Pillar 3 Disclosures 2010

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Certain statements in this Pillar 3 Disclosure document are forward looking. Although Nationwide believes that the expectations reflected in these forward-looking statements are reasonable, we can give no assurance that these expectations will prove to be an accurate reflection of actual results. Because these statements involve risks and uncertainties, actual results may differ materially from those expressed or implied by these forward-looking statements.

We undertake no obligation to update any forward-looking statements whether as a result of new information, future events or otherwise.

1 Overview

1.1 Background

The European Union Capital Requirements Directive came into effect on 1 January 2007. This introduced consistent capital adequacy standards and an associated supervisory framework in the EU based on the Basel II Accord. The Directive is enforced in the UK as rules and guidance by the Financial Services Authority ("the FSA") in the Handbook. The rules include disclosure requirements known as "Pillar 3" which apply to banks and building societies. These are designed to promote market discipline through the disclosure of key information about risk exposures and risk management processes.

In May 2008, the FSA granted Nationwide permission to use Internal Ratings Based (IRB) approaches for credit risk and capital management. The disclosures in this document are based on IRB approaches for certain portfolios and Standardised for the remainder of credit risks and operational risk, as detailed in the capital management section (4.1).

1.2 Basis and Frequency of Disclosures

This document sets out the 2010 Pillar 3 Disclosures for Nationwide. The sole purpose of these disclosures is to give information on the basis of calculating Basel II capital requirements and on the management of risks faced by the Group. This is done in accordance with the rules laid out in the FSA Handbook (BIPRU Chapter 11). The disclosures may differ from similar information in the Annual Report and Accounts 2010 prepared in accordance with International Financial Reporting Standards ('IFRS'); therefore, the information in these disclosures may not be directly comparable with that information.

Unless otherwise stated, all figures are as at 4 April 2010, our financial year-end, with comparative figures for 4 April 2009 where relevant. Pillar 3 Disclosures are published annually and as soon as is practicable after the publication of the Annual Report and Accounts.

1.3 Location and Verification

These disclosures have been reviewed by the Group's Audit Committee, the Executive Risk Committee and the Board Risk Committee, and are published on the Group's corporate website.
(nationwide.co.uk/investorrelations).

All figures disclosed within this document have been subject to internal verification. These disclosures have not been externally audited and do not constitute any part of the Group's financial statements.

1.4 Scope

Nationwide is an EEA parent institution that is regulated by the FSA. The Basel II Framework therefore applies to Nationwide and its subsidiary undertakings (together, the "Group"). The Group also includes the business combinations that occurred in the previous financial year (2008/09) from the mergers with Derbyshire and Cheshire building societies, and assets and liabilities acquired from the Dunfermline Building Society (together, the "regional brands").

There is a requirement to calculate and maintain regulatory capital ratios on both a Group basis and on a "solo consolidation" basis. However, there are no differences between the basis of consolidation of the Group for accounting and prudential purposes. The principal subsidiaries included under solo consolidation are:

- The Mortgage Works (UK) plc
- UCB Home Loans Corporation Limited
- Derbyshire Home Loans Limited
- E-Mex Home Funding Limited
- Nationwide Syndications Limited

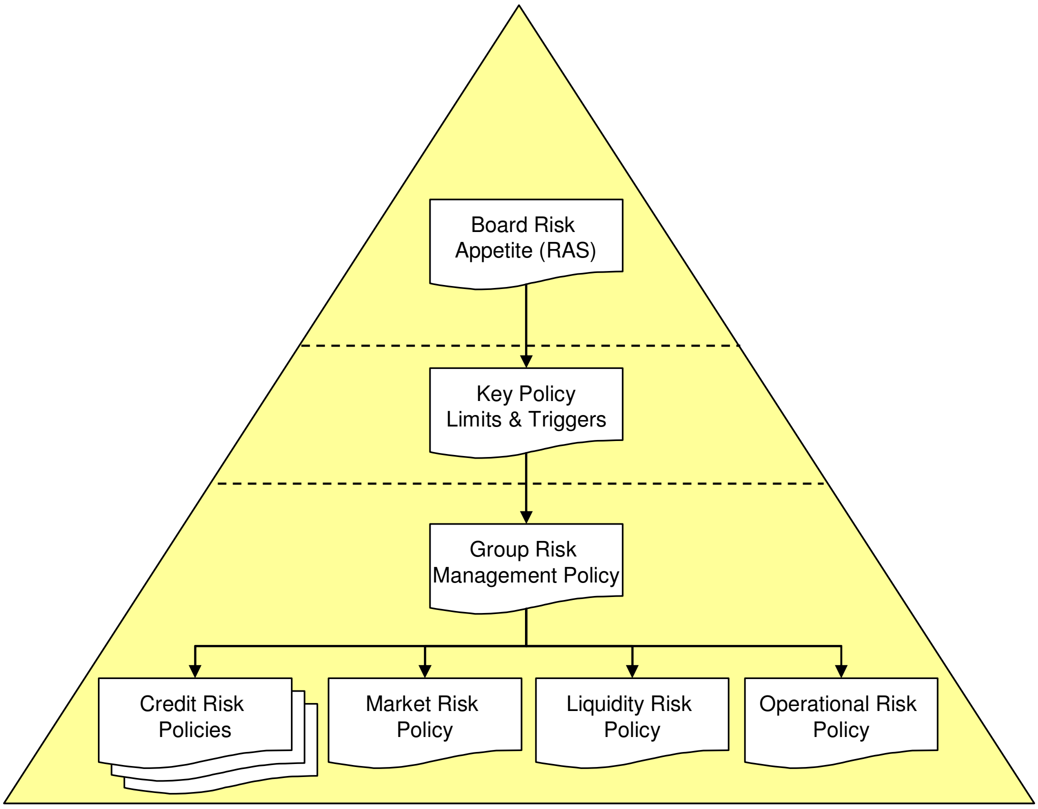
All of the Group's subsidiaries are included in the Pillar 3 disclosures. Nationwide International Limited is regulated by the Isle of Man Financial Supervision Commission and has its own regulatory capital requirement. In addition, Nationwide has a branch in Republic of Ireland (Nationwide UK Ireland) which is a retail deposit taker and is regulated by the Central Bank and Financial Services Authority of Ireland. With that exception, the Group does not foresee any practical or legal impediments to the transfer of capital resources or the repayment of liabilities within the Group. Full details of the principal subsidiary undertakings are included in Note 21 to the Annual Report and Accounts.

2 Risk Management

2.1 Group Risk Management Framework

Nationwide operates within a comprehensive Group Risk Management Framework (GRMF) which comprises the following:

1. The Board Risk Appetite Statement (RAS);
2. Key policy limits, triggers and mandates owned by the Board;
3. An overarching Group Risk Management Policy approved by the Board;
4. Detailed Risk Management Policies for specific risks approved by risk committees with delegated powers;
5. The adoption of the "Three Lines of Defence" approach to managing the risks.



The framework interacts with key processes of corporate management which the Board also oversees:

- Corporate Plan;
- Internal Capital Adequacy Assessment Process (ICAAP);
- Internal Liquidity Adequacy Assessment (ILAA);
- Stress testing of capital and liquidity.

2.2 Board Risk Appetite

Nationwide is the custodian of its members' long-term financial interests. As a mutual organisation with no shareholders, the Board is prudent when deciding upon its appetite for risk relative to its banking peers, in order to take a long-term view of value creation. As such, the Board has agreed to adopt an overall low Risk Appetite, expressed in terms of the following six categories:

- Solvency
- Liquidity
- Funding
- Asset Quality
- Quality of Earnings
- Operational Risk

The Board owns, sets and monitors key policy limits and triggers for the first five categories that provide the context for the detailed risk management policies, limits and triggers. In addition, separate Key Risk Indicators are set and monitored for operational risk appetite in respect of the key operational risk categories outlined in Section 8.

2.3 Risk Management Policies

The Board has assessed the Group's most significant risk categories as credit risk, market risk, liquidity and funding risk, and operational risk. The Board Risk Appetite sets the context for each of these and there are detailed risk management policies with specific limits and triggers, documented as follows:

Risk policy

For all material risks within Nationwide's Risk Profile the Board's approach to risk management is documented within a set of detailed risk management policies. These are owned and approved by the relevant mandated risk committee and the Board, and are supported by comprehensive limits, triggers, and processes.

Risk measurement

Robust and discriminatory internal ratings systems and models are used to measure the Group's credit risk exposures. The systems and models have been developed and validated according to documented and approved model development policies and procedures. Similarly, appropriate quantitative and qualitative methodologies have been developed to measure the Group's other material risk exposures, in line with industry best practice.

Risk control

Control of the Group's current and future exposure to risk is managed by the imposition of increasingly granular limits, triggers and mandates. These are embedded within risk policies and set by the relevant policy-owning committee. This provides a clear hierarchical structure for identifying and managing risk against Risk Appetite.

Risk mitigation

All credit risk exposures, whether fully performing or otherwise, are reviewed at least annually. Behavioural scoring techniques are used to measure retail exposures; for commercial and treasury exposures, a comprehensive health check on the financial standing of the borrower or counterparty is carried out. Both methods enable the Group to assess whether the level of credit given to borrowers remains acceptable.

Business streams are responsible for all of the material risks within Nationwide's Risk Profile to ensure that appropriate mitigation techniques are undertaken which minimise the Group's exposure to each risk type. Additionally, they are responsible for minimising losses arising from the materialisation of a risk. Credit risk mitigation is described in more detail in section 5.7.

Risk monitoring and reporting

Specialist risk support functions are responsible for measuring and reporting performance against capital targets, as well as the limits, triggers and mandates contained within the relevant Risk Management Policies. Management information is provided to the risk committees and to the Executive Risk Committee every month. Risk Appetite is also monitored by the Board Risk Committee and summary information is prepared for consideration by the Board quarterly.

At all levels of reporting, if past or future forecast business performance appears to have moved, or is likely to move, outside of agreed parameters, or there is a breach or near-breach of policy limits, the relevant committee will ensure that the most appropriate course of action is implemented. Thereafter, if the situation persists the matter will be escalated, ultimately to the Nationwide Board.

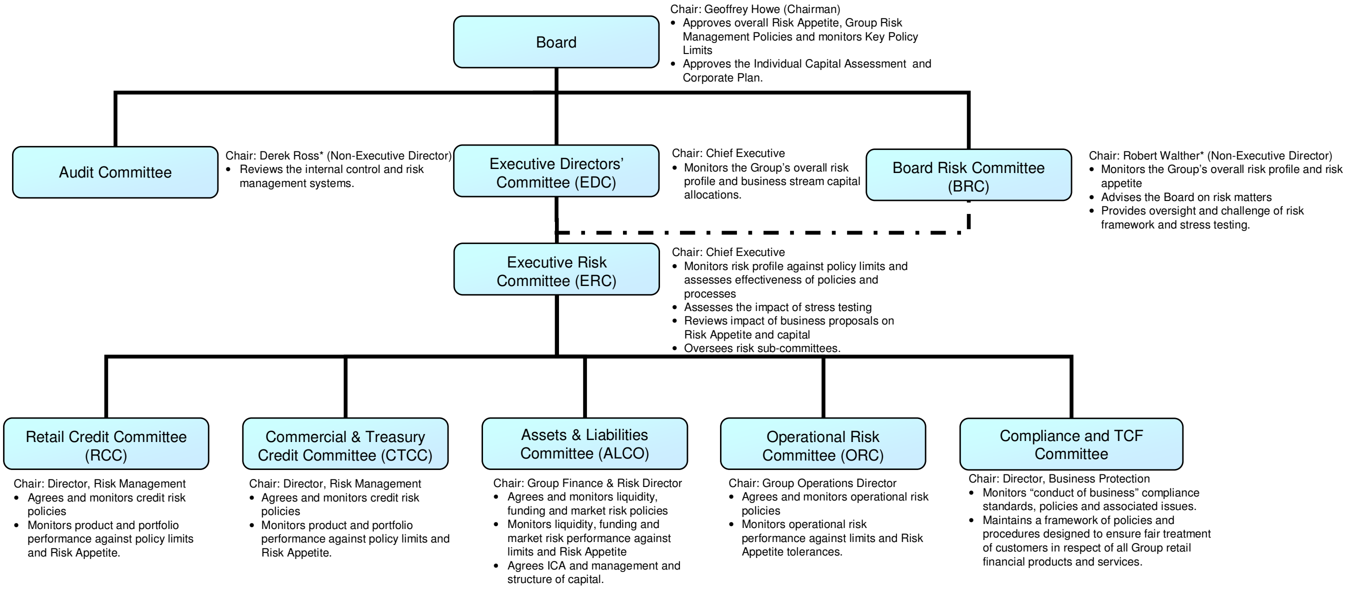
Risk governance & responsibilities

Governance and responsibilities for risk management is aligned to the Three Lines of Defence. Detailed responsibilities for risk committees and individuals in both Business Streams and Risk Management Division are set out in risk policies and include mandates where appropriate.

