



Building Society

15 million members building society, nationwide

Annual Report & Accounts 2018





2018 highlights

Building society, nationwide

We are the world's largest building society. We thrive when our members thrive, and this has been another strong year for us. Together we can achieve more.

Building thriving membership

More members are doing more with us



Record current
accounts opened

816,000

With more people opening with Nationwide than any other brand²
2017: 795,000

Record gross
prime mortgage
lending

£29.4 billion

2017: £29.1 billion

Member
financial benefit¹

**£560
million**

2017: £505 million

Record membership
**15.5 million
members**

of which 8.1 million engaged members³
2017: 15.1 million/7.8 million

Record first
time buyers

76,000

helped onto the housing ladder.
Around 1 in 5 in the UK

2017: 75,000



Built to last

A stable and secure Society that uses its members' money wisely

4.9%

UK leverage ratio

Reflects our careful
approach to looking after
our members' money

2017: 4.4%

0%

cost growth while
growing membership

£1,979 million underlying costs
2017: 10% /£1,979 million

**£1,022
million**

underlying profit⁴

Within our financial
performance framework
2017: £1,030 million

**£977
million**

statutory
profit

2017: £1,054 million



Building legendary service

Our members expect the best service

1st
Customer satisfaction

With a lead of 4.6% ahead of our high street peer group⁵
2017: 1st with lead of 6.7%

Specialist Support Service
4,500

members needing extra support helped, returning around £1.4 million in fees

44%
More current account members using our 24/7 mobile services

Now 2 million members in total.
2017: 41% growth and 1.4 million members

Building PRIDE

Happy employees look after our members

297
Carillion employees

taken on within 7 days of its collapse



110

teams voluntarily engaged in efficiency projects

74%
Employee engagement

3% below global high performing benchmark, and 9% above financial services sector norm
2017: 78%

Building a national treasure

Our social purpose is at the heart of what we do

UK's 
most trusted financial brand⁶

with a lead of 3.8%.
2017: 1st with 1.3% lead⁷

Community involvement
66%

of employees get involved with fundraising, volunteering or payroll giving
2017: 75%

Started a 5 year programme to invest

£20 million

in member directed community grants



¹ More information on member financial benefit is included on page 27 of the Financial review.

² Source: eBenchmarkers April 2017 to March 2018, CACI April 2017 to March 2018, BACS Payments Schemes monthly CASS switching market data and internal sources.

³ Engaged members are defined as those who hold a mortgage or savings account with us (with a balance greater than £5,000) or who hold their main personal current account with us.

⁴ Further information on underlying profit is on page 26 and the financial performance framework on page 32 of the Financial review.

⁵ © GfK 2018, Financial Research Survey (FRS), 12 months ending 31 March 2018 and 12 months ending 31 March 2017, proportion of extremely/very satisfied customers minus proportion of extremely/very/fairly dissatisfied customers summed across current account, mortgage and savings. High street peer group defined as providers with main current account market share >4% (Barclays, Halifax, HSBC, Lloyds Bank (inc C&G), NatWest, Santander and TSB). Prior to April 2017, high street peer group defined as providers with main current account market share >6% (Barclays, Halifax, HSBC, Lloyds Bank inc C&G (Lloyds TSB prior to April 2015), NatWest and Santander).

⁶ Source: Nationwide Brand and Advertising tracker - compiled by Independent Research Agency, based on all consumer responses, 3 months ending March 2018. Financial brands included Nationwide, Barclays, Co-operative Bank, First Direct, Halifax, HSBC, Lloyds, NatWest, TSB and Santander.

⁷ Source: Nationwide Brand and Advertising tracker - compiled by Independent Research Agency, based on all consumer responses, 3 months ending March 2018 (2017: 3 months ending March 2017). Financial brands included Nationwide, Barclays, Co-operative Bank, First Direct, Halifax, HSBC, Lloyds, NatWest, TSB and Santander.



Contents

Strategic Report

- 1** 2018 highlights
- 5** Our mutual difference is our business model
- 7** Chairman's letter
- 9** Chief Executive's review including strategic cornerstone updates
- 25** Risk overview
- 26** Financial review

Governance

- 34** Board of directors
- 39** Executive Committee biographies
- 41** Report of the directors on corporate governance
- 83** Report of the directors on remuneration
- 94** Directors' report

Business and Risk Report

- 98** Principal risks
- 101** Managing risk
- 104** Top and emerging risks
- 105** Credit risk
- 130** Liquidity and funding risk
- 141** Solvency risk
- 145** Market risk
- 149** Pension risk
- 151** Business risk
- 152** Model risk
- 152** Operational risk
- 155** Conduct and compliance risk

Financial Statements

- 159** Independent auditors' report
- 168** Income statements
- 169** Statements of comprehensive income
- 170** Balance sheets
- 171** Statements of movements in members' interests and equity
- 173** Cash flow statements
- 174** Notes to the financial statements

Other Information

- 233** Annual business statement
- 236** Underlying profit
- 236** Forward looking statements
- 236** Glossary
- 237** Index





Strategic Report

Becky, member since 2004

Strategic Report

- 1 2018 Highlights
- 5 Our mutual difference is our business model
- 7 Chairman's letter
- 9 Chief Executive's review including strategic cornerstone updates:
 - Building thriving membership
 - Built to last
 - Building legendary service
 - Building PRIDE
 - Building a national treasure
 - Outlook
- 25 Risk overview
- 26 Financial review

The Strategic Report has been approved by the Board of directors and signed on its behalf by:

Joe Garner
Chief Executive
21 May 2018

Winning our members' trust

Becky is a part time primary school teacher. Her husband, Simon, writes for an agency that supports the charity sector.

Outside of work, their three children are into everything sporty, from gymnastics to football. All in all, Becky and Simon are kept busy.

And when they're not ferrying their offspring around, they're out and about keeping in touch with family, or 'relaxing' on a country walk.

They both rely on Nationwide for their banking and have their joint account and credit cards with us.

"We originally chose Nationwide when we were younger - in a time before kids."

"At that time, FlexAccount offered free cash withdrawals abroad and we wanted to travel around the world, so that was a great deal for us. These days we're just as attached to Nationwide because it's a building society.

They feel like an organisation you can trust. That's so important when you're busy because, with their values, you can rely on them to treat you right, even when you're not paying complete attention."





Our mutual difference is our business model

For over 130 years, we have been driven by the belief that ordinary people can achieve extraordinary things when they work together, and by our purpose of building society, nationwide, helping people save to buy their own home.

This focus on building society remains as important to us today as when we were founded – our social purpose is an intrinsic part of why we exist, rather than an add-on. We're proud that we still use the power of the collective to help individual members and their families to achieve their financial goals, whether that's:

- Helping them into a home of their own – we remain the UK's second largest mortgage provider.
- Saving for the future – we look after around £1 in every £10 saved in the UK.
- Looking after their day-to-day banking needs – we've opened 16% of all new current accounts in the UK this financial year.

Our mutuality defines us, our values and how we go about our business. From treating our members and their money with respect to returning the maximum financial benefit we can sensibly afford, from treating our employees well to paying our taxes, from contributing to society by championing the needs of our members to our community funding programme, we are different and that counts.



Coffee and convenience: making our members in Didcot feel at home in one of our new look branches.



Our mutual difference is our business model *continued*





Chairman's letter

David Roberts

Dear fellow member

Appearances can be deceptive. To some observers, Nationwide might look like a bank. We certainly offer products and services that look the same, but are quite different in practice. We start from a very different place, one that has profound implications. What truly defines us is that, as a mutual, we are owned by our members.

A different philosophy

Unlike most company reports, I don't want to begin by talking about annual profits, as whilst this might make sense for a shareholder-owned business, it is not the best starting point for Nationwide. Our purpose is different; in the last two years we have refreshed our strategy – which we describe as 'building society, nationwide'. This means we are tasked with delivering value to current and future members and we focus on what really matters to our members: delivering outstanding service, great value products and strong support for local communities, all underpinned by the financial strength befitting an important financial institution such as ours.

Our Chief Executive, Joe Garner, details our performance over the last year in his review for members that follows. As you will see, the Society made demonstrable progress against our objectives.

'We focus on what really matters to our members'

In particular, the fact that we have the most trusted brand in financial services¹ is telling. So too that we have the best customer satisfaction against our high street peer group². Also that we returned £560 million of member financial benefit in the year by offering better rates, fees and incentives than the average across our competitors – please see page 27 for more on all this. This unrelenting focus on what really matters to members resulted in strong growth.

We helped around 1 in every 5 first time buyers onto the housing ladder. We provide a safe home for £1 in every £10 saved in the UK. We opened more current accounts than any other brand³. Overall membership grew to a new high. And our financial performance continued to be strong in very competitive markets. Whilst this overall performance was pleasing, we can always improve, and I can assure members that your Board remains focused on ensuring the Society delivers outstanding service and value to every member, all the time.

Difference in practice

A critical element of the Nationwide approach is to start by doing the right thing for our people. Because it's part of Nationwide's DNA, and because we see an inseparable relationship between treating our people well and our people treating members well.

One of the most important questions we ask at Board and right across the Society is, 'Is this right for our members?' Only then do we see whether it has business potential.

I believe the service my colleagues deliver is better, not because our processes and systems are better, but because our people act differently. This ethos goes right through the branch network, right through the contact centres, through all our operations. Please do not think I am complacent; every day we strive to learn from our mistakes and do better. But, in an industry where trust in major providers is at very low levels, I believe Nationwide stands apart for service and care. Two practical examples come to mind.

When construction giant Carillion collapsed, we immediately secured the jobs of almost 300 contractors by stepping in to take them on. It was the right thing to do to secure the services members rely on, and for the people involved – and a demonstration that our philosophy of care extends to our supplier and other relationships.

'A critical element of the Nationwide approach is to start by doing the right thing for our people'

We also had a case recently where an elderly member was about to make a large money transfer. One of our employees noticed she was unusually anxious, approached her and discovered that she was being set up for a fraud. Our colleague managed to dissuade her, let her daughter know and alerted the police. These are sensitive issues; after all, members can choose what they do with their money. Sadly, we are seeing more of this type of attempted fraud and, while I can't say that others would not have done the same, I can say our colleague did the right thing and we're proud of her.

Our philosophy extends to our approach to reward, where again we are different. We aim to pay fair market rates to the people who serve our members. In our pension scheme, we make one of the highest pension contributions of our peer group.

¹ Source: Nationwide Brand and Advertising tracker – compiled by Independent Research Agency, based on all consumer responses, 3 months ending March 2018. Financial brands included Nationwide, Barclays, Co-operative Bank, First Direct, Halifax, HSBC, Lloyds, NatWest, TSB and Santander.

² © GfK 2018, Financial Research Survey (FRS), 12 months ending 31 March 2018, proportion of extremely/very satisfied customers minus proportion of extremely/very/fairly dissatisfied customers summed across current account, mortgage and savings. High street peer group defined as providers with main current account market share >4% (Barclays, Halifax, HSBC, Lloyds Bank (inc C&G), NatWest, Santander and TSB).

³ Source: eBenchmarkers April 2017 to March 2018, CACI April 2017 to March 2018, BACS Payments Schemes monthly CASS switching market data and internal sources.



Chairman's letter *continued*

We do this because we think it's important for our people to invest for their future. It's also an important part of encouraging people to stay with Nationwide. It is clear that what brings people to work at Nationwide is more than money and, for our most senior executives, we aim for total financial reward to be lower than most of our key competitors. We also don't reward anyone for maximising profit. We believe fundamentally in teams not individuals, so variable pay for everyone employed by the Society is based on the achievement of our goals, such as the growth of our membership and improvements in our service quality.

The other important matter on pay relates to gender pay, a subject that has received a lot of publicity in the last few months. There are two key tests here. First, equal pay measures pay between men and women carrying out the same or similar roles. We carry out regular audits to make sure our pay policies are operating free from gender bias and we are encouraged by our record on equal pay.

The second test is the gender pay gap, namely the difference between the average pay of men and women across the whole organisation. Our Gender Pay Report published in March shows that, along with many organisations, we have a distributional issue to address, with more men than women in senior roles, and more women than men in junior ones. We have started to address this at Board level, where we now have more female independent directors than male – on which, a warm welcome to Gunn Waersted, our newest director. We can and will do more to make sure more women and Black, Asian and Minority Ethnic (BAME) employees get into senior roles. You can read more about our work here in the Nomination and Governance Committee report on page 77.

Membership with a difference

We are also on a journey to give our members more say on the big decisions facing the Society, see page 51 for more on this. It's why we invited members to join our Board strategy day last October. We have also put local members in control of £20 million of our social investment for the next five years. And we listen. One example amongst many: at last year's AGM, members spoke out about interest rates being reduced on Loyalty Saver since the base rate reduction in August 2016. We can't entirely defy market forces, but we responded by being one of the few providers to pass on in

full last November's base rate rise to these accounts. In March this year we launched a 1.40% Loyalty Single Access ISA, which attracted £8.5 billion in deposits.

Our philosophy of membership also underpins why we delivered over half a billion pounds in value back to members in the last 12 months. That's a clear difference between us and our competitors. Nationwide's philosophy is to pay as much as we can sustainably afford for our members, for example in terms of fair savings rates. Many organisations start from a different place, looking to pay as little as circumstances allow. This difference epitomises our philosophy and, allied with our focus on rewarding loyalty, demonstrates the Nationwide way.

Our difference also extends to seeking to make a real contribution to the UK housing market. Providers of finance have an important role in ensuring that there is an appropriate supply of credit, and that we make sure people are only taking on appropriate levels of commitment that won't get them into trouble later.

'We delivered over half a billion pounds in value back to members in the last 12 months'

In particular, we focus on first time buyers, because they are the members of the future. We are also using our financial and convening power to regenerate and develop homes on some land in our own backyard in Swindon. We do this because we see the need locally and because we aspire to help create solutions nationally.

Taking a different path

In many ways, Nationwide's is a traditional model. The challenge is to keep what is great, and to evolve to meet the new and emerging needs of our members, particularly in mobile and digital banking. We do this with innovative products like the lifetime mortgage that we introduced to help older members access the wealth tied up in their homes. If we are successful in our bid for funding from the RBS competition fund, we will also launch a mutual alternative to business banking for the UK's millions of small business owners. There's more in our Chief Executive's review about that.



Branches may seem unfashionable to some, but not to Nationwide. We may live in an increasingly digital, 'always on' world, but our members tell us they continue to value human contact and community service. When we look at our network, our mindset is how do we keep open branches that communities want, and modernise them to match how members want to interact, not how much can we save if we close them. That doesn't mean we will never close a branch, but it does mean we will try hard to make them viable. We're not called Nationwide for nothing.

To conclude, my intention here is not to show that the Society is perfect, far from it. We are human and we will err. Rather, it is to show that behind the mortgage, ISA or current account, there is something truly different. And a team of people who are different. I believe this difference resonates strongly in Britain today, because, as Joe's review will show, we are winning record numbers of new members and maintaining our leading satisfaction scores over our high street peer group⁴.

**Thank you, our members:
together we are stronger.**

**And on behalf of our members, thank you to Nationwide's people:
you make the difference.**

David Roberts
Chairman

⁴ © GfK 2018, Financial Research Survey (FRS), 12 months ending 31 March 2018 and 12 months ending 31 March 2017 proportion of extremely/very satisfied customers minus proportion of extremely/very/fairly dissatisfied customers summed across current account, mortgage and savings. High street peer group defined as providers with main current account market share >4% (Barclays, Halifax, HSBC, Lloyds Bank (inc C&G), NatWest, Santander and TSB). Prior to April 2017, high street peer group defined as providers with main current account market share >6% (Barclays, Halifax, HSBC, Lloyds Bank inc C&G (Lloyds TSB prior to Apr 15), NatWest and Santander).



Chief Executive's review

Joe Garner

Dear fellow member

Our mutuality is what makes Nationwide fundamentally different from most other businesses. As we are owned by you, our members, our purpose is to build society, nationwide, helping you to finance your goals and to contribute to making society a better place to live. Our primary purpose is a social – not commercial – one.

More and more people are experiencing the value of mutuality. This year our membership reached an all-time high of 15.5 million. And 'engaged' members – those who hold a main current account, or a balance of at least £5,000 in savings or a mortgage with us – hit a record of 8.1 million.

Our approach is deliberately simple. It involves three areas of greatest focus – the quality of our service, the value we deliver, and our financial strength.

We start from the premise that, as we manage members' life savings and are a systemically important business for the UK economy, our financial strength and stability is critically important. Strong finances and a low risk profile are what we aim for. I'm therefore pleased to report that we finished the year financially stronger than ever, with all-time high capital levels and strong profits.

'This year our membership reached an all-time high of 15.5 million'

We improved our CET1 ratio, a measure of our financial strength, to 30.5% (2017: 25.4%). And we enhanced our UK leverage ratio, a measure of our ability to cope with unforeseen shocks, to 4.9% (2017: 4.4%). The ratio measures how much capital we have as a proportion of our assets, principally lending. Meanwhile, we achieved underlying

profits of over £1 billion, in line with our financial performance framework, while investing in significant growth and higher business volumes.

We also had a record year for gross prime mortgage lending, although overall net lending fell, in line with our lower appetite for buy to let lending, along with increased prime mortgage redemptions as we managed margins in the long-term interests of the Society. We also held our own in a savings market where people are saving less. These are considerable achievements given that competitive pressures have intensified in all our core markets, and margins are being squeezed.

Turning to service, Nationwide is the UK's most trusted¹ financial institution and has a longstanding reputation for customer care. This year we led our high street peer group for the sixth year in a row for customer satisfaction, ending the year with a lead of 4.6% over our nearest competitor². Satisfaction with our main current account was higher still at more than 10 percentage points ahead of our nearest high street peer group competitor³. Plus, we attracted a record number of new current accounts, and continue to perform well on switching. In fact, it was the best year in our history for current account openings.

Having demonstrated that we can really make a difference for personal current account customers, we would like to do the same for UK businesses. It's a market still dominated by five big banks, and where less

than 5% of businesses switch their accounts. So we have decided to apply for money from the RBS funds set aside by the government to improve business banking competition. If successful, we will launch a straightforward business current account targeted at the UK's smallest businesses, which employ one in three people in the UK. Everyday banking for everyday businesses.

'Nationwide is the UK's most trusted¹ financial institution'

In addition to service we want to deliver real value for our loyal members, which we aim to do in a number of ways. Not least by providing great products and services. As we don't have to reward shareholders, we can invest more in better pricing – on interest rates, fees and incentives – that will benefit members. We call this member financial benefit and it added up to £560 million last year (2017: £505 million). Much of this went to savings members who have suffered years of historically low interest rates. We also launched a range of 'just for members' products, providing members with access to our competitive rates and outstanding service in meeting their financial needs. Over 100,000 of our members earned 'Recommend a Friend' rewards by encouraging family and friends to move their main current account to us.

¹ Source: Nationwide Brand and Advertising tracker – compiled by Independent Research Agency, based on all consumer responses, 3 months ending March 2018. Financial brands included Nationwide, Barclays, Co-operative Bank, First Direct, Halifax, HSBC, Lloyds, NatWest, TSB and Santander.

² © GfK 2018, Financial Research Survey (FRS), 6 year lead held over period 12 months ending 31 March 2013 to 12 months ending 31 March 2018. Each monthly data point contains customer feedback referring to previous 12 months. Proportion of extremely/very satisfied customers minus proportion of extremely/very/fairly dissatisfied customers summed across current account, mortgage and savings. High street peer group defined as providers with main current account market share >4% (Barclays, Halifax, HSBC, Lloyds Bank (inc C&G), NatWest, Santander and TSB). Prior to April 2017, high street peer group defined as providers with main current account market share >6% (Barclays, Halifax, HSBC, Lloyds Bank (inc C&G) (Lloyds TSB prior to Apr 15), NatWest and Santander).

³ © GfK 2018, Financial Research Survey (FRS), 12 months ending 31 March 2018, proportion of extremely/very satisfied main current account customers minus proportion of extremely/very/fairly dissatisfied main current account customers. High street peer group defined as providers with main current account market share >4% (Barclays, Halifax, HSBC, Lloyds Bank (inc C&G), NatWest, Santander and TSB).








Chief Executive's review *continued*

Nationwide could not thrive like this without the support of the 18,000 colleagues who serve members on a daily basis and I'd like to thank our people publicly for their enormous contribution to our success. We believe that we have grown a unique culture at Nationwide. One which is underpinned by what we describe as an 'ethic of care' which

translates into high engagement scores for our people, and outstanding care for our members. Feedback from the Banking Standards Board and our own surveys indicate that our people believe in our mission, and work with great passion day in, day out for the good of the membership and our Society. You can read more on page 19.

'We're operating from a platform of strength and success'

A more detailed review of this year's performance follows, organised around our strategy of **'building society, nationwide'** and the five cornerstones that underpin it:

	<p>Building thriving membership</p> <p>is about helping our members achieve important goals in their lives, whether that's owning a home, saving for the future, or just helping them managing their everyday finances. The more members we serve and the deeper the relationship, the bigger our contribution can be.</p>
	<p>Built to last</p> <p>is about keeping our members' money safe, by being financially secure, profitable and sustainable for the long-term.</p>
	<p>Building legendary service</p> <p>describes our determination to provide the outstanding service our members value and expect. Technology is changing people's expectations of service. In particular, people expect to be able to use both traditional and digital channels seamlessly. This means we need to innovate as customers' habits change so we deliver in the way they want, but we remain committed to a very human service.</p>
	<p>Building PRIDE</p> <p>among colleagues and nurturing our mutual values helps our people look after our members even better. Which is why we want them to have one of the best workplaces in Britain.</p>
	<p>Building a national treasure</p> <p>is about being recognised for the contribution that we make to the wider society, and using our success to make a difference on issues that are important to members. Naturally, this one will not be for us to judge.</p>

We measure our performance against each cornerstone and I'm pleased to report we're making good progress against the vast majority of our targets, as you'll see in this report. We're also simplifying our measures – our key performance indicators – to focus on what we believe matters most to members (see page 12).

So we're operating from a platform of strength and success. Outstanding in our service. Growth in our membership. And strength in our finances. This gives us confidence that we can continue to support our members in these changing times.

Looking ahead we expect the rate of technology innovation to accelerate sharply. We live in an 'always on' world where the

availability of internet and mobile banking has become an essential service that members rely on. It will also become an increasingly important part of who consumers trust with their information. This will only be magnified by the advent of Open Banking and all financial providers will have room to improve.

We are therefore developing plans to ensure Nationwide is fit for the future and able to take advantage of the opportunities that change presents. This will include providing capacity for the significant business volumes our strong growth trajectory generates, and increasing the speed of innovation across the Society. At the same time, we will look to further reinforce our resilience against the backdrop of increasing dependence on

technology platforms, and growing cyber threats. We will refine our operational and technology strategy and the investment this is likely to require accordingly, and provide an update on these plans later in the year.

Thank you for your loyalty and support for the continued success of Nationwide Building Society.

Joe Garner
Chief Executive Officer



Chief Executive's review *continued*

Measuring our difference – aligning our targets with our purpose

In last year's Annual Report and Accounts we introduced our refreshed strategy, and our purpose of 'building society, nationwide', underpinned by five cornerstones that define what we stand for, what we do and how we do it. Our report card on each of these can be found on pages 13-23.

Lots of organisations have a catalogue of targets or 'key performance indicators', as do most banks. Nationwide is not like most organisations, and we're not a bank. We are a mutual with the aim of helping members to finance their goals. That means we don't have shareholders asking us to pursue ever higher profits. Instead we aim to make sufficient profits to run a safe and sustainable business

and invest in services for members, within the parameters of our established financial performance framework and Board Risk Appetite (see page 32 and page 102 respectively). We will continue to do this while also shining a light on a much more focused set of mutual measures. Ones that truly underscore what we believe matters most to our members and to our Society. Ones rooted in the critical

importance that trust continues to play in financial services. And ones that will make it easier for members to judge how we are doing against our stated purpose.

That's three things – outstanding service, value for members and society, and financial strength.





Chief Executive's review *continued*

The following three measures will therefore be the focus of our reporting for the coming financial year (2018/19) and until 2022.

Outstanding service

Our customers deserve the highest levels of service – among the UK's best

Service matters to us because it matters to our members. We want our members to experience service that is genuinely heartfelt, easy, lifelong and personal. We measure ourselves against our high street competition using the long-established Financial Research Survey (FRS), where we want to be the best in sector, with daylight between us and our nearest competitor.

To stretch ourselves further, going forward we will also measure ourselves against the UK's very best organisations. This will be assessed through the Customer Service Institute's UK Satisfaction Index (UKCSI), where we aim to be in the top 5.

Targets

FRS:
1st with a lead of more than 4% over our nearest high street competitor

UKCSI:
UK top 5

Value for members and society

Creating mutual value by doing more with and for our members and their communities

We aim to help members achieve important goals in their lives. The more members we have, and the more we do for them, the bigger our contribution. That's why we measure the number of 'engaged members' – those holding their current account, savings or mortgage with us. As we want to deepen relationships with existing members, we will also measure 'committed members' – those with an engaged membership product plus another product.

We share our success with members through better pricing than the market average. This 'member financial benefit' added up to £560 million last year. The amount varies each year, depending on our trading environment and investment priorities.

Our social purpose motivates us to contribute to local communities. We're proud to have committed 1% of our pre-tax profits to charities since 2007 and are concentrating on helping people across the UK find a place fit to call home.

Targets

At least £400 million in member financial benefit next year

Engaged members:
10 million by 2022

Committed members:
4 million by 2022

Community investment:
1% of pre-tax profits, as voted by members

Financial strength

Ensuring a safe and sustainable business for current and future members

First and foremost, members deserve to know their money is safe and secure. As a mutual, we approach profitability differently to most organisations. We don't have shareholders to pay and our members own us. So profit is not an objective in itself, rather a means of how Nationwide stays strong and invests in employees and infrastructure.

We are built to last so our financial performance framework is designed to keep our capital at prudent levels and greater than regulations require. We will measure our success using the leverage ratio, which assesses the Society's ability to meet its financial obligations and withstand unforeseen events. It's a universally recognised indicator of long-term safety and sustainability.

Target

UK leverage ratio:
Greater than 4.5%



Building thriving membership

Helping you achieve your goals

Because we help our members achieve important goals in their lives, the more members we serve the bigger our contribution can be – whether that's owning a home, saving for the future, or just helping them manage their everyday finances.

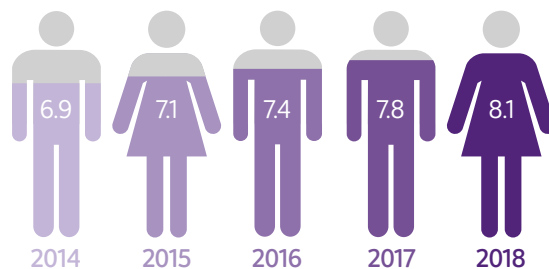


Growing membership makes us stronger and we measure progress by the number of engaged members we have – members who have their main personal current account with us, or a mortgage or savings account with a balance greater than £5,000⁴.

Key performance indicators

Measure

Engaged members (million)



Performance

Engaged members grew by 330,000 during the year to 8.1 million, largely driven by growth in current account members.

Target: 10 million by 2022

As a mutual Society, owned by our members, Nationwide thrives when our members thrive. In the last year we have thrived together, delivering consistently strong trading results in our core product markets.

Member financial benefit over £500 million

We calculate the additional financial benefit of membership – this takes the form of better rates, fees and incentives than the market average that we can offer members because

we do not have to reward shareholders. Our member financial benefit for the year totalled £560 million (2017: £505 million)⁵.

A place to call home

We continued to be true to our founding aim of helping members into homes of their own. Altogether, we had a record year for gross prime lending, at £29.4 billion (2017: £29.1 billion). Total net lending for the year was £5.8 billion (2017: £8.8 billion) in line with our decision to reduce our buy to let lending through The Mortgage Works, along with increased prime mortgage redemptions, as we managed margins in the long-term interests of the Society in a fiercely competitive market.

We helped a record 76,000 first time buyers (2017: 75,000) and almost 400,000 (2017: 326,000) homeowners in all. We're delighted

that in the last five years we've helped over 250,000 first time buyers onto the housing ladder, and we remain committed to helping them with access to competitive mortgage products and incentives like cashback. Meanwhile, we are helping one in seven potential homeowners holding a Help to Buy ISA with us to save for their first home.

We also listened to member feedback and, after carefully considering affordability criteria, we increased our maximum loan for a 95% LTV mortgage from £250,000 to £350,000.

We aim to adapt to the changing needs of our members, expanding our mortgage proposition in November 2017 to become the

only major high street lender to offer a lifetime mortgage. We believe we should support members in later life looking to access the capital tied up in their property, and have had over 3,800 enquiries to date. We've been careful to design a product that is good value and includes all checks and balances to ensure members fully understand how it works. We also intend to launch a retirement interest only mortgage, giving members another choice in how they manage their lifestyle in later life.

As we had signalled, we significantly reduced our buy to let lending through The Mortgage Works. This was a result of our decision to reduce risk and tighten our lending criteria

⁴ From 2018/19 this changes to balances of greater than £1,000 for savings members.

⁵ Further information on member financial benefit is included on page 27 of the Financial review.



Chief Executive's review *continued*

ahead of regulatory changes, combined with a reduction in the market size since the introduction of a stamp duty surcharge in 2016. Looking after our members is about more than just providing products and services. We're determined to champion the interests of our members to ensure they are treated fairly. So, when it became clear that some potential

borrowers on new leasehold homes were facing onerous, potentially unfair terms and rapidly escalating ground rents, we took a stand against this by refusing to lend in such circumstances. We also very much support continued Government action to challenge bad practice around leasehold homes and high ground rents.

Homes are not always owned of course. Our members include tenants and landlords as well as homebuyers, so we also wanted to contribute to better standards for renters. To do this, we have put together a cross-industry partnership to help landlords deliver high quality properties to rent.

Supporting savers

The market has been extremely difficult for savers for a number of years. Notwithstanding the rate rise in November, interest rates remain at historic lows and people are saving less. We have consistently attempted to protect depositors and encourage a saving habit by offering rates on average more than 50% higher than the market average⁶, and by offering a range of loyalty accounts.

We launched a range of loyalty bonds and fixed rate ISAs for members with at least one year's membership; we doubled the maximum balance allowed in our Loyalty Saver account to £100,000; and in March

we launched a Loyalty Single Access ISA paying 1.40%, which attracted £8.5 billion in deposits by the end of April 2018.

This commitment to rewarding loyalty helped us grow our overall savings members to 11.6 million. In a highly competitive market our deposit balances grew by £3.5 billion in the year, primarily driven by higher current account balances and the success of our Single Access ISAs. And overall, Nationwide continues to provide a safe home for £1 in every £10 saved in Britain.



In sickness and in health: Vaniya and Neena have been married 45 years now and Nationwide members for nearly half that time. Retired doctor, Vaniya, says:

'We stick with Nationwide as they continue to deliver better rates and recognise their members' loyalty'

Vaniya and Neena, members since 1998.

First choice for everyday finances

We want to be members' first choice for their finances, and our unique combination of outstanding service and good value has helped record growth of current account members for the fourth year running.

In fact, we opened a record 816,000 accounts in all (2017: 795,000), more than any other brand⁷, taking our current account base to 7.3 million (2017: 6.8 million). Our share of main standard and packaged accounts grew to 7.9% (2017: 7.6%), a new high, with our share of all accounts increasing to 9.4% (2017: 8.9%).

Improvements to our student proposition, where we offer the only completely fee-free student account on the market, saw us double the number of accounts opened to 21,000. We continued to enhance our current accounts by focusing on the features members value most. We extended the travel and mobile phone insurance on our FlexPlus account and reduced fees for transactions and unauthorised overdrafts on our FlexAccount. We also introduced text alerts for unauthorised overdrafts to help members manage their finances.

During the year, we shifted the focus of our unsecured lending and protection products to be available 'just for members'. This reduced the number of credit cards we issued, in line with our expectations, to 160,000 (2017: 206,000). However, overall balances were 3.9% higher at £1.8 billion. We also made our personal loans a 'just for members' product, and grew the outstanding balances for personal loans by £74 million to £2.0 billion. Meanwhile, we are making good progress with the transition of our existing home insurance policies to RSA and have successfully launched our new home insurance product, also in response to member feedback.

Meeting the needs of small businesses

Around a million of our members run their own business, and we've been asked many times if we can provide a mutual business account as an alternative to the big five banks, but the costs of market entry have been prohibitive in the past. In March, thanks to the availability of the Alternative Remedies Fund, financed by RBS to boost competition in banking, we announced we would apply for up to £50 million of funding to launch a business current account. If our bid is successful, we will launch an account targeted at small and micro-businesses, providing a mutual business alternative to the big five banks, who between them hold 85% of business accounts.

Just for members

We want our members to feel part of something special.

Part of something that looks after members and puts their interests first. Of a movement that does the right thing in the right way. Of a Society that gives back to our society more broadly.



- Rewarding members with 'just for members' products
- 'Recommend a Friend' to earn rewards – around 100,000 members benefited last year
- Take pride in the 1% of pre-tax profits we give to charity
- Help shape our Society at Member TalkBacks, through Member Connect, at our AGM
- Our specialist support service is here for you when you need it most.

⁶ Market interest rates are based on Bank of England whole of market average interest rates over the period, adjusted to exclude Nationwide's balances.

⁷ Source: eBenchmarkers April 2017 to March 2018, CACI April 2017 to March 2018, BACS Payments Schemes monthly CASS switching market data and internal sources.



Built to last

A safe and secure home for your money

We aim to be here for the long term. To look after our members' money, help finance their futures, and to make a real contribution to society. So we have put in place a financial performance framework to ensure we are 'built to last'.

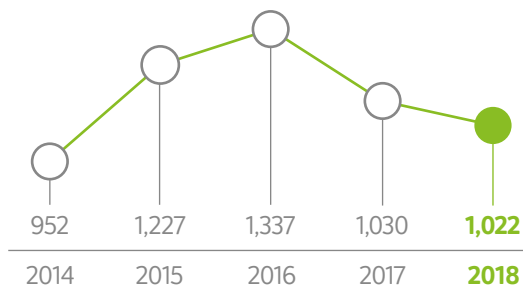


We have a low-risk business model, with prudent levels of capital underpinning our financial strength and ensuring we are safe and secure. Profit is the means to an end for Nationwide, not an end in itself. As we do not have to pay dividends to shareholders, instead of seeking ever higher profits we seek to use our profitability to balance financial strength, investment in our Society and future growth.

Key performance indicators

Measure

Underlying profit (£m)



Performance

Underlying profit for the year of £1,022 million is in line with the financial performance framework

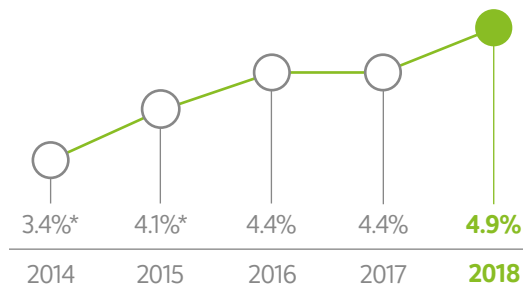
Target: Underlying profit consistent with the financial performance framework

Statutory profit (£m)



Measure

UK leverage ratio⁸ (%)



Performance

Our UK leverage ratio ended the year at 4.9%

Target: Greater than 4.5%

*CRR leverage ratio basis

Financially strong and secure

We finished the year with all time high capital ratios and strong profitability. Our Common Equity Tier 1 ratio, a measure of capital strength, rose to 30.5% (2017: 25.4%). We improved our UK leverage ratio, an important measure of our financial strength and an indicator of our ability to cope with unexpected shocks, to 4.9% (2017: 4.4%).

This was supported by issuing a second tranche of CCDS, a form of Common Equity Tier 1 capital specific to building societies, demonstrating capacity and liquidity in the CCDS market. And we achieved underlying profits of £1,022 million (2017: £1,030 million), in line with our financial performance framework. Our statutory profit for the year was £977 million (2017: £1,054 million).

These results have been the product of excellent trading in our core businesses, and the fruits of the efficiency programme we put in place last year. In a year where our business and membership have grown, we are pleased to report we held our costs flat, thanks to a focus on both efficiency and operational change.

⁸ From 2016 Nationwide has been granted permission to report a UK Leverage ratio on the basis of measurement announced by the PRA. Prior years (2014 and 2015) are reported on a CRR basis and include eligible central bank reserves.



Chief Executive's review *continued*

Culturally, we've reinforced to our people that every pound we spend is a pound of our members' money. We've encouraged them to come forward with suggestions on how to spend more wisely with the Arthur Webb Challenge Cup, a suggestion scheme for which we received over 100 team entries. Operationally, we've focused heavily on our 'Right First Time' initiative and have also begun to digitise member journeys for

current accounts and mortgages, making better use of members' and colleagues' time. We also simplified our management structure, and reduced our headcount in many areas of the business, relying upon organic turnover of our employees as far as possible.

We have a responsibility to protect our members from fraud and ensure that the Society has robust systems of control to guard against facilitating other financial crimes such as money laundering, bribery and corruption. Our policies and controls are designed to apply robust but appropriate standards and we continue to evolve controls to keep our members' money safe and comply with regulatory expectations.

Investing in technology and infrastructure

An important part of being built to last is investing in our business. This means building on earlier investments that have enabled our very rapid current account growth, increased mobile adoption by members, and underpinned our service distinction.

Looking ahead, it's clear that the pace of change is accelerating. Technology is changing how people live and work, and Nationwide will need to continue to respond to member expectations. Today's consumer lives in an 'always on' world and naturally expects the same from their financial provider. Service availability, in particular for internet and mobile banking, plus cash machines and payments, has become a key utility that members depend on. Meanwhile, no business is immune to growing cyber threats.

So, digital innovation and systems resilience are increasingly fundamental aspects of our member service experience and the trust customers have in their financial providers. At the same time, recognising that all businesses have room to improve, we will ensure the Society has the capacity to meet the demands of its strong business growth. We are therefore reviewing our operations and technology to keep Nationwide well ahead of future needs. This will include the opportunities presented by integrated platforms, cloud technology, and automation. We will refine our technology strategy accordingly, and the investment plan this might require. Importantly, we do so having achieved a position of considerable financial strength, good trading performance and demonstrable cost discipline.



Giving better value to members

As a mutual, owned by our members and here to serve their interests, ensuring that we offer really good value products is a priority.

That doesn't mean that we will necessarily be at the top of every 'best buy' table – at least not until they measure long-term value, rather than short-term teaser rates.

What it does mean is that we aim to give members better value than they receive from banks – on top of the outstanding service we provide.

We think about profits differently

Members sometimes ask why, if we are a mutual, we need to make profits. We see profits as an important indicator of our success as a business. Importantly, they ensure the stability members expect, they fund investment in our service, and they support business growth – all after we've delivered real value to members through better pricing.

But because we have a social purpose, the pursuit of ever-larger profits is not the driving force for what we do. We don't aim to maximise profits for shareholders, but to make sufficient profits to run a safe and sustainable business and to create more value for members through future growth.

We put our profits to work in a number of ways. First, we put money away for more challenging times – we maintain a strong capital buffer. Then we use our profits to support future growth, contributing to the long-term success of the Society and extending the benefits of mutuality to more members. Profits are also important so we can invest in our branch and digital

networks, and for developing the products and services we expect our members to want in the future.

The Society's profits are delivered after we have given value to members through better pricing, which added up to more than £500 million this year.

Each year, we make different choices about how we use the value we create. If the economy is weak, we may need to put more capital aside. If rates rise, homebuyers might need more support than savers.

Further information on member financial benefit and the financial performance framework is included in the Financial review on pages 27 and 32 respectively.



Building legendary service

Our service difference

We believe that the quality of our service sets us apart from our competitors.

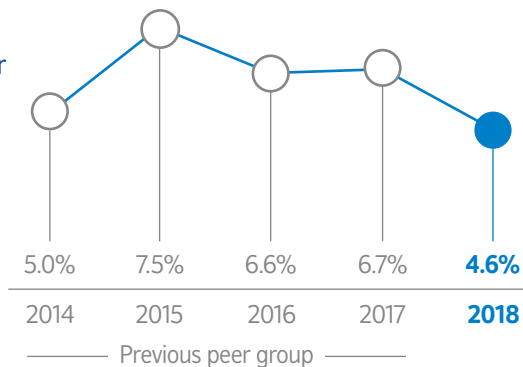
We have widened our comparison group this year, comparing ourselves to all those organisations with a main current account market share greater than 4%, rather than 6% in previous years, but we have remained number one for customer satisfaction against our more challenging high street peer group⁹. By providing outstanding service that is heartfelt, easy, lifelong and personal, we hope to retain and attract members. As we continue to stretch ourselves, we will also measure ourselves against the UK's very best organisations, not just within the financial sector.



Key performance indicators

Measure

Overall customer satisfaction (lead over our high street peer group)⁹



Performance

Despite setting ourselves a more testing target, we ended the year with our lead over our nearest competitor at 4.6%⁹.

2017/18 Target:
1st with a lead of 2%

Nationwide has built its business around caring for members, and for society. The quality of our service matters to us because it matters to our members. Service is not an abstract concept. It is what happens when our employees and our members connect with each other. That makes it a fundamental part of our relationship with members and a key part of why Nationwide remains the UK's most trusted financial institution¹⁰.

We work hard to maintain and improve standards even as consumer expectations grow higher each year. We measure member satisfaction against our high street peer group and we were ranked number one for the sixth consecutive year⁹, ending the year with a lead of 4.6% ahead of our high street peer group. Our lead

of 4.6% is well ahead of our strategic target. We also lead our high street peer group for main current account satisfaction, with a lead of more than 10 percentage points¹¹ and we opened a record number of new current accounts. Our strong member satisfaction is also reflected in a lower level of complaints than our peers relative to our size and scale¹².

So we are in a strong position. But being a leader for service among financial providers is not enough. If we are to deliver truly legendary service, we need to be among the best in the UK. That's why we've decided to introduce a new measure next year, benchmarking ourselves against the all-sector UK Customer Satisfaction Index¹³, published by the Institute of Customer Service.

We are currently ranked number seven in a top 10 that includes Amazon and John Lewis, with a target of the top 5.

Members also need to be able to rely on us to keep their money safe, and we're encouraged that we have among the lowest fraud losses in the industry. Protecting our members is increasingly challenging in an ever-evolving world where threats are constantly changing, and where fraudsters exploit new technologies and increasingly target members directly with scams. We continue to evolve our fraud defences, investing in our own future technology, and supporting members with education that empowers them to help protect themselves.

⁹ GfK 2018, Financial Research Survey (FRS), 6 year lead held over period 12 months ending 31 March 2013 to 12 months ending 31 March 2018. Performance chart covers 12 months ending 31 March 2014 to 12 months ending 31 March 2018. Each monthly data point contains customer feedback referring to previous 12 months. Proportion of extremely/very satisfied customers minus proportion of extremely/very/fairly dissatisfied customers summed across current account, mortgage and savings. High street peer group defined as providers with main current account market share >4% (Barclays, Halifax, HSBC, Lloyds Bank (inc C&G), NatWest, Santander and TSB). Prior to April 2017, high street peer group defined as providers with main current account market share >6% (Barclays, Halifax, HSBC, Lloyds Bank inc C&G (Lloyds TSB prior to Apr 15), NatWest and Santander).

¹⁰ Source: Nationwide Brand and Advertising tracker – compiled by Independent Research Agency, based on all consumer responses, 3 months ending March 2018. Financial brands included Nationwide, Barclays, Co-operative Bank, First Direct, Halifax, HSBC, Lloyds, NatWest, TSB and Santander.

¹¹ © GfK 2018, Financial Research Survey (FRS), 12 months ending 31 March 2018, proportion of extremely/very satisfied main current account customers minus proportion of extremely/very/fairly dissatisfied main current account customers. High street peer group defined as providers with main current account market share >4% (Barclays, Halifax, HSBC, Lloyds Bank (inc C&G), NatWest, Santander and TSB).

¹² Source: FCA Aggregate complaints data H2 2017.

¹³ UK Customer Satisfaction Index, January 18.



Chief Executive's review *continued*

Digital convenience with a human touch

Technology is constantly changing consumer expectations of service. In particular, people expect to be able to use both traditional and digital channels seamlessly. This means we need to make it as easy to move between branch, digital and telephone channels as it is to switch between satellite, streaming and terrestrial TV channels.

As we improve and expand our digital services, more members choose them as their first point of call with us, with mobile increasingly the first choice. Mobile active current account members grew 44% to 2 million, and mobile log-ons were up 49% over the year. We

launched a 'Discover Mobile' campaign to encourage members to try our mobile services and we expect mobile active current account members to increase from 33% in 2018 to 44% by 2019.

Our Banking app has improved significantly with our iOS rating increasing from 3.0 to 4.8 (out of 5.0). We have extended what can be done with the app, including instant registration, reporting lost and stolen cards, letting members set up new payees and view pending transactions.

We will make more improvements during 2018/19, including the ability to freeze or unfreeze your card if you have mislaid it; a MoneyWatch service to put members in control of their spending; and an auto-advice service offering simple automated investment advice.

We're also using technology to improve our members' 'real world' dealings with us. For example, we've digitised our mortgage journey in branches, halving the interview time and making the whole experience a more efficient use of our members' and colleagues' time.

Branches of the future: convenience, conversation, consultation and community

Although many members are enthusiastic users of digital technology, we know many still value the personal service they receive in our branches. Although our branches face the same economic pressures as those of our competitors, as a mutual we believe that they will continue to play an important role for our members, which is why we invested £73 million in them during the year.

We also recognise that the way our members want to use our branches is changing. We successfully trialled a new '4C' concept, and by the end of April we had rolled out

36 new style branches – from Barnstaple to Aberdeen – with plans to update our entire branch network over the next four years. In these branches members can choose between four service zones depending on their needs:

Convenience – quick and easy services that members can access from machines or a staffed counter;

Conversation – a space to chat when you need some help;

Consultation – somewhere to talk more privately;

Community – a relaxed space for members with time to spare, who can stop for a coffee, explore our history or the work we do in our local communities.

We are also using technology to integrate our branches with our other channels. An example of this is Nationwide Now, a video-conferencing service that connects members in one branch with an adviser in another – a service that is more convenient for members and more efficient for the Society.

Open Banking: making the most of your money

Open Banking is a new requirement from the Competition & Markets Authority to boost competition in financial services and provide consumers with more choice and control over how they can manage their money. If a consumer gives their consent, Open Banking enables them to benefit from new services

by sharing their financial data with authorised third-party providers. Nationwide is looking at how we can differentiate ourselves in the market and best serve our members. As the most trusted financial brand on the high street¹⁴, we're also responding to the needs of members with guidance on how to share

data securely. We are also committed to working with innovative partners to launch new digital propositions that will help make a difference to members' lives, and the way they manage, budget and save their money.



We're here for you when you need it most

During the Second World War, when many people lost their homes to bombing, the Society adopted the principles of 'sympathy, simplicity and speed' to help those who were affected. This included bringing in special measures, like interest only payments. So our ethic of care is a deeply-rooted part of our culture.

Today we have special support services in place to help vulnerable members facing hardship.

When members are unexpectedly laid low by physical or mental illness, bereavement, caring responsibilities or job loss, money worries can

loom large. As a mutual, our ethic of care is a deeply-held part of our culture.

Our Specialist Support Service, which began as a collaboration with Macmillan Cancer Support, has been extended to other life-limiting conditions and mental health challenges, and has helped over 5,000 members since it was launched in 2015.

Our 'Money Worries' team works with members who are worried about their finances to understand and guide them through financial difficulties.

¹⁴ Source: Nationwide Brand and Advertising tracker – compiled by Independent Research Agency, based on all consumer responses, 3 months ending March 2018. Financial brands included Nationwide, Barclays, Co-operative Bank, First Direct, Halifax, HSBC, Lloyds, NatWest, TSB and Santander.



Building PRIDE

Making Nationwide a great place to work

We want to be one of the country's best places to work and we believe that our mutual heritage and social purpose helps connect our people around a clear philosophy of care.

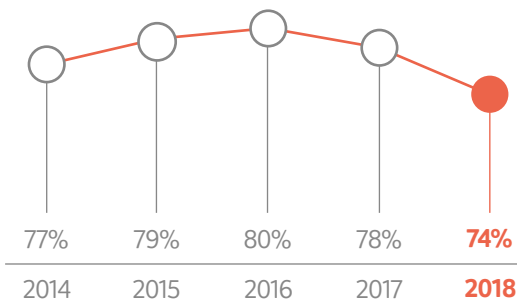


Not just because this is the right thing to do but because this is a key ingredient of our service record and part of our competitive advantage. Engaged and valued colleagues are much more likely to deliver the service our members deserve, which in turn helps grow our business and deliver more value to our members.

Key performance indicators

Measure

Employee engagement



Performance

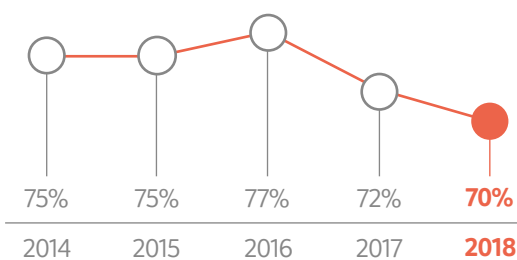
Engagement (Global HP benchmark 2018 = 77%)

We scored 74% for employee engagement, which is slightly below the global high performing (HP) benchmark

2017/18 Target: Global HP Benchmark

Measure

Employee enablement



Performance

Enablement (Global HP benchmark 2018 = 71%)

Employee enablement, at 70% is just below the global HP benchmark

2017/18 Target: Global HP Benchmark

PRIDE is about our people – about the culture and values we share, and doing the right thing. These are fine words, but it's actions that make a real difference.

In January we were proud to live our values by taking on 297 Carillion contractors after the company collapsed. At a time of huge uncertainty for them, we gave stability and security to the people who provide valued services for our Society. This was wholly consistent with our culture and values and good for our Society.

We measure engagement and enablement through an independent employee survey (ViewPoint) each year. In 2018, 90% of our people completed the survey; an extremely high participation level that we're proud of. Results this year show that our engagement

score dropped by 4% and our enablement by 2% and we didn't hit our stretching global high performing benchmark. That said, engagement remains extremely high at 74%, and 9 percentage points above the financial services norm.

We also participated in the Banking Standards Board's survey on culture for the second time, and remain one of the strongest performers. We were particularly encouraged that 95% of our employees said our purpose and values are meaningful to them. We score relatively well on questions related to personal resilience, but over one third of employees often feel under pressure to perform at work. While it's important that our employees perform to their full potential, we also want our people to enjoy a balanced working environment.

One part of being a good place to work is rewarding our people fairly. Nationwide was one of the first employers to offer a living wage in 2014, and in recent years we increased our pension contributions significantly. This year, we stepped away from paying bonuses linked to individual performance, replacing these with a 'Sharing in Success' scheme that rewards colleagues for collaborating and cooperating in growing our business and serving our members – for doing the right thing in the right way, in line with our values.

Working practices also contribute to employee satisfaction. Our colleagues value the flexible working contracts we offer to fit around their lives – from flexi-time, part time, job sharing, compressed hours and remote working – as well



Chief Executive's review *continued*

as providing for specific needs, such as flexible working during religious festivals, and adoption and fertility treatment leave. We believe this flexibility is a key reason why 86% of our female colleagues return to work after maternity leave. PRIDE is also about developing our people, and we are investing in our leadership capabilities at all levels of the Society.

In line with our core belief that we can achieve more together than alone, we are building a more connected leadership community. We've identified a Leadership 200 group – including 20 'People's Choice' leaders chosen by an all-employee vote. Most of them have taken part in a development programme, 'Leading for Mutual Good', which aims to equip them to lead the business well into

the future. We've also launched 'Developing My Leadership', a programme for all our people to expand their knowledge and capabilities and develop their own personal leadership skills.



Putting members and their money first

Rising to the challenge

Inspiring trust

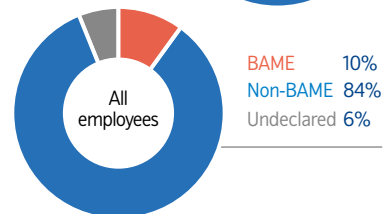
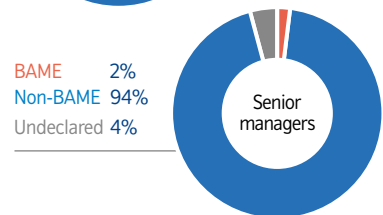
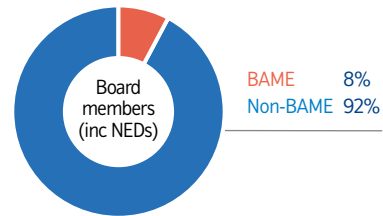
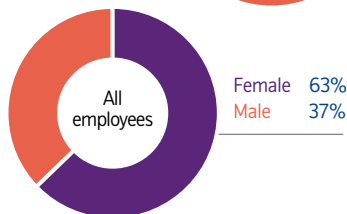
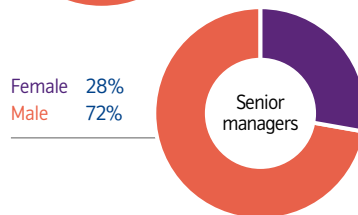
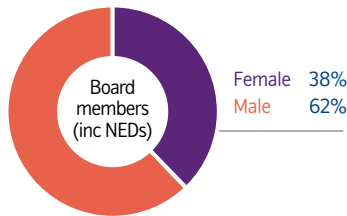
Doing the right thing in the right way

Excelling at relationships

Strength in diversity

Nationwide is committed to diversity. Not because rules require it but because we want to be inclusive, to nurture a workforce that represents all communities across the UK, and to offer opportunities to everyone.

We are focused on delivering our equality, diversity & inclusion strategy for 2015-2020. As a result, we are pleased to have increased the representation of women on our Board (including non executive directors (NEDs)) and we are confident we will meet our 2020 target of 33-35% for female senior managers. Progress towards our 2020 target of 8-15% for Black, Asian and Minority Ethnic (BAME) senior leaders is proving more of a challenge and we are redoubling our efforts to achieve our target by, for example, offering sponsorship and mentoring.



Gender pay gap reporting

We issued our first gender pay gap report in March 2018. Our mean gender pay gap – the difference in average hourly pay between all men and women – is 29% and is on a par with the rest of the UK retail banking sector. This is very much a function of the nature of our business and our resulting employee

profile. The gender pay gap for our senior population of approximately 300 managers is just 4%. This gap could be closed by moving only a handful of people. Our overall gender pay gap is therefore driven by having far fewer men in our junior roles – for example, only one in five of our junior branch roles is occupied by a man. To reduce our gender pay gap to zero would require us to change approximately 4,000 of

these junior positions to be held by men. Nevertheless, we remain committed to identifying opportunities to help women to progress to senior roles. We have already made good progress on our Board with 38% female representation. We have also delivered unconscious bias training for our people managers, and we set targets for female representation at all levels.

Our employees are fundamental to the overall success of the Society and the delivery of our strategic objectives. We place great importance on the culture of the Society and the behaviours and values that underpin it. People-related risks and opportunities are well understood across the Society. This is thanks to regular

people-related risk assessments on both internal and external environmental factors and other issues including cultural, social, employee welfare, legislative, recruitment and retention. We monitor these on an ongoing basis and have policies and controls in place to manage people-related risks and to mitigate against material risk exposure to the Society and its members.

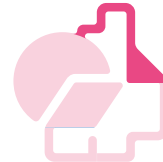
In addition, we engage regularly with our colleagues, and encourage them to escalate issues of concern to be discussed and debated with management and the Board, with changes implemented where necessary.



Building a national treasure

Making society a better place together

Possibly our most ambitious cornerstone, deeply rooted in our mutuality, is our desire to be a force for good for our members and society, contributing to the life of the nation. How our difference makes a difference.



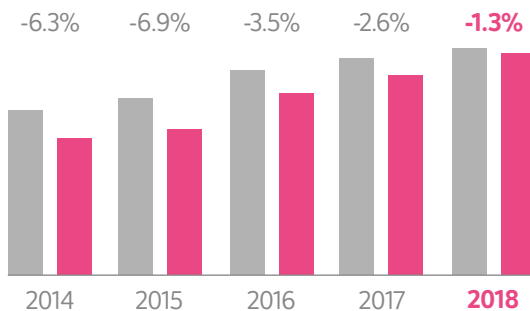
Importantly, we measure our success by how others see us, with independent assessments of trust and prompted brand consideration. After all, this is not one for us to judge ourselves on.

Key performance indicators

Measure

Prompted brand consideration (all consumers)

- 1st position peer
- Nationwide



Performance

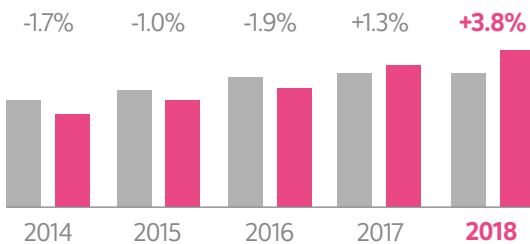
We ended the year in 2nd position, 1.3% behind the leader¹⁵

Target: 1st place with a lead of 4% by 2022

Measure

Trust (all consumers)

- 1st position peer
- Nationwide



Performance

We ended the year in 1st place with a lead of 3.8%¹⁵

2017/18 Target: 1st with a lead of 3%

Social purpose has been part of our founding DNA for over 130 years, and has helped make us the UK's most trusted financial brand¹⁶. But our mutual values make us want to go further, to use that trust to become a driving force for good in society.

We are a responsible business; we pay our taxes and we were the 11th highest UK

business taxpayer in PwC's annual Total Tax Contribution survey of the 100 Group¹⁷; we pay decent wages, we treat suppliers fairly; and we work hard to improve our sustainability – and we will continue to operate this way. It's our nature to believe we can always do more. Indeed, Nationwide was originally set up to help people to save and borrow to build their own homes.

Over 130 years on and we're still helping people into homes of their own. But we cannot hide from the fact that decent homes to buy or rent are out of reach for more and more people. So, we are combining our deep knowledge and experience with our new social investment strategy to make our contribution to Britain's housing market in a socially responsible way.

¹⁵ Source: Nationwide Brand and Advertising tracker – compiled by Independent Research Agency, based on all consumer responses, (3 months ending March for each year 2014–2018). Financial brands included Nationwide, Barclays, Co-operative Bank, First Direct, Halifax, HSBC, Lloyds, NatWest, TSB and Santander. For 'prompted brand consideration' data includes consumer responses of 'first choice' or 'seriously considered' brand.

¹⁶ Source: Nationwide Brand and Advertising tracker – compiled by Independent Research Agency, based on all consumer responses, 3 months ending March 2018. Financial brands included Nationwide, Barclays, Co-operative Bank, First Direct, Halifax, HSBC, Lloyds, NatWest, TSB and Santander.

¹⁷ The 100 Group represents the views of the Finance Directors of FTSE 100 and several large UK organisations.



Chief Executive's review *continued*

Everyone deserves a place fit to call home

Our refreshed five-year social investment programme is one way we are 'building society, nationwide'. In line with our member vote

in 2007, we will continue to invest at least 1% of our pre-tax profits to support good causes, including tens of millions of pounds in housing

initiatives. This will take the form of three separate programmes focusing on helping communities help themselves.

Stronger together: helping local communities to provide better homes

Through a new community funding programme, we will make £20 million available in grant funding for housing-related charities and organisations over the next five years. The projects will be driven by local needs and chosen by local members. We piloted this programme in the north of England, where nine projects received a total of £270,000, and we have since launched in Wales, Scotland, Northern Ireland and the West Midlands. We will extend this across the rest of the UK in 2018/19. In each

region we will create a Community Board made up of Society colleagues, members and local housing experts who will manage the community funding programmes in their region.

As well as getting this new programme underway, we maintain our longstanding support for other charities and in total we have made charitable donations of £5,001,235 this year (2017: £5,539,117). We continued to work with housing and homelessness charity Shelter, helping 4,900 people into a home of their own.

Meanwhile, our support for the Elderly Accommodation Counsel's 'Live Safely and Well at Home' campaign enabled 5,700 older people to stay in their own homes. We've also set up a partnership with homeless charity St Mungo's, to support rough sleepers across the country.

A blueprint for sustainable development: Oakfield

In Swindon, where we are headquartered, we're partnering with the borough council on a regeneration scheme to deliver a housing project. Key to the success of the Oakfield development is our desire to involve local people in the planning and build process. Our community organiser has been listening to local residents' views on the number and type of homes to be built, as well as the green spaces and facilities people would like to see, which will turn a housing development into a living community. We intend this development to inspire other organisations to develop homes in partnership with their local communities.



Reinventing renting: championing tenants and landlords

Recognising that one in five¹⁸ people now live in privately rented homes, and our members and customers include both landlords and tenants, we wanted to take action to raise standards in private renting, considering the needs of all those involved and delivering high quality homes for rent. Last September we put together a Partnership Board of organisations from across the rental sector. The Board aims to create understanding of how the market functions and to collaborate on collective policy suggestions to bring to Government. As well as Nationwide, our Partnership Board includes the National Landlords Association (NLA), the Association of Residential Lettings Agents (ARLA Propertymark), Shelter, Countrywide and The Nationwide Foundation.



