.2)		(20.2)
At 5 April 2006	88.8	48.6	46.3	8.9
Net (losses)/gains from changes in fair value	(73.2)	59.8	(55.5)	53.3
Amounts transferred to income statement on disposal and impairment	4.2	(4.5)	4.3	(4.4)
Decrease/(increase) in tax liability	20.6	(15.1)	19.1	(11.5)
<b>At 4 April 2007</b>	<b>40.4</b>	<b>88.8</b>	<b>14.2</b>	<b>46.3</b>

The above adjustments between 4 April 2005 and 5 April 2005 were made in accordance with the transitional rules of IFRS, whereby adjustments necessary to comply with IAS 32, IAS 39 and IFRS 4 were made as at 5 April 2005.

## 46 Financial commitments

	Group		Society	
	Contract amount	Credit risk weighted amount	Contract amount	Credit risk weighted amount
2007	£m	£m	£m	£m
Irrevocable undrawn loan facilities	4,050.9	989.9	3,844.8	940.0
Unpaid share capital of subsidiary company	-	-	28.3	28.3
Undrawn formal standby facilities, credit lines and other commitments to lend	27.0	2.7	27.0	2.7
	4,077.9	992.6	3,900.1	971.0

	Group		Society	
	Contract amount	Credit risk weighted amount	Contract amount	Credit risk weighted amount
2006	£m	£m	£m	£m
Irrevocable undrawn loan facilities	3,279.4	775.2	3,085.2	720.8
Unpaid share capital of subsidiary company	-	-	28.3	28.3
Undrawn formal standby facilities, credit lines and other commitments to lend	25.0	2.5	25.0	2.5
	3,304.4	777.7	3,138.5	751.6

## 47 Capital and leasing commitments

Capital commitments	Group		Society	
	2007	2006	2007	2006
	£m	£m	£m	£m
Capital expenditure contracted for but not provided for in the Accounts	24.9	25.2	24.8	21.7

Leasing commitments	Group		Society	
	2007	2006	2007	2006
	£m	£m	£m	£m
At the balance sheet date, commitments under operating leases relating to land and buildings were as follows:				
Amounts falling due:				
• Within one year	22.2	22.7	21.7	22.3
• Between one and five years	67.1	61.9	66.0	60.9
• After five years	109.8	95.2	106.6	92.0
	199.1	179.8	194.3	175.2
At the balance sheet date, subleasing payments receivable under non-cancellable subleases	8.3	8.0	7.5	8.0
At the balance sheet date, future minimum lease payments receivable under non-cancellable operating leases were as follows:				
Amounts falling due:				
• Within one year	3.9	4.6	3.8	4.6
• Between one and five years	10.9	13.2	10.4	13.1
• After five years	11.8	16.0	11.6	15.8
	26.6	33.8	25.8	33.5

## 48 Financial instruments

### Strategy in using financial instruments

Financial instruments incorporate the vast majority of the Group and Society's assets and liabilities. Given the dominant position of the Society within the Group structure, the term 'Group' is used in the remainder of this note to cover the activities of both Group and Society. Furthermore since the risks of the organisation are managed on a Group basis, the risk disclosures have been presented below only on a consolidated basis.

The Group accepts deposits from customers at both fixed and floating 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, credit risks and liquidity risks.

The Group uses derivative instruments to manage various aspects of market risk. However, in doing so it complies with the Building Societies Act 1986 which limits our use of derivatives to the management of changes in interest rates, exchange rates or other factors defined by the Act.

The principal derivatives used in balance sheet risk management are interest rate swaps, forward rate agreements, interest rate options, cross-currency interest rate swaps, interest rate futures, foreign exchange contracts and credit derivatives. Derivatives are used to hedge balance sheet exposures arising from fixed and capped rate mortgage lending, equity and 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 typically used in managing such risks. Such risks may alternatively be managed using on balance sheet instruments as part of an integrated approach to risk management.

Activity	Risk	Type of derivative instrument used
Fixed rate savings products and funding activities in Sterling involving either fixed rate instruments or instruments with embedded options	Sensitivity to changes in interest rates	Interest rate swaps, interest rate futures, options and forward rate agreements
Fixed and capped rate mortgage lending and investment activities involving either fixed rate instruments or instruments with embedded options	Sensitivity to changes in interest rates	Interest rate swaps, options and forward rate agreements
Investment and funding in foreign currencies	Sensitivity to changes in foreign exchange rates	Cross-currency interest rate swaps and foreign exchange contracts
Equity-linked investment products	Sensitivity to changes in equity indices	Equity-linked futures, options and interest rate swaps
Investment of liquid resources in debt securities	Sensitivity to changes in obligor credit risk leading to default	Credit default swaps

Derivative products which are combinations of more basic derivatives are used only in circumstances where the underlying position being hedged contains the same risk features. For example, guaranteed equity bonds issued by the Nationwide Investment Group may be hedged with a single contract incorporating both the interest rate and equity index risk incurred. In such cases the derivatives used will be designed to match exactly the risks of the underlying asset or liability. Exposure to market risk on such contracts is therefore fully hedged.

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.

## 48 Financial instruments (continued)

### Control of derivatives

The Assets and Liabilities Committee (ALCO) is responsible for setting limits over the use of derivative products for managing exposure to interest rates, foreign exchange rates and equity indices. The Credit Committee sets Group credit policy and regularly monitors and reviews credit exposures arising in all aspects of Group operations, including derivatives.