Risk committees ensure that risk policies and their terms of reference are reviewed annually or more frequently, as required.

2.4 Board and Risk Management Committee Structure

The framework is supported by a well-established risk committee structure, summarised as follows:



Board

Chair: Geoffrey Howe (Chairman)

- Approves overall Risk Appetite, Group Risk Management Policies and monitors Key Policy Limits
- Approves the Individual Capital Assessment and Corporate Plan.

Audit Committee

Chair: Derek Ross* (Non-Executive Director)

- Reviews the internal control and risk management systems.

Executive Directors' Committee (EDC)

Chair: Chief Executive

- Monitors the Group's overall risk profile and business stream capital allocations.

Board Risk Committee (BRC)

Chair: Robert Walther* (Non-Executive Director)

- Monitors the Group's overall risk profile and risk appetite
- Advises the Board on risk matters
- Provides oversight and challenge of risk framework and stress testing.

Executive Risk Committee (ERC)

Chair: Chief Executive

- Monitors risk profile against policy limits and assesses effectiveness of policies and processes
- Assesses the impact of stress testing
- Reviews impact of business proposals on Risk Appetite and capital
- Oversees risk sub-committees.

Retail Credit Committee (RCC)

Chair: Director, Risk Management

- Agrees and monitors credit risk policies
- Monitors product and portfolio performance against policy limits and Risk Appetite.

Commercial & Treasury Credit Committee (CTCC)

Chair: Director, Risk Management

- Agrees and monitors credit risk policies
- Monitors product and portfolio performance against policy limits and Risk Appetite.

Assets & Liabilities Committee (ALCO)

Chair: Group Finance & Risk Director

- Agrees and monitors liquidity, funding and market risk policies
- Monitors liquidity, funding and market risk performance against limits and Risk Appetite
- Agrees ICA and management and structure of capital.

Operational Risk Committee (ORC)

Chair: Group Operations Director

- Agrees and monitors operational risk policies
- Monitors operational risk performance against limits and Risk Appetite tolerances.

Compliance and TCF Committee

Chair: Director, Business Protection

- Monitors "conduct of business" compliance standards, policies and associated issues.
- Maintains a framework of policies and procedures designed to ensure fair treatment of customers in respect of all Group retail financial products and services.

**This diagram is based on 4 April. From July 2010, Alan Dickinson (Non-Executive Director) will chair the Board Risk Committee and, from July 2010, Roger Perkin (Non-Executive Director) will chair the Audit Committee.*

Delegated committees are responsible for satisfying themselves that no material changes in risk levels and profiles have occurred or are planned. Where appropriate, they will prepare policy and strategy papers for agreement by the Board Risk Committee and/or the Nationwide Board. These papers will propose the appropriate scale, portfolio mix and/or desired return to fit with the Group's overall Risk Appetite. In addition, the Board Risk Committee in its oversight capacity reviews Risk Appetite and supporting policies and may request changes or additional measures.

The framework includes feedback mechanisms to ensure the continuing relevance and appropriateness of the governance, structure and risk monitoring metrics and escalation of issues.

2.5 Coverage of Risks

Pillar 3 disclosures in this document cover credit risks (section 5), market risks (section 6), liquidity and funding risks[1] (section 7) and operational risks (section 8). Additional information regarding risk can be found in the 2010 Annual Report and Accounts (pages 29-36).

Responsibility for risk management (first line of the "Three Lines of Defence" model) lies with operational areas. Responsibilities for risk oversight and governance (the second line) lie with the specialist risk support functions in Risk Management Division (RMD) and powers delegated through the Executive Risk Committee to specialist risk committees.

[1] *Included for completeness as liquidity and funding risk falls outside the disclosure requirements for Pillar 3.*

Responsibilities for the Group’s main risks have been allocated as follows:

Key Risks	FIRST LINE	SECOND LINE	
	Risk Management	Risk Oversight (RMD)	Risk Governance[1]
Credit Risk			
• Retail credit risk	Retail Lending	Retail Credit Risk	Retail Credit Committee
• Commercial credit risk	Commercial Lending	Commercial & Treasury Credit Risk	Commercial & Treasury Credit Committee
• Treasury credit risk	Treasury Division	Commercial & Treasury Credit Risk	Commercial & Treasury Credit Committee
Market Risk	Treasury Division and Product Areas	Market Risk	Assets & Liabilities Committee
Liquidity and Funding Risk	Treasury Division and Product Areas	Market Risk	Assets & Liabilities Committee
Operational Risk	All business areas	Operational Risk Unit	Operational Risk Committee

[1] *Oversight of all risk governance committees is provided by the Executive Risk Committee.*

First line of defence: senior management responsibilities

All Business Stream managers are responsible for managing business performance in line with the Group’s overall Risk Appetite (per the Group Risk Management Framework described above). This requires them to manage their areas in line with operational performance targets and objectives cascaded from the Group’s Corporate Plan, capital limits set within its Capital Plan, and risk exposure limits set within Group Risk Management Policies.

Second line of defence: risk committees

All risk committees have Board-mandated responsibility to: monitor business performance against Risk Appetite; to set, monitor and report on risk policy and methodology; and to challenge the risk management approach undertaken for their specific risks.

Second line of defence: specialist risk support functions

Specialist risk functions within Risk Management Division support the Board-mandated risk committees to fulfil their delegated responsibilities in respect of risk governance. These functions cover each of the significant categories of risk, namely retail, commercial and treasury credit risk, market risk, liquidity and funding risk, and operational risk, and play a major role in supporting the operational areas to manage their risks effectively on a day-to-day basis.

In addition, a Risk Analysis & Capital Planning function sits alongside the specialist risk support functions and is responsible for developing and maintaining the risk and capital management frameworks within which the entire Group operates.

All of the functions within Risk Management Division are mandated to carry out their responsibilities by the Board through the Executive Risk Committee.

Third line of defence: Internal Audit

Group Internal Audit independently reviews the first and second lines of defence to provide objective assurance as to the adequacy and effectiveness of internal controls across the business. A risk-based programme of work is undertaken which is designed to provide appropriate coverage of the key business risks and processes. The Audit Committee approves the Annual Audit Plan and receives regular reports on the results of audit work.

3 Capital Resources

3.1 Total Available Capital

At 4 April 2010 and throughout the financial year, the Group complied with the capital requirements that were in force as set out by the FSA. The Group's Internal Ratings Based (IRB) Waiver Application was approved by the FSA in May 2008 with subsequent confirmation from the FSA that Nationwide had cleared the conditions required to use its IRB models to calculate capital requirements.

The following table shows the composition of capital resources under Pillar 3 for the Nationwide Group as at 4 April 2010:

Table 1: Capital composition

		Group		Solo	
		2010	2009	**2010**	2009
	Notes	**£m**	£m	**£m**	£m
Tier 1					
General reserve	1	**6,363**	6,218	**6,160**	5,976
Permanent Interest Bearing Shares (PIBS)		**1,524**	1,526	**1,524**	1,526
Pension fund deficit adjustment		**355**	167	**355**	167
Intangible assets		**(353)**	(211)	**(353)**	(211)
Deductions	2	**(232)**	(186)	**(232)**	(186)
Material holdings in non-solo consolidated subsidiaries	3	**-**	-	**(16)**	(16)
		7,657	7,514	**7,438**	7,256
Tier 2					
Revaluation reserve		**68**	69	**68**	69
Subordinated debt		**2,132**	2,233	**2,132**	2,233
Collective impairment allowance		**97**	60	**97**	60
Deductions	2	**(232)**	(186)	**(232)**	(186)
Material holdings in non-solo consolidated subsidiaries	3	**-**	-	**(16)**	(16)
		2,065	2,176	**2,049**	2,160
Qualifying holdings in non-solo consolidated subsidiaries	4	**-**	-	**(46)**	(409)
Total capital		**9,722**	9,690	**9,441**	9,007

1. *The comparative figures for 2009 have been adjusted to reflect changes made to the initial accounting for the acquisition of core parts of the Dunfermline Building Society.*
2. *Certain deductions from capital are required to be allocated, 50% to tier 1 and 50% to tier 2 capital. Deductions are subject to different treatment under IRB in respect of net expected loss over accounting provisions and certain securitisation positions. These are calculated in accordance with FSA guidance.*
3. *Under solo consolidation, material holdings are excluded from capital and deducted equally from tier 1 and tier 2.*
4. *Under solo consolidation, qualifying holdings are excluded from capital and deducted to calculate total capital.*

- The increase in intangible assets is due to additions of £184 million relating primarily to the Society's investment in a new systems platform to meet the future needs of the business;
- Deductions have increased as the number of exposures in collections has increased; and
- The qualifying holdings in non-solo consolidated subsidiaries have decreased following the repatriation of capital to the Society from certain subsidiaries.

3.2 Tier 1 Capital

Tier 1 capital comprises:

- General reserve;
- Permanent Interest Bearing Shares (PIBS); and
- Adjustments as required by the rules governing capital resources.

The general reserve represents the Group's accumulated accounting profits, including gains from acquisition of Cheshire Building Society and core parts of the Dunfermline Building Society, as well as adjustments for pensions and property disposals.

PIBS are unsecured, deferred shares and rank behind the claims of all subordinated note-holders, depositors, creditors and investing members of Nationwide. Further details about PIBS are provided in Note 36 to the 2010 Annual Report and Accounts.

Adjustments are required by the rules governing capital resources:

- An adjustment is made to tier 1 capital in respect of the Group's pension obligations. For accounting purposes, the present value of obligations less the fair value of plan assets in respect of the Nationwide Pension Fund ("the Fund") is included as a liability and hence deducted from the general reserve. For capital purposes this amount is added back to the Group's capital position; instead, a deduction is made for the additional funding that is expected to be paid to the Fund over the next five years. At 4 April 2010, £355m had been added back to capital in this regard which represents the aggregate of this adjustment.
- An adjustment is also made in respect of intangible assets. For accounting purposes, items including computer software, other intangibles resulting from business combinations, and goodwill are capitalised as intangible fixed assets where they meet certain criteria. Intangibles are deducted from capital under the regulatory rules; at 4 April 2010 £353m had been deducted from capital in respect of intangible assets.
- Deductions (£464m) are also made under Basel II in respect of expected loss, where it exceeds accounting provisions for IRB exposures, and certain securitisations split equally between tier 1 and tier 2.

3.3 Tier 2 Capital

Tier 2 capital comprises:

- The Group's property revaluation reserve;
- Qualifying subordinated notes;
- Collective impairment allowance (for exposures treated on the Standardised basis); and
- Adjustments as required by the rules governing capital resources.

Subordinated notes are unsecured and rank behind the claims of all depositors, creditors and investing members (other than holders of PIBS) of the Society. More details of the subordinated notes are included in Note 35 to the 2010 Annual Report and Accounts.

Adjustments are required by the rules governing capital resources:

Deductions (£464m) are made under Basel II in respect of expected loss, where it exceeds accounting provisions for IRB exposures, and certain securitisations split equally between tier 1 and tier 2.

Under FSA rules, qualifying subordinated notes cannot exceed 50% of the total of tier 1 capital, and tier 2 capital cannot exceed tier 1 capital.

3.4 Solo Consolidation

Under the solo consolidation basis, deductions are required in respect of material holdings in subsidiaries that are excluded from solo consolidation. Material holdings represent shares and any other interest in the capital of an individual credit institution or financial institution where they exceed 10% of the share capital of the issuer. A deduction of £32m is made for material holdings allocated evenly between tier 1 and tier 2 capital.

In addition, qualifying holdings in subsidiaries are excluded from solo consolidation (£46m); under the rules these are deducted before the total of tier 1 and tier 2 capital to give the final capital position for the Solo Group. A qualifying holding is a direct or indirect holding in a non-financial undertaking which represents 10% or more of the capital or of the voting rights which makes it possible to exercise a significant influence over the management of that undertaking.

4 Capital Adequacy

4.1 Capital Management

Nationwide manages its capital resources in excess of regulatory requirements. Capital is monitored on a monthly basis against the capital plan and supported by a range of limits and triggers that ensure that capital continues to be within the Board's Risk Appetite. In addition to calculating the minimum Capital Resource Requirement (CRR) as required under BIPRU rules, the Group uses an economic capital framework to support the management of its capital requirements. The CRR covers all Pillar 1 risks (credit risk, operational risk and market risk).