¹⁸ According to data from the Residential Landlords Association (April 2017) and English Housing Survey (March 2016).



Chief Executive's review *continued*

Building a national treasure *continued*

The Nationwide Foundation

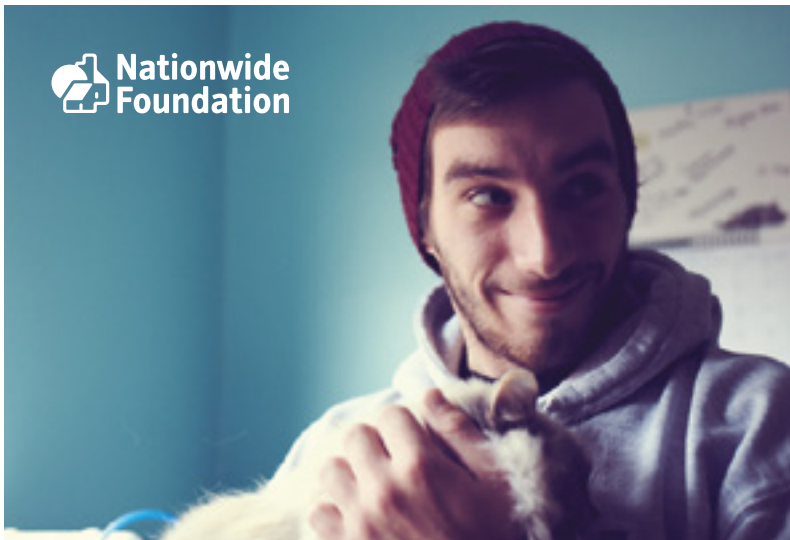
The Nationwide Foundation is an independent charity, which the Society set up in 1997. Each year, we donate 0.25% of Nationwide's pre-tax profits to the Foundation – £2.8 million in 2017/18 – as part of the 1% of pre-tax profits we give to good causes. The Foundation's vision is that everyone in the UK should have access to a decent, affordable home, and it funds three programmes to help achieve this ambition:

For more information on any of this work please go to nationwidefoundation.org.uk

1. Nurturing ideas to change the housing system – to protect and create decent affordable homes. The Foundation is supporting West London residents of two housing estates in their bid to transfer their homes to community ownership, protecting and increasing the supply of decent, affordable homes.

2. Backing community-led housing – helping local people take control of their housing. The Foundation is funding the National Custom & Self Build Association's programme to create an expert taskforce to support communities who want to develop affordable self-build housing schemes.

3. Transforming the private rented sector – to provide affordable, decent homes for tenants. The Foundation is funding a collaborative programme to transform the private rented sector for vulnerable tenants in Manchester, including 'test and learn' grants, and giving tenants a stronger voice in finding solutions.



Treading lightly

As a large organisation, we have a responsibility to help sustain our environment and we continue to make progress toward our 2020 targets, doing what we said we would: reducing our carbon footprint and reducing the amount of waste we produce.

We're seeking to reduce our impact on the environment, working with our supply partners to build on our commitment to use renewable energy. Following the success of the solar farm that produces 50% of our electricity, we've now signed an agreement to take the balance of our

electricity from sustainable sources (wind and hydro power) making our electricity supply 100% 'green'.

Our zero-to-landfill policy is well embedded and all our waste is either recycled or used for energy recovery. We've reduced the waste we produce by 216 tonnes (12%), thanks to new ways of working, beating our 2020 target two years early.

The commitment we've made to be among the top performers in environmental sustainability is reinforced by our participation in the Carbon Trust's 'Triple Standard'. We were amongst the first to be certified and subsequently re-certified

to this demanding standard, and are undertaking another re-certification.

Working with our suppliers in April this year we achieved the Carbon Trust's coveted level 2 Supply Chain Standard, and we're now pushing for level 3 with a meaningful plan to reduce emissions.

We support the recommendations of the Financial Stability Board Taskforce on Climate-related Financial Disclosures (TCFD) released in June 2017. We are continuing to assess how, as a building society with a social purpose, we can best implement the recommendations.

Supporting our communities

Whilst our new social investment strategy is focused on housing, we encourage our colleagues to continue to support the local causes they are most passionate about.

In 2017/18:

- 66% of our colleagues were involved in fundraising, volunteering or payroll giving. £1.8 million was raised for charity by our members and colleagues this year.
- The value of colleagues volunteering their time was £0.7 million (all colleagues are given up to 14 hours to volunteer during work time each year).



Chief Executive's review *continued*

Outlook

The UK economy has proved considerably more resilient than some people feared immediately after the Brexit referendum, though the pace of growth is likely to remain relatively subdued, reflecting ongoing Brexit uncertainties. With economic growth expected to be modest over the next two years, inflation is likely to moderate, gradually reducing the squeeze on household budgets. Subdued growth may mean a small rise in the unemployment rate from recent 43-year lows and only gradual, limited interest rate increases by the Bank of England.

Turning to the outlook for our own business, we anticipate modest growth in our core product markets, reflecting the outlook for the economy as a whole. With employment growth expected to slow and pressure on household budgets fading only gradually, mortgage lending is likely to rise at a fairly pedestrian pace. While demand in the housing market looks set to remain subdued, lack of supply will provide support for prices. We expect the mortgage market to remain extremely competitive.

Consumers have been saving less, but we expect household deposit growth to pick up a little, to around 4% a year. We will continue to focus on providing the attractive rates that have helped us maintain our deposit share at 10% in an extremely competitive market.

More generally, consumers continue to switch rapidly to digital services, and the new era of Open Banking presents both challenges to established providers, and opportunities for a trusted brand like Nationwide to bring the benefits of mutuality to a wider community.

We look to the future from a position of strength and will continue to seek to deliver the outstanding service, mutual value and financial security our members deserve from us. We will support our members at all life-stages, introducing new services to meet their developing needs. We'll reward our members by offering compelling value loyalty products to deepen our relationships with them. And we will look to invest to ensure the Society is financially strong and able to meet the future needs of our members.





Risk overview

Effective risk management is at the heart of our business and has an important part to play in delivering our shared purpose of 'building society, nationwide' by making sure we are safe and secure for the future.

We have a low-risk business model, but if we are to serve our members' interests, some risk is unavoidable. We have well-established risk management processes to ensure the risks we take are controlled and managed appropriately.

How we manage our risks

We manage our risks through an Enterprise Risk Management Framework, which sets out the minimum standards, and associated processes, for successful risk management to support strategic decision making. Through this framework, the Board sets Risk Appetite

which formally defines how much risk we are prepared to take to achieve our objectives. This shapes our strategy for managing risks and determines the controls we put in place to mitigate them. We manage these risks with robust, consistent processes, supported

by appropriate tools, guidance and systems. We then monitor these risks and their mitigation using key indicators and report our performance against appetite to the Board. For further detail see the Business and Risk Report page 97.

Our principal risks

Nationwide is exposed to the principal risks as set out below, which are effectively managed through the Society's Enterprise Risk Management Framework as described on page 101.

Credit risk	The risk of loss as a result of a member, customer or counterparty failing to meet their financial obligations.
Solvency risk	The risk that Nationwide fails to maintain sufficient capital to absorb losses throughout a full economic cycle and sufficient to maintain the confidence of current and prospective members, investors, the Board, and regulators.
Market risk	The risk that the net value of, or net income arising from, Nationwide's assets and liabilities is impacted as a result of market price or rate changes. As Nationwide does not have a trading book, market risk only arises in the banking book.
Business risk	The risk that volumes decline or margins shrink relative to the cost base, affecting the sustainability of the business and the ability to deliver the strategy due to macro-economic, geopolitical, industry, regulatory or other external events.
Liquidity and funding risk	Liquidity risk is the risk that Nationwide is unable to meet its liabilities as they fall due and maintain member and stakeholder confidence. Funding risk is the risk that Nationwide is unable to maintain diverse funding sources in wholesale and retail markets and manage retail funding risk that can arise from excessive concentrations of higher risk deposits.
Pension risk	The risk that the value of the pension schemes' assets will be insufficient to meet the estimated liabilities, creating a pension deficit.
Model risk	The risk of weaknesses or failures in models used to support key decisions, including in relation to the amount of capital and liquidity resources required, lending and pricing, resourcing and earnings.
Operational risk	The risk of loss resulting from failures of internal processes, people and systems, or from external events.
Conduct and compliance risk	The risk that Nationwide exercises inappropriate judgement or makes errors in the execution of its business activities, leading to: non-compliance with regulation or legislation; market integrity being undermined; or an unfair outcome being created for customers.

In the year ahead, we envisage the top and emerging risks to our strategy being:

- **Cyber security** – The risk that customer services are disrupted or data is lost through a failure to protect against a sophisticated ransomware, malware or Distributed Denial of Service (DDoS) attack.
- **Operational resilience** – The risk that our systems and processes are unable to cope with increased customer demand for digital, 'always-on' services, and we are unable to provide stable and resilient services to our members.
- **Regulatory change** – The risk that we are unable to comply with complex changes required by regulation which come into force over the coming year.
- **Competitive environment** – The risk that we fail to respond to changes in our core markets driven by new technologies, regulation, or changing consumer behaviour, affecting our ability to deliver the legendary service and quality products our members expect.
- **Geopolitical and macro-economic environment** – The risk that our borrowers are unable to repay the money they owe us, as a result of changes in the wider economy, such as Brexit, or other economic or political factors.



Financial review

Mark Rennison

“Nationwide is the world’s largest building society and is well-capitalised and profitable. As a building society we are able to manage our profits in our members’ interests, investing in current and future services to improve the financial lives of our members.”

In summary

Our financial performance for the year demonstrates our continued focus on delivering long-term value to our members whilst ensuring we maintain capital strength. Statutory profit before tax was £977 million (2017: £1,054 million) and underlying profit before tax was £1,022 million (2017: £1,030 million). Our 2017/18 financial performance includes the impact of our debt buy-back exercise (£116 million charge within net income) which will deliver increased capital strength and reduced funding costs in the future, whilst the prior year included a one-off gain of £100 million from the sale of our investment in Visa Europe.

Our focus on efficiency has resulted in a flat cost base year on year and we remain committed to maintaining a low trajectory of cost growth in the future. Provisions for liabilities and charges have reduced during the year reflecting the higher charge for PPI and Plevin customer redress in the prior year, following the confirmation of the FCA’s time bar for complaints.

Our robust financial performance and the successful issuance of Core Capital Deferred Shares (CCDS) have resulted in a further improvement of our capital ratios, which remain comfortably above regulatory requirements and demonstrate our financial strength.

UK leverage ratio:
4.9%
(2017: 4.4%)

Underlying profit:
£1,022m
(2017: £1,030m)

Statutory profit:
£977m
(2017: £1,054m)

Income statement

Underlying and statutory results		
	Year to 4 April 2018 £m	Year to 4 April 2017 £m
Net interest income	3,011	2,960
Net other income	121	325
Total underlying income	3,132	3,285
Underlying administrative expenses	(1,979)	(1,979)
Impairment losses	(105)	(140)
Underlying provisions for liabilities and charges	(26)	(136)
Underlying profit before tax (note i)	1,022	1,030
Bank levy (note ii)	(45)	(42)
Financial Services Compensation Scheme (FSCS) (note ii)	1	-
(Losses)/gains from derivatives and hedge accounting (notes ii and iii)	(1)	66
Statutory profit before tax	977	1,054
Taxation	(232)	(297)
Profit after tax	745	757

Net Interest
Margin:
1.31%
(2017: 1.33%)

Underlying Cost:
Income Ratio:
63.2%
(2017: 60.2%)

Statutory Cost:
Income Ratio:
64.6%
(2017: 60.3%)

Notes:

- Underlying profit represents management’s view of underlying performance and is presented to aid comparability across reporting periods.
- Within the statutory results presented in the financial statements:
 - bank levy is included within administrative expenses
 - FSCS costs are included within provisions for liabilities and charges
 - gains from derivatives and hedge accounting are presented separately within total income.
- Although we only use derivatives to hedge market risks, income statement volatility can still arise due to hedge accounting ineffectiveness or because hedge accounting is either not applied or is not achievable. This volatility is largely attributable to accounting rules which do not fully reflect the economic reality of the hedging strategy.



Financial review *continued*

Total income and margin

Net interest income has increased marginally during the year to £3,011 million (2017: £2,960 million), with the benefit of lower funding costs being largely offset by a decrease in mortgage income, reflecting sustained competition in retail lending markets. Net interest margin (NIM) of 1.31% is therefore slightly lower than the prior year (2017: 1.33%).

The impact on mortgage pricing of competition in the retail lending markets, and our continued focus on delivering long-term value to our members, has meant that £24 billion of member balances have switched across all prime mortgages during the year. This includes the continued run-off of our

legacy base mortgage rate (BMR) balances which reduced by £6.6 billion to £22.7 billion.

We expect our reported margin to trend lower in the year ahead as market conditions remain highly competitive.

The negative impact to NIM from the decline in mortgage margins has been partly offset by savings rates which remain low across the industry. In line with our mutual principles, we continue to resist lowering savings rates where possible and seek to offer long-term value to our members wherever possible. We were the first in the industry to pass on the full benefit of the recent base rate rise (in November 2017) to those members whose savings rates fell by 0.25% following the last base rate reduction in August 2016. During the year our

member deposit balances increased and our market share of deposits was maintained at 10.0% (4 April 2017: 10.1%).

Other underlying income has decreased during the year to £121 million (2017: £325 million), predominantly due to a £116 million charge relating to our debt buy-back exercise during the year and the prior year impact of a one-off gain of £100 million from the sale of our investment in Visa Europe. The debt buy-back exercise involved the Society issuing circa £2.1 billion of new bonds, which we consider to be MREL eligible, and the repurchase of older bonds. This has resulted in an increase in our capital strength and a reduction in our future cost of wholesale funding.

Member financial benefit

As a building society, we seek to maintain our financial strength whilst returning value to our members through pricing, propositions and service. We measure the value provided to our members through the highly competitive mortgage, savings and banking products that we offer as our *member financial benefit*, which we quantify as:

Our interest rate differential + incentives and reduced fees

Interest rate differential

We measure how our average interest rates across our member balances in total compare against the market over the period.

For our two largest member segments, **mortgages** and **retail deposits**, we compare the average member interest rate for these portfolios against relevant industry benchmarks. A market benchmark based upon data from CACI is used for mortgages and a Bank of England benchmark is used for retail deposits, both adjusted to exclude Nationwide balances. The differentials derived in this way are then applied to member balances for mortgages and deposits.

For unsecured lending, a similar comparison is made. We calculate an interest rate differential based on available market data from the Bank of England and apply this to the total interest-bearing balances of **credit cards** and **personal loans**.

Member incentives and reduced fees

Our member financial benefit measure also includes amounts in relation to higher incentives and reduced fees to members, and includes annual amounts provided for the following:

- Mortgages: the differential on incentives for members compared to the market
- 'Recommend a friend': the amount paid to existing members, when they recommend a new current account member to the Society

- FlexPlus account: this current account is considered market leading against major banking competitors, with a high level of benefits for a relatively smaller fee. The difference between the monthly account fee, which was increased from £10 to £13 during the year, and the market average of £16 is included in the member financial benefit measure.

For the year ended 4 April 2018, this measure shows we have provided our members with a financial benefit of £560 million (2017: £505 million). This reflects our ongoing commitment to delivering long-term value to our members despite strong levels of competition in our core markets.

Member financial benefit is derived with reference to available market or industry level data. No adjustment is made to take account of factors such as customer mix, risk appetite and product strategy, due to both limitations in availability of data and to avoid bias from segments in which Nationwide may be under or over-represented. Going forward, we will continue to develop our methodology to ensure it captures all the key elements of financial benefits where data is available.



Financial review *continued*

Administrative expenses

As a result of our significant focus on efficiency underlying administrative expenses have remained flat year on year at £1,979 million (2017: £1,979 million). During the year we have made good progress with our efficiency programme, successfully embedding £105 million of sustainable savings, meaning that we are on course to achieve our target of realising £300 million of sustainable savings by 2022. As the programme develops we will evolve our target of cost savings with a current expectation that this will increase; we will provide an update in this regard later in 2018/19. Sustainable savings have been achieved through process simplification, targeted reductions in third-party spend and organisational simplification, including the closure of operations that are not aligned to our core markets. Over the course of the year the number of permanent employees, on a full time equivalent basis, has decreased by 3% (2017: 2% increase).

Savings achieved during the year have helped to mitigate the impact of increases in underlying costs which were primarily driven by:

- higher pension costs (£36 million) largely as a result of market conditions impacting defined benefit costs
- annual pay award and other inflationary increases (£37 million)
- rising variable costs (£20 million) following further significant business growth, with mortgage balances increasing 4% over the year and with 12% more main current accounts than we had a year ago
- spend on initiatives to support longer-term efficiency was £27 million higher than in the previous year, resulting in total efficiency investment of £70 million during 2017/18. Initiatives include the redesign of member processes, organisational simplification and improvements to the way we deliver change.

We continue to invest to support the long-term interests of our members, including improvements to our branches, continued updates to our digital channels and preparations for Open Banking. During the year we have also continued investment in IT resilience to ensure that our systems remain safe and secure for our members, and to ensure compliance with UK and EU regulatory requirements.

Whilst we have made good progress towards achieving our sustainable savings targets, the reduction in total income has caused our underlying CIR to increase to 63.2% (2017: 60.2%).

Achieving more sustainable cost savings and embedding further efficiencies into our business remains a priority for the Society and we remain committed to maintaining a low trajectory of cost growth in the future.

Impairment losses

Impairment losses have decreased by £35 million to £105 million (2017: £140 million). This reduction reflects a prior year charge of £52 million in relation to enhancements to our provisioning methodology, primarily in relation to the credit risks associated with maturing interest only loans. This has been partially offset by the impact of updating provision assumptions to reflect current economic conditions. Delinquency levels have remained low across portfolios during the period, although there is some limited evidence of affordability pressures increasing after a period when inflation has exceeded wage growth.

Impairment losses		
	Year to 4 April 2018 £m	Year to 4 April 2017 £m
Residential lending	11	58
Consumer banking	97	78
Retail lending	108	136
Commercial and other lending	(1)	(5)
Impairment losses on loans and advances	107	131
Impairment (reversals)/losses on investment securities	(2)	9
Total	105	140

Underlying provisions for liabilities and charges

We hold provisions for customer redress to cover the costs of remediation and redress in relation to past sales of financial products and post sales administration, including compliance with consumer credit legislation and other regulatory requirements. The charge for the period primarily relates to customer redress provisions recognised in respect of PPI and Plevin, including the cost of administering these claims. More information on customer redress and FSCS provisions is included in note 27 to the financial statements.

Taxation

The tax charge for the year of £232 million (2017: £297 million) represents an effective tax rate of 24% (2017: 28%) which is higher than the statutory UK corporation tax rate of 19% (2017: 20%). The effective tax rate is higher due to the 8% banking surcharge, equivalent to £43 million (2017: £62 million), and due to the tax effect of disallowable bank levy and customer redress costs of £8 million and £nil (2017: £8 million and £19 million) respectively. Further information is provided in note 11 to the financial statements.



Financial review *continued*

Balance sheet

Total assets have increased by £7 billion year on year to £229 billion (4 April 2017: £222 billion). This growth has been driven by a £6 billion increase in residential mortgage balances due to strong trading in prime mortgages during the period.

Despite sustained competition in the savings market, alongside slower market growth, we have maintained our market share of deposits at 10.0% (4 April 2017: 10.1%) reflecting the highly competitive products that we offer to our members. In addition, we have had significant

success in growing the number of members who bank with us, opening 816,000 new current accounts during the year (2017: 795,000), with our market share of standard and packaged accounts now 7.9% (2017: 7.6%).

Assets	4 April 2018		4 April 2017	
	£m	%	£m	%
Residential mortgages (note i)	177,299	92	171,263	91
Commercial and other lending	10,716	6	12,597	7
Consumer banking	4,107	2	3,949	2
	192,122	100	187,809	100
Impairment provisions	(458)		(438)	
Loans and advances to customers	191,664		187,371	
Other financial assets	34,841		31,231	
Other non-financial assets	2,593		3,068	
Total assets	229,098		221,670	
Asset quality		%		%
Residential mortgages (note i):				
Proportion of residential mortgage accounts 3 months+ in arrears		0.43		0.45
Average indexed loan to value of residential mortgage book (by value)		56		55
Average indexed loan to value of new residential mortgages business		71		71
Impairment provisions as a percentage of non-performing balances		5.3		5.3
Consumer banking:				
Non-performing loans as percentage of total balances (excluding charged off balances) (note ii)		4		4
Impairment provisions as a percentage of non-performing balances (including charged off balances) (note ii)		89		86

Return on assets:

0.33%
(2017: 0.34%)

Liquidity coverage ratio:

130.3%
(2017: 124.0%)

Notes:

- Residential mortgages include prime and specialist loans, with the specialist portfolio primarily comprising buy to let (BTL) lending.
- Charged off balances relate to accounts which are closed to future transactions and are held on the balance sheet for an extended period (up to 36 months, depending on the product) whilst recovery procedures take place.

Residential mortgages

This financial year was our strongest ever for gross prime mortgage lending at £29.4 billion (2017: £29.1 billion) reflecting the competitively priced products and good long-term value that we offer our members. Total gross mortgage lending was £33.0 billion (2017: £33.7 billion) and represented a market share of 12.8% (2017: 14.0%). Our total net mortgage lending reduced by £3.0 billion to £5.8 billion (2017: £8.8 billion) due to a reduction in gross buy to let (BTL) lending following the affordability criteria changes we made last year and increased prime mortgage redemptions from ongoing market competition driving highly competitive new business rates.

The impairment provision balance is broadly unchanged at £145 million (4 April 2017: £144 million). Arrears performance improved marginally during the year, with cases more than three months in arrears improving to 0.43% of the total portfolio (4 April 2017: 0.45%), despite some evidence of a greater strain on affordability given higher inflation and low wage growth.

Commercial and other lending

During the year, our commercial and other lending balances decreased by £1.9 billion to £10.7 billion following our strategic decision in 2016/17 to reduce our commercial real estate (CRE) portfolio through managed run-off. As a result, our overall commercial lending portfolio is increasingly weighted towards registered social landlords, with balances of £6.8 billion (4 April 2017: £7.5 billion). The registered social landlords' portfolio is fully performing, reflecting its low risk nature. The impairment provision held against CRE balances is £15 million (4 April 2017: £25 million).



Financial review *continued*

Consumer banking

Consumer banking comprises personal loans of £2.0 billion (4 April 2017: £2.0 billion), credit cards of £1.8 billion (4 April 2017: £1.7 billion) and current account overdrafts of £0.3 billion (4 April 2017: £0.2 billion).

The asset quality of the portfolio remains strong. Impairment provisions have increased to £298 million (4 April 2017: £269 million), reflecting both book growth and the impact of updating provision assumptions to reflect current economic conditions.

Other financial assets

Other financial assets total £34.8 billion (4 April 2017: £31.2 billion), primarily comprising liquidity and investment assets held by our Treasury function of £30.8 billion (4 April 2017: £25.4 billion) and derivatives with positive fair values of £4.1 billion (4 April 2017: £5.0 billion). Derivatives relate primarily to interest rate and foreign exchange contracts which economically hedge financial risks inherent in our core lending and funding activities.

Growth in on-balance sheet liquid assets is predominantly due to the replacement of off-balance sheet Funding for Lending Scheme (FLS) liquidity with on-balance sheet Term Funding Scheme (TFS) drawdowns. Our Liquidity Coverage Ratio (LCR) has increased to 130.3% (4 April 2017: 124.0%). At 4 April 2017, our LCR was impacted by an agreement to purchase £1.2 billion of residential mortgage backed securities (RMBS) under a programme to securitise Bradford & Bingley residential mortgages. Excluding this item our 2018 and 2017 LCR would have been broadly consistent.

Members' interests, equity and liabilities

	4 April 2018 £m	4 April 2017 (note i) £m
Member deposits	148,003	144,542
Debt securities in issue	34,118	40,339
Other financial liabilities	33,173	23,978
Other liabilities	1,401	1,678
Total liabilities	216,695	210,537
Members' interests and equity	12,403	11,133
Total members' interests, equity and liabilities	229,098	221,670

Wholesale
funding ratio
(note ii):
28.2%
(2017: 27.1%)

Notes:

- Comparatives have been restated as detailed in note 1 of the financial statements.
- The wholesale funding ratio includes all balance sheet sources of funding (including securitisations).

Member deposits

Member deposits have increased reflecting both an increase in current account credit balances from £17.5 billion to £19.8 billion and a growth in savings balances due to the success of our competitively priced products; on average our member deposit rates are more than 50% higher than the market average¹. In a highly competitive market, our market share of UK household deposits remained relatively stable at 10.0% (2017: 10.1%).

Debt securities in issue and other financial liabilities

Other financial liabilities have increased by £9.2 billion driven by an increase in bank deposits (which includes TFS drawdowns) and subordinated liabilities, which have been issued during the period to finance core activities and to fund the bond buy-back exercise. Correspondingly, debt securities in issue have reduced by £6.2 billion primarily due to lower wholesale funding balances following the debt buy-back exercise.

The growth in other financial liabilities has been partly offset by a decrease in Nationwide International balances which have now fully run

off following our strategic decision in 2016/17 to exit the business. This outflow was managed in an orderly manner, with the funding replaced by additional member deposits and the use of wholesale funding where appropriate.

The wholesale funding ratio has increased to 28.2% (4 April 2017: 27.1%), predominantly due to TFS drawdowns during the period to support core activities and replace off-balance sheet Funding for Lending Scheme maturities.

Members' interests and equity

Movements in the year reflect the retained profit after tax and the issuance of CCDS, details of which are included in the Capital structure section below.

Statement of comprehensive income

Statement of comprehensive income	Year to 4 April 2018 £m	Year to 4 April 2017 £m
(Movements shown net of related taxation)		
Profit after tax	745	757
Net remeasurement of pension obligations	22	(255)
Net movement in cash flow hedge reserve	(191)	(247)
Net movement in available for sale reserve	31	52
Other items	1	2
Total comprehensive income	608	309

Further information on gross movements in the pension obligation is included in note 30 to the financial statements. Further information relating to movements in the cash flow hedge reserve is included in note 7 to the financial statements.

¹ Market interest rates are based on Bank of England whole of market average interest rates over the period, adjusted to exclude Nationwide's balances.



Financial review *continued*

Capital structure

Our capital position has strengthened during the period with our CET1 and UK leverage ratios increasing to 30.5% and 4.9% respectively (4 April 2017: 25.4% and 4.4%), comfortably in excess of the regulatory capital requirements.

Capital structure (note i)		
	4 April 2018 £m	4 April 2017 £m
Capital resources		
Common Equity Tier 1 (CET1) capital	9,925	8,555
Total Tier 1 capital	10,917	9,547
Total regulatory capital (note ii)	13,936	12,154
Risk weighted assets (RWAs)	32,509	33,641
UK leverage exposure	221,992	215,894
CRR leverage exposure	236,468	228,428
CRD IV capital ratios		
	%	%
CET1 ratio	30.5	25.4
UK Leverage ratio (note iii)	4.9	4.4
CRR leverage ratio (note iv)	4.6	4.2

Notes:

- Data in the table is reported under CRD IV on an end point basis.
- Total regulatory capital was restated as at 4 April 2017 to include accrued interest on subordinated liabilities and subordinated capital. Further information is provided in note 1 to the financial statements.
- The UK leverage ratio is shown on the basis of measurement announced by the Prudential Regulation Authority (PRA) and excludes eligible central bank reserves from the leverage exposure measure.
- The Capital Requirements Regulation (CRR) leverage ratio is calculated using the CRR definition of Tier 1 for the capital amount and the Delegated Act definition of the exposure measure and is reported on an end point basis.

The maintenance of strong capital ratios is a core requirement of the Society's strategic objective to be 'Built to Last'. In September 2017, five million CCDS were issued raising £0.8 billion of CET1 capital. The issuance enhanced the liquidity and relevance of the CCDS instrument, while also helping to maintain broad access to capital markets. These CCDS form a single series together with those previously issued in December 2013. Further information can be found in note 31 to the financial statements. Detailed information on Nationwide's capital instruments can be found within the Pillar 3 Disclosure 2018 at nationwide.co.uk

CET1 capital resources have increased over the year by £1.4 billion, mainly due to the CCDS issuance (£0.8 billion), and profit after tax for the period of £0.7 billion. Risk weighted assets (RWAs) have reduced over the year by

approximately £1.1 billion, primarily due to the continued run-off of the commercial book. These movements have resulted in an increase in the CET1 ratio, to 30.5%.

The UK leverage ratio increased to 4.9% at 4 April 2018, as a result of the CCDS issuance and profits for the period. The CRR leverage ratio also increased to 4.6%.

The Basel Committee published their final reforms to the Basel III framework in December 2017. The amendments include changes to the standardised approaches for credit and operational risks and the introduction of a new RWA output floor. The rules are subject to a lengthy transitional period from 2022 to 2027. In addition, the PRA's revised expectations for IRB models for residential mortgages will be effective from the end of 2020.

These reforms will lead to a significant increase in our risk weights over time and we currently expect the consequential impact on our reported CET1 ratio to ultimately be a reduction of the order of 45-50% relative to our current methodology. We note however that organic earnings through the transition will mitigate this impact such that our reported CET1 ratio will in practice remain well in excess of the proforma levels implied by this change, and leverage requirements will remain our binding constraint based on latest projections. These reforms represent a re-calibration of regulatory requirements with no underlying change in the capital resources we hold or the risk profile of our assets. Final impacts are subject to uncertainty for future balance sheet size and mix, and because the final detail of some elements of the regulatory changes remain at the PRA's discretion.



Financial review *continued*

IFRS 9

IFRS 9 will be implemented in the financial statements for the year ending 4 April 2019. It is estimated that the new IFRS 9 expected credit loss (ECL) provisioning approach results in an increase in provisions of £172 million. The reclassification and measurement of financial assets results in a reduction in carrying

value of £36 million. The resulting impact on members' interests and equity, net of deferred tax, is £162 million. The CET1 ratio impact of IFRS 9 is a reduction of 31 basis points before taking regulatory transitional relief into account, and a reduction of 10 basis points once this relief is included. The equivalent UK leverage ratio

impact is estimated as a reduction of 3 basis points before regulatory transitional relief and no reduction once this relief is included. As a result, IFRS 9 is not expected to have a significant impact on the Group's capital position.

Financial performance framework (FPF)

As a mutual, we aim to optimise, rather than maximise, profit and retain sufficient earnings to support future growth, sustain a strong capital position and allow us to invest in the business to provide the products and services that our members demand. We have used the most recent guidance from regulators regarding the maximum expected capital requirement for Nationwide to develop our financial performance framework. This framework provides parameters which will allow us to calibrate future performance and help ensure that we achieve the right balance between distributing value to members, investing in our business and maintaining our financial strength.

The most important of these parameters is underlying profit which is a key component of Nationwide's capital. We believe that a level of underlying profit of approximately £0.9 billion to £1.3 billion per annum over the cycle would meet the Board's objective for sustainable capital strength. This range will vary from time to time, and whether our profitability falls within or outside this range in any given financial year or period will depend on a number of external and internal factors, including conscious decisions to return value to members or to make investments in the business. It should not be construed as a forecast of the likely level of Nationwide's underlying profit for any financial year or period within a financial year.



Governance

Vaniya, member since 1998

Governance

- 34** Board of directors
- 39** Executive Committee biographies
- 41** Report of the directors on corporate governance
 - Corporate governance report
 - Audit Committee report
 - Board Risk Committee report
 - Board IT and Resilience Committee report
 - Nomination and Governance Committee report
- 83** Report of the directors on remuneration
- 94** Directors' report



Supporting members with more of their financial needs

Vaniya chose Nationwide for entirely pragmatic reasons.

'It was the better rates and lower charges. And they had a branch nearby.'

Vaniya spent his working life looking after others, first as a gynaecologist and then in General Practice and he is still a trustee of the local branch of the Crossroads Care charity, an organisation that cares for our carers by offering respite care and support. Nowadays, with more time on their hands, Vaniya and his wife, Neena, love to travel.

This year, they're visiting Japan and North America.

'We have our current account and savings with Nationwide,' says Vaniya. 'We also have some stocks and shares ISAs through their investment service. The reason we stick with Nationwide hasn't really changed over the years. They continue to deliver better rates and recognise their members' loyalty.'



Board of directors

Meet your Board of directors who were in office at 4 April 2018, including Gunn Waersted, who is seeking election as non executive director.



Baroness Usha Prashar CBE PC (69)

Non executive director since January 2017 (independent)

r

Brings to the Board

Usha is a highly experienced policy adviser, with a singular mix of insight across the public, not-for-profit and broadcasting sectors. Her wealth of public and voluntary sector expertise helps inform Nationwide's regulatory perspectives and social purpose. Usha shares the Society's commitment to contributing to the community and voluntary work.

Current external appointments

Deputy Chair, the British Council
 Honorary President, UK Community Foundations
 Member, the Home Building Review Panel.

Previous positions include

Member, European Select Committee
 Chairman, House of Lords European Union Home Affairs sub-committee
 Non executive director, ITV
 Non executive director, the Cabinet Office
 Non executive director, Unite plc
 Non executive director, Channel 4
 Non executive director, Energy Saving Trust
 Non executive director, Ealing, Hounslow and Hammersmith Health Authority
 Inaugural Chairman, the Judicial Appointments Commission.

Tony Prestedge (48)

Executive director since August 2007

e

Brings to the Board

Tony combines deep operational experience from over 20 years in financial services, with a passionate focus on delivering exceptional service across every member touch point with the Society. In November 2017, the Board asked Tony to assume executive responsibility for the Society's operations and a review of technology strategy to serve member needs in the years ahead and a multi-channel digital world. Tony will then reassume responsibility for Relationships and Distribution, where he is responsible for 13,000 colleagues, our branch network and contact centres. Tony will also become Deputy Chief Executive with effect from 1 June 2018.

Current external appointments

None.

Previous positions include

Managing Director, Home Finance and Retail Support and Operations Director, Barclays plc
 Director, Woolwich Mortgage Services Limited
 Director, Global Home Loans Limited
 Director, Opportunity Now.

Key

- a** Audit Committee
- e** Executive Committee
- it** Board IT and Resilience Committee
- ng** Nomination and Governance Committee
- r** Remuneration Committee
- ra** Results Approval Committee
- ri** Board Risk Committee
- ★** Indicates chair of a Committee

Board of directors *continued***Joe Garner (48)**

MA (Cantab)
Chief Executive Officer since
April 2016

**Brings to the Board**

Joe has spent his working life in consumer-focused businesses, including 14 years in financial services. Throughout his career, Joe has championed the interests of colleagues and customers, believing that looking after both is not only the right thing to do, but the key to commercial success. Since joining Nationwide, he has rallied the organisation around the binding social purpose of 'building society, nationwide'.

Current external appointments

Director, UK Finance
Member, Financial Conduct Authority Practitioner Panel
Chairman and trustee, British Triathlon Trust.

Previous positions include

CEO, Openreach
Deputy CEO, HSBC Bank plc
Head of HSBC's UK Retail and Commercial Business
Non executive director, the Financial Ombudsman Service.

Lynne Peacock (64)

BA (Hons)
Non executive director since
July 2011 and senior director since
July 2016 (independent)

**Brings to the Board**

Lynne has an exceptional background in financial services, including an extensive understanding of the mutual sector. In addition to leading a retail bank and a building society, she has operated at Board level for over 20 years, overseeing brand development, mergers and acquisitions, change management and business transformation. Lynne is a strong advocate of mutuality, and is Chair of the trustees of a charity for people with learning difficulties.

Current external appointments

Non executive director, Serco Group plc
Non executive director, Jardine Lloyd Thompson Group plc (from 1 May 2018)
Chair of trustees, Westminster Society for People with Learning Disabilities.

Previous positions include

CEO, National Australia Bank's UK business
CEO, Woolwich plc
Non executive director, Scottish Water
Non executive director, Standard Life Aberdeen plc (plus certain subsidiaries not individually listed – stepped down 29 May 2018).

Kevin Parry OBE (56)

MA (Cantab), FCA
Non executive director since
May 2016 (independent)

**Brings to the Board**

Kevin is a chartered accountant with a distinguished career in financial services and professional practice, spanning audit, regulation, risk management and finance. In this year's new year's honours list he received an OBE in recognition of his charitable work for disadvantaged children as Chairman of the Royal National Children's SpringBoard Foundation.

Current external appointments

Chairman, Intermediate Capital Group plc
Senior Independent Director, Standard Life Aberdeen plc (plus certain subsidiaries not individually listed)
Non executive director and Chairman of the Audit and Risk Committee, Daily Mail and General Trust plc
Chairman, Royal National Children's SpringBoard Foundation.

Previous positions include

Chief Financial Officer, Schroders plc
CEO, Management Consulting Group plc
Managing Partner, Information Communications and Entertainment, KPMG LLP.

Board of directors *continued***Tim Tookey (55)**

BSc (Hons), FCA

Non executive director since
June 2015 (independent)**Brings to the Board**

Tim is a chartered accountant with over 30 years' experience in finance, across retail and commercial banking, life and pensions, and insurance. As a full-time Chief Financial Officer, Tim has the background and expertise to analyse and test the Society's financial and risk strategies.

Current external appointments

Chief Financial Officer, Quilter plc (previously known as Old Mutual Wealth Management Limited)

Director, Westmoreland Court Management (Beckenham) Ltd.

Previous positions include

Chairman, Alliance Trust Savings Limited

Chief Financial Officer, Friends Life Group Limited

Group Finance Director, Lloyds Banking Group

Finance Director, Prudential plc's UK business.

Rita Clifton CBE (60)

MA (Cantab), FRSA

Non executive director since
July 2012 (independent)**Brings to the Board**

A former CEO and Chair of brand consultancy Interbrand, Rita is a widely recognised expert on branding. This and her consumer insight help ensure that member interests are central to Board business. Rita has helped some of the UK and world's iconic firms understand how to use research, marketing strategy and communications to build sustainable brand value. She is also a long standing advocate for environmental and sustainability issues.

Current external appointments

Non executive director, ASOS plc

Non executive director, Ascential plc (previously known as EMAP plc)

Member of Assurance and Advisory Panel of BP's carbon off-setting programme 'Target Neutral'

Trustee, the Henley Festival Trust.

Previous positions include

London CEO and Chairman, Interbrand

Vice Chairman, Saatchi & Saatchi

Non executive director, Dixons Retail plc

Non executive director, Bupa Limited

Non executive director, Populus Limited

Trustee, WWF (Worldwide Fund for Nature)

Member, the UK Government's Sustainable Development Commission

Advisory roles to organisations including: British Airways, Barclays, BT, Citigroup, Visa and the British Army.

Chris Rhodes (55)

BSc (Hons), ACA

Executive director since
April 2009**Brings to the Board**

Chris has worked in financial services for 30 years, holding senior leadership positions in finance, operations, retail distribution and risk management. His track record in product design means he is now responsible for defining propositions for the Society's 15 million members.

Current external appointments

Trustee, National Numeracy

Director, Lending Standards Board.

Previous positions include

Director, Retail Distribution for Alliance and Leicester Group

Deputy Managing Director, Girobank

Managing Director of Retail Banking, Alliance and Leicester Group

Group Finance Director, Alliance and Leicester Group.

Board of directors *continued***Mitchel Lenson (63)**

MBA, BA (Hons), ACIB, FSI
 Non executive director since
 July 2011 (independent)

**Brings to the Board**

Mitchel has an exceptional leadership track record in technology, operations and programme management. In a 30-year career in financial services he has held senior management positions across retail, corporate, investment banking and private wealth and asset management. In addition, Mitchel has advised on financial services in the private equity sector and has ongoing involvement in the fintech space.

Current external appointments

Non executive director,
 The Currency Cloud Group Limited.

Previous positions include

Group Chief Information Officer,
 Deutsche Bank AG

Managing Director, Global Head
 of Operations & Operation IT,
 UBS Warburg

Director, Group Operations,
 Credit Suisse First Boston

Partner, Olivant & Co

Non executive director, NYFIX.

Mai Fyfield (48)

MA, BA (Hons)
 Non executive director since
 June 2015 (independent)

**Brings to the Board**

Mai combines her experience as an economist and her full-time executive role at Sky Group to inform the Board's strategic thinking and assessment of new opportunities and initiatives. Strategy has been at the forefront of Mai's career, in an industry focused on customer experience and service delivery. She is a champion of diversity and helping women succeed in senior management and Board positions.

Current external appointments

Chief Strategy and Commercial Officer,
 Sky plc.

Previous positions include

Director Jupiter Entertainment.

David Roberts (55)

BSc (Hons), MBA, PhD (Honorary) CFifs
 Non executive director and Chairman
 elect from September 2014.
 Chairman since July 2015 (independent
 upon appointment as Chairman)

**Brings to the Board**

David combines a distinctive blend of leadership experience across major listed corporations, the mutual movement, and public service, including 35 years in financial services. He is a passionate champion of Nationwide's social purpose and of the Society's commitment to help improve the financial lives of its members. David also strongly believes in the economic value of commerce and the importance of rebuilding trust in big business.

Current external appointments

Chairman, Beazley plc

Vice Chair, NHS England

Associate non executive director,
 NHS Improvement

Non executive director,
 Champion Wilcocks Limited

Advisor Board member, The Mentoring
 Foundation Advisory Council

Member, Strategy Board, Henley Business
 School, University of Reading.

Previous positions include

Group Deputy Chairman,
 Lloyds Banking Group plc

Executive Director and Executive Committee
 Member, Barclays Bank plc and CEO,
 International and Commercial Banking

Chairman and CEO, Bawag PSK AG

Non executive director, BAA plc

Non executive director, Absa Group SA.

Board of directors *continued***Mark Rennison (57)**

BA (Hons), FCA
Executive director since
February 2007

**Brings to the Board**

Mark is a chartered accountant with over 30 years' experience in financial services. His track record in the sector, including expertise in treasury operations, risk management and capital planning, equip him to lead the sustained and safe operation of a large financial business like Nationwide.

Current external appointments

Chair, UK Finance, Financial Risk and Policy Committee
Director, Arkose Funding Limited.

Previous positions include

Partner, PricewaterhouseCoopers LLP.

Gunn Waersted (63)

MBA (Siviløkonom)
Non executive director since
June 2017 (independent)

**Brings to the Board**

Gunn has a distinguished international career, including senior leadership positions in financial services, telecommunications and petrochemicals. Gunn's diverse industry background brings additional external perspective to the Board. She is a strong advocate of the need for strong people cultures to ensure a genuine focus on the customer.

Current external appointments

Chair, telecommunications firm Telenor ASA

Chair, Norwegian Government owned firm Petoro AS.

Previous positions include

CEO, Wealth Management Division, CEO of Nordea Bank Norway and Executive Vice President at Nordea Bank Group

CEO, Sparebank1Gruppen and Head of the SpareBank1 alliance

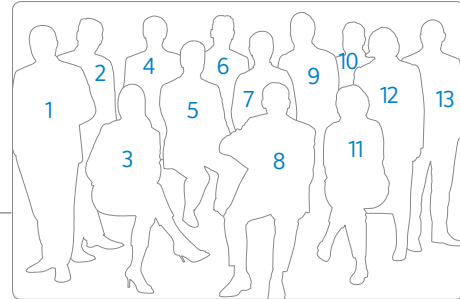
CEO, Vital Forsikring and Executive Vice President of DnB

Chair, Ferd and BI

Non executive director, Statkraft, Statoil amongst others.



Executive Committee biographies



As well as sitting on the Board of directors, the following people are also part of the Executive Committee:

- 8 Joe Garner
- 9 Chris Rhodes
- 6 Mark Rennison
- 5 Tony Prestedge

Executive Committee biographies *continued***Martin Boyle**

Chief Transformation Officer

1

“We’re putting our members and their money at the heart of every investment decision we make”

Martin leads a multi-million pound strategic investment and change portfolio and is responsible for delivering the Society’s most transformational programmes, balancing modern, digital convenience with Nationwide’s human touch. He came to the Society in 2004 as a result of the Society’s merger with The Portman Building Society. Before that Martin had over 20 years’ change experience in consulting and retail financial services.

Graeme Hughes

Chief Relationships and Distribution Officer

2

“I’m proud that our people are so committed to delivering truly legendary service to all our members”

Graeme has spent 33 years with Nationwide, since joining as a management trainee in 1984. He worked through a host of roles at the Society, locally, regionally and in head office, including as a branch manager. He now leads the teams whose focus is the service we provide to our members, transforming the channels they use to interact and connect with us.

Sara Bennison

Chief Marketing Officer

3

“Our aim is to engage people with the concept of ‘building society’ and how its ideals benefit this generation and the next”

Sara started her career in advertising agencies, working across a variety of major brands in the UK and Asia. She joined Nationwide in 2016 having spent the previous decade at BT and then Barclays. She is responsible for all Nationwide’s marketing, research, member engagement, social investment and internal communications.

Lee Raybould

Chief Data Officer

4

“We can use data to make our Society more efficient and our members’ lives easier”

Lee has worked for Nationwide since 1995 and is a qualified accountant. He has undertaken a number of finance roles, as well as time spent in Commercial, Strategy & Planning and in Savings. He previously managed Nationwide’s financial reporting activities, before being appointed to lead the Society’s Data and Analytics community last year. Lee leads the community which is responsible for transforming the Society’s data and analytics capability to better serve members’ needs.

Janet Chapman

Chief Internal Auditor

7

“Our members deserve the highest standards in everything we do, including the challenge of rigorous and robust auditing”

Janet joined Nationwide in 2017, following an extensive career in financial services in the UK and the US. She leads the Internal Audit community – the Society’s third line of defence, and was most recently with Citigroup where she was Chief Auditor for the institutional businesses. Before that, Janet was Chief Auditor for the Americas at The Bank of Tokyo Mitsubishi. Her early career was spent with Accenture as an IT consultant.

Mark Chapman

Chief Legal Officer and Society Secretary (from 1 March 2018)

10

“Guiding the Society to do the right thing in the right way for our members”

Mark joined the Society on 1 March as the leader of Legal and Secretariat, providing expert advice and guidance on legal and regulatory issues, as well as delivering a comprehensive secretariat service. He was most recently the General Counsel of Barclays UK. Prior to Barclays, Mark was General Counsel at Nomura International having previously worked as a litigator at Freshfields. He joins the Society having taken time out to volunteer and teach at a school in a township in the Western Cape of South Africa.

Alison Robb

Chief People Officer

11

“Being a great employer and investing in our people is vital to our focus on the needs of our members”

Alison leads Nationwide’s people matters, including recruitment, training, diversity and the development of teams to meet our members’ needs. A qualified chartered accountant, Alison worked for KPMG and WH Smith before joining Nationwide in 1996. She has worked across the Society including in the finance and strategy functions.

Julia Dunn

Chief Risk Officer

12

“We run a stable, low-risk organisation that always strives to do the right thing for its members”

Julia joined Nationwide in 2013 as Chief Compliance Officer. She now leads the Risk Community, helping to keep the Society, and its members, safe and secure. A qualified chartered accountant, Julia previously spent 13 years in supervision and enforcement with the Financial Services Authority, and latterly the Financial Conduct Authority as Director of Retail Banking supervision.

Richard Beck

Chief Strategy and External Relations Officer

13

“We have a unique opportunity to define Nationwide by the value it brings to members and to society”

Richard joined Nationwide in 2016 to lead the Society’s strategy development, along with relations with media, government and other opinion-formers. He has advised companies on strategy and reputation in Asia, Europe and the Americas. Before Nationwide, Richard spent 17 years in financial services, including as an HSBC Group General Manager, and five years running an international consultancy.



Report of the directors on corporate governance

For the year ended 4 April 2018

Dear fellow member

It is my pleasure to present to you the Corporate governance report for the 2017/18 financial year.

Nationwide is the world's largest building society. We are a mutual and this sets us apart from other businesses as we are owned by and run for the benefit of you, our members.

Our status as a mutual means that we do not pay dividends to shareholders, which allows us to reinvest

our profits into improving products, as we strive to provide legendary service and reward the loyalty of our members. During the last financial year, this has enabled Nationwide to deliver £560 million of member financial benefit primarily through better value mortgages, current accounts and savings rates.

Our Membership

Members are the heart of Nationwide and are central to everything we do. A member of Nationwide is anyone who has a current account, mortgage or savings account with us as well as some of our wholesale investors, notably those who hold our Core Capital Deferred Shares (CCDS). As a member, you own Nationwide and alongside our employees are stakeholders with a real say in how the Society is run. During the year it has been a pleasure to meet many members at both the Annual General Meeting and at our regular Member TalkBacks held at various locations around the UK. Your votes and attendance at these events are invaluable as they provide an opportunity to voice your opinions and have a say as to how Nationwide should be run. For example – in our 2019 Annual General Meeting members will be able to vote to appoint Ernst & Young LLP as the Society's external auditor and more information about this can be found on page 66. In the spirit of encouraging member participation, a cross-section of members were also invited to participate in the Board strategy day in October 2017. This was an opportunity for the Board to listen first hand to the views of our members and for our members to meet the Board and have an open dialogue. I hope to meet many more of you and hear your views at events like this during the coming year as we continue to broaden and deepen the direction and interaction between members and the Society.

Our Governance

As Chairman, it is my role to lead the Board, ensuring it operates effectively, within a strong and sound governance framework. This helps us maintain the stability of Nationwide and keeps your finances safe. The effectiveness of your Board is subject to regular challenge. During the past year, we undertook an externally facilitated review. As a Board we are determined to assess ourselves against best practice standards, identifying ways to improve and implement any changes into our day-to-day business practice. More on this review can be found on page 52.

At Nationwide we strive for excellence in corporate governance, in particular, through adoption of the relevant parts of the UK Corporate Governance Code ('the Code'). Although the Code sets the standards for public listed companies, we aim to comply with the Code's ethos, and where appropriate, principles and provisions to ensure alignment with good practice, transparency and openness – as we believe this is the right thing to do.

We also aim to develop our governance framework to take account of developing best practice, helping us run the Society well, and in a manner that is open and transparent to all, ensuring our governance arrangements stay fit for purpose in an ever evolving corporate and economic environment.

Following a number of recent high profile cases and ongoing Government scrutiny, the Financial Reporting Council is due to publish a revised edition of the Code later this year.

In striving for excellence in corporate governance we are already seeking ways in which we can further strengthen the Society's governance framework to prepare for the introduction of the revised Code, for example with the nomination of a non executive director to ensure the voice of colleagues are brought directly to the Board. Further information about our governance structure and adherence to the Code can be found in the Governance Principles section on page 43 and also in the Committee reports.

Our Board

The Board has collective responsibility for the oversight and success of your Society – setting the strategy, holding the Executive to account and promoting ethical leadership, including setting the culture and values that make Nationwide special. One of my primary responsibilities as Chairman is to make sure the Board of Nationwide has the correct mix of skills, diversity and independence to lead the organisation and provide the appropriate level of oversight and challenge for the business. Whilst Nationwide is a building society and not a FTSE 100 company, we have already achieved the voluntary Davis Review target for women's representation on FTSE 350 Boards to be a minimum of 33% by 2020. In addition, we have also met the Parker Review target of each FTSE 100 listed company having at least one director drawn from an ethnic background ahead of 2021.



Report of the directors on corporate governance *continued*

I believe firmly that having the right blend of experience, skill and diversity leads to a better functioning Board and ultimately a better Society. Further information regarding the skills and diversity of the Board can be found in the Nomination and Governance Committee report. As members can see, we have a strong Board drawn from a wide range of backgrounds, with our colleagues Baroness Usha Prashar and Gunn Waersted both making strong contributions during their first year on the Board.

Our People and Culture

The culture of Nationwide and the way our people behave underpins a sound corporate governance framework and is fundamental to the long term health of the Society. Culture is shaped by many things, in particular the

“tone from the top”. Your Board pays close attention to culture and seeks to shape the way we operate to ensure it is in the interests of both the Society and its members. I would like to draw members’ attention to two areas considered by your Board in the past year. Firstly, at Nationwide we now operate a variable pay plan, Sharing in Success, across the organisation which offers all eligible employees the opportunity to receive an award that recognises everyone’s collective contribution to achieving our strategy. The Board believes strongly that the Society operates at its best when everyone is focused on working together as a team and therefore have designed our pay policy to reflect that belief. Secondly, Nationwide promotes openness, honesty and transparency and to demonstrate this I am proud to say that I have continued my role as the Whistleblowers’

Champion. I am responsible for ensuring that appropriate procedures are in place to allow employees to speak up, without any fear or favour, if they believe that something does not feel right for our members or our business. My colleagues on the Board receive an update, so that they are aware of the types of concerns raised during the year.

Finally, I would like to thank you for your continued support over the last year and rest assured that myself, the Board and all of my colleagues here at Nationwide will continue to adhere to the best governance practices possible to deliver excellent value, first class service and to keep your finances safe both now and in the future.

David Roberts,
Chairman

Governance at Nationwide

Corporate governance is the set of internal standards and principles established by the Board to ensure sound and prudent control of the Society to keep members’ money and interests safe. Everyone in Nationwide has a role in Governance:





UK Corporate Governance Code principles

The Code comprises five principles

After due consideration, it is the belief of the Board that for the 2017/18 financial year Nationwide has complied with the principles of the Code to the extent applicable to building societies (according to the Building Societies Association Guidance June 2016). Details of the principles, with reference to where you can read more about how Nationwide complied with them, are set out below:

Leadership

Every company¹ should be headed by an effective board which is collectively responsible for the long-term success of the company.

Role of the Board – Page 45

As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy.

Roles and responsibilities – Page 46

The Chairman is responsible for leadership of the Board and ensuring its effectiveness on all aspects of its role.

Roles and responsibilities – Page 46

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

Roles and responsibilities – Page 46

Effectiveness

There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.

Nomination and Governance Committee report – Page 77

The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

Board effectiveness review – Page 52

All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.

Board composition – Page 52

All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.

Attendance chart
How the Board operates – Page 48

The Board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.

Board composition
Nomination and Governance Committee report
– Pages 52 and 77

The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.

How the Board operates – Page 48

All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.

Nomination and Governance Committee report
Gunn Waersted case study
– Page 81



Report of the directors on corporate governance *continued*

Accountability

The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting, risk management and internal control principles and for maintaining an appropriate relationship with the company's auditors.

Audit Committee report – Page 59

The board should present a fair, balanced and understandable assessment of the company's position and prospects.

**Audit Committee report
Directors' report**
– Pages 59 and 94

The board is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.

Risk appetite – Page 102

Remuneration

There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.

Remuneration Committee report
– Page 83

Executive directors' remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied.

Remuneration Committee report
– Page 83

Relations with members²

The board should use general meetings to communicate with investors and to encourage their participation.

**Members are building society,
nationwide** – Page 56

There should be a dialogue with members based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with members takes place.

**Members are building society,
nationwide** – Page 56

¹ The UK Corporate Governance Code uses the terminology of 'company' but for the purposes of Nationwide this should be read as Society.

² The UK Corporate Governance Code uses the terminology of 'shareholder' but for the purposes of Nationwide this has been amended to read 'member'.



Report of the directors on corporate governance *continued*

The Role of the Board

The Board is responsible for the Society’s strategy, governance, controls and risk management, ensuring that the Society is able to deliver long-term success for members and is built to last. The Chief Executive Officer derives his authority from the Board and cascades the agreed standards to the business. The Society Secretary is responsible for advising the Board, through the Chairman, on all governance matters.

The Board operates under formal terms of reference which include a schedule of matters reserved to the Board for decision, with the day to day running of the business delegated to the Chief Executive Officer. The Board’s terms of reference can be found on the Society’s website: nationwide.co.uk

Culture

The Board has an important role to play in terms of setting the tone from the top and shaping and monitoring the Society’s culture. Nationwide’s unique culture is defined by its purpose, ‘building society, nationwide’, as well as its mutual heritage and values. It guides decisions and promotes behaviours

that deliver the service excellence and fair outcomes members expect and deserve. Nationwide is incredibly proud of its culture and believes it sets the Society apart within the financial services sector. Introduced in 2002 and regularly refreshed, Nationwide’s PRIDE values set the foundation for ‘how we do things around here’ and is the heartbeat of the Society.

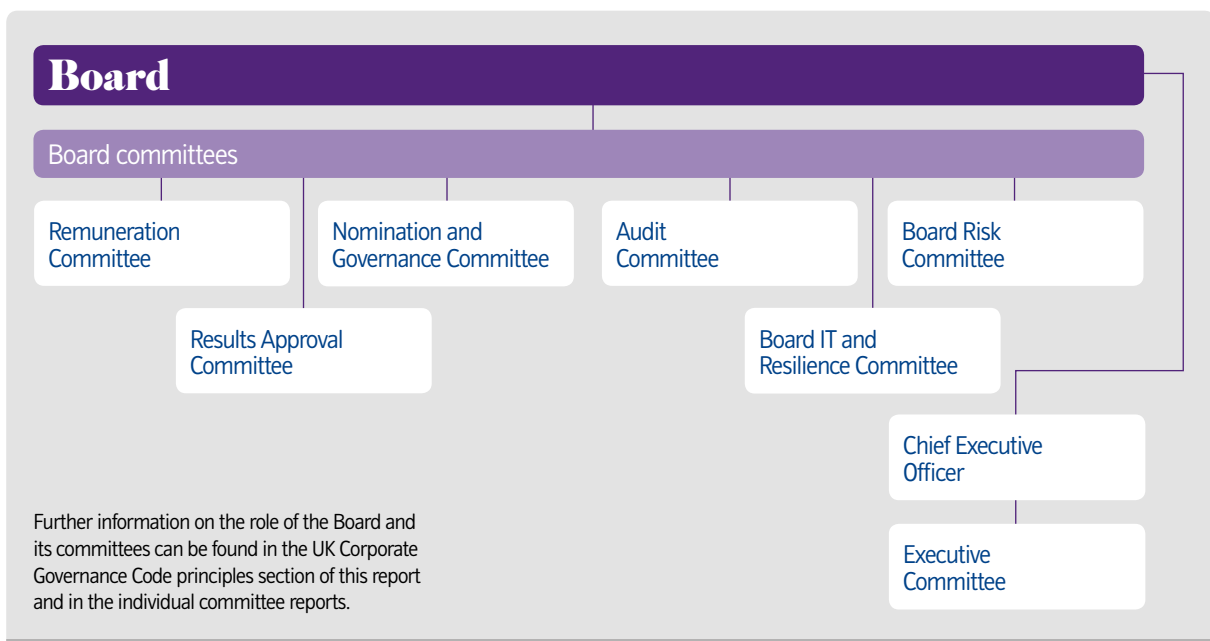
That’s why the Board has been keen to better understand how the culture works and has overseen the development of a new approach that looks at multiple data points to provide insight, including the organisation’s employee survey and the Banking Standards Board³ report. This insight will help the Society to evolve

aspects of the culture to meet the changing needs of employees and members in the future, while preserving so much that is good about the culture of the Society today.

The Board has agreed some key themes to examine in the development of the culture that include efficiency, empowerment, innovation and speaking up. Top of the list of themes to preserve and nurture include the ethic of care and the sense of purpose and belonging that both employees and members say make the Society special and different. The Board will continue to monitor these themes and the development of the culture for the benefit of everyone associated with the Society.

Leadership structure

An overview of the Board structure and its committees as at 4 April 2018 is set out below.





Report of the directors on corporate governance *continued*

Board

The Chairman, non executive directors who chair Nationwide's key Board Committees and the Senior Independent Director are subject to all aspects of the Senior Managers Regime³. Whilst all directors are subject to the Conduct

Rules and must satisfy requirements relating to their fitness and propriety, the appointment of non executive directors who fall outside the Senior Managers Regime is no longer subject to pre-approval by the regulator.

Role	Responsibilities
Chairman	<p>Responsible for leading the Board, ensuring it is effective;</p> <p>Key in setting the tone from the top both in terms of the Society's culture – fostering open and honest debates, and also in setting the strategic direction;</p> <p>Together with the other members of the Board, promotes the long-term success and ensures the accountability of the Society to its members;</p> <p>Supervises and supports the Chief Executive Officer.</p>
Senior Independent Director	<p>Provides a sounding board for the Chairman;</p> <p>Leads the annual review of the Chairman's performance by the Board;</p> <p>Available to directors and members when contact through the usual channels (Chairman or Chief Executive Officer) may not be appropriate.</p>
Non Executive Directors	<p>Collectively set the tone from the top, in particular in relation to culture and governance – holding management to account for embedding and maintaining the Society's culture and values;</p> <p>Contribute to the development of the strategy and risk appetite, exercising effective oversight over risk management and controls;</p> <p>Monitor performance and constructively challenge as appropriate using their skills and expertise to engage in honest debate;</p> <p>Promote the long-term success of the Society for the benefit of members and ensure that the Society meets its regulatory obligations as a regulated firm.</p>
Executive Directors	<p>As members of the Board, collectively with non executive directors, set the strategy, risk appetite and culture and values;</p> <p>Ensure that the Board is kept informed of all significant matters, escalating issues on a timely basis;</p> <p>Accountable to the Board for the execution of the strategy and the performance of the business;</p> <p>Hold specific management responsibilities in the day to day running of the business.</p>
Chief Executive Officer	<p>Responsible for the day to day running of the business and accountable to the Board for the Society's financial and operational performance;</p> <p>Implements and monitors systems for the apportionment and oversight of responsibilities, controls and best practices, policies and processes within the Society which maintain the Society's reputation for operational efficiency and high standards of business conduct.</p>

The Board is supported by the Society Secretary who advises on governance and is responsible for the flow of information to the Board.