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 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 insurance risk. Each of these is considered below. Additional information on risk management and control is included in the Business Review.

### 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 is exposed to movements in interest rates. This exposure is managed on a continuous basis, within limits set by the Board, using a combination of derivative instruments and cash instruments such as loans, deposits and bonds.

The Group does not run a trading book and therefore does not have the type of higher risk exposure run by many banking institutions. Given our policy of hedging fixed rate assets and liabilities back to floating rate, outright interest rate 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 benchmark profile in the light of market conditions.

The Group uses three metrics to monitor interest rate risk and details of these are set out below. The limits around these three 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 market data from the last two years equally weighted. Exposures against limits are reviewed daily by management. Actual outcomes are monitored from time to time to test the validity of the assumptions and parameters/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;
- 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 rise in interest rates. As is the case with VaR, this analysis is done on a daily basis separately for each currency (but with the main risk arising from Sterling exposures) and in aggregate.

*Stress testing (PV200 sensitivity)*. This is calculated in a similar manner to PV01 but against a much more severe 200 basis point (2.0%) parallel rise in interest rates. Both PV01 and PV200 numbers are generated daily.

## 48 Financial instruments (continued)

The average gross exposures (before deduction of the above mentioned benchmark profile) through the reporting period are as follows:

	Average 2007 £m	High 2007 £m	Low 2007 £m	Average 2006 £m	High 2006 £m	Low 2006 £m
VaR	24.4	33.8	10.0	13.3	16.3	10.8
Sensitivity analysis (PV01)	1.1	1.5	0.3	0.8	0.9	0.7
Stress testing (PV200: all currencies)	217.2	300.2	65.6	167.3	218.7	142.1

All exposures include investment of the Group's reserves. During 2006/07, ALCO approved an increase in the fixed rate maturity profile for investment of the Group's reserves, in order to secure a more stable net interest income for the Group over time. The calculated VaR, PV01 and PV200 have increased accordingly.

Other interest rate risk exposures, such as basis risk (the risk of loss arising from changes in the relationship between interest rates which have similar but not identical characteristics – say 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 the ALCO.

### Credit risk

The Group takes on exposure to credit risk, which is 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 note 13). 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 manages its exposure to credit risk.

The Credit Committee is responsible for approving and monitoring the Group's credit exposures which it does through reviewing and approving the Group's lending policy and credit scoring systems and through setting limits on credit exposures to individual counterparties and across countries and industrial sectors. The minutes of the Credit Committee are presented to the Board.

Prior to advancing funds, an assessment is made of the credit quality of borrowers and other counterparties, including retail customers. Multiple rating methodologies may be used to inform the rating decision on individual large credits. For smaller credits, a single source may suffice such as an automated credit scoring system result. It is the Group's policy to lend responsibly, and establish that loans are within the customer's capacity to repay, rather than to rely exclusively on security. Actual exposures against limits are monitored daily.

Maximum credit risk exposure at 4 April 2007 approximates to the carrying value for all assets apart from loans and advances to customers where the carrying value includes a reduction of £101.2million (2006 – £117.7 million increase) in respect of hedged interest rate risk.

The classes of financial instruments to which the Group is most exposed are loans and advances to customers (note 21), loans and advances to banks, investment securities – available for sale (note 18), other financial assets at fair value and derivative financial instruments (note 19).

#### Credit risk - Loans and advances to customers

Of the £116.2 billion within this class, £101.9 billion (87.7%) (2006 – 88.4%) is fully secured on residential property with a further £10.1 billion (8.7%) (2006 – 8.0%) fully secured on land. Only £4.2 billion (3.6%) (2006 – 3.6%) is therefore unsecured and this is primarily made up of other commercial loans, personal loans, credit cards and overdrafts.

Loans and advances to customers can be analysed between PFS: £98.3 billion and commercial: £17.9 billion (2006 – PFS: £86.9 billion and commercial: £14.5 billion).

#### a) Personal Financial Services (PFS)

The PFS portfolio is predominantly made up of £95.3 billion loans fully secured on residential property (2006 – £84.3 billion) with £3.0 billion unsecured consumer lending (2006 – £2.6 billion). By their nature, our PFS lending books are comprised of a large number of smaller loans, have low volatility of credit risk outcomes and are intrinsically highly diversified.

## 48 Financial instruments (continued)

In respect of its PFS book, the Group operates across the whole of the UK but lending is biased towards the south east of England reflecting the concentration of branches in that region and asset growth trends. As at 4 April 2007 around 44% (2006 – 46%) of the residential mortgage book was in respect of the south east.

In its specialist mortgage lender, UCB, the Group sells loans in the markets of self-certification and buy-to-let distributed through intermediaries. UCB balances outstanding at the year end were £6.6 billion (2006 – £6.0 billion) of which £2.7 billion (2006 – £1.7 billion) were in respect of buy-to-let.