Credit risk

The Group has adopted Internal Ratings Based (IRB) approaches for certain credit risk portfolios following FSA approval in May 2008. The scope of our Internal Ratings Based permission is as follows:

Retail IRB	Society prime mortgages[2], unsecured lending (personal loans), and qualifying revolving credit risks (FlexAccount and credit cards).
Foundation IRB	Treasury exposures (excluding corporates).

All other credit risks adopt the Standardised approach. The more significant credit risk portfolios currently using the Standardised approach (commercial lending, Private Finance Initiatives, prime retail mortgages from the regional brands, and specialist retail mortgage lending) will migrate to IRB approaches under a rollout plan.

Market risk

Market risk for the Group arises from foreign exchange risk under Pillar 1 due to foreign currencies in the banking book. The Foreign Exchange Position Risk Requirement (FX PRR) charge is the amount of regulatory capital required to cover the risk of losses on open foreign currency positions due to movements in foreign exchange rates. This is calculated in accordance with the FSA Handbook. Other interest rate risks are not included in regulatory capital under Pillar 1 as the Group does not have a trading book.

Operational risk

The Standardised approach is adopted for operational risk.

Reporting

Capital is reported monthly in the Board Performance Pack. More detailed reports of capital and risk, including information by Business Stream, are considered monthly by the Executive Risk Committee and the Capital Management Working Group (CMWG[3]), a sub-committee of the Assets and Liabilities Committee (ALCo). Specific reports of capital by Business Stream are also included in the monthly packs of the risk committees as appropriate.

4.2 Internal Capital Adequacy Assessment Process

The Group undertakes an Internal Capital Adequacy Assessment Process (ICAAP) which is an internal assessment of its capital needs for Pillar 2 purposes. This internal assessment considers risks included in the Pillar 1 CRR as well as other risks not included in Pillar 1. The ICAAP is performed annually or more frequently should the need arise.

The outcome of the ICAAP is presented in an Internal Capital Assessment (ICA) document covering the Group and its subsidiaries. The ICA covers all material risks to determine the capital requirement over at least a three-year horizon, and takes account of severe economic stresses to satisfy the regulatory requirements and the effect of these on capital.

The ICA is presented to CMWG, ALCo, Board Risk Committee[4] and the Board (with whom ultimate responsibility lies) for challenge and approval. The FSA assesses our ICA and sets Individual Capital Guidance (ICG) for the Group on an IRB basis. The company retains capital in excess of the ICG at all times.

[2] *Prime mortgages originated by Nationwide and Portman only; prime mortgages from the regional brands are treated as Standardised.*

[3] *Liquidity & Capital Management Committee from May 2010, a further development of CMWG.*

[4] *Board Risk Committee was formed in January 2010 and its responsibilities are set out in Section 2.4.*

4.3 Minimum Capital Requirement: Pillar 1

Nationwide's overall minimum Capital Resource Requirement (CRR) under Pillar 1 is calculated by adding the credit risk charge (section 4.4) to that required for market risk and operational risk. The following table shows the Group's CRR and capital resources surplus under Pillar 1 at 4 April 2010:

Table 2: Total minimum Pillar 1 capital requirement

	Group		Solo	
	2010	2009	**2010**	2009
	£m	£m	**£m**	£m
Credit Risk (IRB)	**1,397**	1,366	**1,406**	1,368
Credit Risk (Standardised)	**2,259**	2,320	**2,264**	2,363
Market Risk (FX PRR)	**4**	3	**4**	3
Operational Risk (Standardised)	**346**	296	**346**	296
Capital Resources Requirement under Pillar 1	**4,006**	3,985	**4,020**	4,030
Capital resources (per Table 1)	**9,722**	9,690	**9,441**	9,007
Capital resources surplus over requirement	**5,716**	5,705	**5,421**	4,977

The increase in solo capital resources is due to the repatriation of capital from certain subsidiaries under solo-consolidation.

4.4 Minimum Capital Requirement: Credit Risk

The following table shows the composition of the minimum capital requirement for credit risk at 4 April 2010. The solo figures are slightly higher than the Group as a result of loans to non-solo consolidated subsidiaries.

Table 3: Minimum capital requirement for credit risks

		Group		Solo	
		2010	2009	**2010**	2009
	Notes	**£m**	£m	**£m**	£m
Internal Ratings Based (IRB) exposure classes					
Central governments & central banks		**301**	240	**301**	240
Institutions	1	**169**	239	**169**	239
Retail mortgages (prime secured against residential property)		**432**	333	**432**	333
Qualifying revolving retail	2	**175**	178	**175**	178
Other retail (unsecured loans)		**71**	77	**71**	77
Securitisation positions		**84**	78	**84**	78
Non-credit obligation assets (fixed assets and other)		**93**	106	**102**	108
Counterparty Credit Risk (Derivatives)	1	**72**	115	**72**	115
		1,397	1,366	**1,406**	1,368
Standardised exposure classes					
Regional governments & local authorities		**3**	3	**3**	3
Institutions		**-**	2	**-**	2
Corporates (Non Commercial)		**37**	45	**47**	92
Retail mortgages (secured against residential property)	3	**668**	666	**668**	666
Other Retail		**1**	1	**1**	1
Commercial lending (secured against property)		**1,207**	1,324	**1,207**	1,324
Commercial lending (PFI & other commercial)		**143**	116	**143**	116
Past due		**185**	143	**185**	143
Other		**15**	20	**10**	16
		2,259	2,320	**2,264**	2,363
Total		**3,656**	3,686	**3,670**	3,731

Notes

1. In 2009, Counterparty Credit Risk was included under Institutions; it is now reported as a separate item.

2. Credit cards and current accounts (FlexAccount).

3. Retail mortgages from regional brands and specialist residential lending.

The overall capital requirements in 2010 are similar to 2009. The main increases in exposures from 2009 are in central governments & central banks and retail mortgages (prime) under IRB, while the largest falls are in institutions under IRB and commercial lending (secured against property).

The total minimum capital requirements are not materially different on a Group or solo basis; the disclosures in the remainder of this document are therefore shown on a Group basis only.

5 Credit Risks

5.1 Credit Risk Overview

Introduction

Credit risk is defined as the risk that a borrower or counterparty fails to pay the interest or to repay the capital on a loan. Risks are inherent across most of the Group’s activities and may arise from changes in credit quality, and the recoverability of loans and amounts due from counterparties. Adverse changes in the credit quality of borrowers or a general deterioration in UK economic conditions could affect the recoverability and value of the Group’s assets and therefore its financial performance. Comprehensive risk management methods and processes have been established as part of the Group’s overall governance framework to measure, mitigate and manage credit risk within the Group’s Risk Appetite.

Exposure as shown in these credit risk disclosures is defined as Exposure Value under the regulatory definitions for capital purposes. Exposure Value (calculated as exposure at default, EAD, under IRB) is an estimate of the expected utilisation of a credit facility and will be equal to or greater than the drawn exposure excluding any credit risk mitigation.

Exposures

The credit risk exposures at 4 April 2010 and the averages for the year are summarised as follows:

Table 4: Credit risk exposures

	Average 2009/10	4th April 2010	**Average 2008/09**	4th April 2009
	£m	£m	**£m**	£m
Internal Ratings Based (IRB) exposure classes				
Central governments & central banks	**37,805**	**35,519**	35,820	38,183
Institutions	**17,511**	**14,581**	26,218	19,785
Retail mortgages (prime secured against residential property)	**112,280**	**110,848**	114,533	113,931
Qualifying revolving retail	**8,771**	**9,684**	7,847	8,002
Other retail (unsecured loans)	**1,198**	**1,165**	1,267	1,220
Securitisation positions	**6,437**	**6,250**	7,270	7,290
Non-credit obligation assets (fixed assets and other)	**1,374**	**1,158**	1,228	1,325
Counterparty Credit Risk (Derivatives)	**3,642**	**3,656**	3,304	4,301
	189,018	**182,861**	197,487	194,037
Standardised exposure classes				
Regional governments & local authorities	**35**	**35**	39	38
Institutions	**38**	**-**	36	139
Corporates (Non Commercial)	**475**	**458**	649	585
Retail mortgages (secured against residential property)	**22,603**	**22,613**	18,354	22,553
Other Retail	**18**	**14**	23	21
Commercial lending (secured against property)	**20,972**	**20,624**	21,056	21,386
Commercial lending (PFI & Other Commercial)	**1,592**	**1,792**	1,463	1,444
Past due	**1,776**	**1,934**	905	1,533
Other	**682**	**677**	572	949
	48,191	**48,147**	43,097	48,648
Total*	**237,209**	**231,008**	240,584	242,685

**Note that this figure differs from the total assets figure reported in the Annual report due to a different calculation which includes adjustments for securitisation and derivatives.*

The following chart and tables show the geographical distribution; these are followed by the residual maturity of these exposures at 4 April 2010.

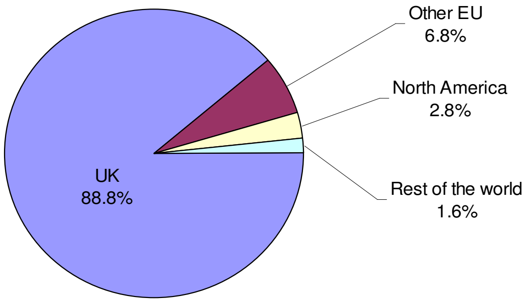


Table 5: Geographical distribution of credit risk exposures (2010)

	UK	Other European countries	North America	Rest of the World	Total
	£m	£m	£m	£m	£m
IRB exposure classes					
Central governments & central banks	28,138	3,758	1,731	1,892	35,519
Institutions	4,380	6,057	2,564	1,580	14,581
Retail mortgages (prime secured against residential property)	110,848	-	-	-	110,848
Qualifying revolving retail	9,684	-	-	-	9,684
Other retail (unsecured loans)	1,165	-	-	-	1,165
Securitisation positions	2,333	1,954	1,804	159	6,250
Non-credit obligation assets (fixed assets and other)	1,158	-	-	-	1,158
Counterparty Credit Risk (Derivatives)	940	2,364	307	45	3,656
	158,646	14,133	6,406	3,676	182,861
Standardised exposure classes					
Regional governments & local authorities	35	-	-	-	35
Institutions	-	-	-	-	-
Corporates (Non Commercial)	89	285	71	13	458
Retail mortgages (secured against residential property)	22,613	-	-	-	22,613
Other Retail	14	-	-	-	14
Commercial lending (secured against property)	19,421	1,203	-	-	20,624
Commercial lending (PFI & Other Commercial)	1,792	-			1,792
Past due	1,916	18	-	-	1,934
Other	616	18	43	-	677
	46,496	1,524	114	13	48,147
Total	205,142	15,657	6,520	3,689	231,008

Table 6: Geographical distribution of credit risk exposures (2009)

	UK	Other European countries	North America	Rest of the World	Total
	£m	£m	£m	£m	£m
IRB exposure classes					
Central governments & central banks	35,803	2,280	49	51	38,183
Institutions	5,676	11,096	2,049	964	19,785
Retail mortgages (prime secured against residential property)	113,931	-	-	-	113,931
Qualifying revolving retail	8,002	-	-	-	8,002
Other retail (unsecured loans)	1,220	-	-	-	1,220
Securitisation positions	2,634	2,303	2,125	228	7,290
Non-credit obligation assets (fixed assets and other)	1,325	-	-	-	1,325
Counterparty Credit Risk (Derivatives)	1,234	2,412	445	210	4,301
	169,825	18,091	4,668	1,453	194,037
Standardised exposure classes					
Regional governments & local authorities	38	-	-	-	38
Institutions	122	1	-	16	139
Corporates (Non Commercial)	121	425	39	-	585
Retail mortgages (secured against residential property)	22,553	-	-	-	22,553
Other Retail	21	-	-	-	21
Commercial lending (secured against property)	20,146	1,240	-	-	21,386
Commercial lending (PFI & Other Commercial)	1,444	-			1,444
Past due	1,519	14	-	-	1,533
Other	867	40	39	3	949
	46,831	1,720	78	19	48,648
Total	216,656	19,811	4,746	1,472	242,685

Table 7: Residual maturity of credit risk exposures (2010)