³ This is an annual survey undertaken by the Banking Standards Board covering 25 firms, including 9 systemically important institutions in the UK (of which Nationwide is one) plus a range of other mid-sized and small banks and building societies. It aims to raise standards across the sector. Over 2,000 colleagues at NBS participated in the last assessment.

⁴ The Senior Managers Regime allocates specific responsibilities to Senior Managers to enhance individual accountability across the business. It applies to UK banks, building societies, credit unions, branches of foreign banks operating in the UK and the largest investment firms regulated by the PRA and the FCA.



Report of the directors on corporate governance *continued*

Board Committees

In order to ensure that adequate time is devoted to Board business, the Board operates through a number of formally constituted committees.

The terms of reference of the Board and its committees are reviewed at least annually and can be found on the Society's website: nationwide.co.uk

Committee	Responsibilities
Audit Committee	The Audit Committee provides oversight of, amongst other things, financial reporting, internal and external audit, and the adequacy and effectiveness of internal controls and risk management systems.
Board IT and Resilience Committee	The Committee provides oversight and advice to the Board on the Society's IT strategy, architecture, delivery performance and resilience controls, including cyber risk, as well as overseeing the Society's data management strategy.
Board Risk Committee	The role of the Committee is to provide oversight and advice to the Board in relation to current and potential future risk exposures and future risk strategy, including determination of risk appetite. In addition, the Committee is responsible for monitoring compliance oversight, the Enterprise Risk Management Framework (ERMF), risk monitoring, and risk adjustments to remuneration.
Nomination and Governance Committee	The Nomination and Governance Committee assists the Chairman in keeping the composition of the Board under review, making recommendations to the Board on executive level appointments and leading the appointments process for nominations to the Board. The Committee also reviews the Board's governance arrangements and makes recommendations to the Board to ensure that the arrangements are consistent with best practice.
Remuneration Committee	The Remuneration Committee is responsible for determining and agreeing with the Board the framework or broad policy for remuneration of the Chairman, the directors and other senior executives of the Society, including employees who are identified as material risk takers under the PRA Remuneration Code and, within the terms of the agreed policy, the specific remuneration packages for these roles.
Results Approval Committee	The role of the Committee is to review and execute decisions made by the Board in relation to Nationwide's Annual Report and Accounts, the Interim Results and the Interim Management Statements.

Executive

There is a clear division of responsibilities between the Chairman, as leader of the Board, and the Chief Executive Officer who is responsible for the day to day running of the business.

To the extent that matters are not reserved to the Board of directors, responsibility is delegated to the Chief Executive Officer, who is assisted by the Executive Committee and the Executive Risk Committee.

Role	Responsibilities
Executive Committee	The Executive Committee is Nationwide's key operational committee which oversees the day to day operations of the Society's business. This Committee meets once a month, reviews matters that are to be presented to the Board of directors, and is composed of the Chief Executive Officer, the three other executive directors and the nine individuals who form the Society's senior leadership team. You can find more information about Nationwide's senior leadership team on page 34.
Executive Risk Committee	The Executive Risk Committee, which meets monthly, is responsible for ensuring a coordinated approach across all risks and oversight of the risk committees, such as the Operational Risk Committee, Assets and Liabilities Committee, Credit Committee, Conduct and Compliance Committee and the Model Risk Oversight Committee. The Committee's membership comprises the four executive directors and a number of other members of the Executive Committee. It is chaired by the Society's Chief Risk Officer.



Report of the directors on corporate governance *continued*

How the Board operates

The Board met fourteen times during the year. The meetings were structured to ensure that the Board covered a range of items (as detailed below) relating to the Society's business and performance through open debate. The Chairman also met with the non executive directors, without executives present, on a number of occasions.

The attendance record for Board members during the period is set out below. The table shows the actual number of meetings attended with the number of meetings for which directors were eligible to attend shown separately.

During the year – in addition to regular review of progress against the Society's Plan – the Board also held a strategy day to review and

challenge the current strategy, making sure it remained appropriate for the Society. The Board was joined by a number of members for the event who were taken from a pool of volunteers representing a cross section of the Society's members.

	Attended	Eligible to attend
Rita Clifton	12	14
Mai Fyfield	14	14
Joe Garner*	14	14
Mitchel Lenson	14	14
Kevin Parry	14	14
Lynne Peacock	14	14
Usha Prashar	14	14
Tony Prestedge*	14	14
Mark Rennison*	14	14
Chris Rhodes*	14	14
David Roberts	14	14
Tim Tookey	13	14 ²
Gunn Waersted ¹	11	12

* Executive Director

1 Joined the Board on 1 June 2017

2 It was noted that Tim Tookey was abstaining from the audit tender debate owing to a potential conflict of interest previously notified to both the Chairman of the Audit Committee and the Chairman of the Board.

Under the direction of the Chairman, the Society Secretary is responsible for ensuring good information flows and as such the Secretary focuses on providing high quality and timely information to the Board – often in the form of formal papers. All directors receive papers for Board meetings. These are delivered electronically, allowing directors to access information no matter where they are in the world, whilst at the same time reducing paper

consumption. Should a director be unable to attend a meeting, the Chairman seeks the director's views in advance of the meeting. The amount of time that the Society's non executive directors are expected to commit to their role at Nationwide is agreed on an individual basis, as part of the appointment process, and depends upon their responsibilities. Time commitments are also reviewed annually, or more regularly if needed,

as Nationwide recognises the need to take account of changes in best practice – for example any revisions to the Code recommending different or expanded roles of Board Committees. For this year, the Chairman has individually confirmed with each non executive that they have been able to allocate sufficient time to fulfilling their duties. The Chairman will spend an average of 2.5 days per week on Nationwide business.



Report of the directors on corporate governance *continued*

What the Board did this year

The Board reviews all areas of strategic importance throughout the year. Board activities were structured to support the Society's strategy, focusing on the cornerstones as outlined on pages 13 to 23.

The following is a non-exhaustive list of some of the matters that the Board has considered during the year:



Building Thriving Membership

Items discussed

- The enhancement of a membership proposition, including: establishing a clearer concept of membership in communications – helping members understand what membership means for them; developing advocacy amongst members; delivering tangible member benefits; meeting the needs of members at key life stages; and rewarding loyalty.
- Development of a revised mortgage lending strategy taking into account changes in market dynamics, including ongoing strength in the first-time buyer market and the growth of switching. The Board also considered how best to support members looking to borrow later in life through its lifetime mortgage (announced in November 2017 on nationwide.co.uk) and how to drive improvements in the private rental market.
- Recognising that the Society is a mass market provider with regard to saving and investments, the Board was involved in focusing the Society's approach on meeting the needs of its existing member base. The Board recognised that there was an opportunity to make investments more accessible to the broader membership and that the focus should be on meeting the needs of the mass market across all life stages.



Built to Last

Items discussed

- Developing the Nationwide calculation of member financial benefit – as a mutual, the Society seeks to provide long-term value to members through service quality, channel availability and financial benefit. This is the benefit that Nationwide is able to return to members as a result of not having to respond to shareholders' desire for returns. More detail can be found on page 27.
- Cost and efficiency updates have involved the Board challenging management to deliver sustainable savings across the year and ensuring the Society puts its members, and their money, first.
- Approval of a second tranche of Core Capital Deferred Shares. This is a form of Common Equity Tier 1 capital specific to building societies. This demonstrated capacity and liquidity in the CCDS market as Nationwide's offer was more than two times over-subscribed, which reflected the Society's financial strength, and raised £0.8 billion of capital.



Report of the directors on corporate governance *continued*



Building Legendary Service

Items discussed

- The continued development of the 'mobile first' strategy, supporting and encouraging members to use mobile banking.
- The Board reviewed progress in the Society's branch transformation, recognising that branches continue to remain an important and valued channel for members. Over the next four years the Society will invest in its 620 branches to create a uniquely Nationwide experience in communities with branches acting as a local community hub where members and colleagues come together in the space created.
- Following on from The Big Conversation in 2016 (where the Chief Executive

engaged all 18,000 Nationwide employees to help develop the new Nationwide strategy) the concept of right first time (RFT) was identified as a strategic priority to better meet members' needs and reduce inefficiency. Hundreds of ideas have been submitted by colleagues with the aim of making it easy for members in every interaction; making sure members can access channels with ease, making first contact with speed and certainty that requests will be fulfilled. The Board has championed this work to ensure Nationwide continues to put members at the heart of everything the Society does.



Building PRIDE

Items discussed

- Developing a culture to bring together a range of qualitative and quantitative sources of information – please see the 'Culture' section on page 45 above for more information
- The development and adoption of the Leading for Mutual Good development programme. More detail can be found in the Nomination and Governance Committee's report on page 77.
- The Board has reviewed the adequacy and effectiveness of arrangements for employees and contractors to raise concerns, in confidence, about possible misconduct, wrongdoing and unethical behaviours. Having effective and trusted confidential whistleblowing arrangements is a key priority for the Board in supporting the Society's open and honest culture.



Building a National Treasure

Items discussed

- Social investment – the success of the *living on your side* citizenship strategy (2012-17) was celebrated, having successfully delivered against both engagement (member and employee) and social impact targets. The Board also approved the adoption of a new social investment strategy *building society, nationwide*, focused on the single, material issue of tackling the housing crisis by bringing communities together at a local level to provide decent affordable housing for people in need.
- Developing the Society's brand and working to clearly differentiate Nationwide by telling its unique building society story, and stimulating interest and dialogue.
- Considering what makes a national treasure and how the Society could develop from simple awareness to putting forward viewpoints and leading active campaigns and alignment to other key strategies such as the social investment strategy.



Report of the directors on corporate governance *continued*

Board strategy day member involvement

For the first time a number of members were invited to the Board strategy day in October 2017 to provide member input to future strategy.

“The format of the day was a good idea. We got to meet the people in the “ivory tower” and talk to the Chief Executive – something you wouldn’t get in any other financial service firm I think. We weren’t talked at – the Board listened to you, and you listened to them. It was good that the non executives took time out to meet members like me, they seemed really genuine people and it was good that they were so visible”.

Chris. Member for over 10 years

“I felt that it was good to contribute and it’s an interesting concept – being part of a wider strategy day. Any organisation that listens to its customers is doing the right thing. It’s essential that all businesses should be open with their customers and share what they’re trying to do with them. They can then develop a better offer – one that benefits the business and its customers. The advantage of being able to speak face to face with the Board was that we could let them know what’s important to members”.

Alexander. Member for over 25 years

“The event was well organised and hosted. What was unexpected was that we got so much time with such senior people – it was useful to be able to sit with, and talk to, individuals concerned with running the Society. It was certainly a two way conversation. I didn’t get a sense that we (the members) were being preached at, we were listened to and able to tease out issues that I don’t think the Board were aware of – for example that for older people the Financial Services Compensation Scheme limit of £85,000⁵ can become a real issue when a partner dies. Whilst this isn’t something within the Society’s control it’s good that they’re made aware of it as a challenge their members might face”.

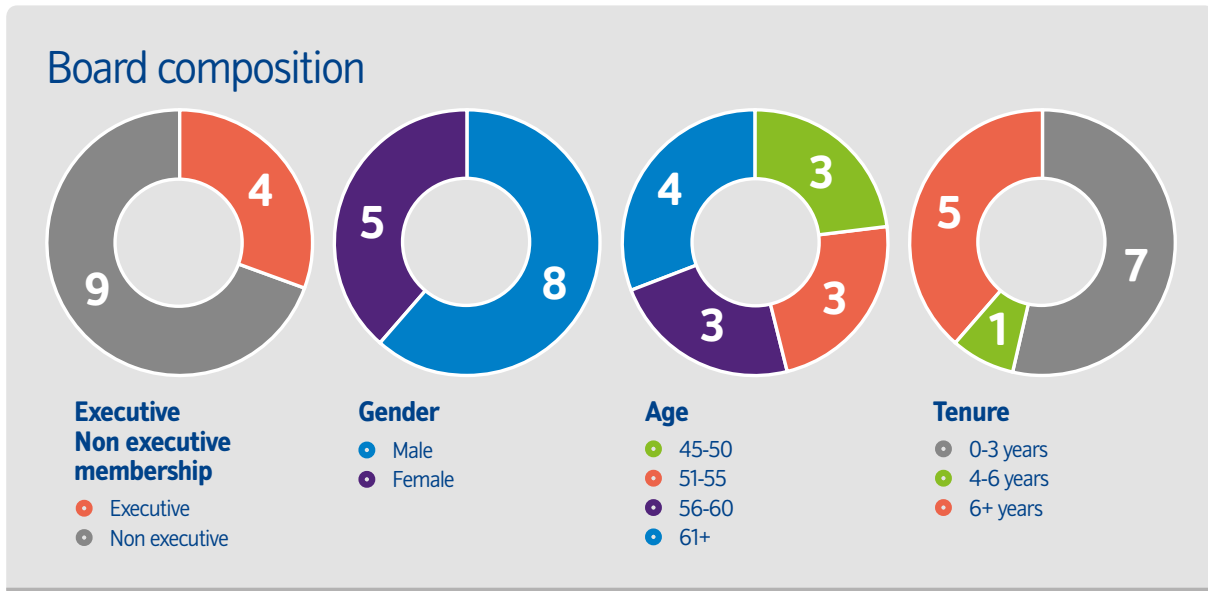
Neil. Member for over 15 years

Information on the Society’s strategy can be found on pages 13 to 23.

⁵ The Financial Services Compensation Scheme (FSCS) can pay compensation to consumers if a financial services firm is unable, or likely to be unable, to pay claims against it. The present limit is set at deposits of £85,000 per person per firm (for claims against firms declared in default from 30 January 2017).



Board Composition



Independence and tenure

All non executive directors have been assessed by the Nomination and Governance Committee to be independent as to character and judgement and to be free of relationships and other circumstances that might impact their independence. David Roberts, Chairman, was deemed to be independent upon his appointment to the role of non executive director and Chairman Elect.

To comply with the UK Corporate Governance Code, all directors of Nationwide are subject to election or annual re-election by the members. If the Board appoints a director to the Board throughout the financial year, that director will be subject to election at the Annual General Meeting (AGM) following his or her appointment. If however, a director is appointed between the period starting with the beginning of the financial year and ending with the AGM, the director will stand for election at the AGM in the financial year following their appointment.

Member nominations

Members of Nationwide have the right to nominate candidates for election to the Board, subject to the Society's Memorandum and Rules (Rules) and compliance with PRA and FCA requirements. No such nominations had been received by 4 April 2018, this being the deadline for election to the Board at the 2018 Annual General Meeting (AGM).

Conflicts of interest

Directors have a legal duty to avoid conflicts of interests. Prior to appointment, potential conflicts of interest are disclosed and assessed to ensure that there are no matters which would prevent that person from taking on the appointment. The Board has considered the current external appointments of all directors which may give rise to a situational conflict and has authorised potential conflicts where appropriate.

If any potential conflict arises, the Society's own Rules permit the Board to authorise the conflict, subject to such conditions or limitations as the Board may determine. In addition, at the start of every Board or Committee meeting the Chair will ask if there are any conflicts (in addition to those already recorded) to be declared. In a situation where a potential conflict arises, the director will excuse themselves from any meeting or discussion, and all material in relation to that matter will be restricted, including Board papers and minutes. For example, during the external audit tender process which was undertaken during the year, Tim Tookey abstained from the evaluation and debate, owing to a potential conflict of interest which had been previously notified to the Board.

Details of the Society's directors' other directorships can be found in the annual business statement.

Board effectiveness

Evaluation of Board performance

A principle of the UK Corporate Governance Code is that "the Board should undertake a formal and rigorous annual review of its own performance and that of its committees and individual directors." This evaluation should consider:

- the balance of skills, experience, independence and knowledge of the business on the Board

- diversity, including gender
- how the Board works as a unit
- other factors relevant to its effectiveness.

The Code outlines that the Chairman should act on the findings of the evaluation by recognising the strengths and weaknesses of the Board and propose to appoint new directors or seek resignation of directors

based upon the evaluation. Evaluation of individual directors should show that each director continues to contribute effectively to the Board, whilst continuing to demonstrate commitment to the role, including the necessary time commitments.



Report of the directors on corporate governance *continued*

Nationwide’s approach to Board effectiveness

Board evaluation is an ongoing process with each annual review driving a programme of continuous improvement throughout the year. Enhancing the effectiveness of the Board is in the interests of the Society and its members and is intrinsic to Nationwide’s ethos as a mutual. The programme which has been developed at Nationwide is designed to ensure that all directors, both executive and non executive, contribute strongly to the good governance of Nationwide.



2017 evaluation

In March and April of 2017 the Board conducted a thorough internal review of its own performance and concluded that it was operating effectively.

The review consisted of a questionnaire being circulated to all Board members, followed by one to one interviews. The results of the questionnaire and interviews were then presented to the

Board for discussion in May 2017 and as a result a number of key themes and an action plan were identified for both the Board and its Committees. These are detailed in the table shown here.

The Board

Key Themes	Action Plan	Implementation
Member engagement: Bringing members' views to the Board	The Board having regard to member views is very important. Ways to best represent these views and channel member feedback to the Board have been identified and an ongoing programme of activities has been developed.	The programme of Member TalkBacks has continued throughout the financial year and for the first time a number of members were invited to the Board strategy day in October 2017 to provide member input to future strategy.
Broadening Board reporting	A broader range of inputs to Board reporting would allow for greater debate in the Board. Wider inputs would also increase the Board’s focus on matters such as competitive landscape, stakeholder views, changes to the business model and technology advances.	<p>During the financial year, both the Chief Executive Officer’s Report and the Business Performance Pack report have evolved and been strengthened to improve Board Reporting.</p> <p>The Chief Executive Officer’s Report opens the Board meeting and provides the Board with a full and transparent perspective on current achievements, issues and challenges and also a view as to what is coming up in the month ahead. It sets the tone for the Board conversation and during the year has developed to show how the Society is progressing against the strategy cornerstones via a mixture of visual and narrative reporting.</p> <p>The Business Performance Pack which provides financial reporting has also been improved during the year to include sections for each strategy cornerstone. There has also been greater engagement with business areas to enhance the insight and forward-looking management information provided to the Board.</p> <p>The Board received a Competitive Landscape report in January 2018 which examined the current market backdrop and how this related to the current competitive environment, and considered its implications for Nationwide’s Strategy.</p> <p>External inputs to the Board have also been sought, for example from the Banking Standards Board, who attended the Board meeting in March 2018.</p>



Report of the directors on corporate governance *continued*

The Board *continued*

Key Themes	Action Plan	Implementation
Forward looking indicators	Ensuring that the Society is built to last is one of the cornerstones of the Nationwide strategy and therefore 5-10 forward looking reportable indicators would be devised for Board review.	The Chief Executive Officer's monthly reporting to the Board provides a forward look at major issues, opportunities and challenges facing the business. The Business Performance Pack has also been enhanced during the year to include more detailed and forward-looking data, organised around the strategic cornerstones.
Board papers: How to improve and sustain high quality Board papers	A timely and well-written Board paper enables strong debate at Board meetings and ensures that the Board has time to focus on matters which are important to the business and members. As a result, Board papers have been improved to state clearly the matter which the Board is being asked to consider and also to reduce the number of papers presented to the Board for noting only.	Guidance on best practice for writing Board papers has been developed and implemented by the Nationwide Secretariat team and training has already been provided across the organisation and will continue to be offered over the coming financial year. Views of the Board are also regularly sought on the quality of Board papers and feedback given to management.
Board visibility	To understand what is really happening in the business and the needs of members, it was agreed that the Board needed to be more visible to employees and at member events. Ways for the Board to do this are currently being developed.	Board members attend the Annual General Meeting, Member TalkBacks, and for the first time a number of members were invited to meet with the Board at its strategy conference.

Audit and Remuneration Committees

Key Themes	Action Plan	Implementation
Seek external advice: Greater input from external sources would benefit committees, particularly the Audit Committee and the Remuneration Committee	To allow Board committees such as Audit and Remuneration Committee to be effective in their roles and to make informed decisions, the best external advisors would be made available to the Committee members.	The Audit Committee has engaged the current auditors PricewaterhouseCoopers to a greater extent and its subject matter experts have attended committees to advise on current debates such as IFRS 9. The new auditors, Ernst & Young, will also bring a fresh perspective and depth of knowledge and insight to the Committee on both Nationwide and the wider industry from 2019/2020. In addition Deloitte addressed a session of the Audit Committee dedicated to Open Banking. The Remuneration Committee continues to source the most appropriate advisors who are available to the Committee as and when appropriate.

Board Risk Committee

Key Themes	Action Plan	Implementation
Greater liaison with the Board IT and Resilience Committee	An improved linkage between the committees would help to ensure that risks which concern the Society's members are being discussed by the appropriate expert committees, therefore removing any repetition.	The terms of reference for the Board IT and Resilience Committee have been clarified so that there is now a very clear delineation between its remit and that of the Board Risk Committee. The Chairman of the Board IT and Resilience Committee is a member of both committees and provides a verbal update to the Board Risk Committee at each of its meetings.



Report of the directors on corporate governance *continued*

Board IT and Resilience Committee

Key Themes	Action Plan	Implementation
Defining its remit	The remit of the committees was capable of being more clearly defined and therefore a review as to what was required of the Board's IT Committee was undertaken.	The remit of the Committee has been changed from IT Strategy and Resilience to Board IT and Resilience to ensure that the matters being considered are the IT and Resilience issues which might impact members the most. Technology strategy is now reviewed at Board level.

Remuneration Committee

Key Themes	Action Plan	Implementation
Performance scorecards	Performance scorecards would be reviewed by the Committee to monitor how business performance in each of the relevant strategic cornerstones would impact variable pay schemes for eligible Nationwide employees.	Performance scorecards detailing progress against each cornerstone target are now routinely presented to the Committee so it is aware of progress and how this might impact the level of variable pay awards at the end of the financial year.

Nomination and Governance Committee

Key Themes	Action Plan	Implementation
Talent management	Ways should be identified to ensure that the Nomination and Governance Committee has enhanced sight of and contact with the talent pipeline. This is to ensure that Nationwide has the best people possible working in the Society.	<p>The Nomination and Governance Committee receives a report at each meeting setting out leadership appointments and vacancies and also receives regular updates on succession planning. It also receives regular updates on Leadership and Talent to understand whether the talent pipeline which currently exists within Nationwide is appropriate.</p> <p>The talent pipeline is being developed further with the top 200 leaders in Nationwide participating in a leadership development programme called Leading for Mutual Good which aims to foster and develop leadership skills within the organisation.</p>

2018 evaluation

The 2018 Board evaluation process was an external review led by Niall FitzGerald, former Chairman and CEO of Unilever.

Whilst the Board was not obliged to use an external reviewer until 2019, the Board agreed that Mr FitzGerald's broad experience as a Chairman would significantly assist the development of the Board.

The review took place between January and March 2018 and consisted of Mr FitzGerald attending both the Board and Board Committee meetings as an observer and a series of one to one meetings with Board members. An initial Board discussion and feedback session took place in April 2018, with Mr FitzGerald producing a report for further discussion with the Board in May.

The Board is still considering the report's key themes and developing an action plan in response to it. Further information in this regard will be presented in the Annual Report and Accounts 2019.



Report of the directors on corporate governance *continued*

Members are building society, nationwide

As a mutual organisation, members are also the owners of Nationwide and, as such, they need to be able to share their views on the overall direction of the business. The Society seeks to ensure they can do this in a number of ways.

The Society's aims are

To make it as easy as possible for members to talk to Nationwide in whichever way they prefer

To listen and respond to members' suggestions and comments with products and services built around their needs

To include members in any activities they would like to be involved in

Contributing to the AGM

The AGM is the key event at which members can have their say on the way the Society is run and hear first-hand from directors. It is the main opportunity to hold the Board to account as members can vote for or against those standing for election and on a number of other key issues.

Member involvement is such an important principle for Nationwide as a mutual. The Society works hard to make it as easy as possible for members to have their say and constantly works to improve communications. Last year more members than ever used the online facilities to cast their vote, with 30% of the voters choosing to do so online, although overall turnout continues to decline, both at Nationwide's AGM and across the building society sector. As has been the practice for a number of years, the meeting will be held at a different venue across the UK each year, meaning the Society is truly nationwide and accessible. This year, the AGM will be coming home to Nationwide's head office building at Nationwide House, Pipers Way, Swindon, SN3 1TA on Thursday 19 July 2018.

The Society also works throughout the year to communicate with members as owners of the business, and to encourage feedback on the way it operates. The main ways in which the Society has done this during 2017/18 are as follows:

Face to face

The popular Member TalkBack programme continued into 2017/18 with the delivery of ten events across the UK. Over 750 members took part in these events over the course of the year. These events aim to facilitate dialogue between the Society's members and the Society's Board and senior management. 100% of members attending felt 'valued' or 'more valued' as a result of taking part with members receiving answers to over 130 questions throughout this programme of events.

The Society has also enabled branch colleagues to get more involved in their communities through different events. Fourteen branches have run 'launch events' to engage members with their newly refitted branches, including Manchester, Wolverhampton and the Strand in London. In a first for the Society, members have also been able to engage with Nationwide colleagues at a number of shows and festivals, including the Royal Norfolk Show, Malvern Autumn Show and Ideal Home Show.

Online

Following the pilot of webinars last year, two further webcasts have taken place in 2017/18. One was specifically available for members to learn more about the mobile banking app, and the other was the ability to tune in to a Member TalkBack event and ask questions directly to the panel. From the live and on-demand views, over 1,200 members have been able to interact with this online content. More web shows are planned for future engagement.

In addition, members are now able to join the Society's Connect community to express their views, ideas and opinions on a number of issues relating to the Society. Members can join here: www.nationwidememberconnect.co.uk

Social media and e-newsletter

The number of followers on our main social media channels has increased by almost 30% over the last 12 months with content relating to our Voices campaign, social investment, fraud education and branch transformation generating the most engagement.

The research Nationwide commissions

As well as the research Nationwide commissions to find out how members rate service, the Society has around 7,000 members signed up to its online customer research panel 'Nationwide Connect', which helps provide feedback on a variety of topics. Each week the panel is asked to take part in a survey. The panel can provide feedback on whatever is concerning them. The Society also asks them to take part in regular online discussions and polls. It's a two-way channel: every quarter the Society sends out a newsletter recognising their contribution and telling them how their feedback has shaped Nationwide's thinking.



Report of the directors on corporate governance *continued*

Wider stakeholders

Nationwide has a diverse range of stakeholders whose interests the Board has regard to when making decisions. In addition to how the Society interacts with its members and its employees, consideration is also given to stakeholder groups including the following:

Communities



Keith

We're building a new community

As a building society, Nationwide believes in putting people at the heart of what it does.

That includes housing, and Nationwide thinks regenerating local areas, working with local people and reinvesting profits will create real communities. In Swindon, close to the Society's headquarters, a new housing project is being developed which aims to put local people at the heart of the planning and design process. Community Organiser, Keith, has been out and about in the local area having conversations with residents and his experiences are set out below.

"I've been finding out what they love about the area and what could be better. We haven't designed any of the homes yet because we want the local community to help shape what we do and how we do it".

"It's important we listen to as many people as possible so that this has meant organising walkabouts of the site, drop ins at local community centres and knocking on the doors of local residents".

"By challenging existing practices and ensuring the views of locals shape our development, we can build the homes the local community really wants and needs".

Investors



Nationwide is active in wholesale funding markets, engaging in the issuance of instruments with a wide range of tenors and levels of subordination.

The Society maintains an active dialogue with the investors in these instruments through a thorough investor relations (IR) programme. During a typical year the IR team will host around 500 meetings, providing current and potential investors with the opportunity to meet senior managers of the Society, through to Board level. Some of Nationwide's wholesale

investors are also members, notably those who hold Core Capital Deferred Shares (CCDS). Investors provide diverse sources of long-term, stable funding. Wholesale investors also contribute towards the Society's loss absorbing capital, helping to ensure that Nationwide is built to last for current and future generations of members.



Report of the directors on corporate governance *continued*

Suppliers



Nationwide’s supplier partners are an essential part of its business operations, being seen as an extension of the organisation and therefore key to the Society’s ability to develop and deliver services to its members.

Nationwide spends approximately £1.4 billion per annum across around 1,200 suppliers, representing about two thirds of its operational cost base. It is important to Nationwide that all third parties represent the Society in a manner that enhances its reputation and relationships with its members, employees and stakeholders. As a result the Society endeavours to partner with organisations that demonstrate a

commitment to its mutual values, ethics, policies and standards, and this is also encoded in the Third Party Code of Practice that third parties commit to.

The Society has a Third Party Portal which is designed to provide any new, potential or existing third parties with all the information they need to know about supplying goods and services to Nationwide.

Supporting Carillion colleagues

On Monday 15 January 2018 news broke that Carillion was taking steps to go into liquidation.



Joseph, Joao and Sundari were three of the 297 Carillion contractors we brought in house.

Colleagues across the Society worked tirelessly to ensure that not only were the critical services that Carillion provided to Nationwide maintained but that individuals, who had delivered these services, were treated fairly. Just a few days later the Society was able to announce its proposal to bring all services provided directly by Carillion in house with 297 Carillion employees being taken on by Nationwide from Monday 22 January. As a mutual the Society believes this was the right thing to do for those who had supported Nationwide every day, providing a variety of services from operational support in data centres through to the security teams and cleaning services in administration sites and branches. Feedback from staff was overwhelmingly positive with former Carillion employees having this to say:

“I was a front of house employee for Carillion and I can’t thank Nationwide enough for taking me on at Caledonia House. Thank you so much”.

Claudene

“I had been working at Sheffield Contact Centre since March 2016 in Security for Car lilion.

I already felt part of the team back then as I had been made welcome by management and staff. It feels even better now that I am part of Nationwide”.

Gary

“Thanks very much to Nationwide for taking us on at Caledonia House.

I know I don’t have long to go until I retire but good to see my workmates are in safe hands. Good to be part of a good team and great organisation. Thank you”.

Ronald


 Report of the directors on corporate governance *continued*


Audit Committee report

“The Audit Committee safeguards Nationwide, provides challenge to management and oversees the integrity of our financial reporting”

Dear fellow member

I am pleased to be able to report on the Committee’s key role of safeguarding the interests of Nationwide for the benefit of its members.

The Committee continues to challenge the financial reports prepared by management, to scrutinise the effectiveness of the Society’s internal controls, to review the Society’s procedures for fighting financial crime, and to oversee the assurance work of our internal and external auditors. We remain alert to external risks. Specifically, uncertainty over future UK economic conditions and cyber threats have both featured in our work.

The Society is required to change its external audit firm no later than 2020, and a key element of the Committee’s work this year has been to identify an appropriate successor to PricewaterhouseCoopers (PwC). The rigorous tender process which the Committee followed is described below, and we

are recommending that members support Ernst & Young LLP to become the Society’s next external auditor from 2019.

There is an important change in accounting applying to Nationwide with effect from 5 April 2018, IFRS 9. I welcome the change in the standard because it increases the prudence for losses on loans, our most important class of balance sheet assets. The Committee has for some three years overseen management’s preparation for the adoption of the new accounting standard and is satisfied that we are able to meet its requirements in full.

If any member has feedback on this report, I should be pleased to receive their comments. I will attend the 2018 AGM and be available to answer members’ questions.

Kevin Parry
Chair – Audit Committee

Who sits on the Committee

The Board believes members of the Audit Committee have the financial, risk, control and commercial expertise required to provide effective challenge to management. Kevin Parry and Tim Tookey are considered by the Board to meet the requirement of the UK Corporate Governance Code to have recent and relevant financial experience.

Committee members who served during 2017/18	Number of meetings attended (eligible to attend)
Kevin Parry (Chairman)	9/(9)
Rita Clifton	8/(9)
Lynne Peacock	9/(9)
Tim Tookey	8/(9)

Regular attendees of the Committee include: Chairman of the Board, Chief Executive Officer, Chief Internal Auditor, Chief Financial Officer, Chief Product and Propositions Officer, Chief Operating Officer, Chief Risk Officer, Director of Financial Reporting and representatives of PricewaterhouseCoopers.



Report of the directors on corporate governance *continued*

How the Committee works

The Audit Committee's members are independent non executive directors. Across the Committee membership, there is a diverse range of experience in business, finance, auditing, risk and controls, with particular depth of experience in the financial services sector. These skill sets enable the Committee to challenge and scrutinise the work of management. The Committee is also able to draw on the expertise of key advisors and control functions, including the internal and external auditors.

The Committee provides oversight and advice to the Board on the matters listed in its terms of reference (available at nationwide.co.uk) and reports to the Board on those matters after each meeting. The Committee is authorised by the Board to obtain any information it needs from any director or employee of the Society. It is also authorised to seek, at the expense of the Society, appropriate professional advice as needed. The Committee did not need to take any independent advice during the year.

The Committee works closely with the Board Risk Committee, as some matters are relevant to both Committees, with two joint meetings held during the year. The joint meeting held in October 2017 included the review of Pillar 3 interim disclosures, and updates from second line oversight and Internal Audit on matters which included measurement and monitoring of unsecured indebtedness, data and data regulations, and cyber security and resilience. The joint meeting held in March 2018 included review of the 2018/19 plans for Risk and Compliance Oversight and Internal Audit.

During the year, the Committee held a number of meetings without management present which included separate meetings with the Chief Internal Auditor, the Society's external auditors, and the Chief Risk Officer.

The Committee reviewed its terms of reference, as part of an annual cycle and recommended a number of enhancements to the Board which were approved in October 2017.

The Committee confirms that its activities during the year were in line with its remit.

The Committee's effectiveness is reviewed annually. Further details can be found in the Board effectiveness section on page 52.

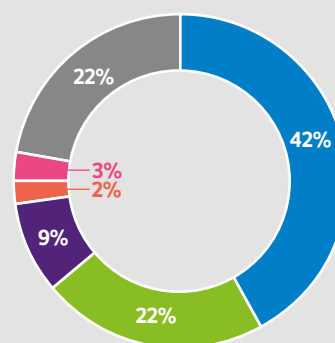
Report on the year

Preparation of the financial statements and external financial reporting

Significant time was spent by the Committee reviewing the half year and full year financial statements. The Committee also reviewed the Preliminary Announcement, the Summary Financial Statements and the Interim Management Statements published in August 2017 and February 2018. In considering the financial statements, the Committee discussed and considered in detail management's analyses, the external auditor's work and conclusions on the main areas of judgement.

Internal controls and risk management systems have been in place to provide assurance over the preparation of the Annual Report and Accounts. Information submitted for inclusion in the financial statements is attested by individuals with appropriate knowledge and experience. The Annual Report and Accounts are scrutinised throughout the process by relevant senior stakeholders. Subsequently, the Audit Committee provides debate and challenge, before requesting Board approval. Key controls in the process are subject to regular testing, the results of which are reported to the Audit Committee.

How the Committee spent its time in the year



- Financial reporting
- Internal controls and risk management (including internal audit)
- External audit
- Financial crime
- Statutory duties
- Other (including meeting administration)

The time spent on external audit matters was unusually high this year due to the audit tender.



Report of the directors on corporate governance *continued*

Key areas/matters considered by the Committee during the year

The significant judgements, issues and actions taken by the Committee in relation to the 2018 Annual Report and Accounts are outlined below.

Each of these matters was discussed with the external auditor during the year and, where appropriate, have been addressed as areas of audit focus in the Auditors' Report.

Area of focus	Committee's response
<p>Accounting policies, including the implementation of IFRS 9 (accounting for financial instruments, notably loans) and IFRS 15 (accounting for revenue)</p> <p>More information on the implementation of IFRS 9 and IFRS 15 is set out in note 1 to the financial statements</p>	<p>The Committee reviewed the Society's accounting policies and confirmed they were appropriate to be used in the financial statements. There are two important developments this year: IFRS 9 and IFRS 15.</p> <p>The Committee monitored the Society's preparations for the introduction of IFRS 9 in 2018/19, building on its work of the past two years. Continuing areas of focus included criteria for determining significant increases in credit risk and post model adjustments. Most post model adjustments are in respect of matters not readily modelled but there is room for some further modelling in the future as more data becomes available. This year extensive discussion took place on chosen economic scenarios and the Committee determined that one scenario should include a severe economic downturn. The Committee tested management's approach in each of these areas, taking account of the Prudential Regulation Authority's objective to ensure consistency of IFRS 9 approaches across the sector. The Committee is satisfied with the outcome of the work and the disclosures of the impact of IFRS 9 provision estimates in the interim results and the year end results.</p> <p>The Committee also received updates from management on preparations for the adoption of IFRS 15, which will also become effective from 2018/19. Having considered all material sources of revenue and, in particular, revenue arising from the sale of general insurance products, the Committee agreed with management's assessment that there will be no significant impact when IFRS 15 is applied.</p>
<p>Alternative Performance Measures (APM) and disclosure of member financial benefit</p> <p>Details on member financial benefit are shown on page 27</p>	<p>The Committee continues to consider that some non-GAAP measures, such as underlying profit, aid an understanding of the Society's results. Definitions are clearly stated and unchanged from last year. During the next financial year the Committee will review the items excluded from underlying profit to ensure our approach remains appropriate.</p> <p>The main performance disclosure that the Committee focused on was the value for member financial benefit in its published financial reporting. This metric articulates the benefit provided to members in the form of differentiated pricing and incentives, representing Nationwide's interest rate differential, lower fees and member incentives compared with market averages.</p> <p>The member financial benefit measure, and the basis on which it should be calculated, was reviewed by the Committee based on work undertaken by the internal and external auditors. The work undertaken drew attention for the need for more embedded robustness in its calculation and improved documentation and control. The process improvements were made in time for the year end calculation. Consequently, the Committee was satisfied with the calculation.</p>
<p>Going concern and business viability statement</p> <p>See the Directors' Report (page 95) for more on the business viability statement and the Directors' Report for going concern</p>	<p>The Committee reviewed the going concern basis of preparation of the financial statements and the statement of business viability for recommendation to the Board for approval. As a deposit taking institution, liquidity management and viability are core requirements for the Society and there is substantial oversight by the Board through the Risk Committee and the Audit Committee. Reviews embraced the following:</p> <ul style="list-style-type: none"> • assessment of profitability, levels of capital and availability of funding and liquidity, together with output of stress tests and reverse stress tests • consideration of the profitability resulting from business activities and factors likely to affect future development, performance and financial position together with the assessment of principal risks. <p>The Committee noted the development of the Society's viability statement in line with best practice guidance issued by the Financial Reporting Council during the year. The Committee noted commentaries suggesting that viability statements should be extended beyond a period of three years but in the light of changes in our economic, technological and regulatory environment, the Committee did not consider it appropriate to alter its current timeframe of three years.</p> <p>The Committee concluded that it remained appropriate to prepare the accounts on a going concern basis and was able to recommend to the Board the viability statement for approval.</p>



Report of the directors on corporate governance *continued*

Key areas/matters considered by the Committee during the year *continued*

Area of focus	Committee's response
<p>Fair, balanced and understandable report and accounts</p> <p>See the Directors' Report for more on fair, balanced and understandable</p>	<p>The Society's Annual Report and Accounts, taken as a whole, must be fair, balanced and understandable. The Committee considered the overall presentation of the financial statements and was satisfied that the reporting, including the disclosures in the notes to the accounts, fairly represented the trading for the year ended 4 April 2018.</p> <p>The Committee considered whether the overall portrayal of Nationwide was open and honest, setting out both successes and challenges, and whether language was used that a person with reasonable knowledge of financial sector financial reporting could understand. The Committee considered whether the reporting was contextualised against the backdrop of the Society's clearly defined strategy.</p> <p>The Committee was provided with a report by management setting out the review processes used to assess the overall presentation of the Annual Report and Accounts. This included an independent management review which concluded that the reporting was clear, consistent, balanced, open and appropriately focused on material items.</p> <p>The Committee reviewed the draft Corporate governance report and was satisfied that it presented an accurate view of the work of the Board and its Committees. The Committee supported work to improve the clarity and presentation of the Corporate governance report.</p> <p>After consideration of management's report and the Committee's own review, the Committee concluded that it could inform the Board that, in its opinion, the Annual Report and Accounts were fair, balanced and understandable.</p>

In compiling a set of financial statements, it is necessary to make estimates and judgements about outcomes that are typically dependent on future events. Significant matters are set out below. In addition, the Committee reviewed and was satisfied that no issues arose in respect of management's application of the effective interest rate method, revenue recognition and hedge accounting.

Area of focus	Committee's response
<p>Impairment provisions for loan portfolios</p> <p>See note 10 to the financial statements</p>	<p>Given the significant loans which Nationwide holds, the Audit Committee ensures that it invests appropriate time to understand the Society's exposure to lending risk and to challenge the modelling assumptions in the impairment provisions.</p> <p>In the continuing low interest rate environment, it is particularly difficult to identify events leading to impairments. The Committee continued to ensure that management considered all relevant factors that could lead to higher provision requirements against loans.</p> <p>The Committee reviewed with management the impact of potential pressure on affordability of loans driven by rising inflation and its impact on household budgets. As a result, an additional provision was introduced to provide for the risk that latent losses exist within the portfolio but had not yet been identified. The Committee reviewed the necessity for maintaining the overlay at each reporting period. At the end of the year, the overlay represented £28 million (2017: £nil) of the total provision.</p> <p>During the year the Committee continued to scrutinise the adequacy of loan loss provisions in accordance with currently in force accounting standards. In particular, the Committee reviewed both the bottom up modelling and the top down aggregate provisioning as a percentage of the total and non-performing book. The Committee was satisfied with the level of provisioning.</p> <p>It was noted that the estimated provisions would be higher under IFRS 9 as a result of moving from an incurred loss to an expected credit loss model. The Committee has reviewed analysis to consider the likely income statement impact in the next three to five years.</p>



Report of the directors on corporate governance *continued*

Key areas/matters considered by the Committee during the year *continued*

Area of focus	Committee's response
<p>Customer redress See note 27 to the financial statements</p>	<p>The assumptions used in calculating the provisions for customer redress can be highly judgemental. In addition, judgement may also be made when reviewing potential conduct issues and deciding whether the outcome is remote, possible (requiring disclosure as contingent liability) or probable (amount to be provided).</p> <p>Given this the Committee reviewed a number of conduct-related issues during the year with management. The largest conduct issue on which the Committee was engaged regularly remained Payment Protection Insurance (PPI) and the Plevin legal case in respect of high levels of undisclosed commission.</p> <p>During the year the Committee considered, with management, the forecasts and sensitivities to forecasts of the expected volumes of complaints in relation to PPI and Plevin. In doing so it reviewed the Society's historical experience of complaints and considered its experience and forecasts in relation to the wider market experience, taking account of the Financial Conduct Authority's advertising campaign. The Committee ensured that provisioning was based on realistic outcomes and up to date information such as the Financial Conduct Authority's determination of the final period for PPI claims.</p> <p>The Committee concluded that the current provisions held by the Society reflected the best estimate of future complaints based on past experience and current expectations of customer behaviour until the end of the PPI time bar in August 2019.</p> <p>The Committee agreed with management to review regularly the performance of actual complaints volumes and the value of those complaints against the forecast amounts in order to consider implications should performance be seen to diverge from the forecasts.</p>

The Committee has responsibility for gaining assurance over the adequacy of the control environment, including the prevention of financial crime. The Committee's review of the operation of internal controls encompassed the following:

Area of focus	Committee's response
<p>Controls</p>	<p>Control environment The Committee continued to monitor efforts to strengthen and enhance the Society's controls and the overall approach to the control environment. The Committee was updated on improvements in the first line control environment, and reviewed management's new approach to mapping critical controls, which included certification by Material Risk Takers of the controls for which they held responsibility. The Committee supported the recommended approach.</p> <p>Financial controls The Committee reviewed the financial controls framework and discussed with management the adoption of an enhanced approach to manual procedures and controls. The Committee also asked that the framework be simplified to eliminate obsolete or duplicative controls.</p> <p>The Committee monitored improvements in a number of areas in the business, including the implementation of a new Treasury system. The Committee concluded that good progress is being made in improving the financial control environment.</p> <p>Security, IT controls and operational resilience The Committee monitored the Society's security agenda and reviewed updates from the Director of Security on activities to further strengthen aspects of security management. Internal Audit also completed several related audits during the year, and the Committee discussed with PwC their findings in respect of privileged access to IT systems. These reports provided insight regarding the progress made by management and informed the security development agenda for the year ahead which was supported by the Committee.</p> <p>The Committee received updates on cyber-attacks, and reviewed the robustness of the Society's cyber defences and its co-operation with anti-crime agencies.</p> <p>Financial crime Financial crime is a broad term that includes anti-bribery and corruption, anti-money laundering, fraud, theft from customers' accounts and card related thefts. The Committee received a number of reports on each of these areas.</p> <p>The Committee noted the developments and improvements in anti-bribery and corruption procedures whilst encouraging management to increase the rate of improvement. The Committee received a report from the Group Anti-Money Laundering Officer and noted the improvement in the capabilities of the Society.</p>



Report of the directors on corporate governance *continued*

Key areas/matters considered by the Committee during the year *continued*

Area of focus	Committee's response
Controls	<p>The Director of Fraud provided a report on the steps being taken and planned to be taken to reduce the losses related to fraud and theft. The report also compared the Society's losses to those of other financial institutions. In the context of the Board's risk appetite, the Committee was satisfied with the steps being taken to reduce losses from financial crime. The Committee reinforced the Society's responsibilities as a mutual to educate members on how to reduce their exposure to fraud and theft.</p> <p>Outsourced services</p> <p>The Society is reliant on the services of a number of out-source providers. During the year, Carillion entered liquidation. Carillion provided extensive maintenance, security and transport services to Nationwide. Prior to its entering into liquidation, the Committee received a report on contingency planning and the financial impacts. The Committee subsequently reviewed the outcome of the implementation of the plan and commended management on its effective implementation.</p>

The Committee has responsibilities beyond financial reporting, considering judgments and estimates and the control environment. Other matters considered during the year were:

Area of focus	Committee's response
Capital and distributions	The Committee is responsible for advising the Board on the affordability of making distributions to holders of Core Capital Deferred Shares (CCDS) and AT1 securities and recommended to the Board that the payments proposed by management be made.
Product Design Framework	Following the review of a specific product, the Committee looked in detail at a number of operational frameworks, including the Product Design Framework which supports how the Society develops its products. The Committee identified the need for improvement in this area to ensure that the Society consistently gives the best possible products and services to its members. As part of its drive to improve the Society's offering, the Committee received reports from management on the Product Design Framework Improvement Programme and asked to be kept informed of progress by means of future updates.
Tax	<p>The Committee was briefed by the Head of Tax Management on key tax issues, and reviewed the management of Nationwide's tax affairs and the management of tax risk in business activities.</p> <p>The Committee reviewed the Society's tax strategy prior to approval by the Board for external publication. A copy of the strategy can be found at www.nationwide.co.uk/about/corporate-information/governance/taxation-strategy</p>



Report of the directors on corporate governance *continued*

Internal Audit

The Committee works closely with the Chief Internal Auditor who reports directly to the Chairman of the Audit Committee. Throughout the year, the Committee carefully monitored the progress of the Internal Audit function.

The Audit Committee approves the work of internal audit annually and through regular quarterly updates, specifically approving any audits that are postponed or cancelled. The scope of work takes account of the function's own assessment of risks, the input of first and second line management and the Audit Committee itself. Added discipline has been established for 2018/19 onwards to ensure that the entire audit universe is audited on a cyclical basis with prioritisation for higher risk areas. The annual audit plan and annual risk and compliance plans are formally approved at a joint meeting of the Audit and Risk Committees.

The Committee received quarterly updates from the Chief Internal Auditor on the work of the Internal Audit function, drawing its attention to the most significant audit work which this year included IT vulnerability; governance and management of customer data, including preparations for the General Data Protection Regulation (GDPR), and project execution. One of the Committee's key areas of focus is to ensure that issues identified by internal audit reports are promptly and thoroughly addressed by management. The number of open audit action points increased during the year. The Committee discussed with the Chief Executive Officer and the Chief Internal Auditor ways of reducing the number of open issues. It was concluded that outstanding audit points needed to be specifically reviewed by the Executive Committee.

The work of Internal Audit is reviewed by a quality control function whose head reports findings directly to the Audit Committee chairman. No major issues arose during the year but the function assisted in the development of robust documentation and recommendation procedures. Quality was also assessed by means of a survey of recipients of internal audit work. The findings were strong and at a higher level than last year. Particular strengths included independence and objectivity, communications and engagement.

Administratively, the Committee reviewed the complement of the audit function and its output productivity and was satisfied that the resources were consistent with the Society's needs. The Audit Committee Chairman and the Chief Internal Auditor review progress on a monthly basis.

External Audit

PwC acted as the Society's external audit firm throughout the 2017/18 financial year. The Audit Committee is responsible for overseeing the relationship with the external auditor, and for the effectiveness of the audit process.

Senior statutory auditor

Hemione Hudson of PwC has been Nationwide's senior statutory auditor since the 2015 year end. Under regulation Ms Hudson would be due for rotation following the 2019 year-end audit which coincides with the audit rotation date. PwC's report can be found on pages 159 to 167.

Audit quality and materiality

The Committee has a responsibility for reviewing the quality and effectiveness of the external audit. The Committee approved the scope of the audit plan and materiality level in advance of the annual audit. Materiality is an aggregate amount which if not reflected in financial statements would result in the financial statements not giving a true and fair view. For 2017/18, overall audit materiality was set at £54.5 million (2017: £52 million), equivalent to 5% of adjusted pre-tax profit.

The Audit Committee Chairman met regularly with the PwC audit partners during the year and discussed in detail the basis of their opinion on the key judgements in the financial statements.

Auditor independence

The Board has an established policy setting out the non-audit services that can be sourced from the external auditor. The aim of the policy, which is reviewed annually, is to safeguard the independence and objectivity of the external auditors and comply with the ethical standards of the Financial Reporting Council (FRC). The policy specifies non-audit services provided by the external auditor that are either permitted or prohibited. The Committee monitors the implementation of the policy and considers proposals from management to use the external auditors for non-audit services. The Committee challenged the appropriateness of the recommendations and the independence threats potentially arising. Additionally, PwC has confirmed that it has complied with relevant regulatory and professional requirements and its objectivity is not impaired. The Committee is satisfied that PwC remained independent throughout the year.

Audit outputs

During the year the Committee reviewed the following reports:

- PwC's year end report for the 2016/17 financial year and its statutory opinion in respect of the year. The report set out key risks identified in their audit work, namely valuation of retail impairment provisions in the secured and unsecured portfolios, judgements in relation to conduct provisions and the manual processes of hedge accounting.

- PwC's reports during the 2017/18 financial year that set out observations in relation to the key risks and audit related matters.
- PwC's transparency report for the year ended 30 June 2017.
- PwC's private reports to the Prudential Regulation Authority (PRA), which focused on key areas as requested by the PRA, including impairments under IAS 39 and IFRS 9, hedge accounting, conduct provisions and cyber risks.

Audit and non-audit fees

The Committee reviewed and approved the external auditor's engagement letter and proposed audit fee.

In order to further safeguard the external auditor's independence, the Society has a non-audit fees policy, under which non-audit work is approved by the Audit Committee where the fee is over £50,000, or by the Audit Committee Chairman and the Chief Financial Officer with ratification at the next Audit Committee meeting where the fee is below £50,000. Non-audit fees are reported to the Committee at each regular meeting.

The fees paid to PwC for the year ending 4 April 2018 totalled £5.5 million (2017: £4.3 million), of which £1.8 million (2017: £1.8 million) were for non-audit services. Non-audit services represented 51% (2017: 68%) of the statutory audit fee. Fees for individual non-audit services where the expenditure was more than £100,000 were:

- Reporting accountants on CCDS issuance, fees of £842,000
- Half year review, fees of £197,000

The fees are set out in the note 8 to the financial statements on page 191.

Having reviewed both the quantum of the non-audit fees and the nature of the work done, the Committee is satisfied that the non-audit fees do not detract from PwC's audit independence.

Audit effectiveness

The Committee reviews the effectiveness of the external audit process on an annual basis. The Committee received a report based on a questionnaire to audit committee members and those members of management who interact with the auditors on the auditors' effectiveness. It showed that the external auditor was performing its duties in an independent and effective manner, but showed a decline in the feedback results compared to prior years. The Committee concluded that the rating given to PwC remained acceptable, but noted areas for improvement, including greater involvement of teams within the Society in the planning of the audit, ensuring appropriate challenge of management at the right time, greater innovation in the audit approach and the use of analytics. PwC recognised the need



Report of the directors on corporate governance *continued*

to respond to the findings, and took appropriate actions in response including enhancing the team. A PwC Board member, unconnected with the audit, will review progress with the Audit Committee Chairman and the Chief Financial Officer in the next few months. Having reviewed the effectiveness of PwC together with the actions for service improvements, the Committee recommended to the Board, which will now recommend to members, PwC's reappointment as external auditor for the 2018/19 financial year.

Statutory auditor rotation

Audit tender

Last year's Audit Committee report referred to the decision to undertake an audit tender process during 2017/18, with the appointment to take effect for the audit of the 2019/20 financial statements. The tender resulted in the proposal, subject to member approval at the 2019 AGM, to appoint Ernst & Young LLP (EY) as external auditor for the year ending 4 April 2020.

Due to audit firm rotation regulations the Society's current auditor, PwC, was not invited to tender but will continue in role until completion of the audit for the financial year ending 4 April 2019. PwC has been auditor since 1991, the last audit re-tender being in 2003.

Scope

The scope of the tender consisted of the Nationwide Group audit and statutory audits of certain subsidiaries and structured entities (excluding dormant companies and those subject to exemption from audit). The appointment will take effect from the 2019/20 financial year. A tender process will be mandatory after no more than ten years, with rotation of the audit firm required no later than 20 years. Subject to satisfactory performance, members will be invited to vote, at the Society's AGM, to reappoint the audit firm on an annual basis.

Governance

The overall objective of the audit tender was to select the best auditor in terms of quality, within a reasonable price range. The Audit Committee retained ultimate authority over the tender process and audit firm evaluation, and made the recommendation for appointment to the Board.

To ensure a transparent and robust selection process, a Steering Committee was established to manage the process, chaired by the Chairman of the Audit Committee and including the Chief Financial Officer.

The Steering Committee was responsible for overseeing the design and execution of the audit tender, including agreeing the key objectives and evaluation criteria. The Committee was supported by members of the Finance & Efficiency Community in executing the tender process.

To avoid influencing, or the perception of influencing, the tender decision, a strict policy was agreed with the participants in the tender process prohibiting the provision of any gifts or hospitality and monitoring other engagement with key decision makers to ensure this related to regular business matters only.

Mr Tookey took a full part in the audit tender process, including all meetings and presentations, and attending the final-stage presentation. However, he abstained from the evaluation and debate, owing to a potential conflict of interest which had been previously notified to the Board. Once the decision to appoint EY had been made, Mr Tookey confirmed his full support for their appointment.

Selection criteria

In order to be successful in the audit tender, the firms were evaluated on the following selection criteria:

- Audit firm and auditor independence, including internal practices to ensure continuing compliance with independence requirements and freedom from conflicts of interest
- Track record for audit quality, including findings by the Financial Reporting Council's Audit Quality Review team, findings from the firm's internal reviews and investigations by regulators
- Technical criteria, including the proposed audit plan, structure of audit, use of innovative tools and transition approach
- Team quality, including experience and working style of the lead partner and senior team members, ability to provide constructive and timely challenge, industry knowledge, access to specialists and audit team continuity
- Ability to bring robust insight and well-informed challenge
- Cultural fit, including the alignment of the firm's values, ethics and related policies with those of Nationwide.

Proposed audit fees were considered to ensure they provided value for money without compromising audit quality; however, fees were not a determining factor in the evaluation.

Tender process

The tender process was conducted as set out on the following page. One of the short-listed firms withdrew during the process due to an independence conflict. This left two firms, including EY, to proceed to the final stages.

Auditor transition

The Committee and the Society's Finance & Efficiency Community will work closely with both PwC and EY during the 2018/19 financial year to ensure an efficient and orderly transition of the external audit. Both existing services and any proposals by EY for new services have been, and will continue to be, monitored and assessed for appropriateness in light of their future role as external auditor and associated independence requirements.

The year ahead

The Audit Committee will continue to play its vital role in safeguarding the financial soundness and resilience of the Society. As well as providing support to the Board in financial matters, and overseeing Nationwide's financial position and prospects, the Committee will ensure that the Society's framework of controls remains robust and effective.

In 2018/19, the Committee will continue to oversee preparations for the introduction and embedding of new requirements, notably the embedding of accounting standard IFRS 9. The Committee will work with the Board Risk Committee to ensure that the Internal Audit, Prudential Risk Oversight and Compliance Oversight functions have appropriate plans in place, and will monitor their progress and implementation.

During the year ahead, the Committee will devote particular attention to the auditor transition process, to ensure that EY is able to make effective preparations to become Nationwide's new external auditor. The Committee will continue to work with the current auditor, PwC, to ensure an effective audit for the 2018/19 financial year.

In the challenging and competitive environment in which Nationwide operates, it is vital that the Society retains the trust of its members, and the assurance which the Audit Committee provides is essential in doing that.

Report of the directors on corporate governance *continued*

Timing	Process stage	Further detail
September 2016 to March 2017	Market assessment and shortlisting of firms	<ul style="list-style-type: none"> A market assessment review was undertaken to identify firms to be invited to tender. This included challenger firms who were asked to respond to a Request for Information. This assessment resulted in a shortlist of three big four audit firms. Shortlisted firms were asked to identify proposed senior members of their engagement teams, including the lead audit partner. These team members were invited to meet informally with certain of the Society's directors including the Chairman of the Audit Committee and Chief Financial Officer.
June 2017	Confirmations of intention to tender	<ul style="list-style-type: none"> Shortlisted firms were asked to confirm formally their intention to tender and ability to meet audit independence criteria.
August 2017	Request for Proposal issued	<ul style="list-style-type: none"> A Request for Proposal (RFP) was issued to the participating firms. An electronic data room was opened for the firms to provide relevant information and responses to questions. The data room remained open throughout the tender process.
September 2017	Management, Chairman and Committee member meetings	<ul style="list-style-type: none"> Firms were invited to a series of structured and targeted engagement sessions with Nationwide's key business leaders, including the Chief Executive Officer, Chief Financial Officer, Chief Risk Officer, Chief Information Officer and Chief Internal Auditor. These sessions provided participating firms the opportunity to understand Nationwide's business and discuss certain subject matter areas in greater depth. Firms were also given the opportunity to meet with the Chairman, all members of the Audit Committee and certain members of the Board Risk Committee.
	Audit technical testing	<ul style="list-style-type: none"> Firms were requested to complete a series of audit technical tests, with the aim of demonstrating their technical capability relevant to the Nationwide audit, presenting their findings to the Steering Committee.
	Written proposals received and assessed	<ul style="list-style-type: none"> Written proposals were received in response to the RFP. Fee quotes were provided and reviewed separately from the main written proposals to ensure these did not unduly influence the overall assessment. All of the written proposals submitted were compliant with the requirements set and the bids were assessed against the selection criteria.
October 2017	Lead audit partner interviews	<ul style="list-style-type: none"> Each participating firm's lead audit partner met with the Chairman of the Audit Committee and Chief Financial Officer, and answered a series of identical questions related to Nationwide's financial reporting and wider industry matters.
	Final presentations	<ul style="list-style-type: none"> Each of the two firms involved in the final round gave a final oral presentation of their proposal to the Audit Committee, with other members of the Board, including the Chairman and Chief Financial Officer, in attendance.
	Committee recommendation that Ernst & Young LLP be appointed for 2019/20	<ul style="list-style-type: none"> The Audit Committee (excluding Tim Tookey as noted on the previous page) evaluated the performance of the two firms across the process as a whole and concluded that both firms had the experience and competence necessary to carry out an effective audit. However, of the two firms, the Audit Committee recommended to the Board a preference for the appointment of Ernst & Young LLP due to their successful demonstration during the process of depth of knowledge of the Nationwide business and wider industry, and consistent evidence of their ability to provide insight and challenge. This recommendation resulted in a resolution by the Board to recommend EY to members at the 2019 AGM.



Strategic Report

Governance

Business and Risk Report

Financial Statements

Other Information

Oliver and Karen, members since 2015


 Report of the directors on corporate governance *continued*


Board Risk Committee report

“Your Board Risk Committee is committed to working with the rest of the Board and with management to ensure that all risks are carefully managed in order that Nationwide continues to be a thriving and sustainable business for all its members, current and future”

Dear fellow member

I am pleased to present the Board Risk Committee’s report for the financial year ended 4 April 2018. During the year, we have continued to focus on building the Society’s long-term resilience in the interests of our members. Despite the Society’s risk profile remaining broadly stable, we have taken a proactive approach to ensure that risk exposures are managed before they have crystallised. As a mutual we are able to make long-term decisions that affect profit through the financial performance framework rather than looking to maximise in year profit as other financial institutions might. In addition, we have focused on how best to support the first time buyer market which means that our credit risk profile is different to others.