The average loan to value (LTV) ratio of the Group's PFS loan portfolio is estimated at 39% (2006 – 39%) whilst the average LTV of new residential mortgage lending was 58% (2006 – 55%). Further LTV information on the Group's PFS loan portfolio is set out as follows:

	2007 %	2006 %
<b>Loan to value analysis:</b>		
Total book		
<70%	87	88
70% - 80%	7	6
80% - 90%	5	5
>90%	1	1
Average loan to value of stock (indexed)	39	39
Average loan to value of new business	58	55
<b>New business profile:</b>		
First-time buyers	19	15
Home movers	31	25
Remortgagers	46	57
Buy-to-let	4	3

Nationwide Group asset quality continues to significantly outperform both the secured and unsecured lending markets. The proportion of residential lending cases currently more than 3 months in arrears is 0.24% (2006 – 0.28%) against an industry average of 0.87% (CML figure as at 31 March 2007) (2006 – 0.97%). For consumer lending, the value of personal loans over 30 days in arrears as a percentage of total loans is 6.2% (2006 – 4.6%) around 25% lower than the average of the members of the Finance and Leasing Association (February 2007) (March 2006 – 40%). For credit card accounts, the value of loans over 30 days in arrears as a percentage of total card accounts is 7.3% (2006 – 6.9%) and are approximately 30% better than the industry benchmark.

The table below provides further information on PFS loans and advances by payment due status as at 4 April 2007:

	2007		2006	
	£bn	%	£bn	%
<b>Not impaired:</b>				
• Neither past due nor impaired	96.6	98	85.2	98
• Past due up to 3 months but not impaired	1.4	2	1.4	2
<b>Impaired:</b>				
• Past due 3 to 6 months	0.2	-	0.2	-
• Past due 6 to 12 months	0.1	-	0.1	-
• Past due over 12 months (£37.1 million)	-	-	-	-
• Possessions* (£13.5 million)	-	-	-	-
	<b>98.3</b>	<b>100</b>	<b>86.9</b>	<b>100</b>

\*Against possession cases, £13.0 million (2006 – £10.6 million) of collateral is held.

£49.1 million (2006 – £44.4 million) of loans that would be past due or impaired have had their terms renegotiated.

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.

## 48 Financial instruments (continued)

## b) Commercial

The make up of the commercial book at 4 April 2007 is as follows:

	2007		2006	
	£bn	%	£bn	%
Loans secured on commercial property	11.3	63	8.9	61
Loans to Registered Social Landlords	5.6	31	4.7	33
Loans advanced under the Private Finance Initiative	1.0	6	0.9	6
	17.9	100	14.5	100

Loans to Registered Social Landlords are secured on residential property.

Loans advanced under the Private Finance Initiative are secured on cash flows from Government backed contracts.

In terms of counterparty concentration, the largest single borrower, including undrawn commitments, represents only 2% (2006 – 2%) of the total commercial book.

Loans secured on commercial property as at 4 April 2007 are well diversified by industry type and an analysis is provided below:

	2007		2006	
	£bn	%	£bn	%
Residential	2.6	23	2.4	27
Retail	2.8	25	2.1	24
Office	2.4	21	2.0	22
Industrial and warehouse	1.3	12	1.1	12
Leisure and hotel	0.9	8	0.7	8
Owner occupied	0.8	7	0.5	5
Other	0.5	4	0.1	2
	11.3	100	8.9	100

Asset quality remains strong with only 84 commercial cases three months or more in arrears (2006 – 69 cases). Arrears balances were £6.1 million (2006 – £3.3 million).

The table below provides further information on commercial loans and advances by payment due status as at 4 April 2007:

	2007		2006	
	£bn	%	£bn	%
Not impaired:				
• Neither past due nor impaired	17.2	97	14.1	97
• Past due up to 3 months but not impaired	0.6	3	0.4	3
Impaired:				
• Past due 3 to 6 months (£30.5 million)	-	-	-	-
• Past due 6 to 12 months	0.1	-	-	-
• Past due over 12 months (£17.9 million)	-	-	-	-
• Possessions (£0.0 million)	-	-	-	-
	17.9	100	14.5	100

£1.2 million of loans that would be past due or impaired have had their terms renegotiated (2006 – £2.1 million).

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.

## 48 Financial instruments (continued)

Credit risk – Loans and advances to banks, investment securities – available for sale, other financial assets at fair value and derivative financial instruments

Credit risk within our Treasury Division arises from the investments held by Treasury in order to meet the liquidity requirements and for general business purposes. This aspect of credit risk is managed by the Treasury Division and the Commercial and Treasury Risk function within the 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 Credit Committee (Commercial and Treasury).

For credit purposes, the Treasury portfolio at 4 April 2007 comprises the following three sub-portfolios:

	2007		2006	
	£bn	%	£bn	%
Financial institutions and sovereigns	12.9	71	11.8	70
Asset backed securities	4.7	26	4.2	25
Corporates	0.5	3	0.8	5
	18.1	100	16.8	100

As at 4 April 2007 100.0% (2006 – 99.9%) of the Treasury portfolio exposure was neither past due nor impaired. There are no assets that would otherwise be past due or impaired whose terms have been renegotiated. As at 4 April 2007 97% (2006 – 96%) of our Treasury investment portfolio comprised assets which are rated single A or better. We continue to have no exposure to emerging markets and only limited exposure to non investment grade debt.

The Group determines that Treasury assets are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement, 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. £4.5 million (0.0%) (2006 – £23.9 million (0.1%)) of the Treasury portfolio is classed as impaired in accordance with this definition. A cumulative impairment loss of £5.6 million (2006 – £10.5 million) has been recognised in the general reserve in respect of these assets.

The Treasury 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.