	On demand	Up to 12 months	1-5 years	5-10 years	More than 10 years	Total
	£m	£m	£m	£m	£m	£m
IRB exposure classes						
Central governments & central banks	-	23,871	3,155	4,973	3,520	35,519
Institutions	-	10,562	2,842	1,115	62	14,581
Retail mortgages (prime secured against residential property)	-	1,047	3,675	10,193	95,933	110,848
Qualifying revolving retail	9,684	-	-	-	-	9,684
Other retail (unsecured loans)		156	856	153	-	1,165
Securitisation positions	-	-	318	1,002	4,930	6,250
Non-credit obligation assets (fixed assets and other)	210	8	5	366	569	1,158
Counterparty Credit Risk (Derivatives)	-	80	3,576	-	-	3,656
	9,894	35,724	14,427	17,802	105,014	182,861
Standardised exposure classes						
Regional governments & local authorities	-	-	35	-	-	35
Institutions	-	-	-	-	-	-
Corporates (Non Commercial)	-	90	285	83	-	458
Retail mortgages (secured against residential property)	8	138	1,054	2,794	18,619	22,613
Other Retail	-	-	5	6	3	14
Commercial lending (secured against property)	-	1,127	10,303	861	8,333	20,624
Commercial lending (PFI & Other Commercial)		19	1,705	68	-	1,792
Past due	-	36	121	341	1,436	1,934
Other	619	-	0	58	-	677
	627	1,410	13,508	4,211	28,391	48,147
Total	10,521	37,134	27,935	22,013	133,405	231,008

Table 8: Residual maturity of credit risk exposures (2009)

	On demand	Up to 12 months	1-5 years	5-10 years	More than 10 years	Total
	£m	£m	£m	£m	£m	£m
IRB exposure classes						
Central governments & central banks	-	31,447	1,925	2,763	2,048	38,183
Institutions		10,698	5,295	3,766	26	19,785
Retail mortgages (prime secured against residential property)	-	795	3,430	10,172	99,534	113,931
Qualifying revolving retail	8,002	-	-	-	-	8,002
Other retail (unsecured loans)	-	62	922	229	7	1,220
Securitisation positions	-	-	351	793	6,146	7,290
Non-credit obligation assets (fixed assets and other)	423	-	264	250	388	1,325
Counterparty Credit Risk (Derivatives)		2,325	1,151	819	6	4,301
	8,425	45,327	13,338	18,792	108,155	194,037
Standardised exposure classes						
Regional governments & local authorities	-	-	21	13	4	38
Institutions	-	126	11	-	2	139
Corporates (Non Commercial)	-	94	199	292	-	585
Retail mortgages (secured against residential property)	-	172	1,270	8,046	13,065	22,553
Other Retail	-	-	7	9	5	21
Commercial lending (secured against property)	-	353	1,548	2,032	17,454	21,386
Commercial lending (PFI & Other Commercial)	-	24	104	137	1,178	1,444
Past due	-	29	96	270	1,138	1,533
Other	-	867	30	30	22	949
	-	1,665	3,286	10,829	32,868	48,648
Total	8,425	46,992	16,624	29,621	141,023	242,685

The maturity of exposures is shown on a contractual basis rather than the actual redemptions experienced by the Group, and does not take into account any instalments receivable over the life of the exposure. As a consequence actual maturity is likely to be materially different.

The Group is firmly committed to the management of credit risk in both its lending and Treasury market activities. For all its lending business the Group employs sophisticated credit scoring, underwriting and fraud detection techniques that support sound credit decision making and work to minimise losses. A proactive approach to the identification and control of loan impairment is maintained, with challenge and oversight provided by the Retail Credit Committee and the Commercial & Treasury Credit Committee with further oversight by the Executive Risk Committee.

5.2 Retail Credit Risk

Prime mortgages[5], revolving retail (Flex Account and credit card), and unsecured lending adopt the Retail IRB approach where Probability of Default (PD), Exposure Value and Loss Given Default (LGD) are calculated using internal rating systems. Other retail portfolios are calculated on the Standardised basis.

The following table shows the Group's exposure for prime Society mortgages under IRB at 4 April 2010:

Table 9: Prime retail mortgage exposures under IRB

PD band	Exposure Value		Exposure Weighted Average LGD		Exposure Weighted Average RW	
	2010	2009	**2010**	2009	**2010**	2009
%	**£m**	£m	**%**	%	**%**	%
0.00 - 0.019	**26,412**	30,002	**3.5**	6.1	**0.6**	0.9
0.02 - 0.029	**27,098**	38,442	**6.3**	8.7	**1.0**	1.3
0.03 - 0.049	**18,358**	21,894	**8.4**	11.6	**1.8**	2.3
0.05 - 0.099	**18,826**	13,463	**12.3**	13.5	**3.9**	4.2
0.10 - 0.49	**15,177**	6,108	**13.7**	19.2	**8.7**	10.5
0.50 - 0.99	**522**	1,310	**9.2**	19.1	**12.9**	24.8
1.00 - 2.99	**2,700**	1,236	**12.2**	10.9	**31.6**	32.3
3.00 - 9.99	**460**	545	**9.6**	11.6	**83.0**	71.8
10.00 - 19.99	**537**	277	**10.4**	9.4	**62.8**	84.4
20.00 - 99.99	**454**	445	**9.7**	9.8	**72.2**	77.2
100.00 - (in default)	**304**	209	**15.1**	3.4	**199.3**	-
Total	**110,848**	113,931				

The PD model for prime mortgages uses a hybrid rating system that combines Point in Time (PiT) grade distributions with conservatively-adjusted probabilities of default. The PiT grade distributions are mapped from the application scores, behavioural scores and arrears status. Each grade is assigned a conservatively-adjusted or long run average PD that is used in the capital calculation. The model allows ratings migration to occur dependent on the economic cycle.

Both LGD and Exposure Value models calculate PiT and downturn estimates, the latter of which are fed into the capital calculation. LGD takes account of house price forecasts, collection costs, loan-to-value (LTV), external credit rating data and the likelihood of loss in the event of default to predict the loss on the property at the point of sale. The regulatory floor of 10% is applied when appropriate and any estimated recoveries after sale are not included. Exposure Value takes account of balances and an adjustment to include the potential for additional months' interest prior to default.

Internal data covering the period back to the early 1990s has been used in the development of both PD and LGD models. This has been supplemented with industry data where appropriate.

[5] *Prime mortgages originated by Nationwide and Portman; prime mortgages from the regional brands are treated as Standardised.*

The following table shows the Group's exposure for qualifying revolving retail portfolios (FlexAccounts and credit cards) under Retail IRB at 4 April 2010:

Table 10: Qualifying revolving retail exposures under IRB

PD band	Exposure Value		Exposure Weighted Average LGD		Exposure Weighted Average RW	
	2010	2009	2010	2009	2010	2009
%	£m	£m	%	%	%	%
0.00 - 0.29	**2,781**	2,147	**45.4**	40.1	**6.9**	4.0
0.30 - 0.49	**3,362**	2,619	**47.7**	44.7	**11.4**	9.7
0.50 - 0.99	**866**	769	**53.5**	48.9	**19.8**	20.8
1.00 - 1.99	**1,095**	974	**50.4**	52.4	**29.4**	34.9
2.00 - 9.99	**899**	1,009	**52.1**	50.5	**67.5**	82.7
10.00 - 39.99	**469**	355	**51.2**	57.1	**105.8**	147.5
40.00 - 99.99	**28**	14	**58.2**	56.6	**77.3**	163.0
100.00 - (in default)	**184**	115	**32.8**	58.6	**-**	-
Total	**9,684**	8,002				

The reported Loss Given Default numbers are under review and are likely to be increased to levels in-line with the previous year following amendments to the underlying models.

The following table shows the Group's exposure for other retail (unsecured lending) under IRB at 4 April 2010:

Table 11: Other retail (unsecured lending) exposures under IRB

PD band	Exposure Value		Exposure Weighted Average LGD		Exposure Weighted Average RW	
	2010	2009	2010	2009	2010	2009
%	£m	£m	%	%	%	%
0 - 0.99	**184**	227	**62.1**	62.1	**55.7**	55.5
1.00 - 1.99	**514**	496	**62.1**	62.1	**77.1**	77.1
2.00 - 5.99	**267**	269	**62.2**	62.1	**90.8**	90.8
6.00 - 9.99	**92**	110	**62.2**	62.1	**99.1**	99.2
10.00 - 19.99	**27**	33	**62.2**	62.1	**124.9**	125.4
20.00 - 99.99	**15**	18	**62.2**	62.1	**166.3**	167.1
100.00 - (in default)	**67**	67	**62.0**	62.1	**-**	-
Total	**1,165**	1,220				

The PD models for unsecured and revolving retail portfolios use rating systems that take Point in Time (PiT) grade distributions of default and adjusts these to determine probabilities of default over a long run average. Key inputs to the PiT grade distributions are arrears status and behavioural or application scores. The adjustments result in long run average, 12-month PDs that are conservative estimates as to how accounts would be expected to perform over an economic cycle.

Both LGD and Exposure Value models take PiT estimates that are adjusted to give downturn results to feed into the capital calculation. Statistical techniques are used to develop homogeneous pools across the unsecured portfolios. These models estimate average loss (percentage) of Exposure Value over a recovery period that is specific to the particular product type, and take account of balances and limit utilisation for each pool, credits to accounts and account age.

Management of retail credit risks

Retail credit risks are managed in accordance with limits set out within the Retail Credit Risk Management Policy. The policy sets out lending criteria and circumstances where specialist underwriting may be needed.

For residential mortgages, a combination of lending policy criteria, credit scoring (including behavioural scoring), policy rules and underwriting are used to make a decision on applications for credit. The primary factors considered are affordability, residential status, residential history, credit history, employment history, nature of income and loan-to-value (LTV). In addition, confirmation of borrower identity is obtained and an assessment of the value of the security being taken as collateral is carried out prior to granting a credit facility. When considering applications, the primary focus is placed on the willingness and ability to repay.

Credit scoring is used to support the customer account management process in the following ways:

- To set customer maximum lending limits;
- To determine account specific recommended limits and product types;
- To set shadow limits to manage unauthorised borrowing; and
- To prioritise collections activity.

A range of LTV limits apply for new business across the mortgage portfolio as a whole and also at portfolio level (prime, specialist lending). Limits are also set for the concentrations of LTV bands.

For unsecured products, similar lending policy criteria are used. Each of the unsecured portfolios has its own credit scoring models (including behavioural scoring), policy and underwriting rules to make decisions on applications for credit and to manage accounts. The factors used are attuned to the portfolio in question although affordability and credit history are considered in all areas. Accounts are subject to behavioural scoring every month.

Ongoing monitoring of all retail credit portfolios is undertaken by the Retail Credit Risk function in Risk Management Division. Reports are sent to the Retail Credit Committee and Executive Risk Committee on a monthly basis. In the event that particular exposures show adverse features such as arrears, specialist lending teams will work with borrowers to resolve the situation.

5.3 Commercial Credit Risk

Nationwide's commercial lending activity relates to the provision of facilities to meet the funding requirements of private sector landlords and property investors, registered social landlords, and funding projects originated under Private Finance Initiatives.

The following table provides an analysis of commercial lending exposure by industry sector (including past due) at 4 April 2010:

Table 12: Commercial lending by industry sector under the Standardised approach

	2010	2009
	£m	£m
Registered Social Landlords	**8,890**	8,062
Private Finance Initiatives (PFI) [1]	**1,507**	1,230
Property Finance lending:		
● Retail	**3,776**	4,094
● Office	**2,859**	3,139
● Residential	**2,309**	2,456
● Industrial and warehouse	**2,037**	2,183
● Leisure and hotel	**1,141**	955
● Owner occupier	**667**	997
● Other	**286**	214
Regional governments and local authorities (lease receivables)	**35**	38
Total	**23,507**	23,368

[1] *PFI treated as unrated corporates*

Commercial credit risks are managed in accordance with limits and asset quality measures which are set out in the Commercial Credit Risk Management Policy. The policy places limits on business volumes as well as the sector, geography, size and seniority of exposures. Reports relating to the profile of the commercial lending portfolio are sent to the Commercial & Treasury Credit Committee and the Executive Risk Committee on a monthly basis.

Lending decisions are based upon independent credit risk analysis supplemented by the use of expert judgement models which assess the obligor's likelihood of default. The output of these models is a borrower grade which maps to a long-run average, one-year Probability of Default (PD). Borrower grades are reviewed at least annually, allowing identification of adverse individual and sector trends.

The Commercial & Treasury Credit Risk function in Risk Management Division has a level of delegated sanctioning authority and underwrites certain credit risks based upon an evaluation of model outputs and a qualitative overlay based on expert judgement. Factors taken into consideration are:

- The borrower's experience;
- Track record;
- Financial strength;
- Ability to repay;
- Transaction structure; and
- Security characteristics.