External challenges have included uncertainty in the macroeconomic environment related to Brexit, as well as rising consumer credit and increasing affordability pressures. The nature of competition in our core markets continues to evolve, accelerated by the pace of technological change and the dynamic nature of threats in the IT and cyber environments. Internally, we have seen a small number of operational incidents impact

on the Society’s risk profile, and the Committee has been focused on supporting management to ensure that our systems are built to last, that conduct matters are proactively identified and resolved and that our members receive the level of service they expect from Nationwide. As a result, we have recently repurposed the IT Strategy and Resilience Committee to become the Board IT and Resilience Committee and further detail can be found in that Committee’s report on page 73.

Whilst ensuring robust management of key risks, this year has seen the Committee support management in laying the foundations for future success through active support for the Society’s strategy, leading the way in enabling efficiency, and embracing innovation. The Committee has overseen the conscious further investment in the Society’s risk capability through recruitment of specialist skills and delivery of training, and continued to develop strong relationships with our regulators.

Tim Tookey
Chair – Board Risk Committee

Who sits on the Committee

Committee members	Number of meetings attended (eligible to attend)
Tim Tookey (Chairman)	8/(8)
Mitchel Lenson	8/(8)
Kevin Parry	8/(8)
Lynne Peacock	8/(8)

Regular attendees of the Committee include: Chairman of the Board, Chief Executive Officer, Chief Risk Officer, Chief Financial Officer, Chief Internal Auditor and representatives of PricewaterhouseCoopers.



Report of the directors on corporate governance *continued*

How the Committee works

The Board Risk Committee is a committee of the Society's Board and was in place throughout the year. It comprises four independent non executive directors whose attendance record is set out above. During the year there were two joint Audit and Board Risk Committee meetings to consider matters of common interest: the overall assurance plan; the annual compliance plan; the annual prudential risk management plan and the annual internal audit plan.

In addition to the regular attendees from management, the Committee invites subject matter experts to present on a variety of topics. Following each Committee meeting, updates were provided to the Board, summarising activities undertaken, areas where the Committee had challenged management and key decisions taken. Updates from the Committee to the Board were accompanied by reports from the Chief Risk Officer.

The Committee delegates responsibility for oversight and challenge of the day-to-day IT and resilience risk, control and oversight arrangements of the Executive, including the effectiveness of the control environment to the Board IT and Resilience Committee. The Board Risk Committee receives regular reports on IT related risk, resilience issues, IT-related risk decisions taken and other important matters to note (with copies of relevant papers made available to its members). More information can be found in the Board IT and Resilience Committee's report. The Committee also oversees the Executive Risk Committee, which is the management committee responsible for ensuring a co-ordinated risk management approach across all of the Society's risks.

A number of enhancements were recommended to the terms of reference, and the Board approved these in October 2017. The Committee reviewed its terms of reference, as part of an annual cycle, in March 2018, and confirmed that its activities over the previous 12 months were in line with its remit. More detail on the Committees' duties and responsibilities can be found within its terms of reference on the Society's website: nationwide.co.uk

The Committee's effectiveness is reviewed annually. Further details can be found in the Board effectiveness section on page 52.

Report on the year

The principal purpose of the Committee is to provide oversight on behalf of, and advice to, the Board in relation to risk-related matters. The Committee further provides advice, oversight and challenge to enable management to embed and maintain a strong risk culture throughout the Society.

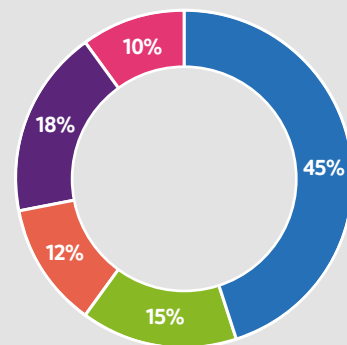
The Committee helps to ensure that the Society remains built to last by considering the current and emerging risk exposures at each meeting. During the year, the Committee also considered longer-term risks to delivering the Society's strategy and emerging issues that could present risks in the future.

During the year the Committee recommended the Society's Board risk appetite to the Board and throughout the year it also monitored performance against this, undertaking appropriate reviews on material risk issues to ensure that the Society remained within appetite. Should an appetite trigger or limit be breached, then more granular reviews would be conducted. In addition, under a delegated mandate from the Board, the Committee approved:

- the Enterprise Risk Management Framework (ERMF) which defines what risk management is and how it works at Nationwide
- the Society's risk strategy
- Pillar 3 disclosures
- the Society's recovery plan.

On behalf of the Board, the Committee also reviewed and approved the Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP) documents for the Society.

How the Committee spent its time in the year



- Prudential
- Operational¹
- Conduct and compliance
- Enterprise risk
- Other (including meeting administration)

¹ It should be noted that the Board IT and Resilience Committee also covers significant areas of operational risk oversight on behalf of the Board Risk Committee.



Report of the directors on corporate governance *continued*

Key areas/matters considered by the Committee during the year

The Committee balanced its agenda to continue to focus on standing areas of risk management whilst ensuring key risks were escalated for consideration during the course of the year.

As part of this, the Committee reviewed the Society's risk profile, facilitated by reporting and analysis from the Chief Risk Officer.

An outline of other key matters considered by the Committee in the year is broken down by risk category and set out below:

Area of focus	Committee's response
<p>Prudential risk</p>	<p>In the course of the year the Committee reviewed the performance of the Society's critical lending portfolios, including its approach to managing risk within its unsecured lending and buy to let portfolios. This included the approval of Nationwide's response to the Prudential Regulation Authority's (PRA's) statement on consumer credit – ensuring that the Society is managing its risks adequately and that they remain within the Board's approved risk appetite.</p> <p>The Committee reviewed a number of aspects of prudential risk as required by the PRA, including the Society's capital and liquidity adequacy (as reported in the ICAAP and the ILAAP respectively), the Pillar 3 risk disclosures, the recovery plan and associated regulatory reporting. Together these regulatory exercises have driven valuable learning for the Society, allowing it to consider how its strategy could be adapted to ensure the Society remains strong, resilient and built to last.</p> <p>The Committee supported management in further refining the Society's recovery plans based on a scenario rehearsal exercise completed in December 2017 and feedback received thereon from the PRA, prudential risk oversight and internal audit. As a result further improvements have been made including refinements to the 'playbook' and in the alignment across contingency plans.</p> <p>The Committee, via a sub-Committee, undertook a robust evaluation of the ability of the Society's business model to endure stress through:</p> <ul style="list-style-type: none"> • consideration of the Bank of England biennial exploratory scenario and annual cyclical scenario stress testing exercises • a review of the 2017 reverse stress test. <p>Through these processes, the Society was challenged to consider how it would react to a range of scenarios including the compression of profitability for a sustained period of time. The Committee considered how the Society would remain resilient and stable in such instances focusing on how its business model could be flexed to adapt, including:</p> <ul style="list-style-type: none"> • diversification through a number of means such as joint ventures and/or fintech propositions • progressing the Society's digital capabilities • focusing on customer segments that may be underserved at present • investing in, and making better use of, the Society's branch network which was seen as a key strength. <p>The Committee reviewed the strategic risks facing the Society through a standalone review. This looked at the longer term risks being considered by management to provide comfort that appropriate action was being taken to manage the risks identified.</p> <p>The Committee oversaw the effectiveness of the approach to risk management within the Society's efficiency programme, making sure that the Society is delivering value for members whilst not adversely affecting its ability to manage risks or aspiration to deliver legendary service.</p> <p>During the year the Committee reviewed the 2016 triennial funding valuation of the Nationwide Pension Fund and the associated de-risking strategy to continue to ensure that pension risk remains within Board risk appetite.</p>
<p>Operational risk</p>	<p>Whilst the Committee retains overall responsibility for Board oversight of all risks, and the recommendation and monitoring of Board risk appetite metrics for all risk categories, the Board IT and Resilience Committee provides oversight and challenge of the day-to-day IT and resilience risk, control and oversight arrangements of the Executive, including the effectiveness of the control environment. The Chairman of the Board IT and Resilience Committee provides regular reports on IT-related risk, resilience issues, IT-related risk decisions taken and other important matters. More information can be found in that Committee's report.</p> <p>The Committee separately reviewed key areas of operational risk exposure during the year including:</p> <ul style="list-style-type: none"> • the dedicated programme of work that was initiated in 2016 to address the General Data Protection Regulation (GDPR) requirements and to enhance members' data protection and privacy • how the Society supports colleagues in managing specific risks including insider threat and IT privileged access. <p>Both of these reviews were conducted to provide reassurance that the risks associated with keeping members' data secure are being managed appropriately by management.</p>



Report of the directors on corporate governance *continued*

Key areas/matters considered by the Committee during the year *continued*

Area of focus	Committee's response
Conduct and compliance risk	<p>The Committee has continued to champion the Society's approach to the ongoing embedding of conduct risk, meaning that Nationwide's products and processes are focused on delivering good customer outcomes. Reviews in the year were conducted to:</p> <ul style="list-style-type: none"> • assess the appropriateness of the Society's fraud refund policy, which is in place to support members when they face financial loss as a result of fraud • review conduct matters with a specific focus on considering the Society's approach to helping vulnerable customers and managing PPI complaints • provide insight into levels of customer indebtedness and outline areas of focus, to provide comfort that the Society continues to lend responsibly and that members' borrowings are at manageable levels. <p>The Committee also challenged management to ensure that the Society continues to be compliant with regulatory requirements including keeping pace with changes such as:</p> <ul style="list-style-type: none"> • Markets in Financial Instruments Directive II (MiFID II) regulation • BCBS239 (principles for effective data aggregation and risk reporting) • Open Banking – more information on this can be found in the Board IT and Resilience Committee report.
Enterprise risk	<p>On behalf of the Board, the Committee endorsed the Board's risk appetite which clearly sets out the amount and type of risk that the Board is comfortable with the Society taking. This is to ensure that it remains sustainable in the long term for all members' benefit. Within the parameters set by the Board's risk appetite, the Committee performed a regular review of the Society's risk performance to ensure that appropriate action was being taken and to inform consideration of risk adjustments to executive remuneration.</p> <p>The Committee approved a revised, and simplified, version of Nationwide's risk strategy during the year. This sets out the Society's approach to managing the emerging risk landscape over the medium to longer term. The Committee also reviewed the effectiveness of, and updates to, the ERMF, to ensure that steps being taken by management to simplify risk processes and improve their effectiveness were appropriate.</p> <p>In the year, the Committee received regular updates from the Society's second line oversight functions, considering the effectiveness of the first line risk management and control operation.</p> <p>The Committee also reviewed and satisfied itself that the Society's segregation of duties between the first and second lines of defence and satisfied itself that it is sufficiently robust to ensure that the Society's operational decisions receive appropriate, timely and sufficient challenge.</p>

The year ahead

Going forward the Society has ambitions to grow its lending portfolios in an increasingly competitive market, ensure its costs are controlled effectively, and continue to strengthen its IT resilience and cyber security whilst managing changing regulatory requirements. Delivering against these objectives will be challenging but these are the right areas to focus on for the benefit of the

Society's members – making sure that they are at the heart of everything Nationwide does. To support this ambition, over the next 12 months the Committee will continue to focus on the top and emerging risks, to monitor the macroeconomic environment, and to ensure the Society delivers what is required by regulators and other authorities – ensuring the Society is built to last.

Several pieces of complex regulation will also come into force during the year ahead. The Committee will continue to support and challenge management in addressing these requirements and in overseeing the strengthening of the Society's business operations, particularly with regard to operational resilience – ensuring that members' interests are safeguarded.


 Report of the directors on corporate governance *continued*


Board IT and Resilience Committee report

“It is my privilege to chair this Board Committee as it oversees the future technology roadmap for the Society whilst focusing our attention on ensuring that our members can interact with us securely and consistently”

Dear fellow member

The past year has been both an exciting and challenging time for your Society. Organisations across the globe have found themselves under pressure from more sophisticated cyber attacks than before. At the same time individuals are increasingly demanding more online facilities and transactions than ever before, with the Society demonstrating a credible record in keeping members, their money and their data safe. As a result, we recognise the need to be there for our members when they need us and on the occasions where we may fall short of expectations we work hard to ensure that any issues are fixed as soon as possible and not repeated.

In the year that we celebrated 20 years since Nationwide launched the first internet bank we are more determined than ever to enable you, our members, to transact with us in the way that best suits you and keep you safe when doing so by supporting initiatives such as **Take Five – To Stop Fraud**. With over 6 million current account holders registered for mobile and online banking services in March 2018, we have grown enormously but our challenge is still to balance our desire to build legendary service and cutting-edge innovation against the need for security.

Mitchel Lenson

Chair – Board IT and Resilience Committee

Who sits on the Committee

Committee members	Number of meetings attended (eligible to attend)
Mitchel Lenson (Chairman)	6/(6)
Mai Fyfield	6/(6)
David Roberts (until 20 March 2018)	6/(6)
Tim Tookey (until 31 August 2017)	2/(2)
Gunn Waersted (from 1 June 2017)	5/(5)

Regular attendees of the Committee include:

Chief Executive Officer,
 Chief Operating Officer,
 Chief Financial Officer,
 Chief Product & Propositions Officer,
 Chief Risk Officer,
 Chief Data Officer,
 Chief Transformation Officer,
 Chief Internal Auditor,
 Chief Compliance Officer and
 the Society's external advisers
 Conrad Prince and Oliver Bussmann.

The Society's other external advisers partner business areas and attend the Committee where their specific expertise is relevant and valuable to the Committee.



Report of the directors on corporate governance *continued*

How the Committee works

The Board IT and Resilience Committee is a committee of the Society's Board and was in place throughout the year – first as the IT Strategy and Resilience Committee and then, from March 2018, as the Board IT and Resilience Committee.

The Committee has a majority of independent non executive directors and their attendance record is set out above. The Committee is supported by six external experts who help the Society keep up to date with digital innovation, the mobile channel, payments, data, security and resilience.

Following each Committee meeting, the Chair of the Committee provided verbal updates to the Board and the Board Risk Committee. There were also two written updates submitted to the Board Risk Committee during the year.

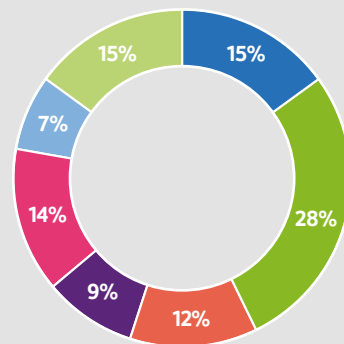
The Committee reviewed its terms of reference in October 2017 and again in March 2018 and confirmed that its activities over the previous 12 months were in line with its remit as set out in its terms of reference. Further enhancements have been made to the terms of reference including the re-purposing of the Committee.

The Committee's effectiveness is reviewed annually. Further details can be found in the Board effectiveness section on page 52.

Report on the year

To support the Society in focusing on technology development, data management and the need for resilience, the Committee (in agreement with the Board) has been re-purposed during the year. The Board IT and Resilience Committee supports the Board and the Board Risk Committee on a number of levels including overseeing the Society's IT and cyber-related risks, IT service delivery and the Society's data management strategy. It provides challenge to, and oversight of, the Society's management team's activities to ensure that the Society's technology delivers the best experience possible to its members. At the same time the Committee is focused on ensuring that the Society's online and mobile products are there when members need them, and keep their data safe. More detail on the Committee's duties and responsibilities can be found within its terms of reference on the Society's website: nationwide.co.uk

How the Committee spent its time in the year



- Service delivery and operational resilience
- Technology strategy and architecture
- Cyber and security
- Data and analytics
- Transformation delivery and operating model
- IT risk and controls oversight
- Other (including meeting administration)



Report of the directors on corporate governance *continued*

Key areas/matters considered by the Committee during the year

Area of focus	Committee's response
<p>Service delivery and operational resilience</p>	<p>The Committee reviewed IT service provision throughout the year considering incidents, root causes, solutions and strategic intent. As part of an annual review, the Committee was informed that total unplanned down time was on par with the previous year and that whilst year on year the number of incidents might have fallen, their complexity had increased. Where incidents have occurred management has reported on lessons learned with a clear view that any underlying complexity or issues be resolved to ensure the Society's IT is built to last.</p> <p>The Committee oversaw, and has supported, activity to manage the risk of IT service outages that might impact customer services and focused on ensuring that any mitigations took into account conduct risk – making sure the customer was treated fairly. The Committee also challenged management to further develop the use of customer experience as a metric for the impact of IT incidents.</p> <p>The Committee reviewed the Society's operational resilience and recovery times experienced during disaster recovery testing. In addition, the Committee has supported the introduction of a resilience implementation programme, building on the result of external review and challenge, to improve the Society's resilience. The Committee has challenged management to continue to develop in this regard.</p>
<p>Technology strategy and architecture</p>	<p>Technology strategy</p> <p>The Committee discussed with management the next steps in developing the Society's technology strategy, that would need to take into account:</p> <ul style="list-style-type: none"> • the vision for technology at Nationwide going forward • implications on the Society's operating model • finance and risk implications • the current state of the Society's technology estate • the development and investment by peers. <p>The Committee recognised that the pace of change in relation to technology is accelerating and that technology will play a larger role in shaping the retail financial services industry over the next ten years than it has over the past fifty. The Society will need to invest to move to a living technology model that will keep pace with change, ensuring suitable technology for its members. Alongside this the Committee reminded management of the need for simplification of IT systems. Looking to the future the Committee assisted management in prioritising its activity across strategic workstreams to make sure the Society manages its resources, and meets members' needs efficiently. The Committee also maintained its drive for further focus on resilience, cost, technical complexity and investment prioritisation to ensure the delivery of a technology strategy that would ensure the Society meets its members' needs.</p> <p>Open Banking</p> <p>Open Banking is an initiative led by the UK's Competition and Markets Authority (CMA). It is intended to create more competition in the banking industry and to encourage better services and more innovation to improve the banking experience – provided members have registered and given their express permission. The idea is to provide a new way for new entrants and online service providers to access the members' bank account (again, provided the member has registered for Internet Banking and given their express permission) and offer a range of online services, such as personalised financial products.</p> <p>It represents a fundamental change in how the Society serves its members, giving control and choice back to the individual. The Committee has challenged management to use this opportunity to improve customer journeys – making them easier and simpler whilst recognising that what works for one group of customers will not work for all.</p> <p>In January 2018 the Society made the decision to delay the introduction of its Open Banking solution to allow greater time to carry out further tests to make sure it offers the best possible service and that the capabilities meet the Society's security standards. Following an extended period of industry testing the Society launched its Open Banking approach in March 2018.</p> <p>Mobile banking</p> <p>The Society launched its current Mobile Banking app in 2016 and since then the Society has strived to develop its capability, including Touch ID and facial recognition support for the latest iPhone. During this time the Committee has supported the Society's management to continue to develop the app to meet members' requirements in a mobile world, resulting in features such as the ability to set up third party payments (which was released in December 2017). Alongside this the Committee has been focused on ensuring the app continues to develop in the form of a stable and resilient platform for users whilst delivering features that delight the Society's two million mobile customers.</p>



Report of the directors on corporate governance *continued*

Key areas/matters considered by the Committee during the year *continued*

Area of focus	Committee's response
Cyber and security	The last twelve months have seen a number of increasingly sophisticated attacks against systems worldwide, including successful hacks, ransomware and phishing attacks. The Society, supported by the Committee, continues to maintain and build its security capability to stay ahead of the cyber risks faced, taking a proactive approach to help keep members safe. The Society works with the wider industry and with the Government's National Cyber Security Centre to share good practice and understanding about new and evolving threats.
Data and analytics	The Committee has supported management in developing the Society's data strategy and its ambition to obtain rich, single source, easily accessible data that would support efficiencies for employees and improved interaction for members. The Committee continues to support and challenge management as the Society prepares for the new EU rules in the General Data Protection Regulation (GDPR) and the UK Data Protection Bill.
Transformation delivery and operating model	<p>Transformation</p> <p>The Committee has continued to review management's progress against the Society's strategic objectives, some of which are enabled by change activity. Particular focus was given to Board reportable programmes within the Society's Transformation Portfolio including:</p> <ul style="list-style-type: none"> • the transformation of the Society's high street presence which brings a new branch design to members • implementation of a new industry leading Treasury IT system. <p>In addition to Board reportable programmes the Committee has also focused on:</p> <ul style="list-style-type: none"> • change initiatives required by the Society's regulators • key technology enablers to ensure members are able to transact with the Society in the way they want to • building out legacy systems, ensuring the Society remains resilient. <p>Improved ways of working</p> <p>During the year the Committee has championed the Society's use of Agile working – bringing together individuals from across the Society with the aim of creating a more efficient and innovative working environment. By streamlining decision making the Society has made progress towards improving processes for customers for products such as retail mortgages.</p>
IT risk and controls oversight	<p>Second line, third line and external reviews</p> <p>As a matter of routine, independent reviews from the Society's second and third line (Oversight and Internal Audit functions) are presented and discussed at each meeting which has developed the Committee's awareness and understanding of thematic issues identified through oversight and internal audit reviews. This, in turn, has helped the Committee in championing the need for the Society's first line (business areas responsible for the day to day work) to identify and own risks and the need for teams to work across the Society to deal with underlying issues.</p> <p>During the year the Committee has also received reports from external reviews of the Society's operational resilience (by Ernst & Young) and cyber security (by PricewaterhouseCoopers) which have enabled it to hold management to account against best practice in the field and shape development plans going forward to ensure the Society continues to effectively balance the features members desire against the need to keep them, the Society and its data safe.</p>

The year ahead

In the year ahead the Committee will continue to provide oversight, challenge and advice on a range of IT, cyber and data issues. It will be a challenging year with the advent of new regulatory requirements needing to be carefully balanced to ensure the best outcome for members. The Committee will also continue with its transformation programme, which has

been shaped to ensure the most critical elements of the Society's strategy are supported. This includes investment to continue to meet regulatory change and mitigate IT and property operational risks, prioritising discretionary spend to deliver improved branch and digital facilities for members, whilst at the same time

ensuring the Society makes best use of members' money. The Committee will also continue to champion how the Society delivers change in a more efficient way. This will mean delivering change at a greater pace through empowered change teams, led with a sense of ownership felt by the Society's communities.

Report of the directors on corporate governance *continued*

Nomination and Governance Committee report

“The Nomination and Governance Committee focuses on the long-term health of the Society by ensuring we have the right people, capability and management structures to deliver for members today, whilst at the same time building the leadership talent for the future”

Dear fellow member

This year Board members have been heavily involved in matters overseen by the Nomination and Governance Committee, including leadership, succession and diversity.

Several Board directors were engaged in the Society’s new flagship leadership development programme called Leading for Mutual Good. I was privileged to have the opportunity to share perspectives on leadership for the future and learnings from my career at the three and a half day immersive events and was inspired by my interactions with the participants, particularly with our People’s Choice representatives – more on this later in the report. With the increased focus on leadership for the future, we can feel confident that we are building the talent we need for robust succession, enabling the Society to continue to flourish.

The Committee has encouraged boldness in the pursuit of greater diversity and inclusion across our Society. This is an area where we recognise that there is more work to do. I’m delighted that non executive director,

Baroness Usha Prashar, stepped forward to sponsor the agenda and supported many of our equality, diversity and inclusion activities over the year.

We continued to focus on strengthening the composition and effectiveness of the Board and I’m now looking forward to seeing the impact of our plans to amplify the voice of members and employees in the Boardroom. The Committee’s attention to matters of corporate governance ensured that the Society continued to demonstrate best practice and supported the development of a more proactive approach by the Society to participating in national policy consultations.

The Committee took a progressive stance over the year and I’m confident that positive action on all our areas of focus has made a strong contribution to our purpose and strategy and a positive cultural impact on our Society.

David Roberts
Chair – Nomination and Governance Committee

Who sits on the Committee

Committee members	Number of meetings attended (eligible to attend)
David Roberts (Chairman)	7/(7)
Kevin Parry	6/(7) ¹
Lynne Peacock	7/(7)
Tim Tookey	6/(7)

Regular attendees of the Committee include:
Chief Executive Officer,
Chief People Officer,
Chief Legal Officer & Society Secretary,
Head of Corporate Governance and Director, Engagement & Leadership.

¹ This reflects the fact that one meeting was arranged at short notice.



Report of the directors on corporate governance *continued*

How the Committee works

The Nomination and Governance Committee is a committee of the Society's Board and was in place throughout the year.

The Committee has a majority of independent non executive directors and their attendance record is set out above. Following each Committee meeting, the Chair of the Committee provided verbal updates to the Board.

The Committee reviewed its activities over the previous 12 months, confirming that they were in line with its remit as set out in its terms of reference. A number of enhancements were recommended to the terms of reference, and the Board approved these in October 2017. A copy of the Committee's terms of reference can be found on the Society's website: nationwide.co.uk

The Committee's effectiveness is reviewed annually. Further details can be found in the Board effectiveness section on page 52.

Report on the year

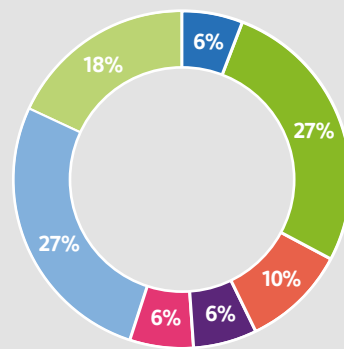
Developing strong leadership capability was a key focus of the Committee during the year. The Committee was pleased to see the formation of a Leadership 200 group and a renewed leadership development proposition, including a flagship programme called Leading for Mutual Good. In an unparalleled move, the composition of the group included a number of award winners elected by colleagues from across the Society. The leadership award winners are known as the People's Choice. Their diverse perspectives had a positive impact on the learning experience for all and the Society is already leveraging their potential and that of the wider group to drive forward strategy initiatives. Members of the Board have been actively involved in the programme, with several participating in the 'Board style' presentations that represent the finale of the events.

In addition, the Committee reviewed the robustness of the Society's succession plans and the health of the talent pipeline on a regular basis. The Society's succession plans informed appointment decisions throughout the year and the pipeline has been rebuilding in line with the changes made to the shape and design of the organisation last year. The Committee also provided sponsorship for the diversity and inclusion agenda, which includes both diversifying the internal talent pipeline and targeted recruitment activity.

The introduction of various new industry wide regulatory regimes that focus on the organisation, structure and accountabilities of directors and senior managers involved significant activity for the Committee. Nationwide's response to the requirements centred on the mapping of senior manager accountabilities in line with the prescribed regulatory functions, oversight of the annual Financial Conduct Authority determined certification process for individuals and the wider embedding of the associated Conduct Rules.

The Committee continued to focus on strengthening the composition of the Board. The appointment of Gunn Waersted during the year is one way the Board has enhanced its overall mix of experience and skills. During the year, the Society increased its broader influence by providing input reflecting the specific issues of the mutual sector to national policy consultations including the Financial Reporting Council's (FRC) review of the UK Corporate Governance Code (the Code). Nationwide's size and scale, backed by its strong reputation for 'doing the right thing', means its voice is listened to by policy makers.

How the Committee spent its time in the year



- Leadership, talent and succession
- Executive resourcing and retention
- Diversity and inclusion
- Board composition and effectiveness
- Individual accountability regimes
- Governance and regulatory requirements
- Other (including meeting administration)



Report of the directors on corporate governance *continued*

Key areas/matters considered by the Committee during the year

Area of focus	Committee's response
<p>Leadership</p>	<p>The Committee has a key role in sponsoring the development of the Society's leadership capability to meet identified current and future needs. To support this the Committee considered the requirements for leadership in the context of the Society's purpose, strategy and target culture. These factors have been expressed through a leadership framework that underpinned the newly formed Leadership 200 group and a refreshed development proposition, including the Leading for Mutual Good programme. The Committee endorsed the programme and several Board directors have been actively involved in its delivery. The Committee also supported the inclusion of People's Choice individuals in the composition of the Leadership 200 group and Leading for Mutual Good programme.</p>
<p>Talent and succession</p>	<p>Guided by the Committee, a closed session of the non executive Board members took place early in the year and concluded that effective emergency succession plans were in place for all Executive Committee roles. For longer term succession plans, the position was more mixed with some roles having good options and other roles requiring targeted market mapping to identify possible external candidates. It was noted that the recent organisational design changes had proven that the Society can develop and promote its own talented people and the resulting appointments, supplemented by strong external appointments, needed to be consolidated.</p> <p>The Board expressed a desire to engage in the development of the Society's talent in a range of ways, which has been achieved through the leadership work referenced above and other interactions. The Society's top talent continues to be supported through career conversations with Executive Committee members and the pipeline talent through well-established development programmes. The commitment to monitor succession through the year was delivered through updates to the Committee.</p>
<p>Executive resourcing</p>	<p>The Committee receives updates at every meeting on leavers, vacancies and appointments in the senior executive population. The Committee recognised that this population continued to be stable given levels of retention during the year, whilst recruitment activity in support of the Society's strategic organisational design changes progressed well. This suggests that Nationwide's ability to attract, retain and move talent appears healthy, despite a competitive job market and changes to reward arrangements. In addition, the Committee was pleased to see lower recruitment costs due to increasing internal search and selection activity and more diversity in the candidate pool, particularly in the latter half of the year.</p>
<p>Diversity and inclusion</p>	<p>The Committee heard progress updates on the Society's diversity and inclusion agenda, which showed the Society was on track to meet its 2020 targets for disability and gender. This was endorsed through the achievement of the Gold Standard in the Employers Network for Equality & Inclusion (ENEI) Benchmark and Level 2 accreditation in the Disability Confident Award.</p> <p>However, the Society was shown to be tracking below target for Black, Asian and Minority Ethnic (BAME) representation at senior levels. The Committee challenged management on this, asking for deeper dives on the matter of BAME diversity and encouraging bolder positive action in recruitment activity, which has started to yield better results. On advice of the Committee, BAME and non-BAME focus groups were held to help increase the Society's understanding of barriers and opportunities to inform its forward agenda. The Committee also secured the sponsorship of non executive director, Baroness Usha Prashar, to support the diversity and inclusion agenda. Usha was involved in the Society's diversity and inclusion week in February 2018, which secured wider participation than previously, showing growing support across the workforce.</p>

Report of the directors on corporate governance *continued*

Laura leader of the year Developing talent

Laura has been with the Society for 17 years – starting out with a Saturday job in the Port Talbot branch. She is now Director of Strategy and Governance in the People and Culture Community. Laura reports to a member of the Society's Executive Committee and in 2017 she was named as the Society's leader of the year.

"I started my career in Nationwide by working part time in the Port Talbot branch whilst training as an accountant with an apprenticeship at a local steel manufacturer. Unfortunately, when I was three quarters of the way through, due to wider cost pressures, funding was pulled. My manager at Nationwide was incredibly supportive and suggested that I look into working full time for the Society. As a result, I moved to Swindon and spent the next seven years undertaking a variety of roles within the Society's finance function. The Society supported me through the remainder of my exams and in 2008 I received my ACCA qualification.

I've since spent four years in the Society's strategy and planning function and the last five years in People and Culture. In both of these

areas I've needed to move away from technical accounting and into areas more focused on relationship building and networking. My line managers have been helpful in working with me to see where I might be able to use my skills, and learn something new.

The most challenging thing I've had to do, perhaps also the most personal, was returning from maternity leave. I now work four days a week as I was very conscious that I wanted to balance being a mum and my career. It's an incredible challenge and there is flexibility on both sides in making this work. I don't think my career choices or potential has changed since having my son and choosing to work part time. I think being awarded Leader of the Year 18 months after returning from maternity leave demonstrates the Society doesn't think it's changed either!

I think my biggest career learning to date is that you have to make the most of development opportunities. There are lots here and it's not just training courses but on the job learning and work shadowing too. Alongside this you have to be willing to take a risk, try something new and really push yourself out of your comfort zone."



Report of the directors on corporate governance *continued*

Key areas/matters considered by the Committee during the year *continued*

Area of focus	Committee's response
<p>Board composition</p>	<p>The remit of the Nomination and Governance Committee includes ensuring the Society has the right mix of knowledge, skills and behaviours on the Board for it to be effective in delivering its responsibilities to provide oversight and governance of the Society and to safeguard the interests of its members. The Committee has also considered how developing best practice, such as that set out in the FRC review of the Code may impact both the Board and its committees.</p> <p>This year the Committee concluded that the risks previously identified regarding the technology-related competency areas had been mitigated through the engagement of external advisers to the Board IT and Resilience Committee.</p> <p>In addition, options were identified for emergency succession for committee roles and other responsibilities, including those roles deemed to have a senior manager function under the regulatory regime.</p> <p>The Committee also considers the Board's current and future composition to understand the requirements for non executive appointments and manages the selection process. All appointments are subject to extensive external checks. Gunn Waersted joined the Board in June 2017 following a search supported by an independent search firm. As with all new directors, Gunn underwent a comprehensive induction programme, designed to help her understand Nationwide, the mutual ethos, and to accelerate her contribution to the Board.</p>

Inducting a new non executive director Gunn Waersted joined 1 June 2017

"The induction programme proved to be essential in bringing me up to speed on key topics. As I have a broad experience from financial services in general, but not from the UK market nor Nationwide, there were two parts of the induction programme which were of special interest to me: the parts covering UK financial market specifics like regulatory framework and competitive positioning; and the Nationwide specifics.

I am a strong believer in culture being the key to delivering long term financial results as well as customer satisfaction – or to use the Nationwide terminology – member satisfaction. The deeply rooted member centricity expressed by the many employees I met during the programme was impressive. The induction programme was very comprehensive, well structured and a good mixture of presentations and dialogues, and left me with a good understanding of the position and characteristics of our Society.

One year on I'm enjoying being part of the Nationwide Board. There is a strong spirit of dedication, engagement and collaboration. I find the Board and management to be open and transparent not only on areas of progress, but even more importantly on the challenging parts. And there are for sure a lot of important challenges to tackle: digitalisation, cyber risks, tougher competition and changing customer behaviour just to mention a few.

I am a member of the Board IT and Resilience Committee, and we are exploring the theme of building digital relationships alongside the physical world of customer interfaces. Mastering the requirements and expectations from both existing and future members will be key to informing our approach and I look forward to continuing our discussions on this topic and focusing on our aspiration to deliver legendary service to our members."





Report of the directors on corporate governance *continued*

Key areas/matters considered by the Committee during the year *continued*

Area of focus	Committee's response
<p>Corporate governance</p>	<p>Throughout the year the Committee has exercised oversight of the Society's governance arrangements on behalf of the Board. This has included reviewing and approving the Nationwide Governance Manual, which sets out how the Society's governance operates. Looking externally, the Committee input into the Society's response to the FRC's review of the Code, highlighting the advantages of the mutual model. A copy of the Society's consultation response can be found on the Society's website: nationwide.co.uk</p> <p>Looking to align with developing best practice the Committee also informed plans for strengthening the employee voice in the Boardroom. This has included considering the nomination of a non executive director charged with specific responsibility for representing employees, People's Choice individuals attending Board sessions and greater engagement of the Board with the Nationwide Group Staff Union amongst other initiatives. The Society believes this approach champions best practice and is in line with the strategy of building PRIDE, which is at the core of the Society's shared purpose in building society, nationwide.</p>
<p>Individual accountability regimes</p>	<p>The Committee continued to focus on regulatory requirements to ascertain fitness and propriety of relevant individuals and ensure senior manager responsibilities were allocated appropriately. As part of its oversight role, the Committee noted the rigour with which Nationwide had responded to the regimes within the first year of their introduction by the regulator and agreed that the interventions and processes established for the Senior Manager Regime were working well. The annual certification process was completed in two phases with only a small number of individuals needing to be supported. The Committee was also satisfied that Conduct Rules were embedded in employee relations policies and processes.</p>

The year ahead

The Committee will continue to play an active role in advancing all the areas outlined in this report. In particular, it will focus on embedding the Society's approach to intensifying the voice of members and employees in the Boardroom, ensuring Nationwide continues to have its finger on the pulse when making decisions. Alongside this it will continue to help the Board and Society to strive for excellence and develop its corporate governance framework in line with

emerging best practice. The Committee will also be paying close attention to succession plans and the development of the Society's talent so that the Society has a team of leaders and future leaders that are committed to Nationwide's purpose, are highly skilled in understanding and meeting members' evolving needs and who can shape the Society's future culture and strategy. In doing so, the Committee will increase its focus on diversity

and inclusion, with continued commitment to the achievement of Nationwide's gender targets and actions to address its gender pay gap, as well as being bolder with plans to strengthen Black, Asian and Minority Ethnic (BAME) representation. In this way, the Society will have the people it needs to fully represent Nationwide's membership and bring fresh and different perspectives to the execution of the Society's ambitions.



Report of the directors on remuneration

"I am pleased that we have a remuneration structure which unites everyone in the Society behind a set of common goals - service, growth and efficiency - which are important to our members and employees alike"

For the year ended 4 April 2018

Dear fellow member

I am pleased to present the Remuneration Committee's report, including details of our directors' pay for the year to 4 April 2018. It is an important subject, as remuneration plays an instrumental role in how Nationwide Building Society both attracts and retains your management team.

Our approach

As a mutual, our approach to reward is different, reflecting our commitment to create a remuneration structure that is aligned with our members' interests. Variable pay for everyone employed by the Society is based on the achievement of goals such as the growth of our membership and service quality, things you have told us are of critical importance to you and are also linked to our core purpose – building society, nationwide. This is what drives our team culture.

Most of the performance related reward for our senior managers is deferred for up to seven years, which means that their money is 'at risk' over a period of time. This allows us to take into account their and the Society's performance over both the short and long term.

People join the Society for a number of reasons beyond the financial, and in overall terms we pay less than the market for our executive team, relative to their peers in large financial service businesses. However, we must accept that we operate in a competitive market and have to recognise that we compete for talent. We do that by looking at base pay and benefits which reflect these market realities.

We voluntarily disclose details of our executive pay arrangements to the extent it is appropriate for us to do so as a mutual.

Our policy

Our remuneration policy was approved by our members in 2017, and sets the framework for our directors'

remuneration. Last year we moved to an approach where all employees, including our executive directors, are assessed based on the same measures in relation to their variable pay. In addition, our most senior team have tailored team and personal goals which feed into their annual performance award. This will continue to apply in 2018/19. Further details of the structure of our remuneration plan for the executive directors are set out in this report.

How the directors have performed

We have continued to deliver strong performance this year, driven by consistent focus on our key goals of growth of membership and service. We have grown our engaged members to 8.14 million and we have made £105 million in sustainable saves against our target of £100 million, showing our progress across the Society in improving efficiency. We remain ahead of our customer satisfaction target for the year and our trading performance has been strong, with record gross lending over 2017/18 and a record number of new current accounts opened.

The impact on directors' performance pay

Our strong results have led to payments being awarded under the Directors' Performance Award (DPA). Details of how these payments have been calculated, including the discretion applied by the Committee, are set out in this report. In achieving these targets, the Committee considers that our directors have continued to deliver real benefits for the Society and all our members.

On behalf of the Remuneration Committee, I recommend that you support our Annual Report on Remuneration.

Lynne Peacock

Chair – Remuneration Committee



Report of the directors on remuneration *continued*

Who sits on the Committee

The members of the Remuneration Committee are all independent non executive directors of the Society and include a member of the Board Risk Committee.

Regular attendees of the Committee include: the Chief Executive, the Leader of People & Culture, the Director of Reward and Pensions and Deloitte LLP, our independent external consultants who were appointed by the Committee following a tender process. Deloitte also provided tax, financial advisory, risk, internal audit and consulting services to the Society during the year. The Committee is satisfied that the advice received is objective and independent, and reviews annually all other services provided by Deloitte to ensure this continues to be the case. Their fees for advice provided to the Committee during 2017/18 were £252,900.

Committee members	Number of meetings attended (eligible to attend)
Lynne Peacock (Chair)	8/(8)
David Roberts	8/(8)
Rita Clifton	6/(8)
Usha Prashar	7/(8)

The Remuneration Committee is supported by the Board Risk Committee on risk related matters including performance pay plan design, the assessment of specific performance measures, and wider issues relating to risk and controls. The Remuneration Committee is also supported by and receives input from the Audit Committee. In no case is any person present when their own remuneration is discussed.

How the Committee works

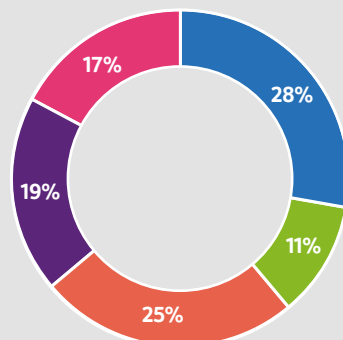
The Remuneration Committee is responsible for determining and agreeing with the Board the remuneration strategy, policy and the specific remuneration packages for the Chairman, the executive directors and other members of the Executive Committee of the Society as well as any other employees who are deemed to fall within scope of the PRA/FCA Remuneration Codes. This includes approving the design of, and determining the performance targets for, the discretionary performance pay plan operated by the Society for the benefit of employees within the Committee’s remit, and approving the total annual payments under such plan.

The Committee also oversees the remuneration policy throughout the Society, with a specific focus on the risks posed by remuneration policies and practices. As part of its oversight role, the Committee receives an update on the pay policies for the wider workforce at least annually.

The Committee’s terms of reference were last reviewed and updated in April 2018. The full terms of reference are available on the Society’s website. The Committee’s effectiveness is reviewed annually.

Report on the Year

How the Committee spent its time in the year



- Performance award outcomes, including consideration of risk adjustment
- Pay strategy and approach for the year
- Remuneration Committee oversight of remuneration across the Society
- Regulatory reporting
- Procedural issues



Report of the directors on remuneration *continued*

Key areas/matters considered by the Committee during the year

Area of focus	Committee's response
Alignment of Remuneration across the Society	The Committee undertook a review of our approach to remuneration across the Society for 2017/18 under which all employees are rewarded for the same achievements under one performance pay plan aligned to our cornerstones and which supports the Society's team culture
Performance Targets	The Committee agreed the performance targets for awards to be made under the Directors' Performance Award (DPA) taking into account the Society's plan
Outcome of DPA	Taking into account input from the Board Risk and Audit Committees, the Committee reviewed and approved the outcome of the DPA to be paid in respect of the year
Base Pay Review	Agreed base salary increases for executive directors
Evolving Regulation	Ongoing work in relation to the PRA/FCA Remuneration Codes and other corporate governance matters and how they apply to Nationwide as a mutual
Directors' Remuneration Report	Approved the Directors' Remuneration Report including the implementation of the remuneration policy for 2018/19
Material Risk Taker (MRT) Identification	Reviewed and approved the identification approach and list of employees who fall within the scope of the PRA/FCA Remuneration Codes

Annual Report on Remuneration – Directors' Performance Award (DPA)

The DPA was the only performance award in which executive directors participated in 2017/18. The DPA is aligned to the key deliverables for the Society and the measures reflect three of the five strategic cornerstones.

The maximum potential award level for 2017/18 was 152% of salary for the Chief Executive and 112% of salary for other executive directors, which has reduced from 160% and 120% respectively in 2016/17.

The all-employee element of the performance pay plan rewards the attainment of challenging strategic and financial metrics drawn from the Society's plan. The senior element also incorporates an amount based on individual performance and behaviours. The Society measures fall within the following broad areas and ensure focus on delivering benefits for our members:

Society measures – Three strategic cornerstones

Building Thriving Membership – Number of engaged members

Building Legendary Service – Customer service satisfaction rating

Built to Last – Sustainable cost savings

+

Individual performance

Objectives reflecting each individual's contribution towards the delivery of the Society's plan as well as individual conduct and behaviours

For the Chief Executive, 28% of the award is based on individual objectives. For the other executive directors, this is 27% of the award.

Payments are made at the discretion of the Remuneration Committee who may reduce or cancel payments if we believe that the plan outcomes are not representative of the overall performance of the Society. The Society also has the ability to claw back performance pay awards for up to ten years after they were awarded in some circumstances.



Report of the directors on remuneration *continued*

Outcomes for DPA 2017/18

Two gateways must be passed before any payment is made under the plan, based on measures of statutory profit and leverage ratio. These gateways were achieved in 2017/18. The Board must also be satisfied that there are no significant conduct, risk, reputational, financial, operational or other reasons why awards should not be made. In reviewing performance under the DPA during 2017/18, the Committee then assessed the Society's performance against three equally weighted measures:

Cornerstone/Measure	Performance target range: threshold – maximum	Performance relative to targets	Outcome	Performance pay achieved (% of salary)	
				Chief Executive	Executive directors
Building Thriving Membership – Number of engaged members	7.75 million - 8.54 million	Target	8.14 million customers	23.5	18.9
Building Legendary Service – Customer service satisfaction rating	1st – 1st + 4%	Maximum	1st in our high street peer group with a 4.6% lead ¹	36.7	27.3
Built to Last – Sustainable cost savings ²	£80 million - £140 million	Above target	£105 million	25.5	20.2
Individual performance element (see further detail below)				28.5	22.0 - 25.5
Total performance pay achieved based on Society performance (prior to Remuneration Committee adjustment)				114.2	88.4 - 91.9
Remuneration Committee discretionary performance and risk assessment – In addition to the measures above, in determining overall award levels, the Committee considered a broad range of factors and for 2017/18 decided to apply a downward adjustment of 7.5% to the total value of performance pay achieved (as set out in the totals above)					
Total performance pay achieved based on Society performance (after Remuneration Committee adjustment)				105.6	81.8 – 85.0
Out of a maximum opportunity (as a % of salary) of:				152	112

¹ © GfK 2018, Financial Research Survey (FRS), 12 months ending 31 March 2018, proportion of extremely/very satisfied customers minus proportion of extremely/very/fairly dissatisfied customers summed across current account, mortgage and savings. High street peer group defined as providers with main current account market share >4% (Barclays, Halifax, HSBC, Lloyds Bank (inc C&G), NatWest, Santander and TSB).

² Subject to remaining within an adjusted cost position of £1,910 million after excluding costs of incremental investment relating to our efficiency programme.

For the element based on individual performance, performance has been assessed against both the delivery of the Society performance scorecard as well as individual goals, conduct and behaviours. The outcome of the Committee's assessment was as follows:

Executive director	Performance pay achieved (% of salary)/maximum available	Comments
J D Garner	28.5/42	A good performance with elements of above target outcomes reflecting strength of leadership across a range of strategic, financial and non-financial objectives resulting in another successful year for the Society
T P Prestedge	25.5/30	An above target performance reflecting strong delivery across both Retail and IT making significant enhancements to the in-branch member experience, cyber security and open banking
M M Rennison	22/30	A good performance with elements of above target outcomes reflecting the strength of our underlying financial results alongside significant progress on costs, efficiency and the Finance and Treasury change agenda
C S Rhodes	23/30	A good performance with elements of above target outcomes following record gross lending, growth in number of engaged members, and strong development across a number of product lines which has been reflected in our FRS scores

For awards in respect of 2017/18, 20% of the award is payable in June 2018 with 20% retained until June 2019. The remaining 60% is deferred, payable in five equal amounts between years three and seven following the date of award. 50% of the upfront portion and 60% of the deferred portion is linked to the performance of the Society's core capital deferred shares (CCDS). These elements are payable in cash subject to a 12 month retention period.



Report of the directors on remuneration *continued*

Executive directors' remuneration

Where indicated, the tables in the following sections have been audited by PricewaterhouseCoopers LLP.

These disclosures are included in compliance with the Building Societies Act 1986 and other mandatory reporting regulations, as well as the Large and Medium-Sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013, which the Society has voluntarily adopted.

The table below shows the total remuneration for each executive director for the years ended 4 April 2018 and 4 April 2017.

Single total figure of remuneration for each executive director (£'000)					
2018 Executive directors (Audited)	Fixed remuneration			Variable remuneration (note iii)	Total pay package
	Salary (note i)	Benefits (note ii)	Pension allowance		
J D Garner	855	217	342	903	2,317
T P Prestedge	580	146	191	493	1,410
M M Rennison	625	189	206	511	1,531
C S Rhodes	580	68	191	480	1,319
Total	2,640	620	930	2,387	6,577

Single total figure of remuneration for each executive director (£'000)							
2017 Executive directors (Audited)	Salary	Benefits (note ii)	Pension allowance	Variable remuneration (note iii)	Buy-out award (note iv)	Total pay package including buy-out award	Total pay package excluding buy-out award
J D Garner	840	181	336	958	1,071	3,386	2,315
T P Prestedge	560	87	185	496	-	1,328	1,328
M M Rennison	614	152	203	523	-	1,492	1,492
C S Rhodes	568	50	187	484	-	1,289	1,289
Total	2,582	470	911	2,461	1,071	7,495	6,424

Notes:

- As disclosed in last year's report, salaries were increased with effect from 1 April 2017. J D Garner and M M Rennison received an increase of 1.8%, C S Rhodes 2.1% and T P Prestedge 3.6%.
- Benefits include private medical cover, car allowance and the use of a company vehicle and driver when required for business purposes.
- Variable remuneration consists of the awards under the DPA. Details of this plan and associated performance measures are set out earlier in this report.
- This buy-out figure represents two elements: i) the initial total value of a deferred award linked to the value of the Society's core capital deferred shares (CCDS), 74% of which was paid in 2016/17 with the remaining 26% paid in March 2018; and ii) cash payments totalling £589,029 paid in four instalments between July 2017 and August 2018. The buy-out awards do not form part of ongoing remuneration.

Executive directors' pensions

M M Rennison is a deferred member of the Society's defined benefit scheme. He did not accrue any additional pension entitlement during the year. The change in accrued pension shown in the table below is as a result of inflationary increases that are required by legislation. The increase in transfer values over the year reflect changes in the assumptions used to calculate pension transfer values for individual pension fund members. For M M Rennison the benefit accrued prior to 1 April 2011, the Normal Retirement Age is 60 and for his benefit accrued between 1 April 2011 and 30 June 2011, his Normal Retirement Age is 65.

Table of the value of pension benefits for executive directors (£'000)								
Executive directors (Audited)	Accrued pension at 4 April 2018 (a)	Accrued pension at 4 April 2017 (b)	Transfer value at 4 April 2018 (c)	Transfer value at 4 April 2017 (d)	Change in transfer value (c)-(d)	Additional pensions earned in year (e)	Transfer value of the increase	Directors' contributions in year
M M Rennison	60	59	1,764	1,583	181	-	-	-

Note:

- The transfer value basis is set by the Nationwide Pension Fund Trustee. Since 4 April 2017 the Trustee has reviewed the transfer value basis that is applicable to all Fund members, including Directors. The transfer values at 4 April 2018 reflect this updated basis as well as the financial conditions at the calculation date.

Explanations:

- and (b) show deferred pension entitlement at 4 April 2018 and 2017 respectively.
- is the transfer value of the deferred pension in (a) calculated at 4 April 2018.
- is the transfer value of the deferred pension in (b) calculated at 4 April 2017.
- is the increase in pension built up during the year. A zero figure means that, after allowing for inflation, no additional pension was built up.



Report of the directors on remuneration *continued*

Chairman and non executive directors

The fees for the Chairman and non executive directors were last reviewed in March 2018. Inflationary increases of around 1.5% have been made to both the Chairman fee and the basic fee for non executive directors. The membership fee for the Nomination and Governance Committee has also been increased to reflect responsibilities and to bring this fee closer to the market.

Fee Policy		
	Fees for 2018/19	Fees for 2017/18
	£'000	£'000
Chairman	395	389
Basic fee	67	66
Senior Independent Director (note i)	40	40
Chairman of the Audit, Board Risk or Remuneration Committee	35	35
Member of the Audit, Board Risk or Remuneration Committee	15	15
Member of the Nomination and Governance Committee	6	5
Chairman of the IT Strategy and Resilience Committee	25	25
Member of the IT Strategy and Resilience Committee	10	10

Note:

i. The Senior Independent Director fee is inclusive of committee membership fees. Committee Chairmen fees will continue to be paid.

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

Single total figure of remuneration for non executive directors

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

Single total figure of remuneration for non executive directors		
	2018 Society and Group fees	2017 Society and Group fees
(Audited)	£'000	£'000
D L Roberts (Chairman)	389	383
R Clifton	96	95
M Fyfield	76	74
M A Lenson	106	105
K A H Parry (note i)	121	99
L M Peacock (Senior Independent Director) (note ii)	141	138
R K Perkin (Senior Independent Director) (note ii)	-	43
U K Prashar (note iii)	81	16
T Tookey	125	130
G Waersted (note iv)	63	-
Total	1,198	1,083
Pension payments to past non executive directors (note v)	251	252

Notes:

i. K A H Parry joined the Board on 23 May 2016.

ii. L M Peacock succeeded R K Perkin as Senior Independent Director on 21 July 2016.

iii. U K Prashar joined the Board on 18 January 2017.

iv. G Waersted joined the Board on 1 June 2017.

v. The Society stopped granting pension rights to non executive directors who joined the Board after January 1990.



Report of the directors on remuneration *continued*

Additional Disclosures

Chief Executive remuneration for the past nine years

The table below shows details of the Chief Executive's remuneration for the previous nine years.

Financial year	Total remuneration £'000	Annual performance pay earned as % of maximum available	Medium term performance pay earned as % of maximum available
2017/18	2,317	69.5	- (note i)
2016/17	3,386 (note ii)	71.9	- (note i)
2015/16	3,413 (note iii)	75.8	80.8
2014/15	3,397 (note iii)	74.4	84.5
2013/14	2,571	83.3	74.9
2012/13	2,258	60.6	41.7
2011/12	2,251	60.6	40.7
2010/11	1,961	75.4	76.9
2009/10	1,539	33.8	61.7

Notes:

- Medium term performance pay ceased at the end of 2015/16.
- Joe Garner commenced his role as Chief Executive on 5 April 2016. His total remuneration for 2016/17 included the value of buy-out awards on joining (2017: £1,070,752). These awards do not form part of ongoing remuneration. If this amount is excluded, the figure for 2016/17 would be £2,315,047.
- The Chief Executive in 2015/16 and all previous financial years shown in the table above was Graham Beale. His total remuneration for 2015/16 and 2014/15 includes awards under the DPA as well as legacy payouts under the directors' previous medium term pay plan as a result of the transition period between plans.

Change in remuneration of Chief Executive

The change in remuneration (base salary, benefits (including pension) and annual performance pay only) for the Chief Executive from 2016/17 to 2017/18 compared to the average for all other employees is shown in the table below. The Society introduced an all-employee performance pay plan with effect from 1 April 2017 to replace a number of specialist schemes. The alignment of the target award has seen a reduction in the overall average employee annual performance pay but an increase in fixed pay. This increase has been partially offset by a reduction in the number of senior employees in the Society, reducing average employee pay.

	Salary	Benefits	Annual performance pay
Chief Executive	1.79%	8.12%	-5.73%
Average employee	2.85%	11.20% (note i)	-18.72%

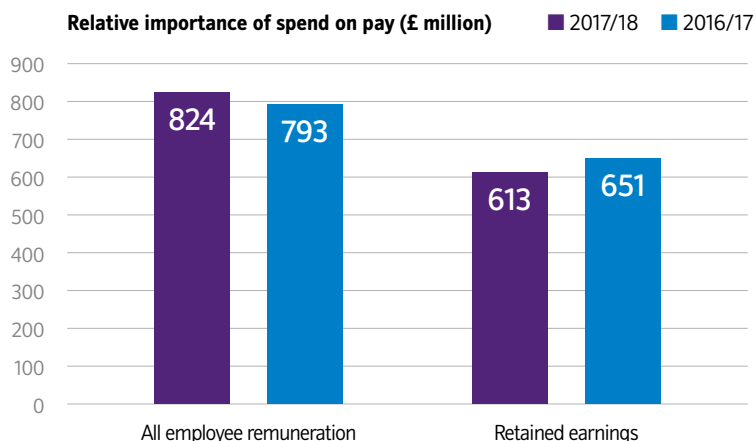
Note:

- Every three years defined benefits schemes undertake a valuation. Following the conclusion of the valuation, the employers' contribution increased from 22.1% to 31.5% with effect from 1 September 2017. The main reasons for this increase in cost is a substantial fall in long-term interest rates and increases to long-term inflation expectations.

Relative importance of spend on pay

The chart opposite illustrates the amount spent on remuneration paid to all employees of Nationwide Building Society, compared with retained earnings.

Payroll costs represent 40.7% (2017: 39.2%) of total administrative expenses. Nationwide's profit after tax for the year was £745 million, of which £132 million was paid as distributions and the remaining £613 million is held as retained earnings.





Report of the directors on remuneration *continued*

Total remuneration bandings

Total remuneration includes base salary, performance awards for 2017/18, pension and benefits/allowances. The total number is based on employees of the Society as at 4 April 2018.

Total remuneration bandings	Total employees
£0 - £50,000	13,966
£50,001 - £100,000	3,592
£100,001 - £250,000	517
£250,001 - £500,000	57
£500,001 - £1,000,000	12
Over £1,000,000	4

Other directorships

Executive directors and members of senior management may be invited to become non executive directors of other companies, subject to the agreement of the Society. These appointments provide an opportunity to gain broader experience outside Nationwide and therefore benefit the Society, providing that appointments are not likely to lead to a conflict of interest. Any fees earned may be retained by the executive director concerned. No executive director earned any fees during the year. With effect from 1 July 2014, the number of external appointments that executive and non executive directors can hold is limited as required under CRD IV.

Payments for loss of office

No payments for loss of office were made during the year.

Payments to past directors

No payments were made to former directors in the year in excess of the minimum threshold of £20,000.

Gender pay gap reporting

The Society is fully committed to promoting a diverse and inclusive workplace and welcomes the Government's introduction of gender pay gap reporting. The gender pay gap measures the difference in earnings between women and men across all roles. Nationwide's mean average gender pay gap, as at 5 April 2017,

which was published in March 2018, was 29%. The full gender pay gap report can be found on the Society's website.

Gender pay is not the same as equal pay. Equal pay is about the pay of men and women who are carrying out the same or equivalent roles. The last internal equal pay audit in 2016 showed that our equal pay policies operate fairly.

CEO pay ratio reporting

Regulations for calculating the ratio between the Chief Executive and average employee remuneration are yet to be finalised and are expected to be confirmed by the Government in 2018. Once these regulations are finalised we will include this as part of our remuneration reporting.

Voting at AGM

Resolutions to approve the Remuneration Policy and the 2016/17 'Report of the directors on remuneration' were passed at the 2017 AGM. In each case votes were cast as follows:

	Report of the directors on remuneration	Remuneration Policy
Votes in favour	558,021 (93.24%)	550,109 (92.04%)
Votes against	40,434 (6.76%)	47,552 (7.96%)
Votes withheld	9,469	10,261



Report of the directors on remuneration *continued*

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

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

2018	1	2	3	4	5	6	7	8
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Fixed (note i)	496	410	122	384	376	362	324	331
Variable								
Cash bonus	149	127	35	117	114	116	96	90
Deferred cash bonus	224	191	24	176	171	174	145	135
Total variable	373	318	59	293	285	290	241	225
Severance (note ii)	-	-	534	-	-	-	-	-
Total remuneration	869	728	715	677	661	652	565	556

Notes:

i. Fixed remuneration includes base salary and car allowance.

ii. Severance includes payments made in addition to payments in lieu of notice in accordance with contractual terms.

The year ahead

The Committee will continue to focus on ensuring that our remuneration structure supports the right culture and behaviours as well as our values as a mutual. Key priorities for 2018/19 include reviewing the impact for Nationwide of the proposed changes to the UK Corporate Governance Code and the introduction of UK legislation requiring quoted companies to publish the ratio of pay between their Chief Executive and average employee.

Our current remuneration policy was approved by our members at the 2017 AGM and unless changed will continue to apply until 2020. A summary of the remuneration policy is set out below together with an overview of how it will be applied in 2018/19. This summary does not replace or override the full approved policy, which is available at nationwide.co.uk. In applying this policy, the Committee is guided by the need to ensure executives are appropriately motivated and rewarded to deliver demonstrable value for our members.

The increase in base salary of 3.5% for J D Garner outlined in the table below takes into account the reduction in pension allowance from 40% to 33% of salary with effect from 1 April 2018. This reduction aligns J D Garner to the other executive members of the Board, whilst ensuring that his total on target remuneration remains broadly flat year on year.