### Geographical exposure

	2007		2006	
	£bn	%	£bn	%
Europe	9.3	52	7.9	47
UK	5.1	28	5.0	30
North America	2.7	15	2.7	16
Other	1.0	5	1.2	7
	18.1	100	16.8	100

### Industry sector/asset class exposure

	2007		2006	
	£bn	%	£bn	%
Overseas banks	9.4	52	8.3	49
UK financial institutions	3.3	18	2.8	17
Asset backed securities	4.3	24	3.4	20
Other financial institutions	0.5	3	1.0	6
Other	0.6	3	1.3	8
	18.1	100	16.8	100

## 48 Financial instruments (continued)

Collateral held as security for Treasury assets is determined by the nature of the instrument. Loans, debt securities, treasury and other eligible bills are generally unsecured with the exception of asset backed securities and similar instruments, which are secured by pools of financial assets. 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, collateral is passed between parties to mitigate the market contingent counterparty risk inherent in the outstanding positions. The posting of collateral is also used to reduce the credit exposure arising on sale and repurchase transactions and guaranteed equity bonds.

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. Netting arrangements similarly apply to guaranteed equity bond transactions.

### Treasury portfolio credit mitigation

The Group has the following credit derivatives in place hedging assets in the available for sale portfolio:

- (a) The credit risk on £405.6 million (2006 – £597.6 million) of assets has been hedged by the Group entering into a credit derivative. Under the terms of this overall risk mitigating transaction the Group retains the risk of credit losses on the assets which are covered by the credit derivative and certain other reference assets, up to a maximum of £29.9 million (2006 – £31.0 million).
- (b) An additional £8.5 million (2006 – £8.6 million) credit derivative exists for protection on an individual asset.
- (c) Forward starting credit derivatives have been entered into to cover the credit risk on £231.9 million (2006 – £239.0 million) of assets within the available for sale portfolio when the existing structure, noted in (a) above, is subject to call in August 2007.

All of the above credit derivatives have been undertaken with A+ or above rated US and European banking institutions.

### 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. The 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.

	2007			2006		
	Average	High	Low	Average	High	Low
VaR	£1.1m	£1.5m	£0.0m	£1.1m	£1.4m	£0.8m

## 48 Financial instruments (continued)

### Liquidity risk

Liquidity risk is the risk that the Group is not able to meet its financial obligations as they fall due or can do so only at an excessive cost.

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 liquid assets, through management control of the growth of business and through wholesale funding facilities.

For each material class of financial liability a maturity analysis is provided in notes 31 to 35. In practice, customer deposits will be repaid later than on the earliest date on which repayment can be required.

As additional support the Group maintains committed standby facilities. As at 4 April 2007, the Group and Society maintained £1.0 billion of committed standby facilities (2006 – £1.5 billion), of which £0.2 billion (2006 – £0.7 billion) are due to mature within one year.

The table below analyses assets and liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date:

At 4 April 2007 – Residual maturity	Repayable on demand £m	Up to 3 months £m	3 - 12 months £m	1 - 5 years £m	More than 5 years £m	Total £m
<b>Assets</b>						
Liquid assets	566.5	6,010.4	1,618.7	4,440.9	4,818.2	17,454.7
Loans and advances to customers	1,146.2	725.7	2,919.8	16,810.6	94,336.1	115,938.4
Other assets	225.3	2,423.3	76.3	216.4	1,044.1	3,985.4
<b>Total assets</b>	<b>1,938.0</b>	<b>9,159.4</b>	<b>4,614.8</b>	<b>21,467.9</b>	<b>100,198.4</b>	<b>137,378.5</b>
<b>Liabilities</b>						
Shares	82,593.2	755.3	1,913.3	1,533.6	-	86,795.4
Amounts owed to banks, customers and debt securities in issue	3,259.0	13,273.2	9,033.7	8,286.8	4,640.5	38,493.2
Other liabilities	747.9	2,277.2	229.7	278.9	429.4	3,963.1
Subordinated liabilities	-	-	-	-	1,617.0	1,617.0
Subscribed capital	-	-	-	-	1,045.4	1,045.4
<b>Total liabilities</b>	<b>86,600.1</b>	<b>16,305.7</b>	<b>11,176.7</b>	<b>10,099.3</b>	<b>7,732.3</b>	<b>131,914.1</b>
<b>Net liquidity gap</b>	<b>(84,662.1)</b>	<b>(7,146.3)</b>	<b>(6,561.9)</b>	<b>11,368.6</b>	<b>92,466.1</b>	<b>5,464.4</b>
<b>At 4 April 2006 – Residual maturity</b>						
	Repayable on demand £m	Up to 3 months £m	3 - 12 months £m	1 - 5 years £m	More than 5 years £m	Total £m
<b>Assets</b>						
Liquid assets	368.6	4,266.0	1,538.5	5,496.5	3,070.7	14,740.3
Loans and advances to customers	811.0	794.5	2,546.5	13,899.1	83,296.5	101,347.6
Other assets	738.9	413.2	265.8	1,620.5	1,459.7	4,498.1
<b>Total assets</b>	<b>1,918.5</b>	<b>5,473.7</b>	<b>4,350.8</b>	<b>21,016.1</b>	<b>87,826.9</b>	<b>120,586.0</b>
<b>Liabilities</b>						
Shares	76,495.1	954.2	2,152.7	1,316.6	-	80,918.6
Amounts owed to banks, customers and debt securities in issue	2,540.6	9,528.3	6,683.2	9,943.5	539.1	29,234.7
Other liabilities	698.7	292.7	418.1	1,057.1	747.2	3,213.8
Subordinated liabilities	-	-	-	-	1,446.3	1,446.3
Subscribed capital	-	-	-	-	741.2	741.2
<b>Total liabilities</b>	<b>79,734.4</b>	<b>10,775.2</b>	<b>9,254.0</b>	<b>12,317.2</b>	<b>3,473.8</b>	<b>115,554.6</b>
<b>Net liquidity gap</b>	<b>(77,815.9)</b>	<b>(5,301.5)</b>	<b>(4,903.2)</b>	<b>8,698.9</b>	<b>84,353.1</b>	<b>5,031.4</b>