Large or high risk exposures are subject to further approval by the Commercial & Treasury Credit Committee and/or the Executive Risk Committee. Consideration is also given to risk mitigation measures which will provide the Group with protection; examples are third-party guarantees, supporting collateral and security, robust legal documentation, financial covenants and hedging.

To ensure that risks are appropriately priced, transactions are further assessed using an internal pricing model which takes into account capital utilisation and return on economic capital as measured against a series of limits/targets disseminated from the Corporate Plan.

Monitoring of asset quality in the commercial portfolio is based upon a number of measures including, economic capital, financial covenant monitoring, pricing movements and external input from rating agencies and other organisations. In the event that particular exposures begin to show adverse features (such as payment arrears, covenant breaches or business trading losses) then a full risk reappraisal is undertaken.

Where appropriate, a specialist recovery team will work with the borrower to resolve the situation. If this proves unsuccessful, the case will be subject to intensive monitoring and management procedures designed to maximise debt recovery.

5.4 Treasury Credit Risk

Treasury credit risks are managed in accordance with limits and asset quality measures which are set out in the Treasury Credit Risk Management Policy. The policy also sets out powers which require higher levels of authorisation according to the size of the transaction or the nature of the associated risk.

Lending and investment decisions are made by applying a qualitative overlay adjustment to the outputs of a quantitative, financial strength rating model. This is in order to reflect material changes in internal and external operating conditions that may not yet be reflected in the financial information. The output from this process provides Nationwide with a long-term unsecured debt rating, comparable to Moody's. Once "on book", all individual exposures are reviewed at least annually.

Treasury uses a number of risk mitigation techniques including netting and collateralisation agreements. Other methods such as disposal and credit derivatives are used periodically to mitigate the credit risk associated with particular transactions or a group of transactions.

Ongoing asset quality monitoring is undertaken by Treasury Division and the Commercial & Treasury Credit Risk function in Risk Management Division. Reports relating to the profile of the Treasury credit portfolio are sent to the Commercial & Treasury Credit Committee and the Executive Risk Committee on a monthly basis. Where necessary, exception reporting also takes place against a range of asset quality triggers including economic capital analysis.

Nationwide uses Standard and Poor's (S&P), Moody's, and Fitch as External Credit Assessment Institutions (ECAIs) for treasury credit risk exposures. S&P is used for Sovereigns, Institutions, Asset Backed Securities, Covered Bonds and Corporates. Moody's is used for Sovereigns, Institutions, Covered Bonds and Asset Backed Securities. Fitch is used for Asset Backed Securities.

The Group's preference for a long-term rating for Institutions and Corporates is the senior unsecured rating. If this is unavailable, then counterparty ratings and deposit ratings are used to record the short-term rating or the commercial paper rating. The issue/note rating is used for Asset Backed Securities.

The issuer and issue credit assessments provided by ECAIs are one of a number of considerations that form part of the credit assessment process. This process is documented within policy and is supported by comprehensive Treasury Credit procedures.

An Internal Ratings Based (IRB) model is used to determine Probability of Default (PD) for Treasury exposures (excluding corporates which are treated as Standardised). Under Foundation IRB, regulatory parameters are used for Loss Given Default (LGD) and the conversion factor. The PD model for banks consists of two key elements – a statistically-driven quantitative financial strength rating and a qualitative overlay. For non-bank entities and investment banks, external ratings are substituted for the quantitative element.

The qualitative adjustment is applied to the calculated quantitative rating or external rating as appropriate to reflect material changes in internal and external operating conditions that may not yet be reflected in the financials or published external ratings. The adjustment also recognises any external support mechanisms that would take effect in the event of the counterparty encountering financial difficulties, environmental (external) factors and business environment (internal) factors.

The model generates a long-term, unsecured debt rating by combining these quantitative and qualitative factors. The output is a numerical rating ranging from 1 to 22, with grades 1 to 10 equating to investment grade status and grade 22 representing default. The following table shows the mapping of internal default grades to external ratings at 4 April 2010:

Table 13: Internal default grades mapped to external ratings

Internal Default Grades	S&P Ratings	Moody's Ratings	Fitch Ratings
1 – 3	AAA to AA	Aaa to Aa2	AAA to AA
4 – 6	AA- to A	Aa3 to A2	AA- to A
7 – 9	A- to BBB	A3 to Baa2	A- to BBB
10 – 12	BBB- to BB	Baa3 to Ba2	BBB- to BB
13 – 16	BB- to B-	Ba3 to B3	BB- to B-
17 – 22	CCC+ to D	Caa to C	CCC+ to D

The following table shows the Exposure Values associated with central governments and central banks under Foundation IRB including commitments at 4 April 2010. Repurchase agreements with the Bank of England are included in the Exposure Value under internal default grades 1-3 which affects the exposure weighted average LGD.

Table 14: Central governments & central banks under Foundation IRB

Internal Default Grades	PD band %	Exposure Value		Exposure Weighted Average LGD		Exposure Weighted Average RW	
		2010	2009	2010	2009	2010	2009
		£m	£m	%	%	%	%
1 - 3	0.000 - 0.03	**35,519**	38,127	**29.0**	26.5	**10.6**	7.8
4	0.031 - 0.04	**-**	-	**-**	-	**-**	-
5	0.041 - 0.05	**-**	-	**-**	-	**-**	-
6	0.051 - 0.07	**-**	-	**-**	-	**-**	-
7	0.071 - 0.10	**-**	56	**-**	45.0	**-**	19.8
8	0.101 - 0.20	**-**	-	**-**	-	**-**	-
9	0.201 - 0.30	**-**	-	**-**	-	**-**	-
10	0.301 - 0.50	**-**	-	**-**	-	**-**	-
11	0.501 - 0.75	**-**	-	**-**	-	**-**	-
12	0.751 - 2.00	**-**	-	**-**	-	**-**	-
13-21	2.001 - 99.99	**-**	-	**-**	-	**-**	-
22	100.00% (in default)	**-**	-	**-**	-	**-**	-
Total		**35,519**	38,183				

The following table shows the Exposure Values associated with institutions under Foundation IRB including commitments at 4 April 2010. Repurchase agreements are included in this table which affects the exposure weighted average LGD where appropriate.

Table 15: Institutions under Foundation IRB

		Exposure Value		Exposure Weighted Average LGD		Exposure Weighted Average RW	
Internal Default Grades	PD band %	2010 £m	2009 £m	2010 %	2009 %	2010 %	2009 %
1 - 3	0.000 - 0.03	**2,487**	5,554	**13.2**	27.1	**4.1**	5.9
4	0.031 - 0.04	**765**	1,104	**44.9**	32.4	**12.6**	11.7
5	0.041 - 0.05	**6,350**	6,047	**13.1**	35.7	**6.6**	11.2
6	0.051 - 0.07	**2,482**	3,608	**33.9**	45.0	**22.3**	22.4
7	0.071 - 0.10	**1,162**	1,761	**38.2**	43.4	**19.8**	26.0
8	0.101 - 0.20	**636**	864	**52.1**	40.4	**50.1**	35.2
9	0.201 - 0.30	**334**	280	**42.0**	45.0	**42.4**	44.2
10	0.301 - 0.50	**280**	4	**52.9**	45.0	**87.4**	65.9
11	0.501 - 0.75	**-**	399	**-**	5.3	**-**	12.4
12	0.751 - 2.00	**14**	5	**45.0**	45.0	**90.3**	111.1
13-21	2.001 - 99.99	**-**	83	**-**	45.0	**-**	120.0
22	100.00% (in default)	**71**	76	**45.0**	45.0	**-**	-
Total		**14,581**	19,785				

The following table shows the Exposure Values with each credit quality step for corporate treasury exposures under the Standardised approach at 4 April 2010:

Table 16: Corporates under Standardised

Credit Quality Step	Risk weight	S&P ratings	Moody's ratings	Exposure values	
				2010	2009
	%			£m	£m
1	20	AAA to AA-	Aaa to Aa3	**40**	18
2	50	A+ to A-	A1 to A3	**22**	34
3	100	BBB+ to BBB-	Baa1 to Baa3	**20**	60
4	100	BB+ to BB-	Ba1 to Ba3	**-**	23
5	150	B+ to B-	B1 to B3	**-**	-
6	150	CCC+ and below	Caa1 and below	**90**	20
Unclassified	100	Unknown	Unknown	**286**	430
Total				**458**	585

Exposure Values for equities are risk-weighted at 100% and included under Standardised “other” (see Table 4). Exposure Values for Asset Backed Securities can be found in section 5.9.

5.5 Impairment Provisions

Assets held 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, delinquency or default in interest or principal payments or the debt is 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 carrying amount of the asset 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.

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.

The following table shows the past due loans and provisions for impaired exposures (equivalent to value adjustments) and charges to the income statement for the year ended 4 April 2010. For the purposes of these disclosures, "past due" is defined as one day or over. The amounts shown as past due represent the full amount of the loan outstanding, not just the amount that is past due.

Table 17: Past due loans and provisions for impaired exposures

	Retail secured lending		Retail unsecured lending		Commercial lending		Other lending		Total	
	2010	2009	**2010**	2009	**2010**	2009	**2010**	2009	**2010**	2009
	£m	£m	**£m**	£m	**£m**	£m			**£m**	£m
Neither past due nor impaired	**122,844**	128,121	**2,074**	2,187	**22,451**	22,427	**538**	659	**147,907**	153,394
Past due:										
Up to 3 months	**3,058**	3,285	**45**	58	**315**	557	**5**	6	**3,423**	3,906
3 to 6 months	**622**	660	**60**	63	**233**	122	**14**	6	**929**	851
6 to 12 months	**456**	420	**67**	70	**318**	229	**15**	4	**856**	723
Over 12 months	**303**	143	**45**	37	**190**	21	**4**	5	**542**	206
Possessions	**190**	248	**-**	-	**-**	12	**-**	-	**190**	260
Total Past Due	**4,629**	4,756	**217**	228	**1,056**	941	**38**	21	**5,940**	5,946
Outstanding balances	**127,473**	132,877	**2,291**	2,415	**23,507**	23,368	**576**	680	**153,847**	159,340
Provisions	**160**	121	**148**	136	**422**	194	**20**	19	**750**	470
Charge for the year	**89**	91	**126**	113	**299**	171	**35**	19	**549**	394

Past due loans, impaired loans and provisions are all UK-based with the exception of £36m impairment charge (2009: £18m) relating to a portfolio of European commercial loans. For more detail of commercial lending, see Table 12.

The following table summarises the movement during the year in impairment provisions:

Table 18: Movement in impaired provisions

	Individual provisions		Collective provisions		Total	
	2009/10	2008/09	**2009/10**	2008/09	**2009/10**	2008/09
	£m	£m	**£m**	£m	**£m**	£m
Balance at 5 April	**229**	11	**241**	201	**470**	212
Charge for the year	**365**	239	**184**	155	**549**	394
Write-offs	**(135)**	(18)	**(124)**	(126)	**(259)**	(144)
Recoveries	**4**	1	**16**	17	**20**	18
Unwind of discount	**(23)**	(4)	**(7)**	(6)	**(30)**	(10)
Balance at 4 April	**440**	229	**310**	241	**750**	470

Further information on the charge to the income statement for provisions and more detailed analysis is included in Note 12 in the Annual Report and Accounts (pages 90-91).

The impairment charge during the year on investment securities of £36 million (2009:£51 million) comprises a £36 million charge on Available For Sale investment securities (2009: £51 million).

Available For Sale assets

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets are impaired. If any such evidence exists for Available For Sale financial assets, the cumulative loss (measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that asset previously recognised) is recognised in the income statement.

A subsequent decline in the fair value of an investment security classified as Available For Sale is recognised in the income statement when there is further objective evidence of impairment as a result of further decreases in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised directly in the Available For Sale reserve. If the fair value of an investment debt security classified as Available For Sale increases in a subsequent period (and the increase can be related objectively to an event occurring after the impairment loss was recognised in the income statement), the impairment loss is reversed through the income statement to the extent of the increase in fair value.

As at 4 April 2010, over 87% of the portfolio is rated A or better with 69% rated AA or above (4 April 2009: 97% rated A or better, 76% rated AA or better).