Report of the directors on remuneration *continued*

Remuneration policy	Operation	Implementation for 2018/19 for executive directors
Base salary	<ul style="list-style-type: none"> Reviewed annually, taking into account market levels of pay, individual skills, performance and experience, and the approach to salaries throughout Nationwide. 	<p>An overall aggregate increase of 2.3% applies across the executive directors which is in line with the pay review for the wider employee population:</p> <ul style="list-style-type: none"> J D Garner £885,000 (3.5%) T P Prestedge £590,000 (1.7%) M M Rennison £635,000 (1.6%) C S Rhodes £590,000 (1.7%)
Benefits	<ul style="list-style-type: none"> Include car benefits, healthcare and insurance benefits. 	No change for 2018/19.
Pension	<ul style="list-style-type: none"> Executive directors receive a cash allowance in lieu of pension Maximum allowance is 40% of salary. 	<p>A reduction in pension allowance has been agreed for J D Garner from 1 April 2018 as set out above.</p> <p>No change for other current executive director pensions for 2018/19 set at 33% of salary.</p> <p>The maximum pension allowance for new appointments is capped at 25% of salary.</p>
<p>Our performance pay plan, the Directors' Performance Award (DPA), comprises two elements:</p> <p>(i) all-employee element; and</p> <p>(ii) an element in which the most senior team participate subject to deferral provisions</p>	<ul style="list-style-type: none"> Rewards annual performance against stretching Society, team and individual measures and objectives Performance measures reflect the priorities of the Society and are drawn from the Society's plan Deferral periods are such that no more than 40% of total performance pay is paid after the performance period and 60% is deferred for between three and seven years At least 50% of awards are linked to the value of the Society's core capital deferred shares and subject to a 12 month retention period Awards are subject to clawback for up to ten years The all-employee element operates on the same basis for all employees. 	<p>No change in maximum award opportunity for 2018/19:</p> <ul style="list-style-type: none"> 152% of base salary for the Chief Executive 112% of base salary for other executive directors <p>Performance measures:</p> <ul style="list-style-type: none"> Gateway measures based on statutory profit, leverage ratio and conduct matters Society performance, subject to minimum performance thresholds, assessed against the following cornerstones: <ul style="list-style-type: none"> Building Thriving Membership – Number of committed members Building Legendary Service – Customer service satisfaction rating Built to Last – Sustainable cost savings. <p>Up to 28% of the award assessed based on individual contribution and behaviours including in relation to conduct matters.</p>
Chairman and non executive director fees	<ul style="list-style-type: none"> Chairman fees normally reviewed and approved by the Remuneration Committee on an annual basis Non executive director fees normally reviewed and approved by the executive directors and the Chairman on an annual basis Non executive directors receive a basic fee and an additional supplement is paid for serving on or chairing a Board Committee The Chairman and non executive directors do not participate in any performance pay plans or pension arrangements. Benefits may be provided if considered appropriate. 	As set out in this report, inflationary increases of 1.5% have been made to the Chairman and non executive director basic fee for 2018/19 and the fee for the membership of the Nomination and Governance Committee has also been increased.



Report of the directors on remuneration *continued*

What our executive directors could earn in 2018/19 based on performance

The table below illustrates the amounts that executive directors would be paid under three different scenarios.

Breakdown of total remuneration for 2018/19 (£'000)				
	J D Garner	T P Prestedge	M M Rennison	C S Rhodes
Fixed Pay				
Salary	885	590	635	590
Pension as a % of salary	33%	33%	33%	33%
Benefits (2017/18 actual)	217	146	189	68
Performance pay				
Target as a % of salary	98%	78%	78%	78%
Maximum as a % of salary	152%	112%	112%	112%
Total remuneration				
Fixed pay – base salary, pension and benefits	1,394	931	1,034	853
Target – assuming we deliver target levels of performance against the measures set out in the DPA	2,261	1,391	1,529	1,313
Maximum – assuming DPA arrangements pay out in full. This would only occur where performance has been truly exceptional across all the measures set	2,739	1,592	1,745	1,514



Directors' report

For the year ended 4 April 2018

Information for the 'Content' items listed in the table below can be found in the section of the accounts as listed against them. These items are required to be shown in the Directors' report by the Building Societies Act 1986 and are incorporated into the Directors' report by this cross referencing.

Content	Section	Pages
Business objectives and future plans	Strategic report	1 to 32
Nationwide results and key performance indicators	Strategic report – Chief Executive's review including strategic cornerstone updates	9 to 23
Charitable donations	Strategic report – Building a national treasure	22
Employee engagement, development, equality, diversity and inclusion	Strategic report – Building PRIDE	19 to 20
Directors' remuneration	Governance – Remuneration Committee	83 to 93
Mortgage arrears	Business and Risk Report	113
Risk management	Business and Risk Report	101 to 103
Principal, top and emerging risks	Strategic report – Risk overview	25
Directors' share options	Annual business statement	235
CRD IV country-by-country reporting	Published online – nationwide.co.uk/about/corporate-information/results-and-accounts	-
Distributions on CCDS instruments	Financial Statements – Note 31	225

Board of directors

The names of the directors of the Society who were in office at the date of signing the financial statements, along with their biographies, are set out on pages 34 to 38.

The only change in the year and up to the date of signing the financial statements was the appointment of Gunn Waersted (non executive director), on 1 June 2017.

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

The Board has agreed that in accordance with the UK Corporate Governance Code, all the directors will stand for election or re-election on an annual basis.

Political donations

No donations were made for political purposes in the year (2017: None).

Participation in the unclaimed assets scheme

The Society participates in the Government-backed unclaimed assets scheme, whereby savings accounts that have been inactive for 15 years, and where the account holder cannot be traced, are eligible to be transferred into a central reclaim fund. The central reclaim fund has the responsibility for retaining sufficient monies to meet the costs of future reclaims for any previously transferred dormant account balances, and to transfer any surplus to the Big Lottery Fund for the benefit of good causes which have a social or environmental purpose. The next transfer to the Reclaim Fund Limited, the administrators of the unclaimed assets scheme, will be undertaken during 2018/19 and follows the last transfer the Society made in April 2017 (£4,996,120). The total contributions from inception to that date are £57,498,792.

Creditor payment policy

The Society's policy is to agree the terms of payment with suppliers at the start of trading, to ensure that suppliers are aware of the terms of payment, and pay in accordance with contractual and other legal obligations. It is the Society's policy to settle the supplier's invoice for the complete provision of goods and services (unless there is an express provision for stage payments) within the agreed payment terms, subject to the full conformity with the terms and conditions of the purchase. The Society's creditor days were 11 days at 4 April 2018 (2017: 12 days).

Environment

The Society reports its greenhouse gas emissions (GHG) below, as required by the Companies Act 2006. For more information on the Society's environmental sustainability performance, see page 23.



Directors' report *continued*

A summary of our performance is as follows:	Year to 4 April 2018	Year to 4 April 2017	Baseline year 4 April 2011
Carbon dioxide (CO₂e) in tonnes (notes i and ii)			
Scope 1 emissions			
Energy	4,374	4,498	4,890
Travel	1,624	1,887	2,448
Scope 2 emissions			
Electricity	29,268	35,840	50,802
Total Scope 1 and 2 emissions (note iii)	35,266	42,225	58,140
PPA carbon reduction (note iv)	(19,972)	(12,925)	-
Absolute carbon outturn	15,294	29,300	58,140
Total carbon dioxide in tonnes per FTE	0.87	1.69	3.46
Water use (cubic metres)	209,207	221,560	259,718
Water use (cubic metres) per FTE	11.87	12.83	15.45
Waste generated in tonnes	2,516	2,847	4,554
Percentage of waste recycled	68%	75%	43%

Notes:

i. CO₂e is an abbreviation of 'carbon dioxide equivalent' and is the internationally recognised measure of greenhouse gas emissions.

ii. When calculating our carbon emissions we have used the DEFRA 2015 conversion factors.

iii. Scope 1 covers direct combustion of fuels and company owned vehicles and Scope 2 covers emissions from electricity.

iv. Represents the contribution of a solar power purchase agreement, producing emissions free energy backed by renewable obligations certificates.

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

The following statement, which should be read in conjunction with the Independent auditor's report on pages 159 to 167, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Report and Accounts, the directors' emoluments disclosures within the Report of the directors on remuneration, the Annual business statement and the Directors' report. The Annual Report and Accounts have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU.

A copy of the Annual Report and Accounts can be found on Nationwide Building Society's website at nationwide.co.uk (Results and accounts section). The directors are responsible for the maintenance and integrity of statutory and audited information on the website. Information published on the internet is accessible in many countries with different legal requirements. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Building Societies Act 1986 (the Act)

As required by the Act, the directors have prepared an Annual Report and Accounts which gives a true and fair view of the income and expenditure of the Society and the Group for the financial year and of the state of the affairs of the Society and the Group as at the end of the financial year, and which provides details of directors' emoluments in accordance with Part VIII of the Act and regulations made under it.

The Act states that the requirements under international accounting standards achieve a fair presentation. In preparing the Annual Report and Accounts, the directors have:

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

British Bankers' Association Code for Financial Reporting Disclosure (the BBA Code)

The Group has continued to adopt the BBA Code in preparing the Annual Report and Accounts.

Going concern

The Group's business activities, along with its financial position, capital structure, risk management approach and factors likely to affect its future performance, are described in the Strategic report and the Business and risk report.

The Group's forecasts and projections, taking account of possible changes in trading performance and funding retention, and including stress testing and scenario analysis, show that the Group will be able to operate at adequate levels of both liquidity and capital for the next 12 months. Furthermore the Group's capital ratios and its total capital resources are comfortably in excess of PRA requirements.

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

Business viability statement

In addition to the going concern statement above, the directors have an obligation in accordance with provision C.2.2 of the UK Corporate Governance Code to confirm that they believe that both the Society and the Group will be able to continue in operation, and to meet its liabilities, as they fall due over a time period of its choosing.

Assessment of prospects

In making this viability assessment, the directors have used a wide range of sources including: the principal and emerging risks which could impact the performance of the Group; the outcome of the Bank of England's 2017 Concurrent Stress Test; and, the Group's financial plan. This plan includes forecasts of detailed financial, capital, funding and customer information over the next five years, together with an assessment of the relevant risks.

The Group's financial plan is produced and reviewed at least annually by the directors. The process for creating the financial plan takes into account the Group's strategic objectives, the risks required in order to meet those objectives and the risk appetite limits in place to ensure that the Group remains safe and secure for its members. The Group's annual planning process involves the following key steps:

- The Board reviews the Group's strategic objectives in the context of the market environment.



Directors' report *continued*

- Economic and market assumptions for the next five years are prepared. These are then used to develop financial, propositional pricing, funding and capital projections.
- In addition to our core projections, a number of downside scenarios are prepared to ensure that the Group would continue to remain profitable if the assumptions included in our forecast were different. For example, in our most recent planning cycle downside scenarios were developed considering the impacts of greater competition, or a less smooth transition from the EU, than anticipated. These downside scenarios represent plausible outcomes, and allow the Group to develop actions to mitigate these scenarios, should they occur.
- The Board also obtains independent assurance from the Group's Risk Oversight function that the financial plan aligns with the Group's strategic ambitions and risk appetite. This assessment also identifies the key risks to delivery of the financial plan, and any relevant adjustments are made to ensure that we remain within our risk appetite.
- These projections, including the plausible downside scenarios, are then reviewed and challenged by the Board to confirm that they fully reflect Nationwide's strategic ambitions, whilst ensuring that they are based on plausible assumptions and remain within the Group's risk appetite. Once approved by the Board, they form the basis of the Group's targets for the following year.

Assessment of viability

Whilst the financial plan represents the best estimate of Nationwide's future prospects, the directors have also considered the financial impact of the alternative scenarios described above and the results of the Bank of England's 2017 Concurrent Stress Test, which outlines the impact on the Group's business model of a severe economic downturn. Due to the Group's strong capital position and robust business model, it would be able to withstand both plausible and severe economic and competitive downturns. The Group has also developed policies and processes for monitoring and managing its top and emerging risks. Further details on this are described in the 'Business and risk report' (pages 104 to 105).

Assessment period used for reviewing Nationwide's viability

Based on the above, the directors have a reasonable expectation that operations of the Society and Group will be able to continue and to meet its liabilities as they fall due, over the next three years to 4 April 2021. The directors have specifically assessed the prospects of the Society and Group over the first three years of the financial plan because:

- The uncertain economic environment caused by the UK's vote to leave the EU, and the pace of regulatory and technological change, mean that the assumptions underpinning the fourth and fifth years of the financial plan may be less reliable.
- It is within the period covered by the Group's future projections of profitability, cash flows, capital requirements and capital resources. It is also within the period covered by both the Bank of England's Concurrent Stress Tests and our own internal alternative downside scenarios.

Fair, balanced and understandable

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

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

Enhanced Disclosure Task Force (EDTF)

The EDTF established by the Financial Stability Board, published its report 'Enhancing the Risk Disclosures of Banks' in October 2012. All EDTF recommendations are reflected in the Annual Report and Accounts and Pillar 3 Disclosure.

Directors' statement pursuant to the disclosure and transparency rules

As required by the Disclosure and Transparency Rules of the Financial Conduct Authority, the directors have included a fair review of the business and a description of the principle risks and uncertainties facing the Group. The directors confirm that, to the best of each director's knowledge and belief:

- The Chief Executive's review and the Financial review contained in the Strategic report include a fair review of the development and performance of the business and the position of the Group and Society. In addition, the Strategic report contains a description of the principal risks and uncertainties.

- The financial statements, prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group and Society.
- In addition to the Annual Report and Accounts, as required by the Act, the directors have prepared an Annual business statement and a Directors' report, each containing prescribed information relating to the business of the Society and its connected undertakings.

Directors' responsibilities in respect of accounting records and internal control

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

- Keep accounting records which disclose with reasonable accuracy the financial position of the Society and the Group and which enable them to ensure that the Annual Report and Accounts comply with the Building Societies Act.
- Take reasonable care to establish, maintain, document and review such systems and controls as are appropriate to the Society.

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

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

The auditors

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

David Roberts
Chairman



Business and Risk Report

Anya, member since 2002

Business and Risk Report

- 98** Principal risks
- 101** Managing risk
- 104** Top and emerging risks
- 105** Credit risk
 - Residential mortgages
 - Consumer banking
 - Commercial and other lending
 - Treasury assets
- 130** Liquidity and funding risk
- 141** Solvency risk
- 145** Market risk
- 149** Pension risk
- 151** Business risk
- 152** Model risk
- 152** Operational risk
- 155** Conduct and compliance risk

For our members and their families

Anya can't remember when she first started her relationship with Nationwide as she didn't have much to do with it.

Her mum opened up her first account for her when she was a child.

Now 24, she still has savings accounts with us including a Loyalty Saver and Flexclusive Regular Saver. She also shares a FlexPlus current account with her mum.

Which is absolutely perfect from Anya's point of view.

"It means we can share the benefits like breakdown cover, travel insurance and mobile phone cover but mum covers the £13 monthly fee."

That's particularly useful at the moment because Anya is still studying to become a primary school teacher.

"Being a Nationwide member feels a bit like being part of a community"

The fact that we're a community that enables family members to support each other is another way in which we're building society.



Business and Risk Report *continued*

Principal risks

Effective risk management is fundamental to the success of Nationwide's business and has an important part to play in delivering our purpose of building society, nationwide by making sure we are safe and secure for the future. Whilst it is accepted that all business activities involve some degree of risk, Nationwide seeks to protect its members by appropriately managing the risks that arise from its activities. Nationwide's risk management processes ensure the Society is built to last by:

- contributing to better decision making, ensuring we take the right risks, in a way that is considered and supports the strategy
- ensuring the risks we do take are appropriately understood, controlled and managed
- maintaining an appropriate balance between delivering member value and remaining a prudent and responsible lender.

Nationwide is exposed to the principal risks as set out below, which are managed through the Society's Enterprise Risk Management Framework as described on page 101. The Society's description of principal risks have been restructured to better align with how the risks are managed. However, the underlying risks to Nationwide remain the same.

Credit risk	Why this risk is important for Nationwide	How Nationwide manages this risk on behalf of members
The risk of loss as a result of a member, customer or counterparty failing to meet their financial obligations.	<p>Borrowers may be unable to repay loans for a number of reasons, such as changes to the economic and market environment or in their individual circumstances. This may lead to:</p> <ul style="list-style-type: none"> • Financial difficulty or other detriment to borrowers who are unable to afford repayments on existing products and services, either with Nationwide or other providers. • Credit losses which adversely impact the Society's profitability, ability to generate sufficient capital and sustainability. 	<p>Nationwide seeks to minimise unaffordable lending and credit losses through:</p> <ul style="list-style-type: none"> • Stringent affordability checks and controls, ensuring lending is responsible and will not cause financial difficulty for members and customers. • Prudent lending policies, operated across specific market segments, which ensure lending remains within the Board's risk appetite. • Continuous monitoring of credit portfolios to identify potential risks, through stress testing, modelling and ongoing reporting to senior management and the Board.

Further information on Nationwide's credit risk exposures and how these are managed can be found on page 105.

Solvency risk	Why this risk is important for Nationwide	How Nationwide manages this risk on behalf of members
The risk that Nationwide fails to maintain sufficient capital to absorb losses throughout a full economic cycle and to maintain the confidence of current and prospective members, investors, the Board and regulators.	<p>A sudden stress or series of unexpected losses may result in Nationwide's capital reserves being depleted. This may lead to:</p> <ul style="list-style-type: none"> • Threats to the ongoing viability of the Society should capital resources be exhausted. • An inability to offer new products to members as capital is not available to support these offerings. • Reputational damage to the Society as members, regulators, investors and counterparties lose trust in Nationwide's ability to operate. 	<p>Nationwide ensures it maintains sufficient capital resources through:</p> <ul style="list-style-type: none"> • Defining a minimum level of capital, including leverage, which the Society is willing to tolerate through Board risk appetite, which is maintained and monitored by the Board and other risk committees. • Structuring capital to meet key regulatory minimums, stakeholder expectations and the requirements of the strategy.

Further information on Nationwide's solvency risk exposure and how this is managed can be found on page 141.

Market risk	Why this risk is important for Nationwide	How Nationwide manages this risk on behalf of members
The risk that the net value of, or net income arising from, the Society's assets and liabilities is impacted as a result of market price or rate changes. As Nationwide does not have a trading book, market risk only arises in the banking book.	<p>Nationwide's income or the value of its assets may be altered by changes in interest rates, currency rates and equity prices. This may lead to:</p> <ul style="list-style-type: none"> • Lower than expected income, adversely affecting the Society's profitability and ability to generate capital. • Capital and liquidity resources which are worth less than expected, impacting the Society's ability to meet its financial commitments and its ongoing viability. 	<p>Nationwide seeks to minimise its exposure to fluctuations in market prices and rates through:</p> <ul style="list-style-type: none"> • Fully hedging market risks where possible and appropriate and taking market risks only when these are essential to core business activities, or are designed to provide stability of earnings. • Continuous monitoring through a variety of techniques including sensitivity analysis, earnings sensitivity, Value at Risk and stress analysis.

Further information on Nationwide's market risk exposure and how this is managed can be found on page 145.



Business and Risk Report *continued*

Principal risks *continued*

Business risk	Why this risk is important for Nationwide	How Nationwide manages this risk on behalf of members
<p>The risk that volumes decline or margins shrink relative to the cost base, affecting the sustainability of the business and the ability to deliver the strategy due to macro-economic, geopolitical, industry, regulatory or other external events.</p>	<p>Nationwide may fail to respond appropriately to changes in the external environment including new technology, consumer behaviour, regulation or market conditions. This may lead to:</p> <ul style="list-style-type: none"> • Products and services which fail to meet members' needs, adversely affecting both the Society's relationship with members and the ability to generate income. • A weakening of our relationships with members as they increasingly conduct their business through third parties. • Degradation of profitability through increased costs or decreased income. 	<p>Whilst changes in Nationwide's operating environment pose risks, they also present opportunities to provide new, innovative products and services to members. Nationwide ensures it is able to adapt to new conditions and continues to meet members' needs whilst remaining safe and secure for the future through:</p> <ul style="list-style-type: none"> • Considering the potential for disruption to the market and operating environment from a range of factors, including technology and consumer trends, through regular Board and senior management reporting. • Continuing to develop new products and services based on member engagement, emerging trends, and technological innovation. • Identifying and monitoring potential risks to its business model through dedicated horizon scanning processes.

Further information on Nationwide's business risk exposure and how this is managed can be found on page 151.

Liquidity and funding risk	Why this risk is important for Nationwide	How Nationwide manages this risk on behalf of members
<p>Liquidity risk is the risk that Nationwide is unable to meet its liabilities as they fall due and maintain member and other stakeholder confidence. Funding risk is the risk that Nationwide is unable to maintain diverse funding sources in wholesale and retail markets and manage retail funding risk that can arise from excessive concentrations of higher risk deposits.</p>	<p>In the event of a downturn in the macroeconomic environment, sudden withdrawals of member deposits or other potential shocks, Nationwide could have insufficient financial resources to meet its commitments. This may lead to:</p> <ul style="list-style-type: none"> • Members being unable to access their money or other products and services. • Disruption to other organisations or the market. • Damage to the Society's reputation, decreased member and stakeholder confidence and increased funding costs. 	<p>Nationwide ensures it is able to meet its liabilities as they fall due and maintain appropriate funding through:</p> <ul style="list-style-type: none"> • Operating a comprehensive suite of policies, limits, stress testing, monitoring and robust governance controls to ensure a stable and diverse funding base and sufficient holdings of high quality liquid assets. • Continuously monitoring liabilities against internal and regulatory requirements, and management of liquidity resources to meet these as they fall due. • Maintaining a contingency funding plan which details the actions available to the Society in a stress situation.

Further information on Nationwide's liquidity and funding risk exposure and how this is managed can be found on page 130.

Pension risk	Why this risk is important for Nationwide	How Nationwide manages this risk on behalf of members
<p>The risk that the value of the pension schemes' assets will be insufficient to meet the estimated liabilities, creating a pension deficit.</p>	<p>Nationwide has funding obligations to defined benefit pension schemes. The value of the schemes' assets could become insufficient to meet estimated liabilities as a result of volatility in the value of schemes' assets and liabilities, driven by market interest rates, inflation and longevity. This may lead to:</p> <ul style="list-style-type: none"> • Insecurity of employee pension arrangements. • A requirement to increase cash funding into these schemes. • An adverse impact on Nationwide's capital position. 	<p>The assets of Nationwide's defined benefit schemes are held in legally separate trusts, each administered by a board of trustees, in accordance with UK legislation. Nationwide minimises the impact of pension risk on both the Society and pension scheme members through:</p> <ul style="list-style-type: none"> • Maintaining effective engagement with the trustees to manage the long-term impact of pension risk on the Society's capital and financial position. • Balancing risk, return and relevant employee considerations.

Further information on Nationwide's pension risk exposure and how this is managed can be found on page 149.



Business and Risk Report *continued*

Principal risks *continued*

Model risk	Why this risk is important for Nationwide	How Nationwide manages this risk on behalf of members
<p>The risk of weaknesses or failures in models used to support key decisions including in relation to the amount of capital and liquidity resources required, lending and pricing, resourcing and earnings.</p>	<p>Model outputs could be inaccurate as a result of inappropriate design or operation. This may affect decision making and lead to:</p> <ul style="list-style-type: none"> • Members being inappropriately offered or refused access to products and services. • Financial loss or insufficient financial resources. • Regulatory censure. 	<p>Models play an ever more important part in supporting the strategy as decision making becomes more sophisticated. This risk is mitigated through:</p> <ul style="list-style-type: none"> • A well governed model development process, operated by expert modelling teams and independently validated by specialists in the second line. • Regular monitoring of model performance and maintenance, supported by independent review.

Further information on Nationwide's model risk exposure and how this is managed can be found on page 152.

Operational risk	Why this risk is important for Nationwide	How Nationwide manages this risk on behalf of members
<p>The risk of loss resulting from failures of internal processes, people and systems, or from external events.</p>	<p>Process, people or system failures or external events could lead to:</p> <ul style="list-style-type: none"> • Disruption either to the services provided to members or to internal processes. • The loss of customer data, assets, or other form of detriment due to external parties (e.g. cyber attack, fraud) or poor internal controls. • Financial loss, through a loss of income, increase in costs, or direct loss. 	<p>Nationwide seeks to minimise detriment and loss to members, customers and the Society through:</p> <ul style="list-style-type: none"> • Regularly identifying and assessing the key operational risks to its strategy, ensuring appropriate controls are in place to mitigate these risks. • Considering the extreme but plausible events which could affect the Society. • Continuing to invest in enhanced controls in key areas including cyber, resilience and data.

Further information on Nationwide's operational risk exposure and how this is managed can be found on page 152.

Conduct and compliance risk	Why this risk is important for Nationwide	How Nationwide manages this risk on behalf of members
<p>The risk that Nationwide exercises inappropriate judgement or makes errors in the execution of its business activities, leading to:</p> <ul style="list-style-type: none"> • non-compliance with regulation or legislation • market integrity being undermined, or • an unfair outcome being created for customers. 	<p>In an evolving regulatory and consumer environment, Nationwide could provide products and services which are misaligned to the needs of customers or market conditions due to the pace of change in customer behaviour, regulation, or the external environment. This may lead to:</p> <ul style="list-style-type: none"> • Unfair customer outcomes, with customers being sold products which are not wanted or needed. • Non-compliance with the letter or spirit of legislation or regulation. • Disruption to the market. • Regulatory censure. 	<p>Nationwide seeks to minimise its conduct and compliance exposure through:</p> <ul style="list-style-type: none"> • Rigorous testing of products and services both before and after providing them to members to ensure they are designed and performing appropriately. • Continually assessing new and existing risks in the conduct and compliance environment (e.g. technology, cyber-crime, changes in consumer or market behaviour and regulatory changes), and ensuring that risk exposures are appropriately managed.

Further information on Nationwide's conduct and compliance risk exposure and how this is managed can be found on page 155.



Business and Risk Report *continued*

Managing risk

Effective risk management is at the heart of the business, ensuring that decisions are made having considered any associated risks to delivery of Nationwide's strategy and our goal to protect members' interests.

The Society manages its risk through an enterprise-wide risk management framework, which sets out the minimum standards, and associated processes, for successful risk management, connecting the Society's strategy with day-to-day risk management activities.

Enterprise Risk Management Framework (ERMF)

Over the past year, Nationwide has evolved the ERMF in response to industry developments, best practice and the shifting risk landscape, to simplify the Society's processes and improve their effectiveness and efficiency. Whilst the visualisation below presents a simplified articulation of how Nationwide manages its risk, the approach to risk management remains fundamentally unchanged.

The diagram below outlines how Nationwide's ERMF is structured to manage the risks to which the Society is exposed.



Risk appetite articulates how much risk the Society is prepared to take in the pursuit of its objectives.

Risk strategy sets out how the Society will manage its material risks within risk appetite over the five years of the Plan.

Control environment, encompasses all the policies and controls we operate on a day-to-day basis to control our material risks within risk appetite.

Risk and control management and governance, defines the processes, tools, structures and systems we used to identify, assess and manage our risks on a day-to-day basis.

Risk incident and control reporting, ensures the appropriate monitoring, aggregation, and escalation of relevant risk and control information to the Board, risk committees, and management to enable effective risk decision making.

The ERMF ensures that risks are managed through robust and consistent processes, supported by appropriate tools and guidance, enabling better business decisions for delivery of Nationwide's strategy.

The Board monitors the Society's risk management and internal control systems and carries out an annual review of their effectiveness. During the year, the Society's risk management and internal control systems have been reviewed and, on the basis of this review, the Board is satisfied that Nationwide has an adequate system of risk management and internal control.



Business and Risk Report *continued*

Managing risk *continued*

Risk appetite

Board risk appetite articulates how much risk the Board is willing to accept on behalf of its members in the delivery of the strategy. The following statements articulate Nationwide's approach to taking risk responsibly in the interests of our members. The Society's ambitions are to:

- Lend in a responsible, affordable and sustainable way to ensure we safeguard members and the financial strength of the Society throughout the credit cycle.
- Maintain sufficient capital and liquidity resources to support current business activity and planned growth and to remain resilient to significant stress.
- Minimise customer disruption, financial loss, reputational damage and regulatory non-compliance, especially those caused by failures of people, processes and systems.
- Provide sustainable customer services over resilient systems.
- Treat customers fairly before, during and after the sales process.
- Offer products and services which meet customer needs and expectations, perform as represented and provide value for money.
- Operate a mutual business model which is sustainable and remains within the requirements of the Building Societies Act in a stress.
- Only incur market risks that are required for operational efficiency, stability of earnings or cost minimisation in supporting core business activities.

Three lines of defence

Nationwide operates a three lines of defence model, ensuring clear separation between risk and control ownership (first line), oversight, support and challenge (second line), and audit assurance (third line). Accountabilities within the three lines of defence model are outlined below:

First line – Risk and control ownership	Second line – Oversight, support and challenge	Third line – Assurance
Specific accountabilities include:	Specific accountabilities include:	Specific accountabilities include:
<ul style="list-style-type: none"> • Setting business objectives • Defining management risk appetite • Identifying, owning and managing risks • Defining, operating and testing controls • Implementing and maintaining regulatory compliance • Adhering to the minimum standards set out in the risk management framework and associated policies • Identifying future threats and risks 	<ul style="list-style-type: none"> • Providing expert advice on business initiatives • Advising the Board on setting risk appetite • Reporting aggregate enterprise level risks to the Board • Conducting independent and risk-based assurance • Interpreting material regulatory change • Setting the risk management framework and associated policies • Identifying future threats and risks 	<ul style="list-style-type: none"> • Performing independent audits of the effectiveness of first line risk and control and second line risk oversight, support and challenge • Taking a risk-based approach to the programme of audit work • Preparing an annual opinion on the risk management and controls framework to present to the Audit Committee

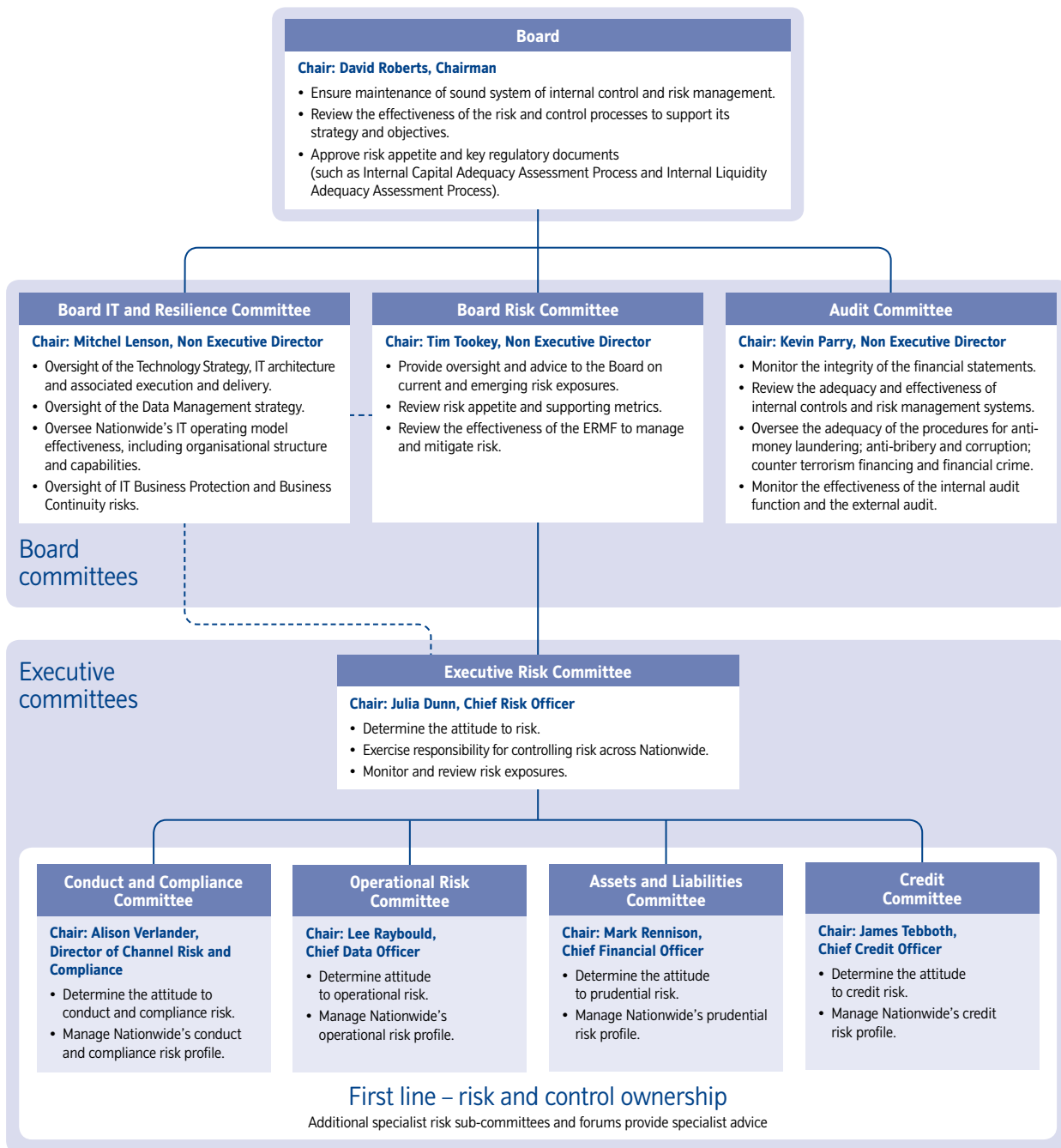


Business and Risk Report *continued*

Managing risk *continued*

Risk Committee structure

The Board Risk Committee and Audit Committee provide oversight and advice to the Board. The Executive Risk Committee ensures a co-ordinated management approach across all risk categories. The risk committee structure is represented in the following diagram.



----- Information flow



Business and Risk Report *continued*

Top and emerging risks

Nationwide accepts that all business activities involve some degree of risk; therefore, steps are taken to protect members by ensuring that these activities are managed appropriately. The Built to Last strategic cornerstone focuses on Nationwide being sustainable, efficient and resilient for members.

Top and emerging risks are identified through the process outlined in the 'Managing risk' section of this report and are closely tracked throughout the governance structure. They are specific instances of one or more of our principal risks which are particularly relevant in the current environment and which the Society will keep under close observation through risk reporting. The top and emerging risks to Nationwide's strategy are detailed in the table below.

Risk	Overview of Risk	Mitigating Actions
Cyber security	<p>Nationwide and other organisations across financial and non-financial sectors continue to be targeted by increasingly sophisticated and frequent cyber attacks including ransomware, malware and Distributed Denial of Service (DDoS) attacks. These attacks can disrupt the provision of services to members or lead to a loss of member data.</p> <p>The threat from cyber attacks is expected to remain high, with heightened geopolitical tensions, potentially increasing the threat to the UK, and the development of ever more sophisticated threats. This becomes more significant as services continue to be accessed online.</p>	<p>Nationwide is:</p> <ul style="list-style-type: none"> Continuing to invest in cyber security, focusing on the development of robust preventative controls, intrusion detection systems and response plans to protect services and member data. Collaborating with industry bodies and law enforcement agencies, to develop a better understanding of, and response to, evolving cyber threats.
Operational resilience	<p>Over recent years there has been a dramatic increase in demand for digital services available at all times. Ever increasing volumes of data must be managed securely and reliably, to avoid disruption to member services.</p> <p>The rate of increase in demand for digital services shows no signs of slowing down, and delivering technological change to match this demand, without impacting system security or stability, remains a challenge across the sector.</p>	<p>Nationwide is:</p> <ul style="list-style-type: none"> Ensuring focus on maintenance of service provision, with oversight through the dedicated Board IT and Resilience Committee. Continuing to invest in the resilience of its systems and implementing robust controls to minimise disruption.
Regulatory change	<p>The regulatory environment continues to evolve, with several key pieces of regulation coming into force in 2018, including the General Data Protection Regulation (GDPR), the Payment Services Directive II (PSD II), Competition and Markets Authority (CMA) remedies and BCBS 239. Each of these requires complex changes to implement and the combined effect is resulting in significant industry-wide challenges for firms to demonstrate and maintain compliance.</p> <p>Nationwide is well placed to respond to new requirements with work already underway to ensure compliance.</p>	<p>Nationwide is:</p> <ul style="list-style-type: none"> Managing implementation of regulatory changes through dedicated programmes which are closely monitored by the Board. Working closely with regulators to ensure compliance with both the letter and the spirit of regulation.
Competitive environment	<p>Competition continues to evolve in Nationwide's core markets driven by changes to regulation, technological innovation, and increasing demand for digital products and services due to the convenience that they can bring. Whilst these provide opportunities to build new and deeper relationships with members, and better meet customer needs through new product offerings, they may also pose challenges to Nationwide's products, systems and pricing, and disrupt how financial services currently operate.</p> <p>Changes in the competitive environment are expected to continue as existing or new competitors launch propositions utilising Open Banking technologies and enhance existing service offerings through artificial intelligence, machine learning and other product innovation.</p>	<p>Nationwide is:</p> <ul style="list-style-type: none"> Continuously monitoring the competitive environment and reviewing the ability of the Society's business model to respond to potential risks and opportunities. Continuing to identify and invest in new and innovative product offerings and technology to deliver on our commitment to provide legendary service to members.



Business and Risk Report *continued*

Top and emerging risks *continued*

Risk	Overview of Risk	Mitigating Actions
Geopolitical and macro-economic environment	<p>Nationwide is inherently exposed to a downturn in macro-economic conditions which can impact customer affordability, credit losses and the availability and cost of financial resources.</p> <p>Numerous factors are expected to impact the geopolitical and macro-economic environment over the coming year. These include:</p> <ul style="list-style-type: none"> • Brexit – whilst the basis of a transition deal is in place, uncertainty remains over the terms of the UK's exit from the EU. Whilst Nationwide's business model means the Society has limited direct exposure to the EU, depending upon the shape of the deal, Nationwide may be exposed to secondary impacts. • Economic conditions and policy – when adjusted for inflation, wages growth is negligible and productivity remains persistently low. When coupled with the withdrawal of some monetary stimulus, customer affordability could be affected. • Geopolitical tensions – there remain significant tensions in the geopolitical environment which have the potential to create headwinds for the UK economy. 	<p>Nationwide is:</p> <ul style="list-style-type: none"> • Monitoring key economic factors for signs of increasing risk or environmental developments. • Undertaking regular assessments of how economic stresses may impact its business model. • Continuing Board review of key developments including Brexit, geopolitical tensions, European and domestic political changes.

Credit risk

Credit risk is the risk of loss as a result of a member, customer or counterparty failing to meet their financial obligations. Credit risk also encompasses refinance risk and concentration risk. Refinance risk is the risk of loss arising when a repayment of a loan or other financial product occurs later than originally anticipated.

Nationwide manages credit risk for each of the following portfolios:

Portfolio	Definition
Residential mortgages	Loans secured on residential property
Consumer banking	Unsecured lending including current account overdrafts, personal loans and credit cards
Commercial and other lending	Loans to registered social landlords, loans made under the Private Finance Initiative and commercial real estate lending. Also includes deferred consideration and collateral balances to support repurchase transactions.
Treasury	Treasury liquidity, derivatives and discretionary portfolios

Maximum exposure to credit risk

Credit risk largely arises from exposure to loans and advances to customers, which account for 85.2% (2017: 85.9%) of Nationwide's total credit risk exposure. Within this, exposure relates primarily to residential mortgages, which account for 92.5% (2017: 91.4%) of total loans and advances to customers and which comprise high quality assets with low occurrences of arrears and possessions. Residential mortgage exposures have increased during the year, driven by Nationwide's continued support for first time buyers which has contributed to the £6 billion growth in prime mortgage balances in the year.

In addition to loans and advances to customers, Nationwide is exposed to credit risk on all other financial assets. For financial assets recognised on the balance sheet, the maximum exposure to credit risk represents the balance sheet carrying value after allowance for impairment. For off-balance sheet guarantees, the maximum exposure is the maximum amount that Nationwide would have to pay if the guarantees were to be called upon. For loan commitments and other credit related commitments that are irrevocable over the life of the respective facilities, the maximum exposure is the full amount of the committed facilities.

Nationwide's maximum exposure to credit risk has risen from £234 billion to £240 billion, reflecting the growth in residential mortgage loans.

Business and Risk Report *continued*Credit risk *continued*

Maximum exposure to credit risk						
2018	Gross balances	Less: Impairment provisions	Carrying value	Commitments (note i)	Maximum credit risk exposure	% of total credit risk exposure
<i>(Audited)</i>	£m	£m	£m	£m	£m	%
Cash	14,361	-	14,361	-	14,361	6
Loans and advances to banks	3,422	-	3,422	101	3,523	1
Investment securities – Available for sale	11,926	-	11,926	-	11,926	5
Investment securities – Held to maturity	1,120	-	1,120	700	1,820	1
Derivative financial instruments	4,121	-	4,121	-	4,121	2
Fair value adjustment for portfolio hedged risk (note ii)	(109)	-	(109)	-	(109)	-
	34,841	-	34,841	801	35,642	15
Loans and advances to customers:						
Residential mortgages	177,299	(145)	177,154	12,204	189,358	79
Consumer banking	4,107	(298)	3,809	42	3,851	1
Commercial and other lending (notes ii and iii)	10,716	(15)	10,701	842	11,543	5
	192,122	(458)	191,664	13,088	204,752	85
Total	226,963	(458)	226,505	13,889	240,394	100

Maximum exposure to credit risk						
2017	Gross balances	Less: Impairment provisions	Carrying value	Commitments (note i)	Maximum credit risk exposure	% of total credit risk exposure
<i>(Audited)</i>	£m	£m	£m	£m	£m	%
Cash	13,017	-	13,017	-	13,017	6
Loans and advances to banks	2,587	-	2,587	115	2,702	1
Investment securities – Available for sale (note iv)	9,831	-	9,831	-	9,831	4
Investment securities – Held to maturity	-	-	-	1,774	1,774	1
Derivative financial instruments	5,043	-	5,043	-	5,043	2
Fair value adjustment for portfolio hedged risk (note ii)	746	-	746	-	746	-
	31,224	-	31,224	1,889	33,113	14
Loans and advances to customers:						
Residential mortgages	171,263	(144)	171,119	12,589	183,708	78
Consumer banking	3,949	(269)	3,680	26	3,706	2
Commercial and other lending (notes ii and iii)	12,597	(25)	12,572	926	13,498	6
	187,809	(438)	187,371	13,541	200,912	86
Total	219,033	(438)	218,595	15,430	234,025	100

Notes:

- In addition to the amounts shown above, Nationwide has, as part of its retail operations, revocable commitments of £9,517 million (2017: £9,202 million) in respect of credit card and overdraft facilities. These commitments represent agreements to lend in the future, subject to certain considerations. Such commitments are cancellable by Nationwide, subject to notice requirements, and given their nature are not expected to be drawn down to the full level of exposure.
- The fair value adjustment for portfolio hedged risk and the fair value adjustment for micro hedged risk (included within the carrying value of loans for the commercial lending portfolio) represent hedge accounting adjustments. They are indirectly exposed to credit risk through the relationship with the underlying loans covered by Nationwide's hedging programmes.
- Commercial and other lending includes deferred consideration relating to an investment in Visa Inc and collateral balances to support repurchase transactions.
- Comparatives have been restated as detailed in note 1 of the financial statements.



Business and Risk Report *continued*

Credit risk *continued*

Movements in impaired loans by credit risk segment

The table below shows the movements during the year of all loans classified as impaired. The balance shown represents the entire financial asset rather than just the overdue elements.

Movements in impaired loan balances					
2018	Prime mortgages	Specialist mortgages	Consumer banking	Commercial and other lending	Total
<i>(Audited)</i>	£m	£m	£m	£m	£m
At 5 April 2017	372	401	233	45	1,051
Classified as impaired during the year	310	343	125	24	802
Transferred from impaired to unimpaired	(285)	(337)	(23)	(5)	(650)
Amounts written off	(17)	(38)	(78)	(22)	(155)
Repayments	(7)	-	(11)	(12)	(30)
At 4 April 2018	373	369	246	30	1,018

Movements in impaired loan balances					
2017	Prime mortgages	Specialist mortgages	Consumer banking	Commercial and other lending	Total
<i>(Audited)</i>	£m	£m	£m	£m	£m
At 5 April 2016	366	412	260	176	1,214
Classified as impaired during the year	323	358	110	6	797
Transferred from impaired to unimpaired	(298)	(333)	(44)	(29)	(704)
Amounts written off	(14)	(37)	(92)	(105)	(248)
Repayments and other movements	(5)	1	(1)	(3)	(8)
At 4 April 2017	372	401	233	45	1,051

Note:

Loans that were classified as impaired and loans that have transferred into or out of the impaired classification are based on the relevant status at each month end, when compared to the previous month end.

Forbearance

Nationwide is committed to supporting customers facing financial difficulty by working with them to find a solution through proactive arrears management and forbearance. This is the case for residential mortgages, consumer banking and commercial lending.

Forbearance occurs when concessions are made to the contractual terms of a loan when the customer is facing or about to face difficulties in meeting their financial commitments. A concession is where the customer receives assistance, which could be a modification to the previous terms and conditions of a facility or a total or partial refinancing of debt, either mid-term or at maturity. Requests for concessions are principally attributable to:

- temporary cash flow problems;
- breaches of financial covenants; or
- an inability to repay at contractual maturity.

The concession events and exit criteria which are used to classify balances subject to forbearance for residential mortgages, consumer banking and commercial lending are described in the relevant sections of this report.



Business and Risk Report *continued*

Credit risk – Residential mortgages

Summary

Nationwide's residential mortgages include both prime and specialist loans. Prime residential mortgages are mainly Nationwide-branded advances made through the branch network and intermediary channels. Specialist lending consists of buy to let mortgages originated under The Mortgage Works (UK) plc (TMW) brand.

Nationwide is committed to helping people become homeowners and continues to actively support first time buyers. New lending in the prime portfolio has seen the residential mortgage exposure grow from £171 billion to £177 billion over the year, with new lending to first time buyers, at £11.8 billion, increasing to 38% (2017: 36%) of all new lending. Nationwide continues to operate with a commitment to responsible lending with a focus on championing good conduct and fair outcomes.

Whilst the average LTV of new lending has remained stable at 71%, increased new lending to first time buyers, at higher LTVs, has resulted in a rise in the proportion of the portfolio with an LTV above 80% to 11.2% (2017: 9.6%). The average indexed LTV across the combined residential mortgage portfolio has increased slightly from 55% to 56%.

The proportion of lending made to the buy to let segment reduced over the year to 11% (2017: 14%). TMW remains a top tier BTL lender and uses this presence and influence in the market to drive improving standards across the industry, providing expertise, opinion and innovation for the benefit of the private rental sector, supporting both landlords and tenants. Through TMW, Nationwide is supporting portfolio landlords, with four or more properties, has expanded into 80% LTV lending and is piloting lending to limited companies.

The proportion of loans in arrears has reduced slightly to 1.5% (2017: 1.6%) and arrears levels remain low across prime and specialist lending, reflecting the favourable economic conditions and low interest rate environment, supported by robust credit assessment and affordability controls at the point of lending, and proactive engagement with borrowers. The proportion of loans more than three months in arrears reduced slightly to 0.43% and is significantly below the UK Finance (UKF) average of 0.81%. Whilst there are no signs of deterioration in the portfolio, with the immediate outlook for the UK being less certain and the buy to let market facing increased costs and potentially less investor demand, the expectation is for a gradual rise in arrears from these low levels.

The provision balance for residential mortgages has remained broadly stable at £145 million (2017: £144 million) and provision coverage on non-performing balances is unchanged at 5.3%.

Lending and new business

The table below summarises the residential mortgages portfolios:

Residential mortgage lending				
(Audited)	2018		2017	
	£m	%	£m	%
Prime	144,049	81	138,004	81
Specialist:				
Buy to let	30,438	18	30,087	18
Self-certified	1,823	1	2,071	1
Near prime	705	-	784	-
Sub prime	284	-	317	-
	33,250	19	33,259	19
Total residential mortgages	177,299	100	171,263	100

Note: Self-certified, near prime and sub prime lending were discontinued in 2009.

Distribution of new business by borrower type (by value)		
	2018	2017
	%	%
Prime:		
Home movers	29	30
First time buyers	38	36
Remortgagers	21	19
Other	1	1
Total prime	89	86
Specialist:		
Buy to let new purchases	2	3
Buy to let remortgagers	9	11
Total specialist	11	14
Total new business	100	100

Note: All new business measures exclude further advances and product switchers.



Business and Risk Report *continued*

Credit risk – Residential mortgages *continued*

In October 2014, the Financial Policy Committee (FPC) introduced a 15% limit on the proportion of new lending for residential mortgages, excluding buy to let, that may be written at income multiples of 4.5 and above. The proportion of new lending at income multiples of 4.5 or higher was 8.3% in the year (2017: 10.6%). This is closely monitored and controlled to remain within risk appetite.

Credit risk

Residential mortgage lending continues to have a low risk profile as demonstrated by a low level of arrears compared to the industry average. The residential mortgages portfolio comprises many relatively small loans which are broadly homogenous, have low volatility of credit risk outcomes and are diversified in terms of the UK market and geographic segments.

LTV and credit risk concentration

LTV is calculated by weighting the borrower level LTV by the individual loan balance to arrive at an average LTV. This approach is considered to most appropriately reflect the exposure at risk.

Average LTV of loan stock		
	2018	2017
	%	%
Prime	55	54
Specialist	58	59
Group	56	55

Average LTV of new business		
	2018	2017
	%	%
Prime	72	72
Specialist (buy to let)	61	62
Group	71	71

Note:

The LTV of new business excludes further advances and product switchers.

LTV distribution of new business		
	2018	2017
	%	%
0% to 60%	26	26
60% to 75%	30	31
75% to 80%	9	9
80% to 85%	14	14
85% to 90%	18	17
90% to 95%	3	3
Over 95%	-	-
Total	100	100

The maximum LTV for new prime residential customers is 95%. The proportion of new lending greater than 80% LTV has increased to 35% (2017: 34%) in part as a result of the strategy to continue to support first time buyers.

Business and Risk Report *continued*Credit risk – Residential mortgages *continued*

Geographical concentration

Residential mortgage balances by LTV and region										
2018	Greater London	Central England	Northern England	South East England	South West England	Scotland	Wales	Northern Ireland	Total	
<i>(Audited)</i>	£m	£m	£m	£m	£m	£m	£m	£m	£m	%
Performing loans										
Fully collateralised LTV ratio:										
Up to 50%	26,771	10,392	6,896	8,727	5,820	2,895	1,383	925	63,809	
50% to 60%	11,496	5,932	4,101	4,502	3,240	1,612	799	389	32,071	
60% to 70%	9,006	6,807	6,136	3,678	3,304	2,375	1,271	392	32,969	
70% to 80%	6,441	4,944	5,568	2,809	2,414	2,495	1,098	403	26,172	
80% to 90%	4,987	2,817	3,386	1,974	1,592	1,453	675	274	17,158	
90% to 100%	506	319	452	306	172	283	63	83	2,184	
	59,207	31,211	26,539	21,996	16,542	11,113	5,289	2,466	174,363	98.4
Not fully collateralised:										
Over 100% LTV (A)	4	4	20	2	3	11	2	169	215	0.1
Collateral value on A	3	3	17	2	2	11	2	144	184	
Negative equity on A	1	1	3	-	1	-	-	25	31	
Total performing loans	59,211	31,215	26,559	21,998	16,545	11,124	5,291	2,635	174,578	98.5
Non-performing loans										
Fully collateralised LTV ratio:										
Up to 50%	489	162	112	122	70	39	23	28	1,045	
50% to 60%	199	100	82	70	44	31	15	11	552	
60% to 70%	78	109	116	60	52	37	22	11	485	
70% to 80%	30	79	100	26	31	39	19	10	334	
80% to 90%	13	32	84	8	6	21	16	8	188	
90% to 100%	4	3	36	3	1	9	7	8	71	
	813	485	530	289	204	176	102	76	2,675	1.5
Not fully collateralised:										
Over 100% LTV (B)	-	1	8	-	-	2	-	35	46	-
Collateral value on B	-	1	8	-	-	2	-	28	39	
Negative equity on B	-	-	-	-	-	-	-	7	7	
Total non-performing loans	813	486	538	289	204	178	102	111	2,721	1.5
Total residential mortgages	60,024	31,701	27,097	22,287	16,749	11,302	5,393	2,746	177,299	100.0
Geographical concentrations	34%	18%	15%	13%	9%	6%	3%	2%	100%	

Business and Risk Report *continued*Credit risk – Residential mortgages *continued*

Residential mortgage balances by LTV and region										
2017	Greater London	Central England	Northern England	South East England	South West England	Scotland	Wales	Northern Ireland	Total	
(Audited)	£m	£m	£m	£m	£m	£m	£m	£m	£m	%
Performing loans										
Fully collateralised LTV ratio:										
Up to 50%	28,493	9,737	6,361	8,783	5,630	2,915	1,208	833	63,960	
50% to 60%	11,822	5,612	3,748	4,637	3,141	1,649	681	357	31,647	
60% to 70%	8,659	6,888	5,737	3,852	3,426	2,366	972	395	32,295	
70% to 80%	5,169	4,905	5,897	2,216	2,198	2,619	1,296	352	24,652	
80% to 90%	3,084	2,483	3,304	1,314	1,207	1,285	707	324	13,708	
90% to 100%	288	237	699	132	102	157	233	140	1,988	
	57,515	29,862	25,746	20,934	15,704	10,991	5,097	2,401	168,250	98.2
Not fully collateralised:										
Over 100% LTV (A)	5	6	40	2	3	16	8	239	319	0.2
Collateral value on A	4	5	35	1	2	15	8	199	269	
Negative equity on A	1	1	5	1	1	1	-	40	50	
Total performing loans	57,520	29,868	25,786	20,936	15,707	11,007	5,105	2,640	168,569	98.4
Non-performing loans										
Fully collateralised LTV ratio:										
Up to 50%	504	153	100	120	66	40	20	25	1,028	
50% to 60%	192	98	69	69	41	28	12	11	520	
60% to 70%	69	105	107	58	49	42	17	12	459	
70% to 80%	17	94	105	21	32	36	24	10	339	
80% to 90%	8	42	86	6	6	18	15	11	192	
90% to 100%	1	7	53	-	1	7	14	7	90	
	791	499	520	274	195	171	102	76	2,628	1.6
Not fully collateralised:										
Over 100% LTV (B)	-	1	12	-	-	2	3	48	66	-
Collateral value on B	-	1	11	-	-	2	3	38	55	
Negative equity on B	-	-	1	-	-	-	-	10	11	
Total non-performing loans	791	500	532	274	195	173	105	124	2,694	1.6
Total residential mortgages	58,311	30,368	26,318	21,210	15,902	11,180	5,210	2,764	171,263	100.0
Geographical concentrations	34%	18%	15%	12%	9%	7%	3%	2%	100%	

Over the year, the geographical distribution across the UK has remained stable.

The value of partially collateralised non-performing loans has reduced to £46 million (2017: £66 million), primarily reflecting the growth in house prices.

During the year the proportion of loan balances with an LTV greater than 80% has increased to 11.2% (2017: 9.6%) reflecting the new lending and support for first time buyers.



Business and Risk Report *continued*

Credit risk – Residential mortgages *continued*

Arrears

The methodology for calculating mortgage arrears is based on the UK Finance (UKF) definition of arrears, where months in arrears is determined by dividing the arrears balance outstanding by the latest contractual payment.

Number of cases more than 3 months in arrears as % of total book		
	2018	2017
	%	%
Prime	0.34	0.36
Specialist	0.83	0.89
Total	0.43	0.45
UKF industry average	0.81	0.91

Favourable economic conditions, including a continued low interest rate environment, have resulted in the arrears performance of both the prime and specialist mortgage portfolios reaching a level where any future changes are more likely to be gradual upward movements rather than further falls. The combined arrears rate of 0.43% was approximately half of the UKF industry average rate of 0.81%.

Impaired loans

Impaired and non-performing loans are identified primarily by arrears status. Impaired accounts are defined as those greater than three months in arrears and include accounts subject to possession. Non-performing accounts include:

- all impaired loans;
- loans which are past due but not impaired, including any loan where a payment due is received late or missed; and
- past term interest only loans which have gone into litigation.

The non-performing loan amount represents the entire loan balance rather than just the payment overdue.

Impairment provisions are held in relation to both the performing and non-performing segments of the residential mortgage portfolio. Provisions reflect losses which have been incurred at the balance sheet date, based on objective evidence. Individual impairment provisions are assigned to accounts in possession and a collective provision is assigned to all other accounts. For currently performing loans, the provision reflects losses arising from impairment events that have occurred within the portfolio but are not identifiable at the reporting date.

Residential mortgages by payment status				
	2018			
	Prime	Specialist	Total	
(Audited)	£m	£m	£m	%
Performing:				
Neither past due nor impaired	142,382	32,196	174,578	98.5
Non-performing:				
Past due up to 3 months	1,294	685	1,979	1.1
Impaired:				
Past due 3 to 6 months	162	159	321	0.2
Past due 6 to 12 months	113	110	223	0.1
Past due over 12 months	89	76	165	0.1
Litigations (past term interest only)	1	1	2	-
Possessions	8	23	31	-
Total non-performing loans	1,667	1,054	2,721	1.5
Total residential mortgages	144,049	33,250	177,299	100.0
Non-performing loans as a % of total residential mortgages	1.2%	3.2%	1.5%	
Impairment provisions (£m)	36	109	145	
Impairment provisions as a % of non-performing balances	2.2%	10.3%	5.3%	
Impairment provisions as a % of total residential mortgages	0.02%	0.33%	0.08%	

Business and Risk Report *continued*Credit risk – Residential mortgages *continued*

Residential mortgages by payment status				
<i>(Audited)</i>	2017			
	Prime	Specialist	Total	
	£m	£m	£m	%
Performing:				
Neither past due nor impaired	136,374	32,195	168,569	98.4
Non-performing:				
Past due up to 3 months	1,258	663	1,921	1.1
Impaired:				
Past due 3 to 6 months	156	173	329	0.2
Past due 6 to 12 months	117	118	235	0.2
Past due over 12 months	91	91	182	0.1
Litigations (past term interest only)	-	1	1	-
Possessions	8	18	26	-
Total non-performing loans	1,630	1,064	2,694	1.6
Total residential mortgages	138,004	33,259	171,263	100.0
Non-performing loans as a % of total residential mortgages	1.2%	3.2%	1.6%	
Impairment provisions (£m)	34	110	144	
Impairment provisions as a % of non-performing balances	2.1%	10.3%	5.3%	
Impairment provisions as a % of total residential mortgages	0.02%	0.33%	0.08%	

Mortgage portfolios at 4 April 2018 included 1,634 mortgage accounts (2017: 1,674), including those in possession, where payments were more than 12 months in arrears. The total principal outstanding in these cases was £182 million (2017: £195 million). The total value of arrears in these cases was £22 million (2017: £20 million) or 0.01% (2017: 0.01%) of total mortgage balances.

Impairment losses for the year		
<i>(Audited)</i>	2018	2017
	£m	£m
Prime	3	11
Specialist	8	47
Total	11	58

Note:

Impairment losses represent the amount charged through the profit and loss account, rather than amounts written off during the year.

Possessions

Number of properties in possession as % of total book				
	2018		2017	
	Number of properties	%	Number of properties	%
Prime	108	0.01	89	0.01
Specialist	150	0.05	136	0.05
Total	258	0.02	225	0.01
UKF industry average		0.03		0.03

Repossessions as a percentage of the total book have remained stable.



Business and Risk Report *continued*

Credit risk – Residential mortgages *continued*

Interest only mortgages

Nationwide does not offer any new advances for prime residential mortgages on an interest only basis. However, there are historical balances which were originally advanced as interest only mortgages or where a change in terms to an interest only basis was agreed (this option was withdrawn in 2012). Maturities on interest only mortgages are managed closely, engaging regularly with borrowers to ensure the loan is redeemed or to agree a strategy for repayment.

The majority of the specialist portfolio comprises buy to let loans, of which approximately 80% are advanced on an interest only basis.

Interest only mortgages – term to maturity							
2018	Term expired (still open)	Due within one year	Due after one year and before two years	Due after two years and before five years	Due after more than five years	Total	% of total book
	£m	£m	£m	£m	£m	£m	%
Prime	54	331	366	1,577	11,271	13,599	9.4
Specialist	126	173	213	1,305	27,795	29,612	89.1
Total	180	504	579	2,882	39,066	43,211	24.4

Interest only mortgages – term to maturity							
2017	Term expired (still open)	Due within one year	Due after one year and before two years	Due after two years and before five years	Due after more than five years	Total	% of total book
	£m	£m	£m	£m	£m	£m	%
Prime	64	337	444	1,636	13,604	16,085	11.7
Specialist	104	202	216	1,173	28,037	29,732	89.4
Total	168	539	660	2,809	41,641	45,817	26.8

Interest only loans that are 'term expired (still open)' are, unless otherwise in arrears, considered to be performing for six months, pending renegotiation of the facility. After six months, if not in litigation, the loans are classified as forborne.

Negative equity on non-performing loans

	Negative equity of non-performing residential mortgages			
	2018		2017	
	Prime	Specialist	Prime	Specialist
	£m	£m	£m	£m
Past due but not impaired	1	2	1	3
Impaired	-	3	1	5
Possessions	-	1	-	1
Total	1	6	2	9

Note:

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

The stable arrears position and growth in house prices have combined to reduce the value of non-performing loans in negative equity.



Business and Risk Report *continued*

Credit risk – Residential mortgages *continued*

Forbearance

The following concession events are included within the forbearance reporting for residential mortgages:

Past term interest only concession

Nationwide works with borrowers who are unable to repay the capital at term expiry of their interest only mortgage. Where a borrower is unable to renegotiate the facility within six months of maturity but no legal enforcement is pursued, the account is considered forborne. Should another concession event such as a term extension occur within the six month period, this will also be classed as forbearance.