## 48 Financial instruments (continued)

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 assets include derivative financial instruments, fair value adjustment for portfolio hedged risk, other financial instruments at fair value, investments in equity shares, other assets, deferred tax assets, accrued income and expenses prepaid, and assets classified as held for sale.

Other liabilities include derivative financial instruments, fair value adjustment for portfolio hedged risk, insurance contract liabilities, other liabilities, provisions for liabilities and charges, accruals and deferred income, current tax liabilities, retirement benefit obligations and liabilities directly associated with assets classified as held for sale.

The Board is responsible for setting limits over the level and composition of liquidity balances. A series of liquidity stress tests are performed each month to confirm that the limits remain appropriate. ALCO is responsible for setting limits over the level and maturity profile of wholesale funding and for monitoring the composition of the Group balance sheet.

The following is an analysis of gross contractual cash flows payable under financial liabilities:

Gross contractual cash flows	Repayable on demand	Up to 3 months	3 - 12 months	1 - 5 years	More than 5 years	Total
	£m	£m	£m	£m	£m	£m
<b>2007</b>						
Shares	82,593.2	799.8	2,000.2	1,676.2	-	87,069.4
Amounts owed to banks, customers and debt securities in issue	3,259.0	13,637.2	9,699.7	10,075.2	5,231.0	41,902.1
Other liabilities	747.9	2,434.3	323.6	416.6	417.8	4,340.2
Subordinated liabilities	-	5.1	71.1	996.5	1,050.7	2,123.4
Subscribed capital	-	-	68.4	271.8	1,583.4	1,923.6
<b>Total liabilities</b>	<b>86,600.1</b>	<b>16,876.4</b>	<b>12,163.0</b>	<b>13,436.3</b>	<b>8,282.9</b>	<b>137,358.7</b>
Gross contractual cash flows	Repayable on demand	Up to 3 months	3 - 12 months	1 - 5 years	More than 5 years	Total
	£m	£m	£m	£m	£m	£m
<b>2006</b>						
Shares	76,495.1	994.4	2,225.8	1,423.8	-	81,139.1
Amounts owed to banks, customers and debt securities in issue	2,540.6	9,761.3	7,123.9	10,880.4	596.4	30,902.6
Other liabilities	698.7	317.9	482.3	1,274.0	826.6	3,599.5
Subordinated liabilities	-	-	37.4	185.9	1,539.9	1,763.2
Subscribed capital	-	-	41.7	187.6	1,301.4	1,530.7
<b>Total liabilities</b>	<b>79,734.4</b>	<b>11,073.6</b>	<b>9,911.1</b>	<b>13,951.7</b>	<b>4,264.3</b>	<b>118,935.1</b>

For information on the contractual maturity of gross loan commitments see note 46.

### Insurance risk

Insurance risk is the risk that arises from the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities. The following risks exist:

- the occurrence of any events specifically insured against;
- for long term insurance business, adverse mortality, morbidity and persistency experience; and
- expense overruns relative to pricing or provisioning assumptions.

The Group manages its exposure to insurance risk by restricting its exposure to market risk through economic hedging and operating as a unit linked office, prudent product design, applying strict underwriting criteria, transferring risk to reinsurers, managing claims, establishing prudent reserves and matching assets to liabilities.

## 48 Financial instruments (continued)

The Group's insurance contract liabilities can be analysed as follows:

Product 2007	Gross £m	Reinsurers' share £m	Net liability £m
Guaranteed equity bonds (GEB)	894.1	-	894.1
Term assurance	256.5	245.5	11.0
Total excluding unit linked products	1,150.6	245.5	905.1
Unit linked	27.4	-	27.4
Total (note 36)	1,178.0	245.5	932.5

Product 2006	Gross £m	Reinsurers' share £m	Net liability £m
Guaranteed equity bonds (GEB)	889.7	-	889.7
Term assurance	273.5	245.0	28.5
Total excluding unit linked products	1,163.2	245.0	918.2
Unit linked	27.3	-	27.3
Total (note 36)	1,190.5	245.0	945.5

In order to minimise exposure to the underlying investment or liquidity risk on GEB, the Group purchases bespoke structured products which are designed to deliver, at maturity, a return which matches the benefits payable to the policyholder and the tax liability that has been incurred on behalf of policyholders. The Group further reduces its exposure to credit risk (i.e. the failure of the counterparty to deliver the appropriate funds) by use of a collateral arrangement.

Our term assurance business is reinsured with 3 reinsurers whose credit ratings are A- or higher.

The Group has no with profit liabilities.