5.6 Credit Risk Concentrations

For residential mortgages, LTV concentration limits are set within policy. Geographic concentration of risk is also monitored, but no specific parameters are deemed necessary for domestic lending. The Group operates across the whole of the UK with a bias towards the south-east of England reflecting a concentration of the market in that region and historically higher asset value growth trends. As at 4 April 2010, approximately 34% (2009: 34%) of residential exposures by account was concentrated in the south-east and Greater London. By their nature, our residential mortgages and unsecured lending comprise a large number of intrinsically highly-diversified small loans and with a low volatility of credit risk outcomes.

For commercial lending, exposure to each of the principal lending categories is monitored and total portfolio exposure constrained via a self-imposed cap set at 17.5% of Nationwide's total business assets. Limits are also set to restrict the size of aggregate exposure to any single counterparty or group of closely-connected counterparties. Concentration of risk within the portfolio is monitored using indicators such as maturity, industry sector and geography, though specific limits are not normally imposed for UK-domiciled lending.

In terms of counterparty concentration, the largest single commercial customer, including undrawn commitments, represents only 1% (2009: 1%) of the commercial portfolio.

Policy limits have also been set to enable the management of treasury credit risk concentrations. These limits are actively monitored and relate to aggregate counterparty, country and asset class exposures.

5.7 Credit Risk Mitigation

The Group uses a wide range of techniques to reduce credit risk of its lending. The most basic of these is performing an assessment of the ability of a borrower to service the proposed level of borrowing without distress. However, the risk can be further mitigated by obtaining security for the funds advanced.

Residential mortgages

Residential property is the Group's main source of collateral and means of mitigating credit risk inherent in its residential mortgage portfolios. All mortgage lending activities are supported by an appropriate form of valuation using either an independent firm of valuers (except historic low LTV re-mortgage cases valued without independent valuation), indexed valuation (further advances) or by Automatic Valuation Model subject to business rules and confidence levels.

All residential property must be insured to cover property risks, which may be through a third party. Additional protection is also afforded to borrowers through optional payment protection insurance.

Commercial

Commercial property is the Group’s main source of collateral and means of mitigating credit risk inherent in its commercial portfolios. Collateral for the majority of commercial loans comprises first legal charges over freehold or long leasehold property (including Companies House registration where appropriate).

For property-based lending, supporting information such as professional valuations are an important tool to help determine the suitability of the property offered as security. In the case of investment lending, the property generates cash flow to cover interest and repay the advance. All valuations are undertaken by members of an internally-approved panel of valuers that is controlled by a dedicated team within Commercial Division.

Nationwide's standard documentation states that it has the power to have the security re-valued at the customer's expense every two years (or upon an act of default) and while a revaluation is not automatically obtained, the merits of obtaining a revaluation are considered at each facility review.

All standard documentation is subject to independent legal review and sign-off in order to ensure that Nationwide's legal documentation is robust and enforceable. Documentation for large advances is tailor-made, specifically prepared by independent solicitors, and is co-ordinated by a specialist loan documentation team who oversee all documentation issues.

A syndication strategy may be adopted to avoid large concentrations of risk and hedging strategies are considered as part of the appraisal process where borrowers have chosen variable rates. Insurance requirements are always fully considered as part of the application process and Nationwide ensures that appropriate insurance is taken out to protect the property e.g. building or terrorism cover, and to cover an important party or to protect against an insurable event.

Treasury

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 Group’s preferred method of documenting derivative activity is the International Swaps and Derivatives Association (ISDA) Master Agreement. It is common in such cases for a Credit Support Annex to be executed in conjunction with the ISDA Master Agreement in order to mitigate credit risk on the derivatives portfolio. Under these agreements the Group values its portfolio in-house using discounted cashflow and options pricing models as appropriate. Any such valuations are agreed with the relevant counterparties, and collateral is then exchanged in order to bring the credit exposure within agreed tolerances.

The Group’s legal documentation with its counterparties for derivative transactions grants legal rights of set-off for those transactions. Accordingly, for credit exposure purposes, negative market values on derivatives will offset positive market values on derivatives with the same counterparty in the calculation of credit risk, subject to an absolute exposure of zero by counterparty.

Guarantees, from connected legal entities or Monoline insurers, may be available for some treasury counterparty debt. Where available, these guarantees may enhance the credit profile of the exposure and provide security in the event of default. Any concentration of exposures in this respect is actively monitored. Further detail about Monoline insurers can be found in the Annual Report & Accounts under Business Review – Treasury Portfolios (page 21).

5.8 Credit Derivatives

The purchase of a credit derivative (credit default swap) is treated as credit substitution and enables credit exposure to be transferred to the credit protection seller (for the future performance of contractual commitments) from the reference asset (to which exposure only arises in the joint event that the asset and the credit protection seller both default).

Exposure to the protected reference asset is recorded at a lower amount as determined by the creditworthiness of the credit protection seller. However, the total exposure remains unchanged.

At 4 April 2010, the Group had credit derivatives in place to cover the credit risk of £88 million notional (2009: £153m notional) of assets within the treasury Available For Sale portfolio. All of the credit derivatives are with US and European banking institutions rated A+ or above.

5.9 Securitisation

Retained securitisation positions

The Silverstone Master Trust programme for retail mortgages is currently the only vehicle that securitises assets originated by the Group. Notes are issued by the Silverstone Master Issuer plc to the Society, either for the purposes of creating collateral to be used for funding or for subsequent sale of notes to investors outside the Group to provide wholesale funding. Nationwide Building Society is both originator and servicer of the programme. Other roles fulfilled by the Society are fully described in the Silverstone base prospectus.

In November 2009 £3.5 billion of 5- and 7-year funding was obtained through the Silverstone Master Trust vehicle. £2.25 billion was publicly purchased. The remaining £1.25 billion bonds were issued to the Society and used to raise funding via a sale and repurchase agreement. All of the assets pledged are retained on the Society’s balance sheet and hence there is no risk transfer. The Silverstone programme is rated by S&P, Moody’s and Fitch.

Purchased securitisation positions

The total Group exposure to purchased securitisation positions at 4 April 2010 was £5.6 billion by market value with mortgage-backed securities accounting for the majority of this exposure. Securitisation provides the Group with a diversified, capital-efficient source of investment income. Investment is undertaken within clearly defined credit risk policy. Nationwide employs a ratings-based approach for calculating risk weighted exposure on its securitisation portfolio. The exposure is managed although there have been no material additions to, or disposals from, the portfolio since April 2009. Reduction in the size of the portfolio as a result of maturing assets has been offset by an increase in the market value of underlying securities.

The following table shows the breakdown of these exposures split by credit quality steps with indicative external credit assessment ratings:

Table 19: Aggregate exposure to purchased securitisation positions

Credit Quality	Risk weight			S&P	Moody's	Fitch	Exposure values		Exposure Weighted average RW	
Step	Most senior tranche	Base (not senior)	Non-granular pool	ratings	ratings	ratings	2010	2009	2010	2009
	%	%	%				£m	£m	%	%
1	7	12	20	AAA	Aaa	AAA	4,911	6,452	9.8	10.2
2	8	15	25	AAA	Aa	AAA	651	366	12.2	16.5
3	10	18	35	A+	A1	A+	123	97	11.8	18.1
4	12	20	35	A	A2	A	218	167	17.9	28.9
5 [1]	20	35	35	A-	A3	A-	69	14	36.6	30.0
6	35	50	50	BBB+	Baa1	BBB+	43	76	42.0	40.1
7	60	75	75	BBB	Baa2	BBB+	87	80	72.5	76.7
8 [2]	100	100	100	BBB-	Baa3	BBB-	58	8	106.0	106.0
9 [2]	250	250	250	BB+	Ba1	BB+	73	29	265.0	265.0
10 [2]	425	425	425	BB	Ba2	BB	17	1	450.5	450.5
11 [2]	650	650	650	BB-	Ba3	BB-	-	-	-	-
Total (Credit Quality Steps 1 -11)							6,250	7,290		
Below 11	1250	1250	1250	Below BB-	Below Ba3	Below BB-	351	288		

[1] *Counterparties classified under non-granular pool with a risk weight of 35% have been classified under Credit Quality Step 5.*

[2] *Additional scalar of 6% applied on risk weighted average.*

The following table shows the breakdown of purchased positions split by exposure type:

Table 20: Aggregate amount of securitisation positions purchased by exposure type

	2009/10	2008/09
	£m	£m
Residential mortgages	**3,479**	3,629
Commercial mortgages	**940**	1,067
Credit card receivables	**229**	181
Loans to corporates or SMEs	**559**	846
Consumer loans	**1,273**	1,591
Other assets	**121**	264
Total 2009/10	**6,601**	7,578

The following table shows the breakdown of retained or purchased positions split by geographic region:

Table 21: Aggregate amount of securitisation positions purchased by geographic region

	2009/10	2008/09
	£m	£m
Europe	**4,074**	4,376
Americas	**2,294**	2,907
Asia/Pacific	**-**	-
Others	**233**	295
Total	**6,601**	7,578

Further details of securitisation can be found in the Annual Report & Accounts under Business Review (page 19), Note 1 (page 77) and Note 19 (pages 99-100).

5.10 Counterparty Credit Risk

The Group uses derivative instruments to hedge its exposure to market risk, for example, interest rate and foreign exchange risk. Counterparty credit risk is the risk that a counterparty to a derivative instrument we hold could default. The risk is mitigated by offsetting the amounts due to the same counterparties ('netting benefits') and by cash deposited by certain of the counterparties ('collateral held').

The following table shows the exposures to counterparty credit risk for derivative contracts at 4 April 2010:

Table 22: Net exposures to counterparty credit risk for derivative contracts

	2010	2009
	£m	£m
Interest rate contracts	**1,976**	2,294
Foreign exchange contracts	**2,872**	3,559
Other contracts	**4**	8
Gross positive fair value of contracts	**4,852**	5,861
Netting benefits[1]	**(1,196)**	(1,200)
Netted current credit exposure	**3,656**	4,661
Collateral held	**(1,151)**	(1,150)
Net derivative credit exposure	**2,505**	3,511

[1] *Netting benefits is after including Potential Future Credit Exposure*

The net derivatives credit exposure represents the credit exposure to derivative transactions after taking account of legally enforceable netting agreements and collateral arrangements, and after including Potential Future Credit Exposure (PFCE) as required in the calculation of exposure. Included within this net exposure are amounts that relate to derivatives held in respect of the Nationwide Covered Bonds LLP which are subject to collateralisation when individual bank credit ratings fall below a certain threshold. This threshold has not yet been reached.

International Swaps and Derivatives Association (ISDA) documentation confers the ability to use designated cash collateral to set against derivative credit exposures in the event of counterparty default. Frequent re-balancing of the collateral requirements reduces the potential increase in future credit exposure.

Collateralisation of derivatives introduces two substantive changes in the incidence of credit exposure:

- The posting of collateral reduces the impact of the current market value to the difference between the market value of the derivatives and the value of the collateral. This difference is limited by the operational use of 'thresholds' and 'minimum transfer amounts', which set criteria to avoid the movement of small amounts of collateral.
- The commitment to post collateral also shortens the timescale within which future changes in interest rates and foreign exchange rates may occur. If the counterparty fails to post additional collateral required, a default can be enforced within a very short timetable. On the assumption that operational procedures are followed, a substantial reduction in the calculation of future increases in credit exposure is permitted.

As part of its regular reporting, the Group calculates any additional requirements to post collateral in the event of a downgrade in its external rating.

Wrong-way risk may occur when exposure to a counterparty is adversely correlated with the credit quality of that counterparty. Hence, there is a tendency for the exposure to increase as the creditworthiness decreases. Where such risk arises, this is taken into account when counterparty reviews are undertaken to allow for management assessment of where appropriate mitigation is required.

5.11 Credit Risk Model Performance

The Group received permission to use Internal Ratings Based approaches in 2008. As a consequence, it is only possible to provide information relating to financial years 2008/09 and 2009/10.

Expected loss is the forecast loss over a one-year time horizon as a result of applying the Group's PD, LGD and Exposure Value models. There are material differences between the methodologies and underlying principles for calculating expected loss according to regulatory requirements rather than under accounting standards. Any comparisons must therefore take into consideration these key differences. Notable differences include timing with regard to default and impairment, and cyclicality where models take account of long run average over the cycle.

The following table sets out model performance as expected loss versus provisions as at year end.

Table 23: Comparison of expected loss and actual loss

	Expected loss at 4 April 2009	Impairment charge at 4 April 2010
	£m	£m
Internal Ratings Based (IRB) exposure classes		
Central governments & central banks	-	-
Institutions	44	45
Retail mortgages (prime secured against residential property)	74	28
Qualifying revolving retail	142	99
Other retail (unsecured loans)	59	57

Nationwide uses a conservative estimate of expected loss in a downturn when calculating its capital requirements; this explains the differences seen between expected and actual losses for retail mortgages and qualifying revolving retail.