Interest only concessions

Where a temporary interest only concession is granted the loans do not accrue arrears for the period of the concession and are not categorised as impaired, unless already impaired, provided the revised interest only repayment amount is maintained.

Capitalisation

When a borrower emerges from financial difficulty, and provided they have made at least six full monthly instalments, they are offered the option to capitalise arrears. This results in the account being repaired and the loans are categorised as not impaired provided contractual repayments are maintained.

Term extensions (within term)

Customers in financial difficulty may be allowed to extend the term of their mortgage. On a capital repayment mortgage this will reduce their monthly commitment; interest only borrowers will benefit by having a longer period to repay the capital at maturity.

Permanent interest only conversions

In the past, some borrowers in financial difficulty were granted a permanent interest only conversion, normally reducing their monthly commitment. This facility was withdrawn in March 2012.

The table below provides details of residential mortgages subject to forbearance.

Balances subject to forbearance						
	2018			2017		
	Prime	Specialist	Total	Prime	Specialist	Total
	£m	£m	£m	£m	£m	£m
Past term interest only	147	136	283	154	141	295
Interest only concessions	512	66	578	501	70	571
Capitalisation	45	59	104	59	72	131
Term extensions (within term)	35	14	49	42	16	58
Permanent interest only conversions	5	24	29	6	33	39
Total forbearance	744	299	1,043	762	332	1,094
Impairment provision on forborne loans	8	9	17	7	11	18

Note:

Loans where more than one concession event has occurred are reported under the latest event.

Balances subject to forbearance have reduced, reflecting the favourable economic conditions, including a continued low interest environment. Consistent with the European Banking Authority reporting definitions, loans that meet the regulatory forbearance exit criteria are not reported as forborne.

Impairment provisions on forborne accounts are calculated to ensure that they appropriately capture any heightened likelihood for these accounts to default.



Business and Risk Report *continued*

Credit risk – Consumer banking

Summary

The consumer banking portfolio comprises balances on unsecured retail banking products, specifically overdrawn current accounts, personal loans and credit cards. Total balances across these portfolios have grown by 4% to £4,107 million during the period (2017: £3,949 million).

Nationwide is aware of the pressure that some of our members will be under, with increasing levels of household debt. We continue to operate with a commitment to responsible lending and a focus on championing good conduct and fair outcomes.

The quality of the unsecured portfolios has remained strong, benefiting from proactive risk management practices and continued low interest rates. Total non-performing balances (excluding charged off accounts) as a proportion of total balances have remained stable over the year at 4%.

Impairment provisions are held against both performing and non-performing segments of the consumer banking portfolio. Provision balances have increased in the year, largely due to updates to provision assumptions to reflect the current economic conditions. Across the consumer banking portfolios this has led to a 3% increase in provision coverage as a percentage of total non-performing balances from 86% to 89%.

Consumer banking balances				
<i>(Audited)</i>	2018		2017	
	£m	%	£m	%
Overdrawn current accounts	277	7	261	7
Personal loans	2,031	49	1,957	49
Credit cards	1,799	44	1,731	44
Total consumer banking	4,107	100	3,949	100

Credit risk

Impaired accounts

Credit risk on the consumer banking portfolios is primarily monitored and reported based on arrears status. Impaired accounts are those greater than three months in arrears or which have individual provisions raised against them. Non-performing accounts comprise all impaired accounts as well as accounts where a payment due is received late or missed. This includes overdrawn accounts with balances in excess of the agreed limit. The non-performing loan amount represents the entire loan rather than just the payment overdue.

The performance of the portfolios is closely monitored, with impairment provisions held for both the performing and non-performing segments of the consumer banking portfolio. Impairment provisions reflect estimated losses which have been incurred at the balance sheet date, based on objective evidence. For performing loans, the impairment provision reflects the assessment of losses arising from events that have occurred but which have not been specifically identified at the reporting date.

Business and Risk Report *continued*Credit risk – Consumer banking *continued*

Consumer banking by payment due status					
	2018				
	Overdrawn current accounts	Personal loans	Credit cards	Total	
<i>(Audited)</i>	£m	£m	£m	£m	%
Performing:					
Neither past due nor impaired	235	1,882	1,656	3,773	92
Non-performing:					
Past due up to 3 months	12	43	33	88	
Impaired:					
Past due 3 to 6 months	4	13	11	28	
Past due 6 to 12 months	3	12	2	17	
Past due over 12 months	3	13	-	16	
	22	81	46	149	4
Charged off (note i)	20	68	97	185	4
Total non-performing	42	149	143	334	
Total consumer banking lending	277	2,031	1,799	4,107	100
Non-performing loans as % of total (excluding charged off balances)	9%	4%	3%	4%	
Impairment provisions excluding charged off balances (£m)	17	56	50	123	
Impairment provisions on charged off balances (£m)	19	65	91	175	
Total impairment provisions	36	121	141	298	
Impairment provisions as a % of non-performing loans (including charged off balances)	86%	81%	99%	89%	
Impairment provisions as % of total balances	13%	6%	8%	7%	

Business and Risk Report *continued*Credit risk – Consumer banking *continued*

Consumer banking by payment due status					
	2017				
	Overdrawn current accounts	Personal loans	Credit cards	Total	
(Audited)	£m	£m	£m	£m	%
Performing:					
Neither past due nor impaired	225	1,822	1,591	3,638	92
Non-performing:					
Past due up to 3 months	12	38	28	78	
Impaired:					
Past due 3 to 6 months	4	10	12	26	
Past due 6 to 12 months	3	11	2	16	
Past due over 12 months	3	14	-	17	
	22	73	42	137	4
Charged off (note i)	14	62	98	174	4
Total non-performing	36	135	140	311	
Total consumer banking lending	261	1,957	1,731	3,949	100
Non-performing loans as % of total (excluding charged off balances)	9%	4%	3%	4%	
Impairment provisions excluding charged off balances	15	48	42	105	
Impairment provisions on charged off balances	13	60	91	164	
Total impairment provisions	28	108	133	269	
Impairment provisions as a % of non-performing loans (including charged off balances)	78%	80%	95%	86%	
Impairment provisions as % of total balances	11%	6%	8%	7%	

Note:

- i. Charged off balances relate to accounts which are closed to future transactions and are held on the balance sheet for an extended period (up to 36 months, depending on the product) whilst recovery procedures take place.

Total non-performing balances (excluding charged off accounts) have increased by 9% to £149 million (2017: £137 million), driven by small increases in early arrears (past due up to three months) on the personal loan and credit card portfolios. However, as the portfolios have continued to grow over recent periods, the non-performing balances, as a percentage of the total consumer banking lending, have remained stable at 4%.

Impairment losses for the year				
	Overdrawn current accounts	Personal loans	Credit cards	Total
(Audited)	£m	£m	£m	£m
Year to 4 April 2018	15	36	46	97
Year to 4 April 2017	12	28	38	78

Note:

Impairment losses represent the amount charged through the profit and loss account, rather than amounts written off during the year.

Impairment losses have increased in the year, driven by both growth in balances and updated provision assumptions to reflect the current economic climate.



Business and Risk Report *continued*

Credit risk – Consumer banking *continued*

Forbearance

Nationwide is committed to supporting borrowers facing financial difficulty by working with them to find a solution through proactive arrears management and forbearance.

The following concession events are included within the forbearance reporting for consumer banking:

Payment concession

This concession consists of reduced monthly payments over an agreed period and may be offered to borrowers with an overdraft or credit card. For credit cards subject to such a concession, arrears do not increase provided the payments are made.

Interest suppressed payment arrangement

This temporary interest payment concession results in reduced monthly payments and may be offered to borrowers with an overdraft, credit card or personal loan. Interest payments and fees are suppressed during the period of the concession and arrears do not increase.

Balances re-aged/re-written

As borrowers repay their debt in line with the terms of their arrangement and begin to emerge from financial difficulty we will repair their accounts, bringing them into an up-to-date and performing position. For personal loans we will re-write their account by extending it over a longer term, to maintain a reduced monthly payment. For credit cards we re-age the account and set the payment status to 'up-to-date', at which point the borrower is treated in the same way as any other performing account.

The table below provides details of the consumer banking exposures which are subject to forbearance.

Balances subject to forbearance				
2018	Overdrawn current accounts	Personal loans	Credit cards	Total
	£m	£m	£m	£m
Payment concession	18	-	2	20
Interest suppressed payment concession	6	32	16	54
Balance re-aged/re-written	-	-	4	4
Total forbearance	24	32	22	78
Impairment provision on forborne loans	3	26	14	43

Balances subject to forbearance				
2017	Overdrawn current accounts	Personal loans	Credit cards	Total
	£m	£m	£m	£m
Payment concession	17	-	2	19
Interest suppressed payment concession	5	29	18	52
Balance re-aged/re-written	-	-	5	5
Total forbearance	22	29	25	76
Impairment provision on forborne loans	3	24	16	43

Note:

Where more than one concession event has occurred, exposures are reported under the latest event.

Consistent with the European Banking Authority reporting definitions, loans that meet the regulatory forbearance exit criteria are not reported as forborne.

Impairment provisions on forborne accounts are calculated to ensure that they appropriately capture any heightened likelihood for these accounts to default.



Business and Risk Report *continued*

Credit risk – Commercial and other lending

Summary

The commercial and other lending portfolio comprises the following:

Commercial and other lending balances				
	2018		2017	
	£m	%	£m	%
Registered social landlords (note i)	6,820	71	7,546	67
Commercial real estate (CRE)	1,868	20	2,568	23
Project Finance (note ii)	906	9	1,096	10
Total commercial lending	9,594	100	11,210	100
Fair value adjustment for micro hedged risk (note iii)	1,043		1,370	
Other lending	79		17	
Total	10,716		12,597	

Notes:

- i. Loans to registered social landlords are secured on residential property.
- ii. Loans advanced in relation to project finance are secured on cash flows from government or local authority backed contracts.
- iii. Micro hedged risk relates to loans hedged on an individual basis.

The strategy for the commercial lending portfolio continues to be to hold and actively manage to maturity in line with contractual terms.

The registered social landlord and project finance portfolios now amount to 80% (4 April 2017: 77%) of the commercial lending portfolio. This increase is due to the run-off of the CRE portfolio, which is subject to shorter maturity dates. Notwithstanding the reduction in CRE lending balances, the exposure remains well spread across sectors and geographic regions. The registered social landlord and project finance assets are fully performing, reflecting their long-term, lower risk nature.

Other lending comprises £71 million of collateral to support repurchase transactions with a central counterparty and £8 million of deferred consideration relating to an investment in Visa Inc.

Credit risk

Credit risk in the commercial loan portfolio is linked to arrears, the level of collateral to cover any loan balances and the availability of credit to refinance loans at contractual maturity. Nationwide adopts robust credit management policies and processes designed to recognise and manage the risks arising, or likely to arise, from the portfolio.

Credit risk in the CRE portfolio continues to reduce as the managed exit of this business continues.

The registered social landlord portfolio is risk rated using internal rating models with the major drivers being financial strength, independent viability assessment ratings provided by Homes England, and the type and size of the registered social landlord. The distribution of exposures is weighted more towards the stronger risk ratings and, against a backdrop of a long history of zero defaults, the risk profile of the portfolio remains low.

The project finance portfolio is secured against contractual cash flows from projects procured under the Private Finance Initiative rather than physical assets. The majority of loans are secured on projects which are now operational and benefiting from secure long-term cash flows, with one case, with a balance of £25 million, which has reverted to the construction phase.

Business and Risk Report *continued*Credit risk – Commercial and other lending *continued***Loan to value**

The following table shows the CRE portfolio split by LTV and region:

CRE lending balances by LTV and region				
2018	London	Rest of UK (note i)	Total	
	£m	£m	£m	%
Performing loans				
Fully collateralised				
LTV ratio (note ii):				
Less than 25%	257	54	311	
25% to 50%	691	241	932	
51% to 75%	297	222	519	
76% to 90%	9	40	49	
91% to 100%	-	4	4	
	1,254	561	1,815	97
Not fully collateralised:				
Over 100% LTV (A)	-	1	1	-
Collateral value on A	-	-	-	
Negative equity on A	-	1	1	
Total performing loans	1,254	562	1,816	97
Non-performing loans (note iii)				
Fully collateralised				
LTV ratio:				
Less than 25%	1	2	3	
25% to 50%	14	1	15	
51% to 75%	4	11	15	
76% to 90%	-	6	6	
91% to 100%	-	-	-	
	19	20	39	2
Not fully collateralised:				
Over 100% LTV (B)	-	13	13	1
Collateral value on B	-	7	7	
Negative equity on B (note iv)	-	6	6	
Total non-performing loans	19	33	52	3
Total CRE loans	1,273	595	1,868	100
Geographical concentration	68%	32%	100%	

Business and Risk Report *continued*Credit risk – Commercial and other lending *continued*

CRE lending balances by LTV and region				
2017	London	Rest of UK (note i)	Total	
	£m	£m	£m	%
Performing loans				
Fully collateralised				
LTV ratio (note ii):				
Less than 25%	217	57	274	
25% to 50%	702	537	1,239	
51% to 75%	466	427	893	
76% to 90%	8	63	71	
91% to 100%	1	9	10	
	1,394	1,093	2,487	97
Not fully collateralised:				
Over 100% LTV (A)	2	5	7	-
Collateral value on A	-	4	4	
Negative equity on A	2	1	3	
Total performing loans	1,396	1,098	2,494	97
Non-performing loans (note iii)				
Fully collateralised				
LTV ratio:				
Less than 25%	1	-	1	
25% to 50%	9	5	14	
51% to 75%	8	5	13	
76% to 90%	-	3	3	
91% to 100%	3	7	10	
	21	20	41	2
Not fully collateralised:				
Over 100% LTV (B)	1	32	33	1
Collateral value on B	-	20	20	
Negative equity on B (note iv)	1	12	13	
Total non-performing loans	22	52	74	3
Total CRE loans	1,418	1,150	2,568	100
Geographical concentration	55%	45%	100%	

Notes:

- i. Includes lending against collateral based in the Channel Islands.
- ii. The LTV ratio is calculated using the on-balance sheet carrying amount of the loan divided by the indexed value of the most recent independent external collateral valuation. The Investment Property Databank (IPD) monthly index is used.
- iii. Non-performing loans include impaired loans and loans with arrears of less than three months which are not impaired.
- iv. All non-performing loans with negative equity are impaired.

Non-performing loans represent 3% of CRE balances (2017: 3%). The value of partially collateralised non-performing loans and the negative equity on collateral for non-performing loans have reduced, reflecting the improving book performance and managed exit activity.



Business and Risk Report *continued*

Credit risk – Commercial and other lending *continued*

Credit risk concentrations

The geographic concentration for CRE lending balances is shown in the loan to value tables above. The concentration to London has increased to 68% (2017: 55%).

The CRE portfolio remains well spread across sectors as shown below:

CRE lending balances and impairment provisions by type (note i)		
	2018	2017
	£m	£m
Retail	400	812
Office	376	472
Residential	837	986
Industrial and warehouse	115	157
Leisure and hotel	120	127
Other	20	14
Total CRE lending	1,868	2,568
Impairment provision:		
Retail	2	7
Office	1	3
Residential	5	6
Industrial and warehouse	-	1
Leisure and hotel	-	6
Other	7	2
Total impairment provisions	15	25

Note:

- i. A CRE loan may be secured on assets crossing different sectors; the balances are therefore attributed to the sector where the majority of the exposure arises. This can lead to recategorisations occurring between periods if the asset mix changes.

Arrears and impairment

Impairment provisions are held in relation to both the performing and non-performing segments of commercial lending and other lending. Provisions reflect estimated losses which have been incurred at the balance sheet date, based on objective evidence. Individual impairment provisions are assigned to facilities exhibiting signs of financial difficulty and a collective provision is assigned to all other accounts. For currently performing loans, the collective provision reflects losses arising from impairment events that have occurred within the portfolio but are not identifiable at the reporting date.

No losses have been experienced on the registered social landlord or project finance portfolios and there is no non-performance within these portfolios. As a result, impairment provisions are required only against the CRE portfolio.

Business and Risk Report *continued*Credit risk – Commercial and other lending *continued*

The table below sets out the payment due status and impairment provisions for the CRE portfolio and other lending.

CRE balances by payment due status				
	2018		2017	
	£m	%	£m	%
Performing:				
Neither past due nor impaired	1,816	97	2,494	97
Non-performing:				
Past due up to 3 months but not impaired (note i)	22	1	29	1
Impaired (note ii):				
Past due up to 3 months	6	-	24	1
Past due 3 to 6 months	11	1	1	-
Past due 6 to 12 months	1	-	3	-
Past due over 12 months	12	1	17	1
Possessions (note iii)	-	-	-	-
Total non-performing balances	52	3	74	3
Total	1,868	100	2,568	100
Impairment provisions				
Individual	11	73	20	80
Collective	4	27	5	20
Total impairment provisions	15	100	25	100
Provision coverage ratios				
Individual provisions as % of impaired balances		37		44
Total provisions as % of non-performing balances		29		34
Total provisions as % of total gross balances		1		1
Estimated collateral:				
Against loans past due but not impaired	22	100	29	100
Against impaired loans	23	77	32	71
Total collateral	45	87	61	82

Notes:

- The status 'past due up to three months but not impaired' includes any asset where a payment due under strict contractual terms is received late or missed. The amount included is the entire financial asset rather than just the payment overdue.
- Impaired loans include those balances which are more than three months in arrears, or against which an individual provision is held.
- Possession balances represent loans for which Nationwide has taken ownership of security pending sale. Assets in possession are realised to derive the maximum benefit for all interested parties. Nationwide does not occupy or otherwise use for any purposes the repossessed assets.

Impairment reversal for the year for commercial and other lending portfolio		
	2018	2017
	£m	£m
Total	(1)	(5)

Note:

Impairment reversals represent the amount recognised through the profit and loss account, rather than amounts written off during the year.



Business and Risk Report *continued*

Credit risk – Commercial and other lending *continued*

Forbearance

Forbearance is recorded and reported at borrower level and applies to all commercial lending including impaired exposures and borrowers subject to enforcement and recovery action. Impairment provisions on forbore loans are calculated on an individual borrower basis.

For commercial customers in financial difficulty, the following concession events are included within forbearance reporting:

Refinance

Debt restructuring, either mid-term or at maturity, will be considered where asset sales or external refinance cannot be secured to repay facilities in full and where a restructure is considered to provide the best debt recovery outcome for both the borrower and Nationwide.

Interest concession

The temporary postponement of interest or a reduction to the interest rate charged, during which period the loans do not accrue arrears, may be considered where the borrower is experiencing payment difficulties.

Capital concession

Capital concessions consist of temporary suspensions to capital repayments to allow the borrower time to overcome payment difficulties, the full or partial consolidation of previous payment arrears or the partial write-off of debt.

Security amendment

Where a borrower seeks the release of assets charged to Nationwide as security for their commercial loan, this will be treated as forbearance where Nationwide's position is weakened in terms of either the loan to value of the remaining exposure or the level of interest cover available.

Extension at maturity

Borrowers who are unable to repay the loan at term expiry may be given short term maturity extensions to allow them time to negotiate the repayment of facilities in full either via asset sales or external refinance.

Breach of covenant

Where a borrower is unable to comply with either financial or non-financial covenants, as specified in their loan agreement, a temporary waiver or amendment to the covenants will be considered, as appropriate.

The table below provides details of the commercial loans which are subject to forbearance.

Lending subject to forbearance		
	2018	2017
	£m	£m
Refinance	78	34
Modifications:		
Interest concession	-	1
Capital concession	50	50
Security amendment	9	56
Extension at maturity	42	126
Breach of covenant	139	80
Total	318	347
Impairment provision on forbore loans	10	17

Note:

Loans where more than one concession event has occurred are reported under the latest event.

Consistent with the European Banking Authority reporting definitions, loans that meet the regulatory forbearance exit criteria are not reported as forbore.

The exposures subject to forbearance have reduced to £318 million (2017: £347 million), reflecting the managed exit activity and improving book performance.



Business and Risk Report *continued*

Credit risk – Treasury assets

Summary

The treasury portfolio is held primarily for liquidity management and, in the case of derivatives, for market risk management. As at 4 April 2018 treasury assets represented 15.3% (2017: 13.7%) of total assets.

The net increase in the portfolio compared to the previous year is predominantly due to increased government bond holdings, and cash balances received under the Bank of England's Term Funding Scheme (TFS).

Treasury asset balances		
	2018	2017
(Audited)	£m	£m
Cash	14,361	13,017
Loans and advances to banks	3,422	2,587
Investment securities	13,046	9,831
Liquidity and investment portfolio	30,829	25,435
Derivative assets	4,121	5,043
Total treasury portfolio	34,950	30,478

Note:

Derivatives are classified as assets where their fair value is positive and liabilities where their fair value is negative. At 4 April 2018 derivative liabilities were £2,337 million (2017: £3,182 million).

In line with the Board's liquidity risk appetite, investment activity is restricted to high quality liquid securities comprising central bank reserves and highly rated debt securities issued by a limited range of governments, multilateral development banks ('supranationals') and government guaranteed agencies. In addition, cash is invested in highly rated liquid assets that are eligible for accessing central bank funding operations.

Liquidity portfolio assets are generally unsecured; however, reverse repos, asset-backed securities and similar instruments are secured by pools of financial assets. During the year, Nationwide disposed of its residual out of policy legacy assets (2017: £172 million). There are no exposures to emerging markets, hedge funds or credit default swaps.

Derivatives are used to reduce exposure to market risks but are not used for trading or speculative purposes.

Managing treasury credit risks

Credit risk within the treasury portfolio arises primarily from the instruments held and transacted by the Treasury function for operational, liquidity and investment purposes. The treasury credit risk function manages all aspects of credit risk in accordance with the Society's risk governance frameworks, under the supervision of the Credit Committee.

A monthly review is undertaken of the current and expected future performance of all treasury assets. An established governance structure exists to identify and review under-performing assets and assess the likelihood of future losses. Assets are impaired where there is objective evidence that current events or performance will result in a loss. As at 4 April 2018 no treasury assets were impaired (2017: £9 million).

In addition, counterparty credit risk arises from the use of derivatives; these are only traded with highly rated organisations and are collateralised under market standard documentation.



Business and Risk Report *continued*

Credit risk – Treasury assets *continued*

Liquidity and investment portfolio

The liquidity and investment portfolio of £30,829 million (2017: £25,435 million) comprises liquid assets and other securities. The size of the portfolio reflects fluctuations in market prices, Nationwide's operational and strategic liquidity requirements and legacy asset disposals. An analysis of the balance sheet portfolios by asset class, credit rating and geographical location of the issuers is set out below.

Liquidity and investment portfolio by credit rating (note i)									
2018		AAA	AA	A	Other	UK	US	Europe	Other
(Audited)	£m	%	%	%	%	%	%	%	%
Liquid assets:									
Cash and reserves at central banks	14,361	-	100	-	-	100	-	-	-
Government bonds	8,937	15	85	-	-	80	5	15	-
Supranational bonds	655	96	4	-	-	-	-	-	100
Covered bonds	1,007	100	-	-	-	51	-	27	22
Residential mortgage backed securities (RMBS) available for sale	738	100	-	-	-	64	-	36	-
Asset backed securities (other)	302	100	-	-	-	56	-	44	-
Liquid assets total	26,000	16	84	-	-	87	2	8	3
Other securities (note ii):									
RMBS available for sale	188	21	19	60	-	100	-	-	-
RMBS held to maturity	1,120	85	5	7	3	100	-	-	-
Other investments	99	-	36	42	22	22	42	36	-
Other securities total	1,407	71	9	16	4	95	3	2	-
Loans and advances to banks (note iii)	3,422	-	47	50	3	84	6	8	2
Total	30,829	16	77	6	1	87	2	8	3

Liquidity and investment portfolio by credit rating (note i)									
2017		AAA	AA	A	Other	UK	US	Europe	Other
(Audited)	£m	%	%	%	%	%	%	%	%
Liquid assets:									
Cash and reserves at central banks	13,017	-	90	-	10	90	-	10	-
Government bonds	6,438	10	90	-	-	78	9	13	-
Supranational bonds	459	88	12	-	-	-	-	-	100
Covered bonds	931	100	-	-	-	51	-	33	16
Residential mortgage backed securities (RMBS) available for sale	922	100	-	-	-	61	-	39	-
Asset backed securities (other)	285	100	-	-	-	83	-	17	-
Liquid assets total	22,052	14	80	-	6	81	3	13	3
Other securities (note ii):									
RMBS available for sale	288	27	3	70	-	98	-	2	-
Commercial mortgage backed securities (CMBS)	11	-	38	24	38	38	62	-	-
Collateralised loan obligations (CLO)	226	86	14	-	-	88	12	-	-
Student loans	120	48	52	-	-	-	100	-	-
Other investments	151	-	32	28	40	44	24	32	-
Other securities total	796	42	19	31	8	69	24	7	-
Loans and advances to banks (note iii)	2,587	-	47	51	2	70	18	10	2
Total	25,435	14	74	6	6	80	5	12	3

Notes:

- Ratings used are obtained from Standard & Poor's (S&P), and from Moody's if no S&P rating is available. Internal ratings are used if neither is available.
- Includes RMBS (UK Buy to Let and UK Non-Conforming) not eligible for the Liquidity Coverage Ratio (LCR).
- Loans and advances to banks includes derivative collateral and reverse repo balances.

Of the total £30,829 million (2017: £25,435 million) liquidity and investment portfolio, £11,926 million (2017: £9,831 million) is classified as available for sale (AFS). This includes all assets except for 'Cash and reserves at central banks', 'Loans and advances to banks' and 'RMBS held to maturity'.



Business and Risk Report *continued*

Credit risk – Treasury assets *continued*

Available for sale reserve

AFS assets of £11,926 million (2017: £9,831 million) are marked to market, with fair value movements recognised in reserves.

Of these assets, £44 million (2017: £66 million) are classified as Level 3 (valuation not based on observable market data) for the purposes of IFRS 13. The decrease from the prior year is primarily due to the partial disposal of Nationwide's investment in VocaLink, valued at £30 million. Details of fair value movements can be found in notes 21 and 22 to the accounts. The table below shows the fair value carrying amount and associated AFS reserve for the liquidity and investment assets.

	2018		2017	
	Fair value on balance sheet	Cumulative AFS reserve	Fair value on balance sheet	Cumulative AFS reserve
	£m	£m	£m	£m
(Audited)				
Liquid assets:				
Cash and reserves at central banks	14,361	(note i)	13,017	(note i)
Government bonds	8,937	(172)	6,438	(383)
Supranational bonds	655	4	459	(4)
Covered bonds	1,007	(8)	931	(17)
RMBS available for sale	738	(1)	922	2
Asset backed securities (other)	302	-	285	-
Liquid assets total	26,000	(177)	22,052	(402)
Other securities:				
RMBS available for sale	188	-	288	4
RMBS held to maturity	1,120	(note i)	-	-
CMBS	-	-	11	-
Collateralised loan obligations (CLO)	-	-	226	-
Student loans	-	-	120	6
Other investments	99	(17)	151	(31)
Other securities total	1,407	(17)	796	(21)
Loans and advances to banks	3,422	(note i)	2,587	(note i)
Total	30,829	(194)	25,435	(423)
AFS reserve before hedge accounting and taxation		(194)		(423)
Hedge accounting adjustment for interest rate risk		99		370
Taxation		20		9
AFS reserve (net)		(75)		(44)

Note:

i. Not applicable for 'Cash', 'RMBS held to maturity' and 'Loans and advances to banks'.

As at 4 April 2018, the balance on the AFS reserve had moved to a £75 million gain, net of tax (2017: £44 million gain). The movements in the AFS reserve reflect general market movements and the disposal of legacy assets. The fair value movement of AFS assets that are not impaired has no effect on profit.

Business and Risk Report *continued*Credit risk – Treasury assets *continued***Country exposures**

The following table summarises the exposure to institutions outside the UK. The exposures are shown at their balance sheet carrying values.

Country exposures									
2018	Cash	Government bonds	Mortgage backed securities	Covered bonds	Supra-national bonds	Loans to banks	Other corporate	Other assets	Total
(Audited)	£m	£m	£m	£m	£m	£m	£m	£m	£m
Austria	-	66	-	-	-	-	-	-	66
Belgium	-	44	-	-	-	-	-	-	44
Finland	-	267	-	24	-	-	-	-	291
France	-	-	-	-	-	156	-	36	192
Germany	-	627	-	-	-	119	-	132	878
Ireland	-	-	-	-	-	1	-	-	1
Netherlands	-	335	263	-	-	-	-	-	598
Total Eurozone	-	1,339	263	24	-	276	-	168	2,070
USA	-	441	-	-	-	215	-	41	697
Rest of world (note i)	-	-	-	472	656	63	-	-	1,191
Total	-	1,780	263	496	656	554	-	209	3,958

Country exposures									
2017	Cash	Government bonds	Mortgage backed securities	Covered bonds	Supra-national bonds	Loans to banks	Other corporate	Other assets	Total
(Audited)	£m	£m	£m	£m	£m	£m	£m	£m	£m
Finland	-	218	-	24	-	-	-	-	242
France	-	-	-	31	-	-	1	54	86
Germany	-	484	-	-	-	44	-	43	571
Ireland	1,258	-	-	-	-	27	-	-	1,285
Italy	-	-	-	-	-	-	3	-	3
Netherlands	-	153	366	-	-	-	-	-	519
Total Eurozone	1,258	855	366	55	-	71	4	97	2,706
USA	16	600	7	-	-	474	-	182	1,279
Rest of world (note i)	-	-	-	400	459	232	-	-	1,091
Total	1,274	1,455	373	455	459	777	4	279	5,076

Note:

i. Rest of world exposure is to Australia, Canada, Denmark, Norway, Sweden and Switzerland.

None of the exposures detailed in the table above were in default at 4 April 2018 (2017: £nil), and no impairment was incurred on these assets in the year (2017: £nil).



Business and Risk Report *continued*

Credit risk – Treasury assets *continued*

Derivative financial instruments

Derivatives are used to reduce exposure to market risks, although the application of accounting rules can create volatility in the income statement in a financial year. The fair value of derivative assets at 4 April 2018 was £4.1 billion (2017: £5.0 billion) and the fair value of derivative liabilities was £2.3 billion (2017: £3.2 billion).

The International Swaps and Derivatives Association (ISDA) Master Agreement is Nationwide's preferred agreement for documenting derivative transactions. A Credit Support Annex (CSA) is always executed in conjunction with the ISDA Master Agreement. Under the terms of a CSA, collateral is passed between parties to mitigate the market-contingent counterparty risk inherent in the outstanding positions. CSAs are two-way agreements where both parties post collateral dependent on the exposure of the derivative. Collateral is paid or received on a regular basis (typically daily) to mitigate the mark to market exposures.

Nationwide's CSA legal documentation for derivatives grants legal rights of set off for transactions with the same overall counterparty. Accordingly, the credit risk associated with such positions is reduced to the extent that negative mark to market values offset positive mark to market values in the calculation of credit risk within each netting agreement.

Under the terms of CSA netting arrangements, outstanding transactions with the same counterparty can be offset and settled net following a default, or another predetermined event. Under CSA arrangements, netting benefits of £2.0 billion (2017: £2.2 billion) were available and £2.2 billion of collateral (2017: £2.8 billion) was held. Only cash is held as collateral.

To comply with EU regulatory requirements, Nationwide has indirect clearing arrangements with a central counterparty (CCP) which it uses to clear standardised derivatives.

The following table shows the exposure to counterparty credit risk for derivative contracts after netting benefits and collateral:

Derivative credit exposure								
Counterparty credit quality (Audited)	2018				2017			
	AA	A	BBB	Total	AA	A	BBB	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Gross positive fair value of contracts	1,584	2,266	271	4,121	2,077	2,576	390	5,043
Netting benefits	(532)	(1,156)	(271)	(1,959)	(797)	(1,030)	(389)	(2,216)
Net current credit exposure	1,052	1,110	-	2,162	1,280	1,546	1	2,827
Collateral (cash)	(1,051)	(1,106)	-	(2,157)	(1,261)	(1,537)	(1)	(2,799)
Net derivative credit exposure	1	4	-	5	19	9	-	28

Liquidity and funding risk

Summary

Liquidity risk is the risk that Nationwide is unable to meet its liabilities as they fall due and maintain member and other stakeholder confidence. Funding risk is the risk that Nationwide is unable to maintain diverse funding sources in wholesale and retail markets and manage retail funding risk that can arise from excessive concentrations of higher risk deposits.

Nationwide manages liquidity and funding risks within a comprehensive risk framework which includes its policy, strategy, limit setting and monitoring, stress testing and robust governance controls.

This framework ensures that Nationwide maintains stable and diverse funding sources and sufficient holdings of high quality liquid assets so that there is no significant risk that liabilities cannot be met as they fall due.

Liquidity and funding levels continued to be within Board risk appetite and regulatory requirements at all times during the year. This includes the LCR, which ensures that sufficient high quality liquid assets are held to survive a short-term severe but plausible liquidity stress. Nationwide's LCR at 4 April 2018 increased to 130.3% (4 April 2017: 124.0%). At 4 April 2017, the LCR was impacted by an agreement to purchase £1.2 billion of residential mortgage backed securities (RMBS) under a programme to securitise Bradford & Bingley residential mortgages. Excluding this item our 2018 and 2017 LCR would have been broadly consistent.

Nationwide also monitors its position against the longer term funding metric, the Net Stable Funding Ratio (NSFR). Based on current interpretations of regulatory requirements and guidance, the NSFR at 4 April 2018 was 131.0% (4 April 2017: 132.6%) which exceeds the expected 100% minimum future requirement.



Business and Risk Report *continued*

Liquidity and funding risk *continued*

Funding risk

Funding strategy

Nationwide's funding strategy is to remain predominantly retail funded; retail customer loans and advances are largely funded by customer deposits. Non-retail lending, including treasury assets and commercial customer loans, are largely funded by wholesale debt, as set out below.

Funding profile					
Assets	2018	2017	Liabilities	2018	2017
	£bn	£bn		£bn	£bn
Retail mortgages	177.2	171.1	Retail funding	148.4	146.9
Treasury assets (including liquidity portfolio)	30.8	25.4	Wholesale funding	58.8	55.5
Other retail lending	3.8	3.7	Capital and reserves	18.2	14.3
Commercial/Other lending	10.7	12.6	Other liabilities	3.7	5.0
Other assets	6.6	8.9			
	229.1	221.7		229.1	221.7

Note: The figures in the above table are stated net of impairment provisions where applicable.

Nationwide's loan to deposit ratio¹ at 4 April 2018 was 125.5% (4 April 2017: 122.6%).

Wholesale funding

The wholesale funding portfolio is made up of a range of secured and unsecured instruments to ensure Nationwide has a diversified funding base across a range of instruments, currencies, maturities and investor types. Nationwide's wholesale funding strategy is to remain active in core markets and currencies. A funding risk limit framework also ensures a prudent funding mix and maturity concentration profile is maintained, and limits levels of encumbrance to ensure sufficient contingent funding capacity is retained.

Wholesale funding has increased by £3.3 billion to £58.8 billion. This is due to £11.0 billion of drawings from the Bank of England's Term Funding Scheme (TFS) during the year, to support core activities, refinance maturing wholesale funding, and replace off-balance sheet Funding for Lending Scheme (FLS) maturities. This additional funding is reflected in Nationwide's wholesale funding ratio (on-balance sheet wholesale funding as a proportion of total funding liabilities) which was 28.2% at 4 April 2018 (4 April 2017: 27.1%).

The table below sets out an analysis by currency of Nationwide's wholesale funding.

	2018						2017					
	GBP	EUR	USD	Other	Total	% of total	GBP	EUR	USD	Other	Total	% of total
	£bn	£bn	£bn	£bn	£bn		£bn	£bn	£bn	£bn	£bn	
Repos	0.7	0.2	-	-	0.9	2	-	-	-	-	-	-
Deposits (note i)	5.4	1.4	-	-	6.8	12	7.7	1.4	0.1	-	9.2	16
Certificates of deposit	4.0	0.1	0.2	-	4.3	7	5.3	-	-	-	5.3	10
Commercial paper	-	-	1.0	-	1.0	2	-	-	1.8	-	1.8	3
Covered bonds	2.5	12.6	-	0.2	15.3	26	3.3	11.4	-	0.2	14.9	27
Medium term notes	2.0	4.6	1.8	0.6	9.0	15	3.1	6.2	3.6	0.8	13.7	25
Securitisations	1.1	1.3	1.3	-	3.7	6	0.9	1.2	1.4	-	3.5	6
TFS	17.0	-	-	-	17.0	29	6.0	-	-	-	6.0	11
Other	0.2	0.6	-	-	0.8	1	0.3	0.8	-	-	1.1	2
Total	32.9	20.8	4.3	0.8	58.8	100	26.6	21.0	6.9	1.0	55.5	100

Note:

i. 2017 included £0.8 billion of protected equity bonds (PEBs), all of which had matured by 4 April 2018.

¹ The loan to deposit ratio represents loans and advances to customers divided by shares + other deposits + amounts due to customers (excluding repurchase agreements and collateral received).

Business and Risk Report *continued*Liquidity and funding risk *continued*

The residual maturity of the wholesale funding book, on a contractual maturity basis, is set out below.

Wholesale funding – residual maturity								
2018	Not more than one month	Over one month but not more than three months	Over three months but not more than six months	Over six months but not more than one year	Subtotal less than one year	Over one year but not more than two years	Over two years	Total
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Repos	0.9	-	-	-	0.9	-	-	0.9
Deposits (note i)	4.5	0.5	1.4	0.4	6.8	-	-	6.8
Certificates of deposit	-	3.6	0.5	0.2	4.3	-	-	4.3
Commercial paper	0.1	0.9	-	-	1.0	-	-	1.0
Covered bonds	0.8	0.1	-	-	0.9	1.6	12.8	15.3
Medium term notes	0.1	0.1	0.1	1.4	1.7	1.8	5.5	9.0
Securitisations	0.1	-	0.3	0.4	0.8	0.9	2.0	3.7
TFS	-	-	-	-	-	-	17.0	17.0
Other	-	-	-	-	-	-	0.8	0.8
Total	6.5	5.2	2.3	2.4	16.4	4.3	38.1	58.8
Of which secured	1.8	0.1	0.3	0.4	2.6	2.5	32.6	37.7
Of which unsecured	4.7	5.1	2.0	2.0	13.8	1.8	5.5	21.1
% of total	11.1	8.8	3.9	4.1	27.9	7.3	64.8	100.0

Wholesale funding – residual maturity								
2017	Not more than one month	Over one month but not more than three months	Over three months but not more than six months	Over six months but not more than one year	Subtotal less than one year	Over one year but not more than two years	Over two years	Total
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Repos	-	-	-	-	-	-	-	-
Deposits (note i)	5.3	1.3	2.0	0.6	9.2	-	-	9.2
Certificates of deposit	0.4	1.7	2.4	0.8	5.3	-	-	5.3
Commercial paper	0.5	0.6	0.6	0.1	1.8	-	-	1.8
Covered bonds	-	-	0.8	-	0.8	0.8	13.3	14.9
Medium term notes	-	-	0.1	1.2	1.3	1.8	10.6	13.7
Securitisations	0.3	-	0.3	0.1	0.7	0.6	2.2	3.5
TFS	-	-	-	-	-	-	6.0	6.0
Other	-	-	-	-	-	-	1.1	1.1
Total	6.5	3.6	6.2	2.8	19.1	3.2	33.2	55.5
Of which secured	0.3	-	1.1	0.1	1.5	1.4	22.4	25.3
Of which unsecured	6.2	3.6	5.1	2.7	17.6	1.8	10.8	30.2
% of total	11.7	6.5	11.2	5.0	34.4	5.8	59.8	100.0

Note:

i. 2017 included £0.8 billion of protected equity bonds (PEBs), all of which had matured by 4 April 2018.

At 4 April 2018, cash, government bonds and supranational bonds included in the liquid asset buffer represented 142% (4 April 2017: 129%) of wholesale funding maturing in less than one year, assuming no rollovers.



Business and Risk Report *continued*

Liquidity and funding risk *continued*

Liquidity risk

Liquid assets

Nationwide ensures it has sufficient liquid assets, both in terms of amount and quality, to meet daily cash flow needs as well as simulated stressed requirements driven by the Society's risk appetite and regulatory assessments. This includes ensuring the currency composition of the liquid asset buffer is consistent with the currency profile of stressed outflows.

The table below sets out the sterling equivalent fair value of the liquidity portfolio, categorised by issuing currency. It includes off-balance sheet liquidity such as bonds received through reverse repurchase (repo) agreements and excludes bonds encumbered through repo agreements.

Liquid assets	2018				2017			
	GBP	EUR	USD	Total	GBP	EUR	USD	Total
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Cash and reserves at central banks	14.4	-	-	14.4	11.8	1.2	-	13.0
Government bonds (note i)	6.8	0.8	0.6	8.2	10.0	0.5	0.7	11.2
Supranational bonds	0.4	-	0.3	0.7	0.2	-	0.3	0.5
Covered bonds	0.6	0.6	-	1.2	0.4	0.5	-	0.9
RMBS (note ii)	1.7	0.3	-	2.0	0.5	0.4	-	0.9
Asset backed securities	0.2	0.1	-	0.3	0.3	-	-	0.3
Other securities	-	-	-	-	0.3	0.2	0.2	0.7
Total	24.1	1.8	0.9	26.8	23.5	2.8	1.2	27.5

Notes:

- i. 2017 includes £4.8 billion of FLS, all of which had matured by 4 April 2018.
- ii. Balances include all RMBS held by the Society which can be monetised through sale or repo.

Nationwide's liquid assets are held and managed centrally by its Treasury function. Nationwide maintains a high quality liquidity portfolio, predominantly comprising:

- reserves held at central banks
- highly rated debt securities issued by a restricted range of governments, central banks and supranationals.

The size and mix of the liquid asset buffer is defined by the Society's risk appetite as set by the Board, which is translated into a set of liquidity risk limits; it is also influenced by other relevant considerations such as stress testing and regulatory requirements.

The average combined month end balance of cash and reserves at central banks, and government and supranational bonds during the year was £27.2 billion (2017: £29.5 billion).

Nationwide also holds a portfolio of high quality, central bank eligible covered bonds, RMBS and asset-backed securities. Other securities are held that are not eligible for central bank operations but can be monetised through repurchase agreements with third parties or through sale.

Nationwide undertakes securities financing transactions in the form of repurchase agreements. This demonstrates the liquid nature of the assets held in its liquid asset buffer and also satisfies regulatory requirements. Cash is borrowed in return for pledging assets as collateral and because settlement is on a simultaneous 'delivery versus payment' basis, the main credit risk arises from intra-day changes in the value of the collateral. This is largely mitigated by Nationwide's collateral management processes.

Repo market capacity is assessed and tested regularly to ensure there is sufficient capacity to rapidly monetise the liquid asset buffer in a stress.

For contingent purposes, Nationwide pre-positions unencumbered mortgage assets at the Bank of England which can be used in the Bank of England's liquidity operations if market liquidity is severely disrupted.



Business and Risk Report *continued*

Liquidity and funding risk *continued*

Residual maturity of financial assets and liabilities

The table below segments the carrying value of financial assets and financial liabilities into relevant maturity groupings based on the final contractual maturity date (residual maturity).

Residual maturity (note i)									
2018	Due less than one month (note ii)	Due between one and three months	Due between three and six months	Due between six and nine months	Due between nine and twelve months	Due between one and two years	Due between two and five years	Due after more than five years	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Financial assets									
Cash	14,361	-	-	-	-	-	-	-	14,361
Loans and advances to banks	3,078	-	-	-	-	-	-	344	3,422
Investment securities	76	64	17	141	89	387	2,498	9,774	13,046
Loans and advances to customers	3,041	1,318	1,925	1,886	1,908	7,564	22,961	151,061	191,664
Derivative financial instruments	12	17	6	231	52	381	1,966	1,456	4,121
Fair value adjustment for portfolio hedged risk	-	(16)	(30)	(19)	(30)	(90)	(53)	129	(109)
Total financial assets	20,568	1,383	1,918	2,239	2,019	8,242	27,372	162,764	226,505
Financial liabilities									
Shares	120,617	2,892	4,403	4,430	3,248	6,593	4,499	1,321	148,003
Deposits from banks	2,343	9	47	5	-	-	17,000	-	19,404
<i>Of which repo</i>	266	-	-	-	-	-	-	-	266
<i>Of which TFS</i>	-	1	-	-	-	-	17,000	-	17,001
Other deposits	3,123	481	1,343	315	50	11	-	-	5,323
<i>Of which repo</i>	680	-	-	-	-	-	-	-	680
Due to customers	402	-	-	-	-	-	-	-	402
Secured funding – ABS and covered bonds	872	65	273	211	224	2,491	9,266	6,288	19,690
Senior unsecured funding	229	4,644	595	980	553	1,845	1,589	3,993	14,428
Derivative financial instruments	39	25	11	6	11	64	305	1,876	2,337
Fair value adjustment for portfolio hedged risk	-	(6)	(6)	(4)	(4)	(8)	(25)	-	(53)
Subordinated liabilities	17	-	49	-	-	-	690	4,741	5,497
Subscribed capital (note iii)	1	1	1	-	-	-	-	260	263
Total financial liabilities	127,643	8,111	6,716	5,943	4,082	10,996	33,324	18,479	215,294
Off-balance sheet commitments (note iv)	13,890	-	-	-	-	-	-	-	13,890
Net liquidity difference	(120,965)	(6,728)	(4,798)	(3,704)	(2,063)	(2,754)	(5,952)	144,285	(2,679)
Cumulative liquidity difference	(120,965)	(127,693)	(132,491)	(136,195)	(138,258)	(141,012)	(146,964)	(2,679)	-

Business and Risk Report *continued*Liquidity and funding risk *continued*

Residual maturity (note i)									
2017	Due less than one month (note ii)	Due between one and three months	Due between three and six months	Due between six and nine months	Due between nine and twelve months	Due between one and two years	Due between two and five years	Due after more than five years	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Financial assets									
Cash	13,017	-	-	-	-	-	-	-	13,017
Loans and advances to banks	2,226	-	-	-	-	-	-	361	2,587
Investment securities (note v)	40	13	116	66	57	216	2,002	7,321	9,831
Loans and advances to customers	2,890	1,309	1,937	1,877	1,910	7,259	22,057	148,132	187,371
Derivative financial instruments	11	94	130	30	121	324	2,317	2,016	5,043
Other financial assets (note v and vi)	36	22	15	28	10	60	265	317	753
Total financial assets	18,220	1,438	2,198	2,001	2,098	7,859	26,641	158,147	218,602
Financial liabilities									
Shares	112,403	1,666	6,169	4,905	4,513	9,842	3,870	1,174	144,542
Deposits from banks	2,499	123	20	48	16	28	6,000	-	8,734
<i>Of which repo</i>	-	-	-	-	-	-	-	-	-
<i>Of which TFS</i>	-	-	-	-	-	-	6,000	-	6,000
Other deposits	2,882	1,075	1,885	336	255	15	11	-	6,459
<i>Of which repo</i>	-	-	-	-	-	-	-	-	-
Due to customers	1,818	130	305	45	67	11	-	-	2,376
Secured funding – ABS and covered bonds	341	20	1,086	128	90	1,394	10,137	6,280	19,476
Senior unsecured funding	894	2,339	3,126	657	1,431	1,765	5,022	5,629	20,863
Derivative financial instruments	37	11	35	41	57	135	505	2,361	3,182
Fair value adjustment for portfolio hedged risk	-	-	(2)	-	1	8	1	-	8
Subordinated liabilities (note v)	-	35	-	-	103	-	700	2,102	2,940
Subscribed capital (note iii and v)	3	-	-	-	-	-	-	276	279
Total financial liabilities (note v)	120,877	5,399	12,624	6,160	6,533	13,198	26,246	17,822	208,859
Off-balance sheet commitments (note iv)	15,784	-	-	-	-	-	-	-	15,784
Net liquidity difference	(118,441)	(3,961)	(10,426)	(4,159)	(4,435)	(5,339)	395	140,325	(6,041)
Cumulative liquidity difference	(118,441)	(122,402)	(132,828)	(136,987)	(141,422)	(146,761)	(146,366)	(6,041)	-

Notes:

- i. The analysis excludes certain non-financial assets (including property, plant and equipment, intangible assets, investment property, other assets, deferred tax assets and accrued income and expenses prepaid) and non-financial liabilities (including provisions for liabilities and charges, accruals and deferred income, current tax liabilities, other liabilities and retirement benefit obligations).
- ii. Due less than one month includes amounts repayable on demand.
- iii. The principal amount for undated subscribed capital is included within the due after more than five years column.
- iv. Off-balance sheet commitments include amounts payable on demand for unrecognised loan commitments, customer overpayments on residential mortgages where the borrower is able to draw down the amount overpaid, and commitments to acquire financial assets.
- v. Comparatives have been restated as detailed in note 1 of the financial statements.
- vi. Other financial assets and liabilities include the fair value adjustments for portfolio hedged risk and the fair value of certain mortgage commitments.

In practice, customer behaviours mean that liabilities are often retained for longer than their contractual maturities and assets are repaid faster. This gives rise to funding mismatches on Nationwide's balance sheet. The balance sheet structure and risks are managed and monitored by ALCO. Nationwide uses judgement and past behavioural performance of each asset and liability class to forecast likely cash flow requirements.

The 2018 table above includes the impact of a debt buy-back exercise that involved the Society issuing £2.1 billion of new MREL compliant bonds to partly fund the repurchase of older bonds, resulting in an increase in our capital strength and a reduction in our future cost of wholesale funding. A total of £4.0 billion of senior unsecured funding was repurchased, with the impact of cancelling associated derivative financial instruments also reflected.

Business and Risk Report *continued*Liquidity and funding risk *continued*

Financial liabilities – gross undiscounted contractual cash flows

The tables below provide an analysis of gross contractual cash flows. The totals differ from the analysis of residual maturity as they include estimated future interest payments, calculated using balances outstanding at the balance sheet date and appropriate forward looking interest rates.

Amounts are allocated to the relevant maturity band based on the timing of individual contractual cash flows.

Gross contractual cash flows									
2018	Due less than one month (note i)	Due between one and three months	Due between three and six months	Due between six and nine months	Due between nine and twelve months	Due between one and two years	Due between two and five years	Due after more than five years	Total
(Audited)	£m	£m	£m	£m	£m	£m	£m	£m	£m
Shares	120,617	2,959	4,462	4,479	3,288	6,708	4,690	1,524	148,727
Deposits from banks	2,370	8	48	64	75	182	17,271	-	20,018
Other deposits	3,123	486	1,345	315	50	11	-	-	5,330
Due to customers	402	-	-	-	-	-	-	-	402
Secured funding – ABS and covered bonds	880	76	297	193	367	2,739	8,006	8,625	21,183
Senior unsecured funding	162	4,712	638	990	629	1,992	1,049	5,274	15,446
Subordinated liabilities	18	-	104	18	56	197	1,004	5,400	6,797
Subscribed capital (note ii)	1	1	4	3	14	13	60	244	340
Total non-derivative financial liabilities	127,573	8,242	6,898	6,062	4,479	11,842	32,080	21,067	218,243
Derivative financial liabilities:									
Gross settled derivative outflows	(13)	(67)	(39)	(237)	(103)	(522)	(2,522)	(5,692)	(9,195)
Gross settled derivative inflows	14	59	41	222	105	521	2,479	5,596	9,037
Gross settled derivatives – net flows	1	(8)	2	(15)	2	(1)	(43)	(96)	(158)
Net settled derivative liabilities	(23)	(63)	(59)	(105)	(46)	(265)	(608)	(1,190)	(2,359)
Total derivative financial liabilities	(22)	(71)	(57)	(120)	(44)	(266)	(651)	(1,286)	(2,517)
Total financial liabilities	127,551	8,171	6,841	5,942	4,435	11,576	31,429	19,781	215,726
Off-balance sheet commitments (note iii)	13,890	-	-	-	-	-	-	-	13,890
Total financial liabilities including off-balance sheet commitments	141,441	8,171	6,841	5,942	4,435	11,576	31,429	19,781	229,616

Business and Risk Report *continued*Liquidity and funding risk *continued*

Gross contractual cash flows									
2017	Due less than one month (note i)	Due between one and three months	Due between three and six months	Due between six and nine months	Due between nine and twelve months	Due between one and two years	Due between two and five years	Due after more than five years	Total
(Audited)	£m	£m	£m	£m	£m	£m	£m	£m	£m
Shares	112,403	1,733	6,228	4,954	4,552	9,943	4,020	1,320	145,153
Deposits from banks	2,499	127	25	51	20	43	6,022	-	8,787
Other deposits	2,882	1,079	1,887	337	255	15	11	-	6,466
Due to customers	1,818	131	306	45	67	11	-	-	2,378
Secured funding – ABS and covered bonds	346	25	1,159	108	280	1,720	10,505	6,686	20,829
Senior unsecured funding	896	2,457	3,199	668	1,557	2,051	5,516	5,980	22,324
Subordinated liabilities	-	-	64	-	201	130	987	2,330	3,712
Subscribed capital (note ii)	1	1	4	3	4	14	42	223	292
Total non-derivative financial liabilities	120,845	5,553	12,872	6,166	6,936	13,927	27,103	16,539	209,941
Derivative financial liabilities:									
<i>Gross settled derivative outflows</i>	2	140	400	106	1,097	56	862	272	2,935
<i>Gross settled derivative inflows</i>	(2)	(135)	(396)	(100)	(1,082)	(43)	(817)	(261)	(2,836)
<i>Gross settled derivatives – net flows</i>	-	5	4	6	15	13	45	11	99
<i>Net settled derivative liabilities</i>	60	129	142	171	122	422	759	1,454	3,259
Total derivative financial liabilities	60	134	146	177	137	435	804	1,465	3,358
Total financial liabilities	120,905	5,687	13,018	6,343	7,073	14,362	27,907	18,004	213,299
Off-balance sheet commitments (note iii)	15,784	-	-	-	-	-	-	-	15,784
Total financial liabilities including off-balance sheet commitments	136,689	5,687	13,018	6,343	7,073	14,362	27,907	18,004	229,083

Notes:

- i. Due less than one month includes amounts repayable on demand.
- ii. The principal amount for undated subscribed capital is included within the due after more than five years column.
- iii. Off-balance sheet commitments include amounts payable on demand for unrecognised loan commitments, customer overpayments on residential mortgages where the borrower is able to draw down the amount overpaid and commitments to acquire financial assets.

Asset encumbrance

Encumbrance arises where assets are pledged as collateral against secured funding and other collateralised obligations and therefore cannot be used for other purposes. The majority of asset encumbrance arises from the use of prime mortgage pools to collateralise the Covered Bond and Silverstone secured funding programmes (note 14 to the financial statements) and from participation in the TFS and previously FLS.

Certain unencumbered assets are readily available to secure funding or meet collateral requirements. These include prime mortgages and cash and securities held in the liquidity buffer. Other unencumbered assets, such as non-prime mortgages, are capable of being encumbered with a degree of further management action. Assets which do not fall into either of these categories are classified as not being capable of being encumbered.

An analysis of Nationwide's encumbered and unencumbered on-balance sheet assets is set out below. This disclosure is not intended to identify assets that would be available in the event of a resolution or bankruptcy.

Business and Risk Report *continued*Liquidity and funding risk *continued*

Asset encumbrance										
2018	Assets encumbered as a result of transactions with counterparties other than central banks				Other assets (comprising assets encumbered at the central bank and unencumbered assets)					Total
	As a result of covered bonds	As a result of securitisations	Other	Total	Assets positioned at the central bank (i.e. prepositioned plus encumbered)	Assets not positioned at the central bank			Total	
						Readily available for encumbrance	Other assets that are capable of being encumbered	Cannot be encumbered		
	£m	£m	£m	£m	£m	£m	£m	£m	£m	
Cash	381	376	-	757	-	13,389	-	215	13,604	14,361
Loans and advances to banks	-	-	1,220	1,220	1,124	-	-	1,078	2,202	3,422
Investment securities	-	-	944	944	30	12,027	-	45	12,102	13,046
Loans and advances to customers	21,000	8,712	-	29,712	37,732	76,791	47,429	-	161,952	191,664
Derivative financial instruments	-	-	-	-	-	-	-	4,121	4,121	4,121
Other financial assets	-	-	-	-	-	-	-	(109)	(109)	(109)
Non-financial assets	-	-	-	-	-	-	-	2,593	2,593	2,593
Total	21,381	9,088	2,164	32,633	38,886	102,207	47,429	7,943	196,465	229,098

Asset encumbrance										
2017	Assets encumbered as a result of transactions with counterparties other than central banks				Other assets (comprising assets encumbered at the central bank and unencumbered assets)					Total
	As a result of covered bonds	As a result of securitisations	Other	Total	Assets positioned at the central bank (i.e. prepositioned plus encumbered)	Assets not positioned at the central bank			Total	
						Readily available for encumbrance	Other assets that are capable of being encumbered	Cannot be encumbered		
	£m	£m	£m	£m	£m	£m	£m	£m	£m	
Cash	1,538	567	-	2,105	-	10,697	-	215	10,912	13,017
Loans and advances to banks	-	-	1,393	1,393	927	-	-	267	1,194	2,587
Investment securities (note i)	-	-	-	-	32	9,732	-	67	9,831	9,831
Loans and advances to customers	19,322	10,412	-	29,734	33,376	75,032	49,229	-	157,637	187,371
Derivative financial instruments	-	-	-	-	-	-	-	5,043	5,043	5,043
Other financial assets (note i)	-	-	-	-	-	-	-	753	753	753
Non-financial assets	-	-	-	-	-	-	-	3,068	3,068	3,068
Total (note i)	20,860	10,979	1,393	33,232	34,335	95,461	49,229	9,413	188,438	221,670

Note:

i. Comparatives have been restated as detailed in note 1 of the financial statements.



Business and Risk Report *continued*

Liquidity and funding risk *continued*

Managing liquidity and funding risk

Nationwide's management of liquidity and funding risks aims to ensure that at all times there are sufficient liquid assets, both as to amount and quality, to:

- cover cash flow mismatches and fluctuations in funding
- retain public confidence
- meet financial obligations as they fall due, even during episodes of stress.

This is achieved through the management and stress testing of business cash flows, and through the translation of Board risk appetite into appropriate risk limits. This ensures a prudent funding mix and maturity profile, sufficient levels of high quality liquid assets and appropriate encumbrance levels are maintained.

The Liquidity and Funding risk framework is reviewed by the Board as part of the annual Internal Liquidity Adequacy Assessment Process (ILAAP). ALCO is responsible for managing the balance sheet structure, including the Funding Plan, and its risks. This includes setting and monitoring more granular limits within Board limits. A consolidated cash flow forecast is maintained and reviewed weekly to support ALCO in monitoring key risk metrics.

A Liquidity Contingency Plan (LCP) is maintained which describes early warning triggers for indicating an emerging liquidity or funding stress as well as escalation procedures and a range of actions that could be taken in response to ensure sufficient liquidity is maintained. The LCP is tested annually to ensure it remains robust. Nationwide also has a Recovery Plan which describes potential actions that could be utilised in a more extreme stress.

Liquidity stress testing

To mitigate liquidity and funding risks generated by its business activities, Nationwide aims to maintain a liquid asset buffer of at least 100% of the anticipated outflows seen under internal stress test scenarios and the regulatory-prescribed LCR.

Potential contractual and behavioural stress outflows are assessed across a range of liquidity risk drivers over 30 calendar days, with the key assumptions shown below. A three month assessment is also performed against which LCP capacity is assessed. Internal stress assumptions are reviewed regularly with changes approved by ALCO, and approved annually by the Board as part of the ILAAP.

During the year, several updates were made to Nationwide's primary internal short-term stress test through the ILAAP. These included a revised assessment period from 30 business days to 30 calendar days and an increase in the severity of certain stressed cash flow assumptions. The net impact of these changes means internal liquidity requirements are materially the same.

Liquidity risk driver	Modelling assumptions used
Retail funding	Significant unexpected outflows are experienced with no new deposits received.
Wholesale funding	Following a credit rating downgrade: <ul style="list-style-type: none"> • zero roll-over of maturing long-term wholesale funding; • zero roll-over of maturing short-term funding received from financial counterparties and partial roll-over from non-financial counterparties; • no new wholesale funding received.
Off-balance sheet	Contractual outflows occur in relation to secured funding programmes due to credit rating downgrades. Lending commitments continue to be met. Collateral outflows arise due to adverse movements in market rates. Inflows from mortgages or retail and commercial loans are assessed on a contractual basis.
Intra-day	Liquidity is needed to pre-fund outgoing payments.
Liquid assets	Asset values are reduced in recognition of the stressed conditions assumed.

At 4 April 2018, under the most severe internal 30 calendar day stress test (a combined market-wide and Nationwide-specific stress scenario), the liquid asset buffer as a percentage of modelled stressed net outflows (£20.5 billion) equated to 120%. At 4 April 2017, the liquid asset buffer as a percentage of stressed net outflows (£22.1 billion) was 118% based on a 30 business day assessment period.