### 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:

2007	Group		Society	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
<b>Financial assets</b>				
Loans and advances to banks	1,490.1	1,490.1	1,321.4	1,321.4
Loans and advances to customers	115,938.4	115,125.9	106,469.1	105,708.6
<b>Financial liabilities</b>				
Shares	86,795.4	86,748.7	86,795.4	86,748.7
Deposits from banks	3,288.7	3,256.2	2,767.4	2,766.2
Other deposits	3,406.7	3,403.8	11,749.2	11,746.3
Due to customers	2,926.1	2,925.5	945.0	945.0
Debt securities in issue	28,871.7	28,867.4	27,568.1	27,442.5
Subordinated liabilities	1,617.0	1,631.8	1,617.0	1,631.8
Subscribed capital	1,045.4	1,053.9	1,045.4	1,053.9

## 48 Financial instruments (continued)

2006	Group		Society	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
<b>Financial assets</b>				
Loans and advances to banks	1,364.0	1,364.0	1,017.4	1,017.4
Loans and advances to customers	101,347.6	101,319.1	92,597.9	92,570.7
<b>Financial liabilities</b>				
Shares	80,918.6	80,916.2	80,918.6	80,916.2
Deposits from banks	2,697.4	2,682.3	1,805.2	1,790.1
Other deposits	3,161.4	3,160.5	7,225.1	7,224.2
Due to customers	2,608.3	2,609.1	941.1	941.1
Debt securities in issue	20,767.6	20,688.3	19,571.7	19,492.4
Subordinated liabilities	1,446.3	1,506.8	1,446.3	1,506.8
Subscribed capital	741.2	747.3	741.2	747.3

## a) 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.

## b) 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.

## c) 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.

## 49 Related party transactions

## Subsidiary, parent and ultimate controlling party

The Group is controlled by the Nationwide Building Society registered in England and Wales which is also considered to be the ultimate parent. Details of subsidiary undertakings can be found in note 23 to these accounts.

## Key management compensation

Total compensation for key management personnel for the year by category of benefit was as follows:

	2007 £'000	2006 £'000
Short term employee benefits	4,532	3,812
Post employment benefits	95	133
Other long term benefits	1,130	1,060
Contractual / other settlements	3,424	-
Total key management personnel compensation for year	9,181	5,005

## 49 Related party transactions (continued)

### Transactions with related parties

A number of transactions are entered into with related parties in the normal course of business. These include loans, deposits and the payment and recharge of administrative expenses. The volumes of related party transactions, outstanding balances at the year end, and the related income and expenses for the year are as follows:

	Society Subsidiaries		Group & Society Key management personnel	
	2007 £m	2006 £m	2007 £m	2006 £m
<b>Loans payable to the Society</b>				
Loans outstanding at 5 April 2006	9,725.4	7,681.1	1.4	1.7
Loans issued during the year	5,145.3	2,201.2	0.4	0.6
Loan repayments during the year	(352.6)	(156.9)	(0.8)	(0.9)
Loans outstanding at 4 April 2007	14,518.1	9,725.4	1.0	1.4
<b>Deposits payable by the Society</b>				
Deposits outstanding at 5 April 2006	4,063.7	1,788.0	1.9	3.0
Deposits issued during the year	4,558.3	2,279.9	1.8	0.6
Deposit repayments during the year	(216.9)	(4.2)	(1.4)	(1.7)
Deposits outstanding at 4 April 2007	8,405.1	4,063.7	2.3	1.9
<b>Net interest income</b>				
Interest receivable	503.9	402.4	0.1	0.1
Interest expense	244.5	129.9	0.1	0.1
<b>Other income and expenses</b>				
Fees and expenses paid to the Society	24.7	22.9	-	-
Fees and expenses paid by the Society	18.7	21.7	-	-

### 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 the directors of the Society or persons connected with the directors of the Society.

The register will be available for inspection by members at the Annual General Meeting on 19 July 2007 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.