5.12 Model Approvals & Validation

The performance and accuracy of credit risk models is critical both in terms of effective risk management and the determination of Basel risk parameters. Probability of Default (PD) parameters are modelled to calculate risk weighted assets (RWAs) for all Internal Ratings Based (IRB) approaches. In addition, where advanced IRB approaches are used, Loss Given Default (LGD) and Exposure Value parameters are also modelled by the Group to determine RWAs. Models that are used to determine IRB parameters have to be reviewed and approved for first use by the FSA as part of the rollout programme.

Internal review and approval for models is carried out by the relevant risk committee (e.g. Retail Credit Committee for retail models). They are supported in this by more technical committees and a Models Group forum (comprising managers of modelling teams across the Group). The approval process therefore ensures that Divisional Directors, senior managers of business areas and technical staff are involved as appropriate.

A key input to the approval process is independent model validation which is carried out by technical staff who have not been involved with building the models. This includes an evaluation of the model development and validation of the dataset used, logic and assumptions, and performance of the model analysis. Where required due to an internal materiality assessment, the Group also engages external risk management consultants to undertake independent reviews. This provides a benchmark against industry practices for consideration under the model approval process by relevant committees.

The validation results are a key factor in deciding whether a model is recommended for use. The frequency, depth and extent of the validation are consistent with the materiality and complexity of the risk being managed. The Group's validation processes include:

- Developmental evidence: to ensure that the credit risk model adequately discriminates between different levels of risk and delivers accurate risk estimates.
- Process verification: whether the methods used in the credit risk models are being used, monitored and updated in the way intended in the design of the model. Initial testing and validation is performed when the model is developed with the performance of models being assessed on an ongoing basis.

Models are subject to regular validation monitoring and performance is reported to the relevant risk committee. If the actual performance of a model falls outside expected criteria, then it will be subject to review. Nationwide's policy is to review all models annually. The models may then be modified or recalibrated as a result.

6 Market Risks

6.1 Market Risk Overview

Market risk is the risk of changes in value of, or income arising from, the Group's assets and liabilities as a result of changes in interest rates, exchange rates, or other market indices. Market risk arises only in the banking book as the Group does not have a trading book. The significant market risks that affect the Group are:

- Interest Rate Risk, including:
  - Basis Risk
  - Prepayment Risk, Attrition Risk and Access Risk for fixed-rate products
  - Swap Spread Risk
- Foreign Exchange Risk
- Pension Obligation Risk, and
- Credit Spread Risk

In addition to these risks, the Group also has funding obligations for a number of defined benefit pension schemes. This exposes the Group to various market risks including interest rate risk, inflation risk and equity risk. Of the above risks, the only market risk that is included under Pillar 1 is in respect of Foreign Exchange (see Section 4); all other market risks are covered under Pillar 2 which is beyond the scope of these disclosures.

Principal market risk exposures are measured daily and reported monthly to the Assets and Liabilities Committee (ALCo). Other exposures are measured and reported monthly, quarterly or annually.

6.2 Interest Rate Risk

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 exposures to interest risks. This is due to the imperfect matching of interest rates and timing differences on the re-pricing of assets and liabilities.

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

The Group's Treasury Division has a mandate to actively and efficiently manage the Group's net interest rate risk position, subject to limits, in light of market conditions and business flows. Treasury Division uses derivative instruments in managing various aspects of market risk, complying with the Building Societies Act 1986, which limits the use of derivatives to the reduction in risk, as defined by the Act.

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

Linear interest rate risk is measured by Value at Risk (VaR), PV01 and PV200; limits have been set for each of these metrics to reflect the Group's low risk appetite.

The average gross Sterling exposures – including the investment of the Group's reserves - through 2009/10 were as follows:

Table 24: Interest rate risk exposures

	Average		High		Low	
	2010	2009	**2010**	2009	**2010**	2009
	£m	£m	**£m**	£m	**£m**	£m
VaR	**83**	68	**88**	86	**79**	47
Sensitivty analysis (PV01)	**2.0**	2.3	**1.9**	1.9	**2.1**	1.5
Stress testing (PV200)	**390**	374	**463**	427	**362**	295

Value at Risk (VaR)

This technique 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 based on historic experience. 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 un-weighted daily market data from the last two years. Exposures against limits are reviewed daily by management. Actual outcomes are monitored periodically to test the validity of 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:

- VaR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures;
- 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 therefore encompass all potential events, particularly those that are extreme in nature;
- Historic data is not necessarily a reliable guide to future events.

The daily market data in the second half of 2008 included some extreme volatility in interest rates. Although this has since reduced, it has not returned to pre-2007 levels. Due to the un-weighted methodology, the 2008 figures will continue to impact the VaR figures reported until late 2010.

Sensitivity analysis (PV01)

This is used to assess the change in value of the Group’s current net worth against a one basis point (0.01%) parallel shift in interest rates. As is the case with VaR, this analysis is done on a daily basis separately for each currency (but with the main risk arising from Sterling exposures) and in aggregate.

Stress testing (PV200)

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

6.3 Basis Risk

Basis risk is the risk of loss arising from changes in the relationship between interest rates which have similar but not identical characteristics (e.g. Bank of England base rate and LIBOR).

The Group’s exposure to basis risk has changed during the period. At the start of the year the position was a net LIBOR asset, reflecting fixed-rate mortgages hedged to LIBOR and funded through Base-linked variable savings. During the year, customer preferences have moved towards variable rate mortgages and fixed-rate savings. These changes have resulted in a net Base asset position by the year end.

Basis Risk exposure is measured by an Earnings at Risk model. This model uses 10 years of data and a 99% confidence interval to determine the impact on earnings over the next 12 months.

Exposures are reported monthly to ALCo and are subject to limits and triggers for consideration of mitigation activity. Risks are managed through transfer pricing, the management of new product mix and by derivative instruments executed by the Group’s Treasury department, where permitted under the Building Societies Act 1986.

6.4 Prepayment, Attrition and Access Risk

Other interest rate risks arise when customer behaviour is different from that anticipated in respect of fixed-rate products: prepayment risk (early redemption or overpayment of fixed-rate mortgages), access risk (early withdrawal of fixed-rate savings), and attrition risk (higher or lower take-up of fixed-rate mortgages).

The lower interest rates and the relative freeing up of the mortgage market has exposed us to changes in customer behaviour, driven by associated changes in the financial dynamics of transactions, particularly with respect to early repayment of fixed-rate mortgages.

These risks are mitigated through appropriate product terms and conditions, application and offer procedures, as well as close analysis of the product pipeline and prepayment and appropriate transfer pricing.

The Group uses individual behavioural models to calculate interest rate risk arising from attrition, prepayment and early access, under defined scenarios. Exposures are reported monthly to ALCo and are subject to triggers for consideration of mitigation activity. Risks are managed through appropriate restrictions in product terms and conditions, transfer pricing and close analysis of the product pipeline and prepayment.

6.5 Swap Spread Risk

Swap spread risk is the risk of loss arising from the changes in the relationship between swap rates and sovereign debt yields. Swap spread risk arises at Nationwide from long-dated sovereign debt that has been purchased for liquidity purposes. This fixed-rate debt has been swapped into LIBOR using an interest rate swap. After taking the swap into account, the mark to market value of the debt falls if the credit spread on sovereign debt increases relative to the credit spread on inter-bank borrowing. The risk is only crystallised if the sovereign debt and associated swap are sold.

Swap spread risk is measured by PV01. A Value at Risk model is also used for the UK portfolio, which is a majority of the balance. The model uses two years' data, a 99% confidence interval and a 10-day holding period.

Exposures are reported monthly to ALCo. The PV01 measure is subject to an ALCo limit.

6.6 Foreign Exchange Risk

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

Foreign currency exposure is hedged on the balance sheet or by using derivatives to reduce currency exposures to acceptable levels. After hedging we have no substantial net exposure to foreign exchange rate fluctuations or changes in foreign currency interest rates. Assets and Liabilities Committee set limits on net currency exposure and these limits 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 as described above in Interest Rate Risk (section 6.2).

The average Sterling equivalent exposures through 2009/10 were as follows:

Table 25: Foreign exchange exposure

	Average		High		Low	
	2010	2009	**2010**	2009	**2010**	2009
	£m	£m	**£m**	£m	**£m**	£m
VaR	**0.2**	0.2	**0.6**	0.5	**0.0**	0.0

In addition, the Group's Pillar 1 minimum capital requirement includes foreign exchange risk through the Foreign Exchange Position Risk Requirement (FX PRR) (see section 4).

6.7 Pension Obligation Risk

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

To mitigate these risks, management, together with the Trustees of the Fund, regularly review reports prepared by the Fund’s independent actuaries to assess these risks and take appropriate actions which may, for example, include adjusting the investment strategy and/or contribution levels.

6.8 Credit Spread Risk

Credit spread risk arises from changes in the credit and liquidity risk premia on marketable assets. This risk is reported to CTCC on a regular basis.

7 Liquidity and Funding Risk

Liquidity and funding risk is the risk that the Group is not able to meet its obligations as they fall due, or can do so only at excessive cost. The Group's operations are funded primarily from retail sources supported by a well-diversified wholesale funding capability. In order to ensure that the Group continues to meet its funding obligations and maintain or grow its business generally, the Group has developed comprehensive liquidity and funding policies. The liquidity and funding policies have been fundamentally reviewed following the new liquidity regime introduced by the FSA in Policy Statement 09/16 which sets out the Handbook rules and guidance under BIPRU 12.

Liquidity requirements arise primarily from on-demand retail deposits, maturing wholesale funding, lending commitments and downgrade obligations for asset-backed finance. A buffer of high-quality liquid assets is maintained to fulfil this requirement.

Liquidity risk is managed against limits using a number of stress scenarios. These limits have been increased further during the period, raising the minimum level of liquidity that is held. Stress scenarios are based upon forward liquidity ladders that extend for various periods out to three months. The scenarios are measured and reported weekly to ALCo.

Secured transactions have been undertaken to increase Group liquidity through the receipt of both cash and other highly liquid assets. Collateral delivered to counterparties has included self-issued covered bonds, Residential Mortgage Backed Securities from our Silverstone programme and other liquid investments issued by third parties. Cash proceeds have been obtained from secured transactions in the money markets, through repurchase transactions and Bank of England Open Market Operations, and in the capital markets through structured borrowings. We made earlier use of the Bank of England Special Liquidity Scheme and Credit Guarantee Scheme and have prepared a funding plan for the FSA which sets out how these schemes will be repaid.

The quality of the liquid assets buffer has been increased to focus on the highest quality government-issued debt. This internal categorisation of liquidity is regarded as our core liquidity.

The proportion of short-term funding has been significantly reduced over the year and the duration of term funding extended. Internal risk methodologies incorporate both on-balance sheet funding transactions (e.g. wholesale funding) and off-balance sheet funding transactions (e.g. collateral swaps, such as the Special Liquidity Scheme).

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

The main liquidity risk measures used by the Group as at the 4th April 2010 were as follows:

Table 26: Liquidity risk exposure

	2010	2009
Core liquid assets (as a percentage of Share and Deposit Liabilities)	**13.8%**	12.8%
Wholesale funding (as a percentage of Share and Deposit Liabilities)	**27.8%**	28.6%
Long-term wholesale funding (as a percentage of total wholesale funding)	**60.9%**	34.7%

8 Operational Risk

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

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

- Third Party
- Business Continuity
- Change
- Customer Experience
- Financial Management & Control
- Fraud
- Information Security
- Information Technology
- Legal & Regulatory
- People
- Premises & Physical Assets

Operational Risk Framework

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

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

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

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

Key operational risk categories

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

Third Party
The Group conducts its business in a fair and open manner and is committed to maximising customer value when undertaking expenditure on goods and services. Risks are monitored to ensure appropriate selection and management of third party suppliers and outsourced services, including compliance with contract law.

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

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

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

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

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

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

The Group's Fraud Strategy is designed to:

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

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

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

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

Legal & Regulatory

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

- Breach of regulation; and
- Breach of law.

Nationwide identifies all material legal and regulatory requirements and relevant voluntary codes and standards affecting the Group and works with business areas to determine how it applies. This is supported by review mechanisms to ensure compliance with material regulatory and legal obligation and a suite of Key Risk Indicators. This enables the business to monitor progress against the key legal and regulatory risk exposures and take action where we are operating outside of risk appetite.