Business and Risk Report *continued*

Liquidity and funding risk *continued*

External credit ratings

The Group's long-term and short-term credit ratings are shown in the table below. The long-term rating for both Standard & Poor's and Moody's is the senior preferred rating. The long-term rating for Fitch is the senior non-preferred rating.

Credit ratings						
	Senior preferred	Short-term	Senior non-preferred	Tier 2	Date of last rating action / confirmation	Outlook
Standard & Poor's	A	A-1	BBB+	BBB	February 2018	Positive
Moody's	Aa3	P-1	Baa1	Baa1	March 2018	Stable
Fitch	A+	F1	A	A-	February 2018	Stable

In August 2017, Standard & Poor's affirmed Nationwide's A/A-1 long and short-term ratings, with a negative outlook. This reflected their view on a negative trend for economic risk in the UK following the outcome of the EU referendum. In November 2017, Standard & Poor's revised the trend on economic risk for the UK banking sector to stable and revised Nationwide's outlook to stable. Nationwide's outlook was then revised to positive in February 2018 reflecting Standard & Poor's expectation that Nationwide's buffer of bail-in instruments could exceed their threshold for two notches of Additional Loss Absorbing Capacity (ALAC) uplift over their 18-24 month forecast horizon following Nationwide's inaugural issuance of senior non-preferred debt.

In addition, Moody's changed the outlook on Nationwide's deposits and senior unsecured debt to stable from negative in August 2017, reflecting its expectation of a moderate deterioration in the operating environment in the UK, to which Nationwide is now more resilient.

In February 2018 Fitch downgraded Nationwide's Long-Term Issuer Default Rating (IDR) to 'A' from 'A+' with a stable outlook. The senior preferred unsecured debt rating was unchanged at A+. The downgrade follows the Society's issue of senior non-preferred debt which, in accordance with Fitch's methodology, becomes the reference obligation for Nationwide's IDR.

The table below sets out the amount of additional collateral Nationwide would need to provide in the event of a one and two notch downgrade by external credit rating agencies.

	Cumulative adjustment for a one notch downgrade	Cumulative adjustment for a two notch downgrade
	£bn	£bn
2018	3.1	3.3
2017	3.3	3.7

The contractually required cash outflow would not necessarily match the actual cash outflow as a result of management actions that could be taken to reduce the impact of the downgrades.



Business and Risk Report *continued*

Solvency risk

Solvency risk is the risk that Nationwide fails to maintain sufficient capital to absorb losses throughout a full economic cycle and sufficient to maintain the confidence of current and prospective investors, members, the Board and regulators. Capital is held to protect members, cover inherent risks, provide a buffer for stress events and support the business strategy. In assessing the adequacy of capital resources, risk appetite is considered in the context of the material risks to which Nationwide is exposed and the appropriate strategies required to manage those risks.

Managing solvency risk

A number of tools are employed to support the management of solvency risk. The Board is responsible for setting risk appetite with respect to solvency risk, which is articulated through its risk appetite statements, and it defines minimum levels of capital, including leverage, that it is willing to operate with. These are translated into specific risk metrics, which are monitored by the Board Risk Committee (BRC), Assets and Liabilities Committee (ALCO) and other internal management reviews.

The capital structure is managed to ensure that Nationwide continues to meet minimum regulatory requirements, as well as meeting the expectations of other key stakeholders. As part of the risk appetite framework, strong capital ratios are targeted relative to both regulatory requirements and major banking peers. Any planned changes to the balance sheet, potential regulatory developments and other factors (such as trading outlook, movements in the available for sale reserve and defined benefit pension deficit) are all considered.

The capital strategy is to manage capital ratios through retained earnings, supplemented by external capital where appropriate. With general reserves forming the majority of capital resources, profitability is an important factor when considering the ability to meet capital requirements. A return on capital framework is in place, based upon an allocation of overall capital requirements, which forms part of the Group's Board risk appetite metrics as well as forming part of the performance monitoring activity for individual product segments. In recent years, Nationwide's ability to supplement retained earnings through the issuance of Common Equity Tier 1 (CET1), Additional Tier 1 and Tier 2 capital instruments has been demonstrated, and its non-core commercial lending portfolios have been significantly deleveraged.

Capital is held to meet Pillar 1 requirements for credit, operational and market risks. In addition, the PRA requires firms to hold capital to meet Pillar 2A requirements, which are set out in the Individual Capital Guidance (ICG). This is a point in time estimate, set by the PRA on an annual basis, of the amount of capital required to be held to meet risks partly covered by Pillar 1 such as credit concentration and operational risk, and risks not covered by Pillar 1 such as pension and interest rate risk.

An annual Internal Capital Adequacy Assessment Process (ICAAP) is also undertaken. This considers the minimum amount of capital to be held in order to cover all risks including credit risks, operational risks, interest rate risks in the banking book and pension risks. It also considers an additional buffer to ensure that the impact of a severe but plausible stress can be absorbed. The PRA sets Nationwide's Pillar 2 capital requirements based on a combination of this internal assessment as well as the results from our annual Concurrent Stress Test.

In December 2017 the PRA issued Policy Statement PS30/17 Pillar 2A Capital Requirements and Disclosure, applicable from 1 January 2018. The Policy now sets Pillar 2A as a firm-specific Total Capital Requirement (TCR), rather than as individual guidance. We expect to receive our first TCR in August 2018.

In order to protect against the risk of consuming Pillar 1 or Pillar 2A requirements (thereby breaching ICG), firms are subject to regulatory capital buffers which are set out in CRD IV. The PRA may also set an additional firm-specific buffer based upon supervisory judgement informed by the impact of stress scenarios on a firm's capital requirements and resources, and taking into account other factors including leverage, systemic importance and any weaknesses in firms' risk management and governance procedures.

Regular stress tests are undertaken, covering Nationwide and its subsidiaries, to enhance the understanding of potential vulnerabilities and how management actions might be deployed in the event of stressed conditions developing. These stress tests project capital resources and requirements over a multi-year period, during severe but plausible scenarios that cover a range of macro-economic or market-wide scenarios, and idiosyncratic scenarios that test particular risks to Nationwide's business model. Stress test results are reported to the Board Risk Committee.

Nationwide aims to be in a position where it would maintain strong capital and leverage ratios in the event of a severe but plausible economic or idiosyncratic stress. Embedded in the risk appetite framework is an expectation to maintain the CET1 and leverage ratios in excess of regulatory minima.

A set of management actions is maintained that would be available in the event of a breach of one or more of the risk metrics, to support the capital position. In a more severe stress, Nationwide would consider the implementation of its Recovery Plan, maintained under UK regulatory rules implementing the European Bank Recovery and Resolution Directive (BRRD), which documents a broad range of management actions. In addition, reverse stress testing is carried out using extreme, highly improbable scenarios to further test the viability of Nationwide's business model.

During 2017, the major UK banks and building societies, including Nationwide, took part in the PRA's annual concurrent stress test (CST), which included two scenarios. The Annual Cyclical Scenario (ACS) assessed firms' resilience to a severe economic downturn, characterised by an increase in the Bank of England base rate to 4%, a 33% fall in UK house prices and a 4.7% fall in UK GDP. In a separate exercise, the Biennial Exploratory Scenario, the PRA assessed firms' responses to longer-term challenges, such as a prolonged 0% base rate and increasing competition in the retail banking sector.

Despite the severity of the ACS, the results illustrate the strength and resilience of Nationwide, with low point CET1 and leverage ratios of 12.3% and 4.5% respectively after the effect of management actions. While the leverage ratio remained relatively stable, risk weighted assets increased significantly causing a reduction in the CET1 ratio, largely due to the use of Point in Time (PiT) modelling approaches for secured portfolios. The PRA has set out their expectations on changes to modelling approaches for these portfolios, with the intention of reducing volatility in risk weights. Nationwide is in the process of reviewing its modelling methodologies to comply with these proposals.



Business and Risk Report *continued*

Solvency risk *continued*

Nationwide, along with the major UK banks, is currently taking part in the 2018 CST. This year's ACS features the same global and domestic economic downturn used for the 2017 exercise, with the addition of Expected Credit Losses (ECLs) modelled under the new IFRS 9 accounting standard. The Bank of England's Financial Policy Committee (FPC) has stated that it expects the introduction of IFRS 9 to result in provisions against loan losses being made earlier in an economic downturn. As a result, capital ratios are expected to fall more sharply than in the 2017 exercise. The FPC intends to use the information provided by the 2018 stress test to understand more fully the impact of IFRS 9 on capital ratios, and to consider changes to the way in which it monitors firms' capital position. We believe that the 2018 ACS will provide useful insight into the behaviour of IFRS 9 provisioning models under stressed conditions.

Capital position

Capital ratios		
	2018	2017
Solvency	%	%
Common Equity Tier 1 (CET1) ratio	30.5	25.4
Total Tier 1 ratio	33.6	28.4
Total regulatory capital ratio	42.9	36.1
Leverage	£m	£m
UK leverage exposure (note i)	221,992	215,894
CRR leverage exposure (note ii)	236,468	228,428
Tier 1 capital	10,917	9,547
UK leverage ratio	4.9%	4.4%
CRR leverage ratio	4.6%	4.2%

Notes:

- The UK leverage ratio is shown on the basis of measurement announced by the Prudential Regulation Authority (PRA) and excludes eligible central bank reserves from the leverage exposure measure.
- The Capital Requirements Regulation (CRR) leverage ratio is calculated using the CRR definition of Tier 1 for the capital amount and the Delegated Act definition of the exposure measure.

The capital disclosures included in this report are on a Capital Requirements Directive IV (CRD IV) end point basis. This assumes that all CRD IV requirements are in force during the period, with no transitional provisions permitted. In addition, the disclosures are on a consolidated Group basis, including all subsidiary entities, unless otherwise stated.

Capital and leverage ratios have remained well in excess of regulatory requirements with a CET1 ratio of 30.5% (4 April 2017: 25.4%) and a UK leverage ratio of 4.9% (4 April 2017: 4.4%).

In September 2017, five million CCDS were issued raising £0.8 billion of CET1 capital. The issuance enhanced the liquidity and relevance of the CCDS instrument, while also helping to maintain broad access to capital markets and further strengthening Nationwide's capital position. These CCDS form a single series together with those previously issued in December 2013. Further information can be found in note 31 to the financial statements. Detailed information on Nationwide's capital instruments can be found within the Pillar 3 Disclosure 2018 at nationwide.co.uk

The CET1 ratio has improved following an increase in CET1 capital resources and a reduction in risk weighted assets (RWAs). CET1 capital resources have increased over the year by £1.4 billion mainly due to the CCDS issuance (£0.8 billion), and profit after tax for the year of £0.7 billion. RWAs have reduced over the period by approximately £1.1 billion, primarily due to the continued run-off of the commercial book. These movements have resulted in the CET1 ratio increasing to 30.5%.

Total regulatory capital ratio has increased to 42.9% (4 April 2017: 36.1%), due to the CET1 capital increases and the net issuance of £0.6 billion of qualifying Tier 2 subordinated debt, in line with plans to meet the pending Minimum Requirement for Own Funds and Eligible Liabilities (MREL).

CRD IV requires firms to calculate a non-risk-based leverage ratio, to supplement risk-based capital requirements. The current regulatory threshold is set at 3.25%. The risk of excessive leverage is managed through regular monitoring and reporting of the leverage ratio, which forms part of risk appetite.

Nationwide has been granted permission to report a UK leverage ratio on the basis of measurement announced by the PRA in August 2016. Minimum leverage requirements are monitored by the PRA on this basis. It is calculated using the Capital Requirements Regulation (CRR) definition of Tier 1 for the capital amount and the Delegated Act definition of the exposure measure, excluding eligible central bank reserves.

The UK leverage ratio has increased to 4.9% at 4 April 2018 (4 April 2017: 4.4%), predominantly due to an increase in Tier 1 capital resources resulting from profits in the year and the issuance of CCDS. The CRR leverage ratio increased at a slower rate to 4.6% (4 April 2017: 4.2%), following an £8 billion increase in exposure during the year, primarily driven by a £5 billion increase in mortgage balances and a £4 billion increase in liquid assets. The difference in exposure measure is caused by the CRR leverage ratio using the Delegated Act definition.

Further details on the leverage exposure can be found in the Group's Annual Pillar 3 Disclosure 2018 at nationwide.co.uk



Business and Risk Report *continued*

Solvency risk *continued*

Nationwide's latest Pillar 2A Individual Capital Guidance (ICG) was received in August 2017. It equates to circa £2.3 billion, of which at least circa £1.3 billion must be met by CET1 capital, and was broadly in line with the previous ICG. This amount is equivalent to 7.1% of RWAs as at 4 April 2018 (4 April 2017: 6.6%), reflecting the low average risk weight, given that approximately 78% (4 April 2017: 75%) of total assets are in the form of secured residential mortgages, of which 82% (4 April 2017: 81%) are prime mortgages, based on the regulatory exposure amounts.

The table below reconciles the general reserves to total regulatory capital on an end-point basis and so does not include non-qualifying instruments.

Total regulatory capital		
	2018	2017
(Audited)	£m	£m
General reserve	9,951	9,316
Core capital deferred shares (CCDS)	1,325	531
Revaluation reserve	68	67
Available for sale reserve	75	44
Regulatory adjustments and deductions:		
Foreseeable distributions (note i)	(68)	(43)
Prudent valuation adjustment (note ii)	(32)	(23)
Own credit and debit valuation adjustments (note iii)	(1)	-
Intangible assets (note iv)	(1,286)	(1,174)
Goodwill (note iv)	(12)	(12)
Excess of regulatory expected losses over impairment provisions (note v)	(95)	(151)
Total regulatory adjustments and deductions	(1,494)	(1,403)
Common Equity Tier 1 capital	9,925	8,555
Additional Tier 1 capital securities (AT1)	992	992
Total Tier 1 capital	10,917	9,547
Dated subordinated debt (note vi and vii)	3,019	2,580
Collectively assessed impairment allowances	-	27
Tier 2 capital (note vii)	3,019	2,607
Total regulatory capital (note vii)	13,936	12,154

Notes:

- Foreseeable distributions in respect of CCDS and AT1 securities are deducted from CET1 capital under CRD IV.
- A prudent valuation adjustment (PVA) is applied in respect of fair valued instruments as required under regulatory capital rules.
- Own credit and debit valuation adjustments are applied to remove balance sheet gains or losses of fair valued liabilities and derivatives that result from changes in Nationwide's own credit standing and risk, in accordance with CRD IV rules.
- Intangible assets and goodwill do not qualify as capital for regulatory purposes.
- The net regulatory capital expected loss in excess of accounting impairment provisions is deducted from CET1 capital, gross of tax.
- Subordinated debt includes fair value adjustments related to changes in market interest rates, adjustments for unamortised premiums and discounts that are included in the consolidated balance sheet, and any amortisation of the capital value of Tier 2 instruments required by regulatory rules for instruments with fewer than five years to maturity.
- Subordinated debt was restated as at 4 April 2017, due to a change in the presentation of accrued interest. Further information is provided in note 1 to the financial statements.

As part of the Bank Recovery and Resolution Directive (BRRD), the Bank of England, in its capacity as the UK resolution authority, has published its policy for setting the MREL and provided firms with indicative MREL. From 1 January 2020, it is anticipated that Nationwide will be subject to a requirement to hold twice the minimum capital requirements (i.e. 6.5% of UK leverage exposure), plus the applicable buffers, which are subject to change but are currently expected to amount to 0.75% of leverage exposure from 1 January 2019. In order to meet this pending requirement, Tier 2 capital has increased by £0.4 billion, following issuance of £1.8 billion and redemption of £1.2 billion of qualifying Tier 2 subordinated debt during the year. In addition, Nationwide issued £2.1 billion of senior non-preferred notes in March 2018, which we consider to be MREL eligible.

At 4 April 2018 total MREL resources were equal to circa 7.5% (4 April 2017: 5.9%) of UK leverage ratio exposure. Nationwide has a strong foundation from which to meet MREL requirements by 2020 through further issuance of senior non-preferred debt.



Business and Risk Report *continued*

Solvency risk *continued*

Risk weighted assets

The table below shows the breakdown of risk weighted assets (RWAs) by risk type and business activity. Market risk has been set to zero as permitted by the CRR, as the exposure is below the threshold of 2% of own funds.

Risk weighted assets			
2018	Credit Risk (note i)	Operational Risk (note ii)	Total Risk Weighted Assets
	£m	£m	£m
Retail mortgages	13,764	3,564	17,328
Retail unsecured lending	5,805	725	6,530
Commercial loans	4,634	210	4,844
Treasury	540	87	627
Counterparty credit risk (note iii)	1,184	-	1,184
Other	1,681	315	1,996
Total	27,608	4,901	32,509

Risk weighted assets			
2017	Credit Risk (note i)	Operational Risk (note ii)	Total Risk Weighted Assets
	£m	£m	£m
Retail mortgages	13,863	3,502	17,365
Retail unsecured lending	5,641	763	6,404
Commercial loans	5,636	100	5,736
Treasury	849	13	862
Counterparty credit risk (note iii)	1,221	-	1,221
Other	1,566	487	2,053
Total	28,776	4,865	33,641

Notes:

- This column includes credit risk exposures, counterparty credit risk exposures and exposures below the thresholds for deduction that are subject to a 250% risk weight.
- RWAs have been allocated according to the business lines within the standardised approach to operational risk, as per article 317 of CRR.
- Counterparty credit risk relates to derivative financial instruments and repurchase agreements.

RWAs have reduced by £1.1 billion to £32.5 billion. This was predominantly driven by a £1 billion reduction in commercial RWAs, due to continued run-off of the portfolio. Details on how RWAs are calculated can be found in the Group's annual Pillar 3 Disclosure 2018 at nationwide.co.uk

IRB model risk

The performance and accuracy of IRB models is critical to the calculation of credit risk capital requirements. The effectiveness of the models is achieved through clear allocation of roles and responsibilities covering model ownership, approval and governance, ongoing model monitoring, review and independent validation. Further information can be found in the 'model risk management of IRB risk ratings systems' section of the Group's annual Pillar 3 Disclosure 2018 at nationwide.co.uk

Regulatory developments

Highlighted below are a number of areas where regulatory requirements are yet to be finalised. Nationwide will remain engaged in the development of the regulatory approach to ensure it is prepared for any change.

Nationwide is currently required to maintain a minimum leverage ratio of 3.25% following the recalibration to adjust for the impact of excluding central bank holdings from the exposure measure. There is a supplementary leverage ratio buffer of 0.35% to be implemented in 2019. Following the Financial Policy Committee's (FPC) announcement on the countercyclical buffer (June 2018: 0.5%, November 2018: 1%), the equivalent countercyclical leverage ratio buffer will be 0.2% from June 2018, increasing to 0.4% from November 2018. Therefore, the minimum leverage ratio requirement is expected to be 4% by January 2019. Nationwide is confident it is in a strong position to meet the minimum requirements.

The Basel Committee published their final reforms to the Basel III framework in December 2017. The amendments include changes to the standardised approaches for credit and operational risks and the introduction of a new RWA output floor. The rules are subject to a lengthy transitional period from 2022 to 2027. In addition, the PRA's revised expectations for IRB models for residential mortgages will be effective from the end of 2020. These reforms will lead to a significant increase in our risk weights over time and we currently expect the consequential impact on our reported CET1 ratio to ultimately be a reduction of the order of 45-50% relative to our current methodology. We note however that organic earnings through the transition will mitigate this impact such that our reported CET1 ratio will in practice remain well in excess of the proforma levels implied by this change, and leverage requirements will remain our binding constraint based on latest projections. These reforms represent a re-calibration of regulatory requirements with no underlying change in the capital resources we hold or the risk profile of our assets. Final impacts are subject to uncertainty for future balance sheet size and mix, and because the final detail of some elements of the regulatory changes remain at the PRA's discretion.



Business and Risk Report *continued*

Market risk

Summary

Market risk is the risk that the net value of, or net income arising from assets and liabilities is impacted because of market price or rate changes, specifically interest rates, currency rates or equity prices. Nationwide has limited appetite for market risk and does not have a trading book. Market risk is closely monitored and managed to ensure the level of risk remains low. Market risks are not taken unless they are essential to core business activities and they provide stability of earnings, minimise costs or enable operational efficiency.

The principal market risks, linked to Nationwide's balance sheet assets and liabilities, are listed in the table below, irrespective of materiality.

Market risk linkage to the balance sheet						
	2018 £bn	Market risk				
		Interest rate risk	Basis risk	Swap spread risk	Currency risk	Product option risk
Assets						
Cash	14.4	•	•			
Loans and advances to banks	3.4	•	•		•	
Investment securities	13.0	•	•	•	•	
Derivative financial instruments	4.1	•	•	•	•	•
Loans and advances to customers	191.7	•	•		•	•
Other assets	2.5	•	•		•	
Total assets	229.1					
Liabilities						
Shares (customer deposits)	148.0	•	•			•
Deposits from banks	19.4	•	•		•	
Other deposits	5.3	•	•		•	
Due to customers	0.4	•	•		•	•
Debt securities in issue	34.1	•	•		•	
Derivative financial instruments	2.3	•	•	•	•	•
Subordinated liabilities	5.5	•	•		•	
Other liabilities (note i)	1.7	•	•		•	
Total liabilities	216.7					

Notes:

- i. Other liabilities include the defined benefit pension scheme. The scheme is exposed to equity risk (the risk of movements in share prices), interest rate risk and credit spread risk. Pension risk is managed separately from Nationwide's core business operations. For further details, see the 'Pension risk' section of this report.
- Represents assets or liabilities exposed to market risk, irrespective of materiality.

The UK economy remained resilient through the year. UK interest rate swap rates were relatively stable during the first half of the year despite the general election and remained just above the record lows seen after the EU referendum in 2016. However, in November 2017 the Bank of England (BoE) increased base rate to 0.50%, reversing the 25 basis point cut made in August 2016. Market rates then rose steadily in the first quarter of 2018 helped by domestic economic data which remained positive against the backdrop of the Brexit negotiations. This was supported by minutes from the BoE in February suggesting that further rate rises may be required sooner than previously expected if inflation remains above the 2% target, and the announcement of the end of the Term Funding Scheme (TFS).

Sterling strengthened during the year, particularly against the US Dollar, recovering much of the loss from the period following the EU referendum. However, currency exchange rates remain volatile, with future movements likely to be dependent upon the path taken to achieve Brexit. Nationwide has limited net exposure to currency risk.

The broader economic landscape continues to be uncertain, including the eventual domestic impact of Brexit. However, the global economic backdrop has become more favourable and global growth is expected to remain robust in years ahead. By the year end, the US Federal Reserve had raised interest rates five times since November 2016.

The Basel Committee on Banking Supervision published the Standards for Interest Rate Risk in the Banking Book (IRRBB) in April 2016. Nationwide expects to be fully compliant with these enhanced disclosure requirements, which will be applicable from 31 December 2018.

The European Commission (EC) proposed a set of reforms to capital requirements for market risk in November 2016. Included within this proposed set of reforms are elements of the Basel Disclosure Standards for IRRBB and more granular instructions for calculation of own funds requirements for market risk in the non-trading book. Nationwide will assess the new guidelines and ensure readiness in anticipation of adoption of the proposal. The EC expects the proposed regulation to be effective from 31 December 2018.



Business and Risk Report *continued*

Market risk *continued*

Market risk management

Nationwide's market risk only arises in the banking book as it does not have a trading book. Most of the exposure to market risk arises from fixed rate mortgages or savings and changes in the market value of the liquidity portfolio. There is a limited amount of currency risk on non-sterling financial assets and liabilities held.

In late 2017, Nationwide implemented a new treasury management system. This system is more comprehensive and enables greater insight into the drivers of risk than was previously available. Internal risk limits remain low to restrict the potential exposure to market risk arising from the daily management of residual positions, with relevant market risk metrics reported to ALCO.

The principal market risks that affect Nationwide are listed below together with the types of risk reporting measures used:

Market risk exposure	Reporting measure
Interest rate risk	Value sensitivity / Value at Risk
Basis risk	Earnings sensitivity
Swap spread risk	Value at Risk
Currency risk	Value sensitivity / Value at Risk
Product option risk	Value at Risk

In addition, stress analysis is used to evaluate the impact of more extreme, but plausible events. These analytical techniques are described below with a review of the exposures during the year.

Sensitivity analysis

Sensitivity analysis is used to assess the change in value of the net exposure to a defined parallel shift in interest rates. For example, a one basis point (0.01%) shift is measured using PV01. This analysis is performed daily by currency.

Earnings sensitivity

Income sensitivity metrics are used to measure and quantify exposure to interest rate risks. These techniques apply rate shocks to the rates paid on liabilities and to the rates earned on assets and the impact on earnings is calculated.

Value at Risk (VaR)

VaR is a technique that estimates the potential losses that could occur from risk positions because of future movements in market rates and prices, over a specified time horizon, to a given level of statistical confidence. VaR is based on historic market behaviour and uses a series of recorded market rates and prices to derive plausible future scenarios. This considers inter-relationships between different markets and rates.

The VaR model used by Nationwide has been upgraded this year as part of the implementation of the new treasury risk system. The VaR model incorporates risk factors based on historic interest rate and currency movements. A 10-day horizon and a 99% confidence level is typically used in day to day VaR monitoring. VaR is used to monitor interest rate, swap spread and currency risks and is not used to model income. Exposures against limits are reviewed daily by management. Actual outcomes are monitored on an ongoing basis by management to test the validity of the assumptions and factors used in the VaR calculation. Values reported below are on the same basis as those used internally.

Although VaR is a valuable guide to risk, it needs to be viewed in the context of the following limitations which may mean that exposures could be higher than modelled:

- 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,
- VaR models often under-predict the likelihood of extreme events and over-predict the benefits of offsetting positions in those extreme events,
- The VaR model uses historical data to predict future events. Extreme market moves outside of those used to calibrate the model will deliver exceptions. In periods of heightened volatility the model is likely to under-predict market risks and in periods of low volatility it is likely to over-predict market risks,
- Historical data may not adequately predict circumstances arising from government interventions and stimulus packages, which increase the difficulty of evaluating risks.

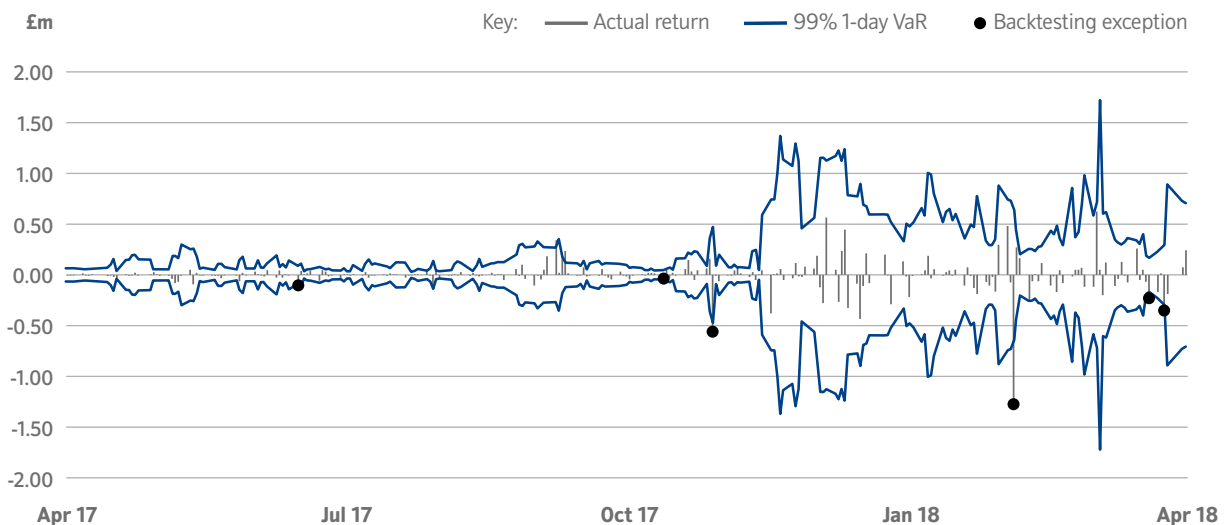


Business and Risk Report *continued*

Market risk *continued*

To seek to mitigate these limitations, backtesting of the VaR model is undertaken regularly to ensure that the model is appropriate. This process compares actual performance against the estimated VaR numbers. An exception is created when a loss is greater than the daily VaR on any given day. The chart below shows the results of this backtesting. The six loss exceptions were due to significant movements in market rates on each of those days, three of which coincided with the publication of minutes from the BoE Monetary Policy Committee meetings. In 2017/18, the backtesting and broader model governance did not highlight any model deficiencies.

VaR backtesting 99%/1-day



The model will continue to be subject to an annual review process to ensure it remains appropriate for risk reporting. The types of risks not captured in VaR include:

- Product option risk for which Pillar 2 capital is held,
- Market liquidity risk – this has a limited impact because, whilst Nationwide requires an appropriate level of market liquidity to manage market risk, it does not have a high ongoing dependency as it does not operate a trading book,
- Level 3 asset valuation uncertainty – only a very small portfolio of these assets is held so the impact is limited. Any valuation uncertainty is included within the Prudent Valuation Adjustment, and
- Interest rate movements that can impact credit/debit valuation adjustments (CVA/DVA). These are not captured in the VaR or sensitivity analysis but are negligible.

Stress analysis

To evaluate the potential impact of more extreme but plausible events or movements in a set of financial variables, the standard VaR metric is supported with sensitivity and stress analysis.

For example, for interest rate risk exposures, the standard PV01 sensitivity analysis is supplemented by the production of stressed sensitivity measures. A more severe 200 basis point (2.0%) parallel shift in interest rates is calculated in a similar manner to PV01; this sensitivity analysis is known as PV200. PV200 numbers are generated and monitored daily.

In addition, stressed VaR is used to estimate the potential loss arising from unfavourable market movements in a stressed environment. It is calculated in the same way as standard VaR, calibrated over a two-year period and on a 99% 10-day basis, but uses market data from a period of significant financial stress.

Interest rate risk

Nationwide's main market risk is interest rate risk. Market movements in interest rates affect the interest rate margin realised from lending and borrowing activities.

To reduce the impact of such movements, hedging activities are undertaken by Nationwide's Treasury function. For example, interest rate risks generated by lending to and receiving deposits from customers are offset against each other internally. The remaining net exposure is managed using derivatives, within parameters set by ALCO.

In addition to our primary lending and borrowing activities, the net income contribution from the assets funded by the reserves, CCDS or core current account balances is potentially subject to the volatility of short term interest rates. This is smoothed using structural hedging to reduce the volatility in earnings.



Business and Risk Report *continued*

Market risk *continued*

The table below highlights the limited amount to which Nationwide is exposed to interest rate risk. The risk is calculated each day and summarised over the financial year:

Interest rate risk						
	2018			2017		
	Average	High	Low	Average	High	Low
	£m	£m	£m	£m	£m	£m
VaR (99%/10-day) <i>(audited)</i>	0.9	5.4	0.1	0.5	2.4	0.1
Sensitivity analysis (PV01) <i>(audited)</i>	0.0	0.2	(0.2)	0.0	0.1	(0.0)
Stress testing (PV200: all currencies)	4.2	39.1	(32.6)	4.0	19.3	(9.3)

Basis risk

Basis risk arises where variable rate assets and liabilities re-price with reference to differing short term interest rate benchmarks. The primary interest rates that Nationwide is exposed to are the Bank of England base rate, Sterling Overnight Index Average (SONIA), three month Libor and six month Libor. Changes in the difference between these rates over time will impact earnings.

Assets and liabilities are offset by a reference rate, or 'basis' type. Exposure to the net mismatch is mitigated, where necessary, by transacting basis swaps to ensure Nationwide remains within internally agreed risk limits.

Earnings sensitivity

Earnings sensitivity measures the risk that income is adversely affected by changes in interest rates. The sensitivity of earnings to changes in interest rates is measured monthly using a forecasting model and potential interest rate scenarios.

The table below sets out the sensitivity of pre-tax future earnings over a one year period to instantaneous parallel rises and falls in interest rates.

Potential favourable/(adverse) impact on annual earnings		
<i>(Audited)</i>	2018	2017
	£m	£m
+200 basis points shift	121	250
+100 basis points shift	56	117
-25 basis points shift	(10)	(68)
-50 basis points shift	(46)	n/a

The following should be noted in relation to the above:

- the interest rate sensitivities set out above are illustrative only and are based on a static balance sheet; all assets and liabilities maturing within the year are assumed to reinvest in like for like products,
- the reported sensitivities will vary over time due to several factors, such as the timing of maturing assets and liabilities, market conditions, product rate flooring assumptions, customer behaviour and strategic changes to the balance sheet mix, and should not therefore be considered predictive of future performance,
- the sensitivity analysis includes all financial assets and liabilities held,
- the model does not take account of any management actions, and
- the impact on equity would be equivalent to the change in net interest income after tax.

The absolute levels of interest rates can influence the flexibility to manage earnings. Illustratively, if rates were to fall then margins may be constrained because it is unlikely that the benefit to borrowers could be fully offset through current account or savings product rate changes.

Swap spread risk

A liquidity portfolio is held to manage liquidity risk. These assets are predominantly fixed rate sovereign debt securities. Interest rate swaps are used to hedge the interest rate risk on these assets. However, there remains a residual risk associated with the possible movement in the spread between sovereign debt yields and swap rates. This 'swap spread risk' reflects the fact that the market value of the liquidity portfolio can change due to movements in bond yields and swap rates. In economic terms, this risk is only realised if a bond is sold and the swap is cancelled ahead of maturity.

This market risk is monitored using a historical VaR metric and the risk is controlled via internal limits linked to capital requirements. Exposures are monitored daily and are reported monthly to ALCO.



Business and Risk Report *continued*

Market risk *continued*

Currency risk

Currency exposure is managed through natural offset on the balance sheet, with derivatives used to maintain the net exposures within limits. ALCO sets and monitors limits on the net currency exposure. The table below sets out the limited extent of the residual exposure to currency risk:

Currency risk						
<i>(Audited)</i>	2018			2017		
	Average	High	Low	Average	High	Low
	£m	£m	£m	£m	£m	£m
VaR (99%/10-day)	0.1	2.2	0.0	0.1	0.2	0.0

Product option risk

Market risk also arises because of customers exercising options contained within fixed rate products which can require changes to hedging. The key product risks are prepayment risk (early redemption or under- or over-payment of fixed rate mortgages), access risk (early withdrawal of fixed rate savings), and take-up risk (higher or lower completions of fixed rate mortgages than expected). These risk exposures are quantified under a range of stress scenarios using models that predict customer behaviour in response to changes in interest rates. The potential impacts are then closely monitored. These stressed risk measures are subject to a set of limits and are reported to ALCO, along with proposed management actions where necessary to bring the exposures within limits. This approach is also used to assess internal capital requirements for product option risks.

Model risk

Managing market risk effectively is highly dependent on effective models. The models are designed as representations of business systems to help describe the impact of various scenarios and to optimise decisions taken as a result.

The risk associated with market risk models is controlled and managed through Nationwide's Model Validation Policy. This requires all significant models be validated by an independent oversight team prior to use. The validation process identifies model strengths and weaknesses, assesses the potential impact of these and suggests appropriate mitigating actions. After implementation, model performance is assessed regularly via back testing and sensitivity analysis. All models are also subject to a more thorough periodic review, at least annually, to ensure they remain fit for purpose. The results of the model performance assessment are used to inform future model development.

Calculations to determine the capital requirements for interest rate risk are made using the same models as those used for monitoring day to day interest rate risk.

Pension risk

Summary

Nationwide has funding obligations to several defined benefit pension schemes. Pension risk is defined as the risk that the value of the pension schemes' assets will be insufficient to meet the estimated liabilities, creating a pension deficit. Pension risk can negatively impact Nationwide's capital position and may result in increased cash funding obligations to the pension schemes.

The largest pension scheme is the Nationwide Pension Fund (the Fund), which has approximately 30,000 participants (Fund members), the majority of which are deferred members (former employee members, not yet retired). The Fund is closed to new employees, although some employees continue to accrue benefits.

In accordance with UK legislation, the assets of the Fund are held in a legally separate trust from the Group's assets and are administered by a board of trustees (the Trustee) who have fiduciary responsibilities to Fund members.

Nationwide has a responsibility to ensure that Fund members are paid the pension they have been promised. To support this aim, Nationwide has dedicated pension resource that ensures pension risk is appropriately monitored and managed, whilst helping to educate and engage Fund members about their pension benefits.

Risk factors

Volatility in investment returns from the assets and the value of the liabilities cause volatility in the Fund's deficit. The key risk factors which impact the deficit are set out below. These factors can have a positive or negative effect on the deficit.

Asset performance

The Fund's liabilities are calculated using a discount rate set with reference to high quality bond yields. This creates a risk that assets perform worse than those bond yields, resulting in the Fund's deficit being volatile or increasing.

The Fund holds a significant proportion of return-seeking assets e.g. equities and credit investments. Return-seeking assets are expected to outperform liabilities in the long-term, but they are risky and volatile in the short to medium-term. Investments in return-seeking assets are monitored by both the Trustee and Nationwide to ensure they remain appropriate given the Fund's long-term objectives. Further details are set out in note 30 to the financial statements.



Business and Risk Report *continued*

Pension risk *continued*

Liabilities

There is a risk that the Fund's liabilities increase to a level which is not supported by asset performance, whether through discount rate changes, increases in long-term inflation expectations, or increases in the longevity of Fund members.

Actuarial assumptions

There is a risk that a change in the methodology used to derive key actuarial assumptions (for example, the discount rate or longevity assumptions) results in a step change in the assessment of the liabilities and therefore deficit (impacting Nationwide's capital and/or deficit funding requirements). The ultimate cost of providing pension benefits over the life of the Fund will depend on actual future events, rather than assumptions made.

Changes in the year

During the year, £86 million of employer deficit contributions were paid. These deficit contributions are included in employer contributions in the table below, together with employer contributions in respect of employee benefit accrual during the period. Following agreement of the 31 March 2016 Triennial Valuation, annual employer deficit contributions of £61 million will be payable over the next four years (in line with an agreed Deficit Recovery Plan) and employer contributions in respect of employee benefit accrual will be paid in line with an agreed Schedule of Contributions. Nationwide can cease paying deficit contributions in certain circumstances, such as the Fund reaching a funding surplus. The effective date of the next Triennial Valuation of the Fund is 31 March 2019.

The retirement benefit obligation that appears within liabilities on the balance sheet has decreased from £423 million to £345 million, as set out below:

Changes in the present value of net defined benefit liability		
	2018	2017
	£m	£m
At 5 April	(423)	(213)
Pension charge	(95)	(64)
Net interest cost	(8)	(5)
Actuarial remeasurement	29	(347)
Employer contributions (including deficit contributions)	152	206
At 4 April	(345)	(423)

The pension charge (recognised in the income statement) increased to £95 million (2017: £64 million), mainly due to a fall in corporate bond yields between April 2016 and April 2017.

The actuarial remeasurement quantifies the impact on the deficit from updating financial assumptions (e.g. long-term inflation) and demographic assumptions (e.g. longevity). Further details can be found in the retirement benefit obligation note 30 to the financial statements.

Outlook

Regular production of analysis, insight and monitoring supports pension risk management and helps Nationwide to anticipate any management actions that may be required. This includes risk appetite articulation and regular reporting to governance committees. In addition, pension risk is embedded into Nationwide's Enterprise Risk Management Framework and stress testing processes. Nationwide monitors all pension regulation and legislation changes which may impact the Fund and Nationwide's obligations to the Fund.

Over the long term, the Trustee intends to further reduce the Fund's risk, and Nationwide actively engages with the Trustee to ensure broad alignment on investment objectives and implementation. This is supported by permanent representation by Nationwide at the Trustee's Investment and Funding Committee and investment working groups, and sharing management information between Nationwide and the Trustee in order to consider specific risk management initiatives.

Potential risk management initiatives include, but are not limited to, adjusting the asset allocation (for example reducing the allocation to equities and increasing the allocation to bonds), adjusting contribution levels and adjusting the level of benefits that employee members of the Fund accrue in the future.



Business and Risk Report *continued*

Business risk

Summary

Nationwide defines business risk as the risk that volumes decline or margins shrink relative to the cost base, affecting the sustainability of the business and the ability to deliver the strategy due to external or internal factors. We actively manage this risk so that we can continue to benefit our current or future members, with a focus on long-term sustainability rather than short-term metrics. Nationwide ensures that it can generate sustainable profits by focusing on recurrent sources of income that provide value which is commensurate with the risks the Society takes. The Society manages and monitors this risk as part of ongoing business performance reporting to senior management and the Board.

Managing business risk

Business risks are identified as part of the Society strategy and financial planning processes. These risks inform potential areas of strategy development and are assessed via a range of sensitivities to our financial plan. This activity is complemented by ongoing financial forecasting and monitoring as well as a range of stress testing activity to consider tail risks or longer-term risks to the Society. Ongoing strategy development ensures that our strategy and associated plans continue to evolve to address risks to our business model by considering changes in the external environment including new technology, consumer behaviour, regulation or market conditions.

These risks are assessed against Board risk appetite, and aligned to the Financial Performance Framework, which ensures the right balance between distributing value to members, investing in the business and maintaining financial strength.

Business risk is managed and mitigated through a range of measures such as:

- **Financial forecasting**
As part of the financial planning process Nationwide forecasts income and costs over a five year period with an updated forecast reviewed by management regularly, taking into consideration the key risks and sensitivities.
- **Monitoring of financial and business performance**
The various components of financial performance are monitored monthly against internal forecasts, limits and triggers across a variety of committees and forums, which consider potential risks and possible mitigating actions. In addition, business areas monitor the demand for products and services to ensure we continue to provide propositions that our members want and need.
- **Stress testing and sensitivity analysis**
Business risk is regularly stress tested as part of internal management reporting such as the financial plan downside and upside scenarios, Internal Capital Adequacy Assessment Process and reverse stress tests. In addition, the PRA's Concurrent Stress Test scenarios provide a test to the business model and the risks it is exposed to.

As an output from these activities the Society identifies potential actions that can be taken if risks crystallise. To help manage more extreme events the Society maintains a Recovery Plan, in line with regulatory guidance, that contains a range of strategic options that could be taken if necessary to protect the Society from severe stresses and ensure it remains sustainable over the long term.

Outlook

Business risks are closely intertwined with the top and emerging risks outlined on page 104. The competitive environment over the last year is expected to continue and increases in competition would increase the level of business risk for Nationwide. In addition, uncertainty in the economic environment caused by Brexit represents potential risks in the short-term, although is expected to have limited long-term impact as the Society has no operations or core business activities based in other European countries.



Business and Risk Report *continued*

Model risk

Summary

Models are widely used throughout Nationwide to support decision making. Whilst they provide significant benefit, using models also carries risk.

Nationwide defines model risk as the risk of weaknesses or failures in models used to support key decisions including the amount of capital and liquidity resources required, lending and pricing decisions, resourcing and earnings.

Model risk is established in Nationwide's Enterprise Risk Management Framework and is managed at a Society level using limits and triggers set according to Board risk appetite, supported by policies, standards and guidelines.

Current environment

The effectiveness of all models is achieved through clear allocation of roles and responsibilities covering ownership for each of the core activities relating to the control of model risk. At Nationwide, each model is required to have a model owner in the first line, typically a Senior Executive. The owner is responsible for the development, implementation and maintenance of the model. Key models are also subject to regular monitoring, which is reported to the relevant risk committee or accountable individual, with a detailed review required at least annually. The model owner is also responsible for ensuring the model has been through the appropriate model governance.

Ultimate responsibility for approving the use of Nationwide's key models resides with the first line risk committees (e.g. Assets & Liabilities Committee, Credit Committee) who ensure that model risk is managed within appetite. Nationwide's risk appetite for models is articulated to ensure they are developed, governed and maintained to a high quality to meet internal standards. Metrics, with limits and triggers, are designed to indicate when there is a systemic issue with model development capability or model management so that senior committees can take appropriate action.

The approval process brings together directors, senior managers of business areas and technical staff to provide challenge and identify issues that would prevent a model being fit for purpose.

Oversight is conducted by an independent team who sits within the Risk Community. Nationwide monitors the risk and materiality of its models on an individual basis. These are aggregated to create a single profile across all models to manage the Society's risk.

Outlook

A key area of focus for model risk management in the coming year will be responding to upcoming changes in regulation, with a corresponding increase in regulatory scrutiny.

Internal Ratings Based (IRB) models are undergoing significant regulatory reform with a view to bringing more consistency to IRB approaches across firms. A number of new regulations have been published by various regulatory bodies to support this reform. A series of model changes are being made to respond to this, ensuring IRB models comply with the new regulations as they come into force.

The publication by the Prudential Risk Authority of the Concurrent Stress Testing (CST) Model Risk Management (MRM) will feed into the regulators assessment of the quality of the models that underpin the CST process this year and Internal Capital Adequacy (ICA) assessment next year. In response, Nationwide continues to enhance the model risk management framework and extract value from the insight delivered by the models.

Operational risk

Summary

Operational risk is the risk of loss resulting from failures of internal processes, people and systems, or from external events. Nationwide manages operational risk across a number of sub-categories, the most significant of which cover cyber, IT resilience and security, business continuity, payments and fraud.

Nationwide operates a three lines of defence model to manage its operational risk. Details on this approach are set out in the Managing risk section page 101. The operational risk profile is informed by risk assessments from across the business, and by review and challenge by both management and the Risk Oversight function. Risk Oversight supports management in managing the risks it faces in its normal day-to-day activities and when implementing change programmes. Nationwide continues to strengthen and embed the operational risk framework, expanding the use of techniques such as scenario analysis and 'war-gaming' to support the understanding of current and future risks and to optimise risk-based decision making across the business.

Nationwide also monitors and reports on the operational risk events that have occurred, to better understand those exposures that require management attention. For the purposes of this report, operational risk events include only those where a financial loss arises from an operational risk incident. Nationwide records operational risk events against causal categories, as well as reporting them against the operational risk categories defined by the Basel Committee on Banking Supervision in Basel II. This allows comparison of operational risk experience with its peer group.

Operational risk experience

A significant proportion of Nationwide's operational risk events have been recorded against three of the Basel categories: 'Clients, Products & Business Practices', 'External Fraud' and 'Execution, Delivery and Process Management'. These categories account for 99.4% by value, and 97.7% by number, of Nationwide's operational risk events (2017: 99.2% by value and 95.1% by number).

Whilst the highest losses are against the Clients, Products and Business Practices (C,P&BP) category, Nationwide typically experiences a relatively low volume of these events. This contrasts with the External Fraud event category, where Nationwide continues to see a high volume of events, with relatively low individual losses. In line with the rest of the financial services sector, Nationwide continues to see the majority of its fraud losses arise from low value fraud events, primarily through 'card not present' fraud.

There have been notable increases in the redress payments associated with PPI claims (recorded in C,P&BP) as a direct result of the August 2019 claims deadline announced by the FCA, and the accompanying advertising campaign. There has been a reduction in other types of loss included within the C,P&BP category and an increase in losses allocated to Execution, Delivery and Process Management.



Business and Risk Report *continued*

Operational risk *continued*

Operational risk events by Basel risk category % of total events by value (note i)		
	2018	2017 (note ii)
	%	%
Clients, products and business practices (note iii)	70.5	78.0
External fraud	5.7	10.0
Execution, delivery and process management	23.2	11.2
Internal fraud	0.3	-
Business disruption and system failure	-	0.1
Damage to physical assets	0.2	0.4
Employment practices and workplace safety	0.1	0.3
Total	100.0	100.0

Operational risk events by Basel risk category % of total events by number (note i)		
	2018	2017 (note ii)
	%	%
Clients, products and business practices	4.6	6.2
External fraud	85.9	76.5
Execution, delivery and process management	7.2	12.4
Internal fraud	0.3	0.3
Business disruption and system failure	0.5	0.5
Damage to physical assets	1.0	3.0
Employment practices and workplace safety	0.5	1.1
Total	100.0	100.0

Notes:

- i. Risk events with losses over £5,000; multiple losses relating to the same event are only counted once.
- ii. Comparatives have been restated to include additional historic data and to align to the current classification methodology.
- iii. Includes the costs of administration and customer redress in relation to ongoing payment protection insurance claims.

Current environment

Over the course of the year, the overall portfolio of operational risks has remained relatively stable, with the notable exception being the growth in the inherent risk of cyber security. Customers quite rightly continue to expect the highest standards when it comes to management of key inherent risks such as cyber-security and IT resilience. These expectations, together with the high pace of change and focus on continued delivery of Nationwide's strategy, have been matched by increased control and monitoring. Nationwide's focus is on being safe, secure, and dependable in order to ensure that service availability and customer data are protected.

The main drivers of operational risk are as follows:

Cyber security

Nationwide recognises the direct impact that a successful cyber attack could have on customers and their ability to carry out the transactions they need to on a day to day basis. The constant threat posed by a cyber attack also directly impacts the existing risks associated with external fraud, data loss, data integrity and data accessibility.

There has been a notable increase in the maturity, intensity and sophistication of organised cyber crime; this has been highlighted by successful high-profile attacks this year across several industries, including financial services. Such attacks continue to raise the profile and increase the public awareness of cyber threats such as Ransomware and Distributed Denial of Service (DDoS).

As a result of the continued threat from cyber crime, security controls have needed to keep pace. Nationwide continues to develop its capability to prevent, detect and respond to any threats or attacks. Significant effort continues to be focused on discharging Nationwide's cyber risk management responsibilities effectively, with ongoing investment in appropriate technology and processes.

Nationwide has strong links with government bodies and continues to work with the wider industry to identify vulnerabilities and share best practice to help combat cyber crime. Cyber security remains a high priority and Nationwide will continue to focus on improving the awareness of its customers and employees, as well as continuing to build its understanding of the developing threats, its defences and its resilience to cyber attacks.



Business and Risk Report *continued*

Operational risk *continued*

IT and operational resilience

Nationwide's implementation of new systems, IT infrastructure and processes, alongside the maintenance of legacy systems, introduces a level of operational complexity that could lead to systems not being available for customers to carry out transactions. In an increasingly digital world, customer expectations are rising, with a significantly lower tolerance of service disruption. Ensuring a highly reliable and widely available service requires resilient IT, business systems and processes.

To support its strategy and to remain resilient Nationwide has refreshed its Operational Resilience Strategy and continues to invest in IT resilience. Nationwide's Operational Resilience Strategy will provide the driving force, co-ordination and governance structure to ensure resilience "by design" is considered throughout Nationwide's processes and architecture.

People risk

Nationwide relies on talented and dedicated people to deliver its strategy and provide first class service, and to operate a strong risk and control framework. Nationwide continues to monitor and closely manage the impact on its people as it delivers the products, services and experience that members want, to ensure that the required levels of skill, knowledge and engagement are maintained.

Pace of change

Nationwide is committed to responding to the varied and evolving needs of its customers, making it easier for them to transact through a range of channels. However, the scale and pace of change can create delivery challenges. Such challenges have the potential to disrupt Nationwide's operating environment and negatively impact the service experienced by customers. These operational risks are managed through a strong focus on service management, transformation governance and programme management disciplines. Nationwide invests significantly in its digital channels, regularly updating the mobile and internet banking services and enabling new payment technologies. There is also a high volume of change driven by regulation; this is explored further as part of the conduct and compliance risk on page 156.

Data

The exponential rise in data used in digital services increases the complexity and cost of managing data securely and effectively. Nationwide is committed to protecting customer data from accidental loss, or from nefarious activities. Nationwide has a dedicated programme of work that was initiated in 2016 to address the GDPR requirements and to enhance members' data protection and privacy. There is a steady flow of regulation that will have an impact on how Nationwide manages data. More information is given in the data section of conduct and compliance risk on page 155.

Fraud

Card fraud remains the largest driver of fraud losses, driven by increasing transaction volumes as a result of business growth and customer behaviour, although the increasing trend seen in previous years appears to be stabilising. Nationwide continues to develop its fraud detection and prevention capabilities with the use of new technologies such as voice analytics. Losses incurred through the digital channels remain low; however, Nationwide is seeing signs of increasing sophistication of attacks. Nationwide is committed to keeping pace with the increases in digital capability and sophistication of attacks by investing in its fraud defences.

Nationwide recognises the impact that fraud also has on its customers and is committed to raising awareness of fraud scams, as well as working closely with the Payments Service Regulator and UK Finance to combat customer losses.

Use of third parties

Nationwide needs to ensure that customer outcomes and service experiences are maintained regardless of whether services are delivered in house or through third parties. Relationships with third parties are managed closely to ensure that the service they offer is in line with acceptable standards and Nationwide's customer ethos.

The collapse of Carillion has acted as a clear reminder of the importance of managing the risks associated with outsourcing services. Nationwide successfully managed the transfer and integration of outsourced activity, minimising the impact on, and providing stability to Carillion staff working on Nationwide contracts.

Outlook

The operational risk outlook focuses on the environment in which Nationwide operates and its strategy. The drivers of operational risk are expected to remain broadly consistent, with the main themes being:

- the scale and pace of change, particularly in a digital environment and with the enablement of Open Banking
- IT resilience and the increasingly sophisticated cyber security threats
- the continued reliance on strategic third-party partners.

Nationwide continues to invest in all these areas to maintain and develop appropriate controls to ensure that residual risk exposures are managed within appetite.



Business and Risk Report *continued*

Conduct and compliance risk

Summary

Conduct and compliance risk is the risk that Nationwide exercises inappropriate judgement or makes errors in the execution of its business activities, leading to non-compliance with regulation or legislation, market integrity being undermined, or an unfair outcome being created for our customers.

Nationwide adopts a Three Lines of Defence model in the way it structures its risk management activities. Nationwide has tailored this approach to reflect our size, complexity, and business model. Details on the approach are included in the Managing risk section of the report on page 101. In 2017, and as an outcome of the Society's Enterprise Risk Management Framework Simplification Programme, Compliance Advice completed the transition to the Second Line, allowing for clearer lines of responsibility and a more efficient way of working to deliver the Society's strategy and goals.

The financial losses associated with conduct and compliance risk are captured in operational risk loss data, the most material of these being Payment Protection Insurance (PPI). The FCA commenced its PPI awareness campaign in 2017, urging policy holders to make a decision on whether to make a complaint before the deadline of 29 August 2019. Nationwide continues its programme of activity to respond to an increase in complaints arising from the FCA advertising campaign, and to address the specific requirements set by the regulator.

Current environment

Nationwide believes in delivering fair outcomes to its customers, through the embedding of effective conduct risk management, improving frameworks and guidance and interpreting and implementing regulatory obligations. We are making good progress in embedding the identification of vulnerability across customer facing and operational areas through a vulnerable customer programme.

Nationwide continues to develop its capability to limit and manage financial crime and is committed to operating a business that prevents, deters and detects money laundering and terrorist financing. To that effect, we continue to make improvements to internal policies and procedures to support this agenda.

The regulatory environment remains challenging, with a variety of complex regulatory changes and new regimes being embedded, as regulators continue to drive an agenda committed to rebuilding trust and confidence in the UK financial services markets. Nationwide continues to support these developments and expects this challenging environment to continue as regulators look to redefine the regulatory regime in preparation for the UK's exit from the European Union.

There is a significant volume of complex regulatory change impacting the financial services industry; some of the key items relevant to Nationwide are listed below:

Data

Nationwide's data strategy looks to provide clear direction for how it manages its data, has a data centric culture and utilises data to deliver the best value to our customers.

The General Data Protection Regulation (GDPR) came into force in May 2018 and applies to personal data. It is more extensive than the Data Protection Act (DPA); and Nationwide has a dedicated programme of work that was initiated in 2016 to address the GDPR requirement and to enhance the members' data protection and privacy.

The BCBS 239 principles are aimed at strengthening banks' and building societies' risk data aggregation capabilities and internal risk reporting practices, in support of risk management and decision-making processes. Nationwide is in the process of enhancing existing data aggregation and reporting capabilities in line with the BCBS 239 principles.

The introduction of Open Banking creates both opportunities and risks for Nationwide. Nationwide views the change as a positive opportunity to deepen relationships with its members. Open Banking also has the potential to drive changes in customer behaviour and how customers interact with their financial services providers.

Capital requirements

The Capital Requirements Directive (CRD) is a European Union legislative package covering prudential rules for banks, building societies and investment firms. The updated CRD V will cover the same elements as CRD IV and regulatory proposals, such as aligning disclosures to international standards; a change in the approach to managing interest rate risk in the banking book; and the introduction of Minimum Requirement for Own Funds and Eligible Liabilities (MREL). Nationwide has plans in place which are designed to meet its future MREL requirements to support the Society's resolvability.

Financial crime

The Criminal Finances Act came into force in September 2017 and makes organisations, including Nationwide, criminally liable if they fail to prevent the facilitation of tax evasion by either an employee or a representative. In common with other firms, Nationwide has reviewed its current procedures to ensure they remain appropriate.

The European Union's Fifth Anti-Money Laundering Directive comes into force in June 2019, and aims to further enhance processes to counter money laundering and terrorist financing. Nationwide has work underway to review the new rules and will introduce any changes required in line with the new directive and industry guidance.



Business and Risk Report *continued*

Conduct and compliance *continued*

Industry reviews

The Financial Conduct Authority's (FCA) market study on competition in the mortgage sector was launched in December 2016, with the interim report published in May 2018 and final report expected at the end of the year. As the UK's second largest mortgage provider, this is of significant interest to Nationwide and the Society will consider the findings against its existing mortgage proposition, making enhancements where appropriate.

The FCA has announced a strategic review of business models in the retail banking sector. It aims to:

- Identify any potential conduct or competition issues;
- Understand how free-if-in-credit banking is paid for;
- Understand the impact of changes such as increased use of digital channels and reduced branch usage on business models; and
- Consider potential consequences for its consumer protection and competition objectives.

An update is expected during 2018 explaining the preliminary analysis and initial conclusions. Nationwide will continue to engage with the regulator to better understand the impact this review will have on the Society.

Following a review by the Competition and Markets Authority (CMA), firms were required to introduce a number of measures designed to increase competition and protect customers from persistent debt. This included publishing overdraft alerts to customers, enabling customers to request five years' worth of transaction history. The CMA is also requiring the introduction of service metrics reporting later in 2018. Nationwide met the initial requirements and has plans in place which are designed to deliver service metrics reporting.

The FCA published a Call for Input in 2016 seeking views on the retained provisions of the Consumer Credit Act (CCA), following the transition of consumer credit regulation from the Office of Fair Trading to the FCA in 2014. Nationwide expects the outcome of the FCA consultation to be made public in the second half of 2018, with final proposals being submitted to Her Majesty's Treasury (HMT) by April 2019.

Nationwide will actively engage with the regulators to respond to these complex regulatory changes; and will continue to provide a secure and dependable variety of products and services which are designed to meet the needs of members and customers.



Financial Statements

Ian, member for over 30 years



The importance of loyalty

Ian's relationship with Nationwide reflects the fact that the Society has grown out of over 200 local building societies up and down the UK.

Ian's first mortgage was actually with Hastings and Thanet which then became part of Anglia that merged with Nationwide in 1987.

Today he has his current account with us (FlexDirect) as well as savings accounts such as Flexclusive Regular Saver and Loyalty Saver.

Recently he took out a Loyalty ISA attracted by the rate of 1.40% AER.

"I do like the fact that the Society offers member-only products that reward our loyalty"

"But being able to keep track of my savings online and see my Loyalty ISA account next to all my other Nationwide accounts was a factor too."

Ian was an accountant with the railways (British Rail, then GWR, then Arriva trains) for most of his working life. "I'm retired now but keep myself busy doing bits and pieces around the home and also travelling around Britain on the railway. One of the benefits of having been a railway employee is that in retirement we can take advantage of free rail travel."



Financial Statements

- 159** Independent auditor's report
- 168** Income statements
- 169** Statements of comprehensive income
- 170** Balance sheets
- 171** Statements of movements in members' interests and equity
- 173** Cash flow statements
- 174** Notes to the financial statements

Note 1

Statement of accounting policies

Note 2

Judgements in applying accounting policies and critical accounting estimates

Performance/Return

Note 3

Interest receivable and similar income

Note 4

Interest expense and similar charges

Note 5

Fee and commission income and expense

Note 6

Other operating expense/income

Note 7

Losses/gains from derivatives and hedge accounting

Note 8

Administrative expenses

Note 9

Employees

Note 10

Impairment provisions on loans and advances to customers

Note 11

Taxation

Financial assets and liabilities

Note 12

Classification and measurement

Note 13

Investment securities

Note 14

Loans and advances to customers

Note 15

Derivative financial instruments

Note 16

Deposits from banks

Note 17

Other deposits

Note 18

Debt securities in issue

Note 19

Subordinated liabilities

Note 20

Subscribed capital

Note 21

Fair value hierarchy of financial assets and liabilities held at fair value

Note 22

Fair value of financial assets and liabilities held at fair value – Level 3 portfolio

Note 23

Fair value of financial assets and liabilities measured at amortised cost

Note 24

Offsetting financial assets and financial liabilities

Other assets and investments

Note 25

Intangible assets

Note 26

Property, plant and equipment

Accruals, provisions, contingent liabilities and other legal proceedings

Note 27

Provisions for liabilities and charges

Note 28

Capital and leasing commitments

Note 29

Contingent liabilities

Employee benefits

Note 30

Retirement benefit obligations

Capital and equity instruments

Note 31

Core capital deferred shares (CCDS)

Note 32

Other equity instruments

Scope of consolidation

Note 33

Investments in Group undertakings

Note 34

Structured entities

Other disclosure matters

Note 35

Related party transactions

Note 36

Notes to the cash flow statements

Note 37

Capital management

Note 38

Registered office



Independent auditors' report

to the members of Nationwide Building Society

Report on the audit of the financial statements

Opinion

In our opinion, Nationwide Building Society's Group financial statements and Society financial statements (the "financial statements"):

- give a true and fair view of the state of the Group's and of the Society's affairs as at 4 April 2018 and of the Group's and the Society's profit and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements, included within the Annual Report and Accounts (the "Annual Report"), which comprise:

- the Group and Society balance sheets as at 4 April 2018;
- the Group and Society income statements and the statements of comprehensive income for the year then ended;
- the Group and Society cash flow statements for the year then ended;
- the Group and Society statements of movements in members' interests and equity for the year then ended; and
- the notes to the financial statements, which include a description of the significant accounting policies.