## 50 Notes to the cash flow statements

	Group		Society	
	2007 £m	2006 £m	2007 £m	2006 £m
<b>Non-cash items included in profit before tax</b>				
Net increase/(decrease) in impairment provisions	47.3	(70.8)	11.2	(86.6)
Impairment (gains) on investment securities	(4.9)	(3.6)	(4.9)	(3.6)
Depreciation and amortisation	124.4	117.5	123.1	115.0
(Profit) on sale of property, plant and equipment	(10.5)	(1.6)	(1.9)	(0.7)
Interest on subordinated liabilities	68.8	64.8	68.8	64.8
Interest on subscribed capital	51.0	47.1	51.0	47.1
(Gain) on the revaluation of land and buildings	(0.9)	(3.5)	(0.3)	(2.0)
(Gain) on the revaluation of investment properties	(1.7)	(5.9)	(1.7)	(0.9)
(Gains) from derivatives and hedge accounting	(0.9)	(10.9)	(2.2)	(9.7)
	<b>272.6</b>	<b>133.1</b>	<b>243.1</b>	<b>123.4</b>
<b>Changes in operating assets*</b>				
Loans and advances to banks	(10.4)	(21.5)	(13.3)	(12.9)
Investment securities	468.2	(409.0)	314.4	(276.5)
Derivative financial instruments and fair value adjustment for portfolio hedged risk	389.7	(507.0)	370.2	(462.4)
Other financial instruments at fair value	159.8	(463.5)	21.3	(21.3)
Loans and advances to customers	(14,857.0)	(8,437.2)	(14,101.3)	(7,746.8)
Other operating assets	185.6	(271.9)	(4,144.9)	(2,679.6)
	<b>(13,664.1)</b>	<b>(10,110.1)</b>	<b>(17,553.6)</b>	<b>(11,199.5)</b>
<b>Changes in operating liabilities*</b>				
Shares	5,876.8	8,324.5	5,876.8	8,324.5
Deposits from banks, customers and others	1,966.8	954.4	5,490.2	2,798.3
Derivative financial instruments and fair value adjustment for portfolio hedged risk	(95.6)	609.5	(150.5)	536.1
Debt securities in issue	8,104.1	(1,610.0)	7,996.4	(1,851.1)
Insurance contract liabilities	38.2	58.4	-	-
Retirement benefit obligations	(120.2)	(57.4)	(120.3)	(57.4)
Other operating liabilities	(45.8)	240.4	128.3	119.1
	<b>15,724.3</b>	<b>8,519.8</b>	<b>19,220.9</b>	<b>9,869.5</b>
<b>Cash and cash equivalents</b>				
Cash and balances with the Bank of England	364.0	368.6	361.1	367.8
Loans and advances to other banks repayable in 3 months or less**	1,779.2	1,460.0	1,169.3	878.6
Investment securities with a maturity period of 3 months or less	3,479.4	2,133.5	3,479.3	2,133.5
	<b>5,622.6</b>	<b>3,962.1</b>	<b>5,009.7</b>	<b>3,379.9</b>

\* The changes in operating assets categories of 'Loans and advances to banks', 'Other financial assets at fair value' and 'Other operating assets' include movements in assets classified as 'Assets classified as held for sale' on the balance sheet. The changes in operating liabilities categories of 'Deposits from banks, customers and others', 'Insurance contract liabilities' and 'Other operating liabilities' include movements in liabilities classified as 'Liabilities directly associated with assets classified as held for sale' on the balance sheet.

\*\* The loans and advances to banks cash equivalents include amounts classified as 'Other financial assets at fair value' and 'Assets classified as held for sale' on the balance sheet.

The Group is required to maintain balances with the Bank of England which, at 4 April 2007, amounted to for the Group and Society £152.1 million (2006 – £138.8 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.

## 51 Post balance sheet events

On 23 April 2007, Portman Building Society savers and borrowers approved the merger of the Portman and Nationwide Building Societies. Subject to confirmation by the FSA, the effective date for the merger is expected to be 28 August 2007. Following the merger, Nationwide Building Society will have assets of more than £160 billion and will serve more than 13 million members.

# Annual Business Statement

## For the year ended 4 April 2007

### 1 Statutory percentages

	2007 %	Statutory limit %
Lending limit	14.6	25.0
Funding limit	28.4	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, investment properties and insurance assets 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; 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.

**2 Other percentages**

	2007 %	2006 %
As a percentage of shares and borrowings:		
• Gross capital	6.5	6.6
• Free capital	6.0	6.0
• Liquid assets	13.9	13.4
Profit for the financial year as a percentage of mean total assets	0.36	0.34
Management expenses as a percentage of mean total assets	0.86	0.85

The above percentages have been prepared from the Society's consolidated accounts and in particular:

- 'Shares and borrowings' represent the total of 'Shares', 'Deposits from banks', 'Other deposits', 'Amounts due to customers' and 'Debt securities in issue'.
- 'Gross capital' represents the aggregate of 'General reserve', 'Revaluation reserve', 'Available for sale reserve', 'Subscribed capital' and 'Subordinated liabilities'.
- 'Free capital' represents the aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment and intangible fixed assets.
- 'Liquid assets' represent the total of 'Cash 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'.

### 3 Information relating to directors and other officers

At 4 April 2007

#### Directors

Name and date of birth	Occupation	Date of appointment to the Board	Other directorships
<b>J G W Agnew</b> MA Chairman 30 July 1941	Banker	1 March 1997	Beazley Group plc, Chairman Beazley Furlonge Ltd, Chairman LMS Capital plc, Chairman Rightmove plc St Mary's School Ascot The Cayenne Trust plc, Chairman Thos Agnew & Sons Ltd
<b>G J Beale</b> BSc, ACA 19 October 1958	Chief Executive Officer	5 April 2003	
<b>B K Simpson</b> MIMIS, FRSA 29 January 1948	Deputy Chief Executive and Chief Operating Officer	2 May 1994 (Retired 5 May 2007)	
<b>S D M Bernau</b> BSc (Econ), FCIB, MCT 15 August 1951	Group Retail Director	1 November 1996	at.home nationwide ltd, Chairman Ethos Independent Financial Services Ltd, Chairman Financial Services Skills Council, Chairman Nationwide Life Ltd Nationwide Unit Trust Managers Ltd The Minchinhampton Golf Club Ltd UCB Home Loans Corporation Ltd, Chairman
<b>M M Rennison</b> BA, FCA 9 August 1960	Group Finance Director	1 February 2007	First Nationwide Nationwide Anglia Property Services Ltd Nationwide Investments (No.1) Ltd Nationwide BES Fund Managers Ltd, Chairman Nationwide Housing Trust Ltd, Chairman Nationwide Lease Finance Ltd Nationwide Mortgage Corporation Ltd, Chairman Nationwide Syndications Ltd, Chairman
<b>D J Rigney</b> ACMA, MBA 1 June 1963	Group Operations Director	1 October 2006	HM Land Registry NBS Fleet Services Ltd Monument (Sutton) Ltd Nationwide Anglia Property Services Ltd