This framework of support, challenge and monitoring:

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

People

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

Premises & Physical Assets

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

Reputation

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

Glossary of terms

Asset Backed Securities (ABS)	Securities that represent an interest in an underlying pool of referenced assets. The referenced pool can comprise any assets which attract a set of associated cash flows, including credit card assets, but are commonly pools of residential or commercial mortgages. Investors in these securities have the right to cash received from future payments (interest and/or principal) on the underlying asset pool.
Basel II Accord	The Basel Committee on Banking Supervision's statement of best practice that defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive, and was implemented in the UK via the FSA Handbook.
BIPRU	The prudential sourcebook for banks, building societies and investment firms which sets out the FSA's capital requirements.
Business Assets	Business assets are total assets (or total group assets) *plus* provisions for bad and doubtful debts, *less* fixed assets, liquid assets and any long-term insurance funds, and currently comprise mostly mortgage assets. As per the Building Societies Act, 75% of these assets must be fully secured on residential property.
Commercial lending	Loans secured on commercial property, loans to Registered Social Landlords and loans undertaken under Private Finance Initiatives.
Core tier 1 capital	Defined by the FSA as tier 1 capital less hybrid capital instruments (innovative tier 1 securities and permanent interest bearing shares for building societies) and certain regulatory adjustments.
Counterparty credit risk	Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.
Covered Bonds	Debt securities backed by a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the Covered Bonds. The Group issues Covered Bonds as part of its funding activities.
Credit quality steps	A credit quality assessment scale as set out in BIPRU 3.4 (Risk weights under the standardised approach to credit risk) and BIPRU 9 (Securitisation).
Credit risk	Risk of financial loss if a customer or counterparty fails to meet an obligation under a contract.
Credit risk mitigation	Techniques to reduce the potential loss in the event that a customer (borrower or counterparty) becomes unable to meet its obligations. This may include the taking of financial or physical security, the assignment of receivables or the use of credit derivatives, guarantees, credit insurance, set off or netting.
CRR	Capital Resources Requirement – the minimum amount of capital resources that a financial institution must hold as set out in Basel II Pillar 1 rules.
Default	Circumstances in which the probability of default is taken as 100% for the purposes of the calculation of regulatory capital and compliance with Basel II. This is defined as when a borrower reaches a predefined arrears status (90 days past due for most borrowing) or where a borrower is considered unlikely to repay the credit obligation in full without the lender taking action such as realising security.
ECAI	External Credit Assessment Institution. An ECAI (e.g. Moody's, Standard and Poor's, Fitch) is an institution that assigns credit ratings to issuers of certain types of debt obligations as well as the debt instruments themselves.
Economic Capital	An internal assessment of the amount of capital required to protect against potential unexpected future losses arising from business activities, across a defined time horizon and confidence interval.
EEA parent institution	A parent financial institution situated in a Member State of the European Economic Area which is not a subsidiary of another financial institution also situated in the EEA.
Expected loss (EL)	A Basel II calculation under the IRB approach to estimate the potential losses on current exposures due to potential defaults over a one-year time horizon. It is the product of PD, LGD and EAD.

Exposure	The maximum loss that a financial institution might suffer if a borrower, counterparty or group fails to meet their obligations or assets and off-balance sheet positions have to be realised.
Exposure Value	A Basel II parameter used in IRB approaches to estimate the exposure (amount outstanding) at the time of default.
Foundation IRB approach	A method of calculating credit risk capital requirements using internal PD models but with supervisory estimates of LGD and conversion factors for the calculation of EAD.
FSA	Financial Services Authority. The financial services industry regulator in the UK.
FX PRR	Foreign Exchange Position Risk Requirement. The capital requirement under BIPRU 7 (Market risk) as part of the calculation of the market risk capital requirement included in Basel II Pillar 1.
GENPRU	General Prudential Sourcebook for banks, building societies, insurers and investment firms which forms part of the FSA Handbook for Basel II.
Guarantee	An agreement by a third party to cover the potential loss to a credit institution should a specified counterparty default on their obligations.
ICA	Internal Capital Assessment – the document produced as a result of the ICAAP.
ICAAP	Internal Capital Adequacy Assessment Process. The Group’s own assessment, as part of Basel II requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements (for credit, market and operational risks) and for other risks including stress events.
ICG	Individual Capital Guidance. The minimum amount of capital the Group should hold as set by the FSA under Basel II Pillar 2 and informed by ICAAP.
Impaired loans	Loans where the Group does not expect to collect all the contractual cash flows or expects to collect them later than they are contractually due.
Individually/collectively assessed	Impairment is measured individually for assets that are individually significant, and collectively where a portfolio comprises homogenous assets and where appropriate statistical techniques are available.
Interest rate risk	Interest rate risk is the exposure of a firm's financial condition to adverse movements in interest rates.
IRB	A Basel II approach for measuring exposure to credit risks. IRB approaches are more sophisticated and risk-sensitive than the Standardised Approach and may be Foundation or Advanced. IRB approaches may only be used with FSA permission.
ISDA	International Swaps and Derivatives Association is the global trade association for over-the-counter (OTC) derivatives, and providers of the industry-standard ISDA contract used to enter into bilateral derivatives transactions.
LGD	Loss Given Default. A Basel ll parameter used to estimate the difference between exposure at default and the net amount of the expected recovery expressed as a percentage of EAD.
LIBOR	London Inter-Bank Offered Rate.
Liquid assets	Total of cash in hand and balances with the Bank of England, loans and advances to banks and investment securities.
Liquidity risk	The risk that the Group does not have sufficient financial resources to meet its obligations as they fall due, or will have to do so at an excessive cost. This risk arises from mismatches in the timing of cash flows.
Long run average PD	Probability of default based on a long run average default rate which would be expected over a full economic cycle.
LTV	Loan-To-Value. A ratio which expresses the amount of a mortgage as a percentage of the value of the property. The Group calculates residential mortgage LTV on an indexed basis (the value of the property is updated on a quarterly basis to reflect changes in the house price index (HPI)).
Market risk	The risk that movements in market risk factors, including foreign exchange rates, interest rates, credit spreads and customer-driven factors will reduce income or portfolio values.
Maturity	The remaining time in years that a borrower is permitted to take to fully discharge their contractual obligation (principal, interest and fees) under the terms of a loan agreement.

Minimum capital requirement	The minimum amount of regulatory capital that a financial institution must hold to meet the Basel II Pillar 1 requirements for credit, market and operational risk.
Model validation	The process of assessing how well a risk model performs, using a predefined set of criteria including the discriminatory power of the model, the appropriateness of the inputs and expert opinion.
Monoline	An entity which specialises in providing credit protection to the holders of debt instruments in the event of default by the debt security counterparty. This protection is typically held in the form of derivatives such as credit default swaps referencing the underlying exposures held.
Netting	The ability to reduce credit risk exposures by offsetting the value of any deposits against loans to the same counterparty.
Operational risk	The risk of loss arising from inadequate or failed internal processes, people and systems or from external incidents.
PFI	Private Finance Initiatives. Loans advanced to provide financial support for "public-private partnerships" between the public and private sectors.
PIBS	Permanent Interest Bearing Shares. Unsecured, deferred shares that are a form of tier 1 capital. PIBS rank behind the claims of all subordinated debt holders, depositors and creditors of Nationwide.
Pillar 1 – Minimum capital requirements	The part of the Basel II Accord which sets out the regulatory minimum capital requirements for credit, market and operational risk.
Pillar 2 – The supervisory review process	The part of the Basel II Accord which sets out the processes by which financial institutions review their overall capital adequacy. Supervisors then evaluate how well financial institutions are assessing their risks and take appropriate actions in response to the assessments. This includes all risks (including Pillar 1 risks) – ICG is an outcome from Pillar 2.
Pillar 3 – Market discipline	The part of the Basel II Accord which sets out the disclosure requirements for firms to publish details of their risks, capital and risk management. The aims are greater transparency and strengthening market discipline.
PiT	Point in time. A modelling approach which assesses the credit risk of an exposure at a single point in time.
PD	Probability of Default. A Basel II parameter used in IRB approaches to estimate the probability that a borrower will default on their credit obligations in the next 12 months.
Prime	Prime mortgages are mainstream residential loans, which typically have a higher credit quality and fit standard underwriting processes. As such, they are likely to have a good credit history, and pass a standard affordability assessment at the point of origination.
Provisions	Amounts set aside to cover incurred losses associated with credit risks.
PV01/PV200	A calculation to assess the change in value of the net present value (NPV) of financial instruments with 1 basis point /200 basis points parallel shifts in interest rates. PV01 shows the sensitivity while PV200 applies a more severe stress test.
Qualifying Revolving Retail Exposures	Facilities to retail customers that provide a revolving facility e.g. credit cards and overdrafts from which credit risks arise. Nationwide’s current account is the FlexAccount.
Rating system	A system for assessing and ranking customers and accounts by risk. A rating system comprises all of the methods, processes, controls, data collection and IT systems that support the assessment of credit risk, the assignment of exposures to grades or pools (rating), and the quantification of default and loss estimates for credit risk exposures.
Repurchase agreement (repo)	A repurchase agreement that allows a borrower to use a financial security as collateral for a cash loan at a fixed-rate of interest. In a repo, the borrower agrees to sell a security to the lender subject to a commitment to repurchase the asset at a specified price on a given date. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or reverse repo.
Retail IRB approach	A method of calculating credit risk capital requirements using internal PD, LGD and EAD models.

Retail loans	Money loaned to individuals rather than institutions, including residential mortgage lending and consumer banking. Residential mortgage lending is secured against residential property. Consumer banking is unsecured lending, including current accounts, credit cards and personal loans, which may be used for various customer uses including car purchases, medical care, home repair and holidays.
Risk Appetite	The articulation of the level of risk that the Group is willing to take (or not take) in order to safeguard the interests of the Society's members whilst achieving business objectives.
RWA	Risk weighted assets. The value of assets, after adjustment, under Basel II rules to reflect the degree of risk they represent.
Securitisation	A process by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities. A company sells assets to an SPE which then issues securities backed by the assets. This allows the credit quality of the assets to be separated from the credit rating of the original company and transfers risk to external investors. The Group has established securitisation structures as part of its funding and capital management activities. These securitisation structures use retail mortgages as the asset pool.
Society	Nationwide Building Society.
Specialist residential lending	Consists of Buy to Let, self-certified and sub-prime mortgages.
SREP	Supervisory Review and Evaluation Process, the FSA assessment of a firm’s own capital assessment (ICA) under Basel II Pillar 2.
Standardised approach	The basic method used to calculate credit risk capital requirements under Pillar 1 of Basel II. In this approach the risk weights used in the capital calculation are determined by supervisory parameters. The Standardised approach is less risk-sensitive than IRB.
Stress testing	Various techniques that are used to gauge the potential vulnerability to exceptional but plausible events.
Subordinated debt	A form of tier 2 capital that is unsecured and ranks behind the claims of all depositors, creditors, and investing members (other than holders of PIBS).
Sub-prime	Loans to borrowers typically having weakened credit histories that include payment delinquencies and potentially more severe problems such as court judgements and discharged bankruptcies. They may also display higher risk characteristics as measured by credit scores, or other criteria indicating heightened risk of default. The definition of sub-prime lending varies from lender to lender, but we define sub-prime as a borrower with a County Court Judgement (CCJ) or default in excess of £1,000 or more than one missed mortgage payment in the last 12 months. We define near-prime as a borrower with a CCJ or default less than or equal to £1,000 or one missed mortgage payment in the last 12 months.
The Standardised Approach (operational risks)	The standardised approach to operational risk, calculated using three-year historical net income multiplied by a factor of between 12-18%, depending on the underlying business being considered.
Tier 1 capital	A measure of financial strength. Tier 1 capital is divided into core tier 1 and other tier 1 capital. Core tier 1 capital comprises general reserves from retained profits. The book values of goodwill and intangible assets are deducted from core tier 1 capital and other regulatory adjustments may be made for the purposes of capital adequacy. Qualifying capital instruments such as PIBS are included in other tier 1 capital (i.e. not core tier 1).
Tier 2 capital	Comprises the Group's property valuation reserve, qualifying subordinated notes and collective impairment allowance (for exposures treated on a Basel II standardised basis). Certain regulatory deductions may be made for the purposes of assessing capital adequacy.
Value at Risk (VaR)	A technique that estimates the potential loss that could occur on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence. In its day-to-day monitoring, Nationwide uses a 10-day horizon and a 99% confidence level.
Wrong-way risk	Defined by the FSA as a situation where there is an adverse correlation between the counterparty’s probability of default and the mark-to-market value of the underlying transaction.

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