## 3 Information relating to directors and other officers (continued)

At 4 April 2007

<b>Mrs S J David</b> MA (Cantab) 20 November 1962	Company Director	16 April 2003	Bacardi Global Brands Incorporated, United States Bacardi Global Brands Ltd Bacardi New Zealand Holdings Ltd, New Zealand
<b>R G Handover</b> 13 April 1946	Company Director	1 May 2000	Dauntsey's School, Chairman Royal Mail Holdings plc The Community Foundation for Wiltshire and Swindon, Chairman
<b>G M T Howe</b> MA (Cantab) 3 September 1949	Company Director	1 January 2005	Gateway Electronics Components Ltd Investec Ltd, South Africa Investec plc Jardine Lloyd Thompson Group plc, Chairman JPMorgan Overseas Investment Trust plc
<b>D A Ross</b> BSc, LLB, FCA, ACMA, CTA (Fellow), FCT 1 August 1950	Building Society Director	1 December 2004	
<b>Ms S Taverne</b> 3 February 1960	Company Director	16 November 2005	National Council for One Parent Families, Chair Vlessing & Taverne Ltd
<b>R P Walther</b> MA, FIA Deputy Chairman 31 July 1943	Company Director	1 July 2002	British United Provident Association Ltd BUPA Health Assurance Ltd BUPA Insurance Ltd Fidelity European Values plc, Chairman Nationwide Life Ltd Nationwide Pension Fund Nominee Ltd Nationwide Pension Fund Trustee Ltd Nationwide Unit Trust Managers Ltd

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. Six executive directors had or have contracts on this basis; they are (with the date of their contract) P F Williamson (5 April 1996) (Mr Williamson retired from the Board on 31 March 2007), S D M Bernau (1 November 1996), J H Willens (1 January 2002) (Mr Willens retired from the Board on 30 September 2006) G J Beale (3 March 2003), D J Rigney (1 October 2006) and M M Rennison (1 February 2007). One executive director, B K Simpson, had a contract which was entered into on 16 April 1992, before the current standard terms were introduced, which was terminable by him on three months' notice or by the Society on payment of an amount equivalent to two years' basic salary. Mr Simpson retired from the Board on 5 May 2007.

**Directors' Share Options**

No director or other officer, including connected persons, has any rights to subscribe for shares in, or debentures of, any connected undertaking of the Society.

## 3 Information relating to directors and other officers (continued)

At 4 April 2007

## Officers

Name	Occupation	Directorships
<b>A J Alexander</b> ACA	Divisional Director (Finance)	Nationwide Healthcare Trustee Ltd NBS Fleet Services Ltd
<b>R T Bailey</b> DMS	Divisional Director (Insurance & Investments)	Foundation Insurance Ltd, Isle of Man Nationwide Life Ltd Nationwide Unit Trust Managers Ltd The New Swindon Company Ltd
<b>M C A Carter</b>	Divisional Director (Mortgages & Savings)	Nationwide International Ltd, Isle of Man
<b>L J Coleman</b> BA (Hons), MBA, ACIB, AMCT	Divisional Director (Treasury)	First Nationwide Nationwide Lease Finance Ltd Nationwide Investments (No.1) Ltd
<b>M J Hodsdon</b> ACIB	Divisional Director (Central Retail Operations)	
<b>G P Hughes</b>	Divisional Director (Retail Network)	
<b>M W Humphreys</b> BSc, PhD	Divisional Director (Information Technology)	UCB Home Loans Corporation Ltd
<b>M R Jenkins</b> BA (Hons), FCA, DIPL	Divisional Director (Commercial)	at.home nationwide Ltd Longwide Ltd Nationwide BES Fund Managers Ltd Nationwide Housing Trust Ltd Nationwide Lease Finance Ltd Nationwide Mortgage Corporation Ltd Nationwide Syndications Ltd
<b>R Johnston</b> LLB, F Col, ACII	Divisional Director (Legal Compliance)	
<b>T K Kaye</b> MBA	Divisional Director (Change Management)	
<b>P Leydon</b> ACIB	Divisional Director (Audit)	
<b>Mrs M R Mason</b>	Divisional Director (Member Account Administration)	
<b>S G Nowell</b>	Divisional Director (Risk Management)	
<b>C P Reed</b>	Divisional Director (Customer Service & Communications)	Institute of Customer Service The Nationwide Foundation
<b>J A Sutherland</b> MA, MBA, FCIB, Dip FS	Divisional Director (Marketing)	Nationwide Life Ltd Nationwide Unit Trust Managers Ltd Nationwide International Ltd, Isle of Man
<b>J R Wood</b>	Divisional Director (Consumer Finance)	Aldbury Housing Association Northamptonshire Grammar School Charitable Trust, Member The Nationwide Foundation Nationwide Pension Fund Nominee Ltd Nationwide Pension Fund Trustee Ltd Nationwide Trust Ltd
<b>J D Wriighthouse</b>	Divisional Director (Human Resources)	Nationwide Healthcare Trustee Ltd Nationwide Pension Fund Nominee Ltd Nationwide Pension Fund Trustee Ltd

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(June 2007)



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