Certain required disclosures have been presented elsewhere in the Annual Report, rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Society.

Other than those disclosed in note 8 to the financial statements, we have provided no non-audit services to the Group or the Society in the period from 5 April 2017 to 4 April 2018.

Our audit approach

Factors considered in setting the audit strategy

On commencement of the audit, we considered both internal and external factors which could influence how we audit the Group. There have been a number of matters we considered when determining the audit strategy this year.

We considered the current macroeconomic environment and regulatory developments during the year, including the impact of ongoing discussions in relation to the European Union withdrawal bill. We assessed these changes and considered them specifically when auditing the Group's impairment of retail loans and advances to customers and provisions for customer redress. Further detail is set out in the key audit matters section below.

Overview

- Overall Group materiality: £54.5 million (2017: £52.0 million), based on 5% of adjusted profit before tax.
- Overall Society materiality: £28.0 million (2017: £33.0 million), based on 5% of adjusted profit before tax.

The key audit matters for our Group and Society audits were:

- Valuation of the retail impairment provisions in the secured and unsecured portfolios (excluding Flex overdrafts).
- The judgements applied to post model adjustments, multiple economic scenarios and staging as it relates to the transitional disclosure for IFRS 9.
- Privileged access to IT systems.
- The risk of error in the manually controlled hedge accounting adjustments.
- The judgements applied to the material conduct provisions including PPI and Plevin.



Independent auditors' report *continued*

Report on the audit of the financial statements *continued*

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the Group and the industries in which it operates, and considered the risk of acts by the Group which were contrary to applicable laws and regulations, including fraud. We designed audit procedures at the Group and significant component level to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We focused on laws and regulations that could give rise to a material misstatement in the Group and Society financial statements, including, but not limited to, the Building Societies Act 1986, the Listing Rules, pensions legislation and UK tax legislation. Our tests included, but were not limited to, inspecting correspondence with regulators, discussions with legal counsel, and testing particular classes of transactions. There are inherent limitations in these audit procedures and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the Group and the Society, the accounting processes and controls, and the industry in which they operate.

We primarily focused our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements and evaluating the disclosures in the financial statements.

We tested and examined information using sampling and other auditing techniques, to the extent we considered necessary to provide a reasonable basis for us to form our own judgements. We obtained audit evidence by testing the effectiveness of controls, substantive procedures or a combination of both.

Within the financial statements, the Group has been recognised as one operating segment. However for the purposes of our audit, we scope the Group at a component level, defined by product or service function, to ensure appropriate granularity of our testing approach.

For components that we considered individually financially significant in the context of the Group's consolidated financial statements, we audited their financial information. We then considered the individual financial significance of other components in relation to primary statement account balances and the presence of any significant audit risks and other qualitative factors (including history of misstatements through fraud or error). These components were subject to specific audit procedures over those account balances or to address the significant audit risks or qualitative factors. Inconsequential components (defined as components that, in our view, did not represent a risk of material misstatement either individually or in aggregate) were eliminated from further consideration for specific audit procedures although they were subject to analytical review procedures.

In addition, we attended all Audit Committee meetings and also held meetings with senior management. We also met privately with the non-executive directors and other key stakeholders, including the regulators of the Group.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Society financial statements
Overall materiality	£54.5 million (2017: £52.0 million).	£28.0 million (2017: £33.0 million).
How we determined it	5% of profit before tax, adjusted for one-off costs. In 2017 there were no one-off costs.	
Rationale for benchmark applied	Statutory profits have been adjusted to remove one-off costs in relation to the debt buy-back exercise this year. The costs are material for 2018, but do not reflect the underlying business performance and are not expected to recur. Management have separately disclosed these costs in the financial statements, due to their one-off nature. Therefore adjusted profit before tax is considered an appropriate benchmark upon which to base our materiality.	



Independent auditors' report *continued*

Report on the audit of the financial statements *continued*

For each component in the scope of our Group audit, we allocated a materiality that is less than our overall Group materiality. The range of materiality allocated across components was between £5 million and £25 million.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £2.7 million for the Group audit (2017: £2.6 million) and £1.4 million for the Society audit (2017: £1.6 million) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Key audit matters

Based on our understanding of the business, changes in the economic environment and our discussions with the Audit Committee, we performed a risk assessment to determine the higher risk areas. We presented those identified higher audit risk areas during the Audit Committee meeting in October 2017. Throughout the year our plan was refreshed and revised to address changes in the external and internal environment and we presented a final, updated risk assessment in the May 2018 Audit Committee meeting.

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

In the table below, we have included an explanation of each key audit matter and how the audit approach was tailored to address it. This is not a complete list of all risks identified by our audit.

Nature of key audit matter	Procedures performed to support our discussions and findings that address the key audit matter
<p data-bbox="164 1032 544 1111">Valuation of the retail impairment provisions in the secured and unsecured portfolios (excluding Flex overdrafts)</p> <p data-bbox="164 1133 333 1160">Group and Society</p> <p data-bbox="164 1167 718 1245">Refer to page 59 (Audit Committee report), page 174 (Accounting policies) and page 194 (Note 10 and Critical accounting estimates and judgements).</p> <p data-bbox="164 1256 735 1359">Allowance for impairment of retail loans and advances to customers amounted to £458 million at year end. This is an area where a high level of judgement is applied in determining the necessity for and then estimating the size of any impairment.</p> <p data-bbox="164 1368 724 1447">Retail impairment is calculated on a modelled basis for each portfolio of loans and advances to customers. Inputs to the models are primarily based on historical data.</p> <p data-bbox="164 1456 735 1615">In the current year, management again adjusted the impairment models to take into account a prolonged period of low interest rates, concerns over higher levels of customer indebtedness and the risks associated with maturing interest only mortgages. We therefore focused our work on testing the model adjustments and updates to assumptions.</p>	<p data-bbox="770 1032 1347 1135">We identified and tested the design and operating effectiveness of key controls over the impairment models. We determined that these controls were effective and could be relied upon for the purpose of our audit.</p> <p data-bbox="770 1144 1350 1357">We tested the key assumptions in the impairment calculation and also agreed them to historical data where appropriate. Where changes had been made in model assumptions, or new adjustments had been made to models, we understood the reasons why changes had taken place and used our industry knowledge and experience to evaluate the appropriateness of such changes. We considered the changes and explanations given to be reasonable based on the evidence provided.</p> <p data-bbox="770 1366 1353 1469">We tested the operation of models used to calculate impairment, including using our specialists to rebuild a sample of two models using management's assumptions. We found no material differences in these tests.</p> <p data-bbox="770 1478 1331 1534">We tested the accuracy and completeness of underlying data used in the impairment models and identified no issues.</p> <p data-bbox="770 1543 1345 1673">We tested all significant model adjustments, including considering the basis for the adjustment, the logic applied, the source data used and the key assumptions adopted. We found these adjustments to be reasonable and supportable based on the evidence provided and our industry knowledge.</p> <p data-bbox="770 1682 1347 1785">We have also considered the completeness of adjustments identified for indicators of impairment given our own assessment of the industry and economic environment. We did not identify any additional material risks not considered by management.</p> <p data-bbox="770 1794 1350 1897">Based on the evidence we obtained, we determined that the impairment model assumptions, data used within the models and refinements to assumptions were reasonable and in accordance with accounting standards.</p> <p data-bbox="770 1906 1310 1962">We have also assessed the completeness and accuracy of the disclosures in the financial statements. We found no exceptions.</p>



Independent auditors' report *continued*

Report on the audit of the financial statements *continued*

Nature of key audit matter	Procedures performed to support our discussions and findings that address the key audit matter
<p>The judgements applied to post model adjustments, multiple economic scenarios and staging as it relates to the transitional disclosure for IFRS 9</p> <p>Group and Society Refer to page 59 (Audit Committee report), page 174 (Accounting policies).</p> <p>IFRS 9 will be implemented by the Group from 5 April 2018 with an expected increase of £172 million in impairment provisions. This is a key audit matter for the 4 April 2018 accounts as the impact of this transition is disclosed in the notes to the financial statements, and is therefore subject to audit.</p> <p>The IFRS 9 standard includes a new impairment model, where losses are recognised on an expected loss basis. This contrasts to the treatment under IAS 39, where losses are recognised when incurred and there is evidence to support the fact the loan may not be recoverable.</p> <p>Furthermore, expected credit losses are required to be measured on a forward-looking basis, reflecting the Group's view of potential future economic events.</p> <p>We focused our audit work on the areas of the methodology that we identified as most judgemental.</p> <p>There are three areas we focused on:</p> <ol style="list-style-type: none"> 1. Post model adjustments made by management by adjusting the output of the core IFRS 9 models; 2. The thresholds selected to determine a significant increase in credit risk ('staging') and hence whether a 12 month or lifetime loss provision is recorded; and 3. Determining appropriate assumptions in applying forward looking multiple economic scenarios in the models. 	<p>We performed testing to confirm that the methodology in the newly developed models materially complied with the requirements of IFRS 9 and found that they did.</p> <p>We understood and critically assessed the models used, including performing independent empirical tests on key model components. No exceptions were noted.</p> <p>To validate management's 'staging' thresholds, we re-performed key aspects of management's testing including the use of back testing to confirm that the criteria selected by management were reasonable. No exceptions were noted.</p> <p>When testing the application of forward looking information, we compared the forward looking assumptions to independent consensus views. We found that management's assumptions were reasonable based on this testing.</p> <p>We performed substantive testing on significant post model adjustments made by management and considered the completeness of adjustments to the output of core models to take account of the risks associated with a severe economic downturn. We concluded that the assumptions in all significant post model adjustments were reasonable and did not identify any additional material risks not considered by management.</p> <p>We performed substantive testing on the extraction of key data from underlying systems and data warehouses that are used in the models without exception.</p> <p>We reconciled the IFRS 9 transitional impact disclosed on page 178 of the accounts to source calculations and models without exception.</p> <p>Based on the evidence obtained we found that the impairment model assumptions, data used within the models and post model adjustments made by management to be reasonable and therefore concluded that the transitional impact disclosed is reasonable.</p>



Independent auditors' report *continued*

Report on the audit of the financial statements *continued*

Nature of key audit matter	Procedures performed to support our discussions and findings that address the key audit matter
<p data-bbox="165 465 427 488">Privileged access to IT systems</p> <p data-bbox="165 517 331 539">Group and Society</p> <p data-bbox="165 551 528 573">Refer to page 59 (Audit Committee report).</p> <p data-bbox="165 584 738 712">In previous years, we identified and reported that privileged access controls to applications, operating systems and data in the financial reporting process required improvements. These controls are critical to mitigate the risk that users can change IT system functionality and data intentionally or through error.</p> <p data-bbox="165 723 738 851">Management have begun to address the control findings, including onboarding some systems to a privileged access system, CyberArk. However given the complexity of Nationwide's IT infrastructure, the majority of systems that we rely on for our audit approach are not on CyberArk.</p> <p data-bbox="165 862 727 967">During the year, we have identified that the privileged access controls still require improvement and due to the pervasiveness of the systems impacted we have increased our substantive testing and testing of mitigating controls.</p>	<p data-bbox="772 465 1326 517">We understood and tested the design and operating effectiveness of the privileged access control environment.</p> <p data-bbox="772 528 1353 656">We identified the inventory of privileged generic accounts and tested if they were controlled appropriately on CyberArk. For any accounts that were not, we tested if there were effective compensating controls and inspected login date stamps to verify if they were logged into during the year.</p> <p data-bbox="772 667 1353 824">In response to the weaknesses identified, we performed additional testing of systems that were not on CyberArk and did not have appropriate mitigating controls. For operating systems, we identified the automated controls we use in our audit procedures and inspected timestamps and code comparisons to test that system functionality had not been amended during the year.</p> <p data-bbox="772 835 1318 880">No inappropriate changes to system functionality were identified through our testing.</p> <p data-bbox="772 891 1318 965">For databases, additional substantive testing was performed on those areas where we identified a higher risk of fraud or error in relation to privileged access, including the following:</p> <ul data-bbox="772 976 1318 1160" style="list-style-type: none"> <li data-bbox="772 976 1198 999">• A higher extent of testing on key reconciliations; <li data-bbox="772 1010 1241 1032">• Increased sample testing of administrative expenses; <li data-bbox="772 1043 1166 1066">• A specific test over the validity of payments; <li data-bbox="772 1077 1171 1099">• Additional risk based manual journal testing; <li data-bbox="772 1111 1318 1160">• Additional payroll testing to mitigate the risk of inappropriate amendments to standing data. <p data-bbox="772 1171 1299 1223">In our procedures performed above, no inappropriate changes to system data were identified through our testing.</p>



Independent auditors' report *continued*

Report on the audit of the financial statements *continued*

Nature of key audit matter	Procedures performed to support our discussions and findings that address the key audit matter
<p data-bbox="164 465 687 517">The risk of error in the manually controlled hedge accounting adjustments</p> <p data-bbox="164 539 336 566">Group and Society</p> <p data-bbox="164 575 609 627">Refer to page 59 (Audit Committee report), page 174 (Accounting policies) and page 189 (Note 7).</p> <p data-bbox="164 636 711 741">The Group and Society apply fair value and cash flow hedge accounting under IAS 39 Financial Instruments: Recognition and Measurement to manage accounting volatility mainly arising due to interest rate and foreign exchange risks.</p> <p data-bbox="164 750 727 855">To qualify for hedge accounting under IAS 39, certain criteria must be met, including documenting the nature and purpose of the hedge, performing testing over its effectiveness and appropriately accounting for the hedging results.</p> <p data-bbox="164 864 708 916">We focused our work on the complex, manual hedge accounting processes, which present a heightened risk of error.</p> <p data-bbox="164 925 719 1055">In November 2017, the Group migrated from their legacy Treasury system to a new system. Given the significance of this front to back migration, we performed additional testing in relation to the migration itself and subsequent operating effectiveness of the new system.</p>	<p data-bbox="770 465 1350 703">We understood and tested the design and operating effectiveness of key controls over the designation and monitoring of hedge relationships and hedge effectiveness testing for both fair value and cash flow hedge relationships. For manual processes, we tested the controls in place that mitigate the risk of error, including user access and completeness and accuracy of inputs. With the exception of the privileged access control findings as documented in the previous key audit matter, we determined that we could place reliance on these controls for the purposes of our audit.</p> <p data-bbox="770 712 1326 927">For a sample of hedges, we examined hedge documentation to assess whether it complied with the requirements of IAS 39, including management's assessment of hedge effectiveness at the time of designation. For a sample of fair value and cash flow hedge relationships, we re-performed hedge effectiveness testing by agreeing inputs to the underlying systems and comparing our results to the modelled calculations. We found these calculations to be effective in calculating hedge effectiveness.</p> <p data-bbox="770 936 1345 1223">We recalculated a sample of automated and manual calculations in both systems used to generate the hedge accounting adjustments and found that the adjustments were materially accurate. We tested key year end reconciliations between the Treasury systems and the general ledger ensuring accurate recording of hedge accounting adjustments in the income statement and balance sheet for fair value hedge relationships. For cash flow hedge relationships, we tested a sample of manual adjustments posted to the cash flow hedge reserve relating to the effective portion of the derivative in the hedge relationship. We found no material differences in the accounting adjustments.</p> <p data-bbox="770 1232 1342 1391">We tested the balance sheet reconciliation between the legacy and new system at the date of migration. At year end, we tested a sample of balance sheet items back to external sources and performed an independent revaluation of the financial instruments. For any processes that remained manual in the new system, we tested the completeness and accuracy of the inputs and calculation.</p> <p data-bbox="770 1400 1283 1478">Based on our testing performed, we found the controls to be reasonable and the hedge accounting adjustments to be in compliance with accounting standards.</p>



Independent auditors' report *continued*

Report on the audit of the financial statements *continued*

Nature of key audit matter	Procedures performed to support our discussions and findings that address the key audit matter
<p data-bbox="164 465 671 517">The judgements applied to the material conduct provisions including PPI and Plevin</p> <p data-bbox="164 539 336 566">Group and Society</p> <p data-bbox="164 575 719 654">Refer to page 59 (Audit Committee report), page 174 (Accounting policies) and page 219 (Note 27 and Critical accounting estimates and judgements).</p> <p data-bbox="164 663 727 819">There is inherent uncertainty in assessing and measuring the potential obligations resulting from ongoing regulatory matters and past sales practices, including mis-selling of Payment Protection Insurance ("PPI") and non-compliance with consumer credit regulations, specifically in respect of the timing and volume of future complaints volumes.</p> <p data-bbox="164 828 719 985">As per the policy statement issued by FCA in March 2017, there is a time-bar for consumer PPI complaints to be raised by August 2019, as well as a FCA-led publicity campaign. Management have continued to make updates to the provision models to reflect the latest complaint trends and the FCA's communications in relation to the timing and extent of its publicity campaign.</p>	<p data-bbox="770 465 1326 544">For significant customer redress provisions, we tested the accuracy and completeness of the data used and re-performed the calculations. We found no material differences in these tests.</p> <p data-bbox="770 553 1326 654">We assessed the assumptions used in the provisions for reasonableness based on our broader industry knowledge and traced the actual claims experience and costs to date to historical data without exception.</p> <p data-bbox="770 663 1342 763">We tested a sample of customer complaints by reviewing the related correspondence with the customers to understand whether there were indicators of inconsistency with the outcome recorded. This testing did not identify any exceptions.</p> <p data-bbox="770 772 1305 851">Specifically, for PPI provisioning, we tested how management updated their provisioning models and assumptions to address actual complaints flow.</p> <p data-bbox="770 860 1289 938">Based on the evidence we obtained, we determined that the provisions have been reasonably calculated and are within an acceptable range of expected outcomes.</p> <p data-bbox="770 947 1337 1081">Given the inherent uncertainty in the calculation of customer redress provisions and their judgemental nature, we considered whether the disclosures of the application of judgement in estimating the provisions adequately reflected the uncertainties associated with customer redress and determined that they did.</p> <p data-bbox="770 1090 1329 1169">No additional material customer redress issues that would require either provision or disclosure in the financial statements were identified as a result of the audit work performed.</p>

Going concern

In accordance with ISAs (UK) we report as follows:

Reporting obligation	Outcome
<p data-bbox="164 1395 735 1603">We are required to report if we have anything material to add or draw attention to in respect of the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the directors' identification of any material uncertainties to the Group's and the Society's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements.</p>	<p data-bbox="770 1395 1337 1496">We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and Society's ability to continue as a going concern.</p>



Independent auditors' report *continued*

Report on the audit of the financial statements *continued*

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

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

With respect to the Annual business statement and Directors' report we also considered whether the disclosures required by the Building Societies Act 1986 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, the Building Society Act 1986 and ISAs (UK) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

Building Society Act 1986 – Opinion on Annual business statement and Directors' report

In our opinion, based on our work undertaken in the course of the audit:

- the Annual business statement and the Directors' report have been prepared in accordance with the requirements of the Building Societies Act 1986;
- the information given in the Directors' report for the year ended 4 April 2018 is consistent with the accounting records and the financial statements; and
- the information given in the Annual business statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given.

Other voluntary reporting

Corporate governance report

The Society prepares a Corporate governance report in accordance with the Disclosure Guidance and Transparency Rules sourcebook ("DTR") of the Financial Conduct Authority and has chosen to voluntarily comply with the UK Corporate Governance Code (the 'Code'). The directors have requested that we review the parts of the Corporate governance report relating to the Society's compliance with the provisions of the DTR and the Code, specified for auditor reporting by the Companies Act 2006, or for review by the Listing Rules of the Financial Conduct Authority, as if the Society were a premium listed company.

In our opinion, based on the work undertaken in the course of the audit, the information given in the Corporate governance report (on pages 41 to 82) about internal controls and risk management systems in relation to financial reporting processes in compliance with rules 7.2.5 and 7.2.6 of the Disclosure Guidance and Transparency Rules sourcebook of the Financial Conduct Authority ("DTR") is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the Group and Society and their environment obtained in the course of the audit, we did not identify any material misstatements in this information.

In our opinion, based on the work undertaken in the course of the audit, the information given in the Corporate governance report (on pages 41 to 82) with respect to the Society's corporate governance code and practices and about its administrative, management and supervisory bodies and their committees complies with rules 7.2.2, 7.2.3 and 7.2.7 of the DTR.

We have nothing to report arising from our responsibility to report if a corporate governance statement has not been prepared by the Society.

Going concern

The directors have requested that we review the statement on page 95 in relation to going concern as if the Society were a premium listed company. We have nothing to report having performed our review.

The directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group

The directors have requested that we perform a review of the directors' statements on page 25 that they have carried out a robust assessment of the principal risks facing the Group and in relation to the longer-term viability of the Group, as if the Society were a premium listed company. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the Code; and considering whether the statements are consistent with the knowledge and understanding of the Group and Society and their environment obtained in the course of the audit. We have nothing to report having performed this review.

Other Code Provisions

The directors have prepared a Corporate governance report and requested that we review it as though the Society were a premium listed company. We have nothing to report in respect of the requirement to report when the directors' statement relating to the Society's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified, under the Listing Rules, for review by the auditors.

Directors' Remuneration

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

In our opinion, the part of the Report of the directors on remuneration to be audited has been properly prepared in accordance with the requirements of the Companies Act 2006.



Independent auditors' report *continued*

Report on the audit of the financial statements *continued*

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Directors' responsibilities in respect of the preparation of the Annual Report and Accounts set out on page 95, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditors' responsibilities for the audit of the financial statements

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

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

Use of this report

This report, including the opinions, has been prepared for and only for the Society's members as a body in accordance with Section 78 of the Building Societies Act 1986 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Building Societies Act 1986 exception reporting

Under the Building Societies Act 1986 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the Society; or
- the Society annual accounts are not in agreement with the accounting records; or
- we have not received all the information and explanations and access to documents we require for our audit.

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the Audit Committee, we were appointed by the members on 26 July 1991 to audit the financial statements for the year ended 4 April 1992 and subsequent financial periods. The period of total uninterrupted engagement is 27 years, covering the years ended 4 April 1992 to 4 April 2018.

Hemione Hudson (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
21 May 2018



Income statements

For the year ended 4 April 2018					
	Notes	Group		Society	
		2018	2017	2018	2017
		£m	£m	£m	£m
Interest receivable and similar income	3	4,818	5,050	4,437	4,724
Interest expense and similar charges	4	(1,807)	(2,090)	(1,964)	(2,244)
Net interest income		3,011	2,960	2,473	2,480
Fee and commission income	5	449	446	445	442
Fee and commission expense	5	(244)	(221)	(244)	(221)
Other operating (expense)/income	6	(84)	100	(86)	100
(Losses)/gains from derivatives and hedge accounting	7	(1)	66	(26)	69
Total income		3,131	3,351	2,562	2,870
Administrative expenses	8	(2,024)	(2,021)	(1,995)	(1,988)
Impairment losses on loans and advances to customers	10	(107)	(131)	(97)	(66)
Impairment recoveries/(losses) on investment securities	13	2	(9)	2	(9)
Provisions for liabilities and charges	27	(25)	(136)	(20)	(136)
Profit before tax		977	1,054	452	671
Taxation	11	(232)	(297)	(115)	(206)
Profit after tax		745	757	337	465

The notes on pages 174 to 231 form part of these financial statements.



Statements of comprehensive income

For the year ended 4 April 2018					
	Notes	Group		Society	
		2018	2017	2018	2017
		£m	£m	£m	£m
Profit after tax		745	757	337	465
Other comprehensive (expense)/income					
Items that will not be reclassified to the income statement					
Remeasurements of retirement benefit obligations:					
Retirement benefit remeasurements before tax	30	29	(347)	26	(345)
Taxation	11	(7)	92	(8)	92
		22	(255)	18	(253)
Revaluation of property:					
Revaluation before tax	26	2	1	2	1
Taxation	11	(1)	2	(1)	2
		1	3	1	3
Effect of tax rate change on other items through the general reserve	11	-	(1)	-	-
		23	(253)	19	(250)
Items that may subsequently be reclassified to the income statement					
Cash flow hedge reserve:					
Fair value movements taken to members' interests and equity		(2,316)	1,671	(418)	71
Amount transferred to income statement		2,057	(2,019)	342	(143)
Taxation	11	68	101	19	18
		(191)	(247)	(57)	(54)
Available for sale reserve:					
Fair value movements taken to members' interests and equity		50	176	50	176
Amount transferred to income statement		(8)	(106)	(8)	(104)
Taxation	11	(11)	(18)	(11)	(16)
		31	52	31	56
Other comprehensive (expense)/income		(137)	(448)	(7)	(248)
Total comprehensive income		608	309	330	217

The notes on pages 174 to 231 form part of these financial statements.



Balance sheets

At 4 April 2018					
	Notes	Group		Society	
		2018	2017*	2018	2017*
		£m	£m	£m	£m
Assets					
Cash		14,361	13,017	14,361	13,017
Loans and advances to banks		3,422	2,587	3,406	2,567
Investment securities	13	13,046	9,831	13,046	9,831
Derivative financial instruments	15	4,121	5,043	3,108	4,022
Fair value adjustment for portfolio hedged risk		(109)	746	(109)	746
Loans and advances to customers	14	191,664	187,371	158,246	153,900
Investments in Group undertakings	33	-	-	31,296	31,757
Intangible assets	25	1,342	1,230	1,330	1,218
Property, plant and equipment	26	887	859	885	857
Accrued income and expenses prepaid		164	191	1,535	1,311
Deferred tax	11	98	103	95	98
Current tax assets		-	-	4	-
Other assets	18	102	692	100	689
Total assets		229,098	221,670	227,303	220,013
Liabilities					
Shares		148,003	144,542	148,003	144,542
Deposits from banks	16	19,404	8,734	18,216	7,563
Other deposits	17	5,323	6,459	6,740	8,028
Due to customers		402	2,376	402	2,376
Fair value adjustment for portfolio hedged risk		(53)	8	(53)	8
Debt securities in issue	18	34,118	40,339	29,734	35,872
Derivative financial instruments	15	2,337	3,182	3,746	4,802
Other liabilities		345	391	3,549	3,186
Provisions for liabilities and charges	27	273	387	271	386
Accruals and deferred income		336	295	335	294
Subordinated liabilities	19	5,497	2,940	5,497	2,945
Subscribed capital	20	263	279	263	279
Deferred tax	11	49	100	23	26
Current tax liabilities		53	82	-	44
Retirement benefit obligations	30	345	423	342	419
Total liabilities		216,695	210,537	217,068	210,770
Members' interests and equity					
Core capital deferred shares	31	1,325	531	1,325	531
Other equity instruments	32	992	992	992	992
General reserve		9,951	9,316	7,883	7,660
Revaluation reserve		68	67	68	67
Cash flow hedge reserve		(8)	183	(113)	(56)
Available for sale reserve		75	44	80	49
Total members' interests and equity		12,403	11,133	10,235	9,243
Total members' interests, equity and liabilities		229,098	221,670	227,303	220,013

*Comparatives have been restated as detailed in note 1.

The notes on pages 174 to 231 form part of these financial statements.

Approved by the Board of directors on 21 May 2018.

D L Roberts Chairman, **J D Garner** Chief Executive Officer, **M M Rennison** Chief Financial Officer



Group statement of movements in members' interests and equity

For the year ended 4 April 2018							
	Core capital deferred shares	Other equity instruments	General reserve	Revaluation reserve	Cash flow hedge reserve	Available for sale reserve	Total
	£m	£m	£m	£m	£m	£m	£m
At 5 April 2017	531	992	9,316	67	183	44	11,133
Profit for the year	-	-	745	-	-	-	745
Net remeasurements of retirement benefit obligations	-	-	22	-	-	-	22
Net revaluation of property	-	-	-	1	-	-	1
Effect of tax rate change on other items through the general reserve	-	-	-	-	-	-	-
Net movement in cash flow hedge reserve	-	-	-	-	(191)	-	(191)
Net movement in available for sale reserve	-	-	-	-	-	31	31
Total comprehensive income	-	-	767	1	(191)	31	608
Issue of core capital deferred shares	794	-	-	-	-	-	794
Distribution to the holders of core capital deferred shares	-	-	(82)	-	-	-	(82)
Distribution to the holders of Additional Tier 1 capital (note i)	-	-	(50)	-	-	-	(50)
At 4 April 2018	1,325	992	9,951	68	(8)	75	12,403

For the year ended 4 April 2017							
	Core capital deferred shares	Other equity instruments	General reserve	Revaluation reserve	Cash flow hedge reserve	Available for sale reserve	Total
	£m	£m	£m	£m	£m	£m	£m
At 5 April 2016	531	992	8,921	64	430	(8)	10,930
Profit for the year	-	-	757	-	-	-	757
Net remeasurements of retirement benefit obligations	-	-	(255)	-	-	-	(255)
Net revaluation of property	-	-	-	3	-	-	3
Effect of tax rate change on other items through the general reserve	-	-	(1)	-	-	-	(1)
Net movement in cash flow hedge reserve	-	-	-	-	(247)	-	(247)
Net movement in available for sale reserve	-	-	-	-	-	52	52
Total comprehensive income	-	-	501	3	(247)	52	309
Distribution to the holders of core capital deferred shares	-	-	(56)	-	-	-	(56)
Distribution to the holders of Additional Tier 1 capital (note i)	-	-	(50)	-	-	-	(50)
At 4 April 2017	531	992	9,316	67	183	44	11,133

Note:

i. The distribution to the holders of Additional Tier 1 capital is shown net of an associated tax credit of £18 million (2017: £18 million).

The notes on pages 174 to 231 form part of these financial statements.



Society statement of movements in members' interests and equity

For the year ended 4 April 2018							
	Core capital deferred shares	Other equity instruments	General reserve	Revaluation reserve	Cash flow hedge reserve	Available for sale reserve	Total
	£m	£m	£m	£m	£m	£m	£m
At 5 April 2017	531	992	7,660	67	(56)	49	9,243
Profit for the year	-	-	337	-	-	-	337
Net remeasurements of retirement benefit obligations	-	-	18	-	-	-	18
Net revaluation of property	-	-	-	1	-	-	1
Net movement in cash flow hedge reserve	-	-	-	-	(57)	-	(57)
Net movement in available for sale reserve	-	-	-	-	-	31	31
Total comprehensive income	-	-	355	1	(57)	31	330
Issue of core capital deferred shares	794	-	-	-	-	-	794
Distribution to the holders of core capital deferred shares	-	-	(82)	-	-	-	(82)
Distribution to the holders of Additional Tier 1 capital (note i)	-	-	(50)	-	-	-	(50)
At 4 April 2018	1,325	992	7,883	68	(113)	80	10,235

For the year ended 4 April 2017							
	Core capital deferred shares	Other equity instruments	General reserve	Revaluation reserve	Cash flow hedge reserve	Available for sale reserve	Total
	£m	£m	£m	£m	£m	£m	£m
At 5 April 2016	531	992	7,554	64	(2)	(7)	9,132
Profit for the year	-	-	465	-	-	-	465
Net remeasurements of retirement benefit obligations	-	-	(253)	-	-	-	(253)
Net revaluation of property	-	-	-	3	-	-	3
Net movement in cash flow hedge reserve	-	-	-	-	(54)	-	(54)
Net movement in available for sale reserve	-	-	-	-	-	56	56
Total comprehensive income	-	-	212	3	(54)	56	217
Distribution to the holders of core capital deferred shares	-	-	(56)	-	-	-	(56)
Distribution to the holders of Additional Tier 1 capital (note i)	-	-	(50)	-	-	-	(50)
At 4 April 2017	531	992	7,660	67	(56)	49	9,243

Note:

i. The distribution to the holders of Additional Tier 1 capital is shown net of an associated tax credit of £18 million (2017: £18 million).

The notes on pages 174 to 231 form part of these financial statements.



Cash flow statements

For the year ended 4 April 2018					
	Notes	Group		Society	
		2018	2017*	2018	2017*
		£m	£m	£m	£m
Cash flows generated from operating activities					
Profit before tax		977	1,054	452	671
Adjustments for:					
Non-cash items included in profit before tax	36	1,202	1,304	1,184	1,190
Changes in operating assets and liabilities	36	7,189	(1,367)	7,746	(2,426)
Taxation		(236)	(297)	(140)	(212)
Net cash flows generated from/(used in) operating activities		9,132	694	9,242	(777)
Cash flows (used in)/generated from investing activities					
Purchase of investment securities		(7,090)	(5,282)	(7,090)	(5,282)
Sale and maturity of investment securities		3,553	6,668	3,553	6,668
Purchase of property, plant and equipment		(159)	(198)	(159)	(198)
Sale of property, plant and equipment		10	10	10	10
Purchase of intangible assets		(365)	(276)	(365)	(276)
Net cash flows (used in)/generated from investing activities		(4,051)	922	(4,051)	922
Cash flows (used in)/generated from financing activities					
Distributions paid to the holders of core capital deferred shares		(82)	(56)	(82)	(56)
Distributions paid to the holders of Additional Tier 1 capital		(68)	(68)	(68)	(68)
Issue of core capital deferred shares		794	-	794	-
Issue of debt securities		22,298	28,437	21,389	28,437
Redemption of debt securities in issue		(27,737)	(26,692)	(26,970)	(25,282)
Interest paid on debt securities		(679)	(727)	(643)	(637)
Issue of subordinated liabilities		3,995	949	3,995	949
Redemption of subordinated liabilities		(1,251)	-	(1,251)	-
Interest paid on subordinated liabilities		(141)	(117)	(141)	(117)
Redemption of subscribed capital		-	(140)	-	(140)
Interest paid on subscribed capital		(14)	(22)	(14)	(22)
Net cash flows (used in)/generated from financing activities		(2,885)	1,564	(2,991)	3,064
Net increase in cash and cash equivalents		2,196	3,180	2,200	3,209
Cash and cash equivalents at start of year		15,243	12,063	15,223	12,014
Cash and cash equivalents at end of year	36	17,439	15,243	17,423	15,223

*Comparatives have been restated as detailed in note 1.

The notes on pages 174 to 231 form part of these financial statements.



Notes to the financial statements

1. Statement of accounting policies

Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as published by the International Accounting Standards Board (IASB) and interpretations issued by the IFRS Interpretations Committee of the IASB as adopted by the European Union. These financial statements have also been prepared in accordance with those parts of the Building Societies (Accounts and Related Provisions) Regulations 1998 (as amended) applicable to organisations reporting under IFRS.

The financial statements have been prepared under the historical cost convention as modified by the revaluation of investment properties, branches and non-specialised buildings, available for sale assets, derivatives, certain mortgage commitments for which a fair value election is made, certain investments in equity shares and certain other deposits. As stated in the Directors' report, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the accounts.

A summary of the Group's accounting policies is set out below. The accounting policies have been consistently applied, except for a voluntary change in accounting policy in respect of segmental reporting, as described below.

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

Adoption of new and revised IFRSs

The Group has adopted the amendments to IAS 7 Statement of Cash Flows with effect from 5 April 2017, which has resulted in additional disclosures of changes in liabilities arising from financing activities. These disclosures are given in note 36.

Minor amendments to IAS 12 Income Taxes have also been adopted, together with amendments from the Annual Improvements to IFRS Standards 2014-2016 Cycle. The adoption of these amendments and improvements had no significant impact for the Group.

Change to accounting policies

Following the Group's decision to wind down its commercial lending business, and the strategic review outlined in the Annual Report and Accounts 2017, the segmental reporting policy has been updated to better reflect the way in which the Executive Committee, as chief operating decision maker, now manages the business. As a result, no segmental disclosure is provided.

Adjustments to comparative information

Balance sheet presentation

Following the disposal of certain investments, the value of the Group's investments in equity shares is no longer material. As a result, this balance sheet line is no longer separately presented. Instead, the remaining balance has been combined with 'Investment securities', with further detail provided in note 13. At the same time, and also due to materiality considerations, the decision was taken to combine the Group's investment properties, valued at £9 million at 4 April 2018 (2017: £8 million), with 'Property, plant and equipment'. Accordingly, the 'Investment properties' balance sheet line item is no longer separately presented.

Accrued interest on subordinated liabilities and subscribed capital

The Group carries subordinated liabilities and subscribed capital at amortised cost. Accrued interest on these liabilities was previously included in 'Accruals and deferred income'. Accrued interest is now presented within 'Subordinated liabilities' and 'Subscribed capital' to provide a consistent presentation with other financial instruments held at amortised cost.

Notes to the financial statements *continued*1. Statement of accounting policies *continued*

Comparatives have been restated as shown below:

Balance sheet extract at 4 April 2017				
		Previously published	Adjustment	Restated
	Notes	£m	£m	£m
Group				
Investment securities	13	9,764	67	9,831
Investments in equity shares		67	(67)	-
Property, plant and equipment	26	851	8	859
Investment properties		8	(8)	-
Accruals and deferred income		333	(38)	295
Subordinated liabilities	19	2,905	35	2,940
Subscribed capital	20	276	3	279
Society				
Investment securities	13	9,764	67	9,831
Investments in equity shares		67	(67)	-
Property, plant and equipment	26	849	8	857
Investment properties		8	(8)	-
Accruals and deferred income		332	(38)	294
Subordinated liabilities	19	2,910	35	2,945
Subscribed capital	20	276	3	279

These restatements had no impact on the Group's or Society's net assets or members' interests and equity at 4 April 2017.

Interest paid on liabilities arising from financing activities

In the cash flow statement, interest paid on debt securities in issue, subordinated liabilities and subscribed capital has previously been included in cash flows from operating activities. Interest paid on these liabilities is now presented as cash flows from financing activities to better reflect the nature of the interest flows. Comparatives have been restated as shown below:

Cash flow statement extract for the year ended 4 April 2017				
		Previously published	Adjustment	Restated
	Notes	£m	£m	£m
Group				
Net cash flows (used in)/generated from operating activities	36	(172)	866	694
Net cash flows generated from/(used in) financing activities	36	2,430	(866)	1,564
Society				
Net cash flows (used in)/generated from operating activities	36	(1,553)	776	(777)
Net cash flows generated from/(used in) financing activities	36	3,840	(776)	3,064

This restatement has no impact on the Group's or Society's net assets or members' interests and equity, or cash and cash equivalents at 4 April 2017.



Notes to the financial statements *continued*

1. Statement of accounting policies *continued*

Future accounting developments

The following pronouncements, relevant to the Group, have been adopted by the EU but are not effective at 4 April 2018 and have therefore not been applied in preparing these financial statements:

Pronouncement	Nature of change	Effective date
IFRS 9 Financial Instruments	IFRS 9 was endorsed by the EU in November 2016 and subsequent amendment endorsed in March 2018. The standard will lead to substantial changes in the accounting for financial instruments. Further details are provided below.	Accounting periods beginning on or after 1 January 2018
Prepayment Features with Negative Compensation (Amendments to IFRS 9)	These amendments allow financial assets with a prepayment option that could result in the option's holder receiving compensation for early termination to meet the 'solely payments of principal and interest' (SPPI) condition if specified criteria are met. These amendments are not expected to have a significant impact for the Group.	Accounting periods beginning on or after 1 January 2019
IFRS 15 Revenue from Contracts with Customers	IFRS 15 was endorsed by the EU in September 2016 and subsequent clarifications endorsed in October 2017. The standard applies to all contracts with customers but does not apply to financial instruments, lease contracts, insurance contracts and certain non-monetary exchanges. IFRS 15 provides a principles-based approach for revenue recognition, and introduces the concept of recognising revenue for obligations as they are satisfied. The standard requires retrospective application. The Group has assessed its non-interest revenue streams and determined that the implementation of IFRS 15 will have no significant impact on the recognition of income.	Accounting periods beginning on or after 1 January 2018
IFRS 16 Leases	IFRS 16 was endorsed by the EU in October 2017. Under the new standard, accounting for finance leases will remain substantially the same. Operating leases will be brought on-balance sheet through the recognition of assets representing the contractual rights of use and liabilities will be recognised for the contractual payments. This may impact the timing of the recognition of expenditure on leased assets. Lessees will recognise interest expense on the lease liability and a depreciation charge on the right-of-use asset. The Group is currently working on the implementation of the new requirements and assessing the impact of the standard. Existing lease commitments that are likely to be included on balance sheet following implementation of IFRS 16 are shown in note 28.	Accounting periods beginning on or after 1 January 2019
Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2)	IFRS 2 Share-based Payment was amended in June 2016 to clarify the accounting for cash-settled share-based payment transactions that include a performance condition, the classification of share-based payment transactions with net settlement features, and the accounting for modifications of share-based payment transactions from cash-settled to equity-settled. The amendment is not expected to have a significant impact for the Group.	Accounting periods beginning on or after 1 January 2018



Notes to the financial statements *continued*

1. Statement of accounting policies *continued*

Pronouncement	Nature of change	Effective date
Transfers of Investment Property (Amendments to IAS 40)	IAS 40 was amended in December 2016 to clarify that an entity shall transfer a property to, or from, investment property when, and only when, there is evidence of a change in use. A change of use occurs if a property meets, or ceases to meet, the definition of an investment property. The amendment is not expected to have a significant impact for the Group.	Accounting periods beginning on or after 1 January 2018
IFRIC 22 Foreign Currency Transactions and Advance Consideration	This interpretation sets out requirements regarding which exchange rate to use in reporting foreign currency transactions (such as revenue transactions) when payment is made or received in advance. The interpretation is not expected to have a significant impact for the Group.	Accounting periods beginning on or after 1 January 2018

IFRS 9 Financial Instruments

IFRS 9 will be implemented in the financial statements for the year ending 4 April 2019 and will replace IAS 39 Financial Instruments: Recognition and Measurement. It includes requirements for the classification and measurement of financial instruments, impairment of financial assets and hedge accounting.

The principal requirements of IFRS 9 are as follows:

Classification and measurement

The classification of financial assets will be based on the objectives of the Group's business model and the contractual cash flow characteristics of the instruments. Financial assets will be classified as held at amortised cost, at fair value through other comprehensive income (FVOCI), or at fair value through profit or loss (FVTPL). With a few limited exceptions, loans and advances to customers will remain at amortised cost, and investment securities will be reclassified from available for sale (AFS) to FVOCI. A limited number of financial assets have contractual cash flows that are not solely payments of principal and interest (SPPI) and will therefore be classified as FVTPL. The only change to the classification and measurement of financial liabilities under IFRS 9 is for liabilities elected to be measured at fair value, where changes in valuation relating to changes in the entity's own credit risk will be presented separately in other comprehensive income rather than in the income statement. At 4 April 2018 the Group does not have any financial liabilities elected to be measured at fair value, and will therefore not be impacted by this change.

Impairment of financial assets

IFRS 9 changes the basis of recognition of impairment on financial assets from an incurred loss to an expected credit loss (ECL) approach for amortised cost and FVOCI financial assets and loan commitments. This introduces a number of new concepts and changes to the approach to provisioning compared with the current methodology under IAS 39:

- Expected credit losses are based on an assessment of the probability of default, loss given default and exposure at default, discounted to give a net present value. The estimation of ECL should be unbiased and probability weighted, taking into account all reasonable and supportable information, including forward looking economic assumptions and a range of possible outcomes. IFRS 9 has the effect of bringing forward recognition of impairment losses relative to IAS 39 which requires provisions to be recognised only when there is objective evidence of credit impairment.
- On initial recognition, and for financial assets where there has not been a significant increase in credit risk since the date of advance, IFRS 9 provisions will be made for expected credit default events within the next 12 months.
- Where a loan has experienced a significant increase in credit risk since initial recognition, even though this may not lead to a conclusion that the loan is credit impaired, provisions will be made based on the expected credit losses over the full life of the loan.
- For assets where there is evidence of credit impairment, provisions will be made under IFRS 9 on the basis of lifetime expected credit losses, taking account of forward looking economic assumptions and a range of possible outcomes. Under IAS 39 provisions are based on the asset's carrying value and the present value of the estimated future cash flows. IAS 39 does not explicitly take account of a range of possible economic outcomes including forecasts of any downturn of the economic cycle.

Hedge accounting

The hedge accounting requirements of IFRS 9 are designed to create a stronger link with financial risk management. A separate financial reporting standard will be developed on accounting for dynamic risk management (macro hedge accounting) and until this is implemented the Group will take the option allowed by IFRS 9 to continue to apply the existing hedge accounting requirements of IAS 39. The Group, however, will implement the revised hedge accounting disclosure requirements included in the related amendments to IFRS 7 Financial Instruments: Disclosure.



Notes to the financial statements *continued*

1. Statement of accounting policies *continued*

Implementation strategy

The Group's implementation strategy for IFRS 9 is based on an integrated solution using common systems, tools and data to assess credit risk and account for ECLs. This is consistent with guidance issued by the Basel Committee on Banking Supervision (BCBS) which sets an expectation of a high quality strategic implementation, and will entail changes to the governance, controls, models and business processes relating to credit loss provisioning. In the first half of the year the development of the core models and systems was completed, and a period of dual running of IFRS 9 processes commenced in advance of implementation. In the second half of the year, in addition to continuing dual run, models were refined and work in respect of assessing the sensitivity of models to different economic conditions was concluded.

Impact of IFRS 9

It is estimated that the new IFRS 9 ECL provisioning approach results in an increase in provisions of £172 million. The reclassification and measurement of financial assets results in a reduction in carrying value of £36 million due to certain retail and commercial loans being reclassified from an amortised cost to a FVTPL basis. The total impact on members' interests and equity, net of deferred tax, is £162 million.

These impacts are based on assumptions and judgements which will be reviewed periodically. IFRS 9 provisions may be more volatile compared to those calculated under IAS 39 due to the forward looking nature of ECL provisions.

Transition

The Group will not restate comparatives on the initial adoption of IFRS 9 but will issue a separate IFRS 9 Transition Report. This report will be issued before the release of the Q1 Interim Management Statement in August 2018.

Other pronouncements

There are a number of pronouncements relevant to the Group that are neither adopted by the EU nor effective at 4 April 2018 and have therefore not been applied in preparing these financial statements. Details of these pronouncements and their impact are provided in the table below.

Pronouncement	Nature of change	Effective date
IFRIC 23 Uncertainty over Income Tax Treatments	This interpretation sets out how to determine the accounting treatment when there is uncertainty over income tax position. The interpretation is not expected to have a significant impact for the Group.	Accounting periods beginning on or after 1 January 2019
Annual Improvements to IFRS Standards 2015 – 2017 Cycle	Amendments have been made to four standards: – IFRS 3 Business Combinations – IFRS 11 Joint Arrangements – IAS 12 Income Taxes – IAS 23 Borrowing Costs. The Group is currently assessing the impact of these improvements.	Accounting periods beginning on or after 1 January 2019
Plan Amendment, Curtailment or Settlement (Amendments to IAS 19)	The amendments require an entity: – to use updated assumptions to determine current service cost and net interest for the remainder of the period after a plan amendment, curtailment or settlement; and – to recognise in profit or loss as part of past service cost, or a gain or loss on settlement, any reduction in a surplus. The Group is currently assessing the impact of these amendments and will determine an appropriate approach to meeting the requirements.	Accounting periods beginning on or after 1 January 2019
IFRS 17 Insurance Contracts	In May 2017 the IASB issued IFRS 17 to replace IFRS 4 Insurance Contracts. IFRS 17 establishes the principals for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the standard. The requirements of IFRS 17 are currently being assessed; however, it is not expected that the new standard will have a significant impact on the Group.	Accounting periods beginning on or after 1 January 2021



Notes to the financial statements *continued*

1. Statement of accounting policies *continued*

Basis of consolidation

The assets, liabilities and results of the Society and its undertakings, which include subsidiaries and structured entities, are included in the financial statements on the basis of accounts made up to the reporting date.

The Group consolidates an entity from the date on which the Group: (i) has power over the entity; (ii) is exposed to, or has rights to variable returns from its involvement with the entity; and (iii) has the ability to affect those returns through the exercise of its power. The assessment of control is based on all facts and circumstances. The Group reassesses whether it controls an entity if facts and circumstances indicate that there are changes to one or more of the three elements of control. The Group deconsolidates subsidiaries from the date that control ceases.

A structured entity is an entity in which voting or similar rights are not the dominant factor in deciding control. Structured entities are consolidated when the substance of the relationship indicates control. The Group considers factors such as the purpose and design of the entity, size and exposure to variability of returns and nature of the relationship.

Upon consolidation, intra-Group transactions, balances and unrealised gains are eliminated.

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

Securitisation transactions

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

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

As explained in note 14, the Group has also entered into self issuances of debt to be used as collateral for repurchase ('repo') and similar transactions. Investments in self issued debt and the related obligation, together with the related income, expenditure and cash flows, are not recognised in the Society's or Group's financial statements. This avoids the 'grossing-up' of the financial statements that would otherwise arise.

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

Interest receivable and interest expense

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

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

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

Fees and commissions

Fees and commissions not directly attributable to generating a financial instrument are recognised on the accruals basis as services are provided, or on the performance of a significant act.

Segmental reporting

The Group's Executive Committee is responsible for allocating resources and assessing the performance of the business and is therefore identified as the chief operating decision maker.

The Group has determined that it has one reportable segment as the Executive Committee reviews performance and makes decisions based on the Group as a whole. No segmental analysis is required on geographical lines as substantially all of the Group's activities are in the United Kingdom. As a result, no segmental disclosure is provided.



Notes to the financial statements *continued*

1. Statement of accounting policies *continued*

Intangible assets

Intangible assets held by the Group consist primarily of externally acquired and internally developed computer software which is held at cost less accumulated amortisation and impairment. In accordance with IAS 38 Intangible Assets, software development costs are capitalised if it is probable that the asset created will generate future economic benefits. Costs incurred to establish technological feasibility or to maintain existing levels of performance are recognised as an expense.

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

Where applicable, directly attributable borrowing costs incurred in the construction of qualifying assets are capitalised.

Computer software intangible assets are amortised using the straight line method over their estimated useful lives of between 3 and 10 years. Amortisation commences when the assets are ready for their intended use. Estimated useful lives are reviewed annually and adjusted, if appropriate, in the light of technological developments, usage and other relevant factors.

Computer software is reviewed for indicators of impairment at each reporting date and whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Where the carrying amount is not recoverable the asset is written down immediately to the estimated recoverable amount, based on value in use calculations.

Leases

Operating leases are leases that do not transfer substantially all the risks and rewards incidental to ownership to the lessee. Operating lease payments and receipts are charged or credited to the income statement on a straight line basis over the life of the lease.

Taxation including deferred tax

Current tax payable on profits, based on the applicable tax law in each jurisdiction, is recognised as an expense in the period in which profits arise.

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

Deferred tax assets are recognised where it is probable that future taxable profits will be available against which the temporary differences can be utilised. Deferred tax is provided on temporary differences arising from investments in subsidiaries, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future. The tax effects of tax losses available for carry forward are recognised as a deferred tax asset when it is probable that future taxable profits will be available against which these losses can be utilised.

Deferred tax assets and liabilities are offset where there is a legally enforceable right to offset current tax assets against current tax liabilities and where the deferred tax assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle on a net basis.

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

Tax related to movements in the fair value of derivatives that are subject to cash flow hedge accounting, which are charged or credited to other comprehensive income and accumulated in the cash flow hedge reserve, is also credited or charged to other comprehensive income and is subsequently reclassified from other comprehensive income to the income statement together with the associated deferred loss or gain from cash flow hedge accounting.

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

Tax related to remeasurements of retirement benefit obligations, which are charged or credited to other comprehensive income, is also credited or charged to other comprehensive income.

Property, plant and equipment

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

Branches and non-specialised buildings are stated at revalued amounts, being the fair value, determined by market based evidence at the date of the valuation, less any subsequent accumulated depreciation and subsequent impairment. Valuations are completed annually, as at 4 April, by external, independent and qualified surveyors who have recent experience in the location and type of properties. Valuations are performed in accordance with the Royal Institution of Chartered Surveyors Appraisal and Valuation Standards and are performed on a vacant possession basis, using a comparative method of valuation with reference to sales prices and observable market rents for similar properties in similar locations.

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

The Group holds a small number of investment properties comprising properties held for rental. These are stated at fair value, determined by market based evidence at the date of the valuation. Valuations are completed annually, as at 4 April, by independent surveyors. Changes in fair value are included in the income statement. Depreciation is not charged on investment properties.



Notes to the financial statements *continued*

1. Statement of accounting policies *continued*

Other property, plant and equipment, including specialised administration buildings and short leasehold buildings, are included at historical cost less accumulated depreciation and impairment. Historical cost includes expenditure that is directly attributable to the acquisition of the items, major alterations and refurbishments.

Where applicable, directly attributable borrowing costs incurred in the construction of qualifying assets are capitalised.

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

- Branches and non-specialised buildings 60 years
- Specialised administration buildings up to 60 years
- Short leasehold buildings the period of the lease
- Plant and machinery 5 to 15 years
- Equipment, fixtures, fittings and vehicles 3 to 10 years

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

Assets are reviewed for indicators of impairment at each reporting date and whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Where the carrying amount is not recoverable the asset is written down immediately to the estimated recoverable amount.

Gains and losses on disposals are included in other operating income in the income statement.

Employee benefits

(a) Pensions

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

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

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

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

Past service costs are recognised immediately in the income statement.

(b) Other post retirement obligations

The Group provides post retirement healthcare to a small number of former employees. The Group recognises this obligation and the actuarial remeasurement in a similar manner to the defined benefit pension plans.

(c) Other long term employee benefits

The cost of bonuses payable 12 months or more after the end of the year in which they are earned is accrued over the period from the start of the performance year until all relevant criteria have been met.

(d) Short term employee benefits

The cost of short term employee benefits, including wages and salaries, social security costs and healthcare for current employees, is recognised in the year of service.

Provisions

A provision is recognised where there is a present obligation as a result of a past event, it is probable that the obligation will be settled and it can be reliably estimated. This includes management's best estimate of amounts payable for customer redress.

The Group has an obligation to contribute to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet compensation claims from, in particular, retail depositors of failed banks. A provision is recognised, to the extent that it can be reliably estimated, when the Group has an obligation in accordance with IAS 37 and the levy is legally enforceable, in line with IFRIC 21 Levies. The amount provided is based on information received from the FSCS, forecast future interest rates and the Group's historic share of industry protected deposits.



Notes to the financial statements *continued*

1. Statement of accounting policies *continued*

Financial assets

Financial assets are recognised initially at fair value. Purchases and sales of financial assets are accounted for at trade date. Financial assets are derecognised when the rights to receive cash flows have expired or where the assets have been transferred and substantially all of the risks and rewards of ownership have been transferred.

The impact of hedging on the measurement of financial assets is detailed in the derivatives and hedge accounting policy below.

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

(a) Financial assets at fair value through the income statement

This category consists of derivative financial assets used for risk management purposes and other financial assets that are designated at fair value through the income statement by the Group.

Assets in this category are carried at fair value. The fair values of derivative instruments are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from third parties. Gains and losses arising from the changes in the fair values are recognised in the income statement.

Where appropriate, the Group recognises the fair value of certain mortgage commitments on the balance sheet to alleviate an accounting mismatch which would otherwise arise from recognising only the movements in the fair value of associated derivatives. The fair value of mortgage commitments is included within other assets or other liabilities. Movements in the fair value are included within gains/losses from derivatives and hedge accounting in the income statement, to offset the fair value movements of the derivatives.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Group's residential and commercial mortgage loans, unsecured lending, loans and advances to banks and cash are classified as loans and receivables.

Loans are recognised when the funds are advanced to customers. Loans and receivables are carried at amortised cost using the effective interest rate method less provisions for impairment.

Loans and receivables acquired through a business combination or portfolio acquisition are recognised at fair value at the acquisition date. The fair value at acquisition becomes the new amortised cost for acquired loans and receivables. Fair value adjustments are made to reflect both credit and interest rate risk associated with the acquired loan assets.

(c) Available for sale assets

Available for sale assets are non-derivative financial assets that are not classified into either of the two categories above. The majority of available for sale assets are measured at fair value using, in the majority of cases, market prices or, where markets have become inactive, prices obtained from market participants. In sourcing valuations, the Group makes use of a consensus pricing service, in line with standard industry practice. In cases where market prices or prices obtained from market participants are not available, discounted cash flow models are used. Further information is provided in notes 21 and 22. Investments in equities that do not have a quoted market price in an active market and whose value cannot be reliably measured are recognised at cost.

Interest on available for sale assets is recognised using the effective interest rate method.

Unrealised gains and losses arising from changes in values are recognised in other comprehensive income, except for amounts relating to impairment losses and foreign exchange gains and losses, which are recognised in the income statement. Gains and losses arising on the sale of available for sale assets are recognised in the income statement, including any cumulative gains or losses previously recognised in other comprehensive income, which are reclassified to the income statement.

(d) Held to maturity

Held to maturity assets are non-derivative financial assets with fixed or determinable payments and fixed maturity dates that the Group has the positive intention and ability to hold to maturity.

Held to maturity assets are carried at amortised cost using the effective interest rate method, less provisions for impairment.

For the financial years ended 4 April 2018 and 4 April 2017, the Group has not reclassified any financial assets between categories.

Impairment of financial assets

(a) Assets carried at amortised cost

The Group assesses at each balance sheet date whether, as a result of one or more events that occurred after initial recognition, there is objective evidence that a financial asset or group of financial assets is impaired. Evidence of impairment may include:

- i) indications that the borrower or group of borrowers is experiencing significant financial difficulty
- ii) default or delinquency in interest or principal payments
- iii) debt being restructured to reduce the burden on the borrower.

The Group first assesses whether objective evidence of impairment exists either individually for assets that are separately significant or individually or collectively for assets that are not separately significant. If there is no objective evidence of impairment for an individually assessed asset it is included in a group of assets with similar credit risk characteristics and collectively assessed for impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. For loans in a hedge relationship, the effective interest rate used for discounting is calculated using the carrying value of the loan including the hedge adjustment. The resultant provisions are deducted from the appropriate asset values on the balance sheet.



Notes to the financial statements *continued*

1. Statement of accounting policies *continued*

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 impairment loss changes, the provision is adjusted and the amount of additional provision or reversal is recognised in the income statement.

Loans remain on the balance sheet net of associated provisions until they are deemed no longer recoverable. 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.

Retail loans

For retail loans cash flows are estimated based on past experience combined with the Group's view of the future considering the following factors:

- i) exposure to the customer
- ii) based on the number of days in arrears at the balance sheet date, the likelihood that a loan will progress through the various stages of delinquency and ultimately be written off
- iii) the amount and timing of expected receipts and recoveries
- iv) the realisable value of any security at the estimated date of sale
- v) the likely deduction of any costs involved in the recovery of amounts outstanding.

The Group's provision methodology recognises previous arrears as a driver of future possible default and therefore accounts which have either capitalised arrears or have been in arrears in the last 12 months typically attract a higher provision level.

Commercial loans

In assessing objective evidence of a loss event for commercial loans, the following key indicators are considered:

- i) contractually due payments exceeding 30 days in arrears
- ii) high loan to value or low interest cover ratio
- iii) other covenant breaches
- iv) loss of significant tenants or other decreases in tenant quality
- v) the probability of the borrower entering bankruptcy
- vi) restructuring of the debt relating to the borrower's financial difficulties ('forbearance')
- vii) local economic conditions (for example, where this impacts on the value of underlying collateral).

Where there is objective evidence of impairment, cash flows are assessed on a case by case basis considering the following factors:

- i) aggregate exposure to the customer
- ii) the viability of the customer's business model and their capacity to trade successfully out of financial difficulties and generate sufficient cash flows to service debt obligations
- iii) the amount and timing of expected receipts and recoveries of collateral
- iv) the likely dividend available on liquidation or bankruptcy
- v) the extent of other creditors' claims ranking ahead of the Group's, and the likelihood of other creditors continuing to support the borrower
- vi) the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident
- vii) the realisable value of security at the expected date of sale
- viii) the likely deduction of any costs involved in recovery of amounts outstanding
- ix) when available, the secondary market price of the debt.

Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired or are considered to be past due.

Where a loan is renegotiated on different terms such that it is substantially a different loan, the loan is derecognised and a new loan is recognised at its fair value.

For those loans, for which no individual impairment is recognised, a collective impairment assessment is made, taking account of the following factors:

- i) size of the loan
- ii) arrears status
- iii) historical loss experience (adjusted for current market conditions)
- iv) the estimated period between impairment occurring and the loss being identified ('emergence period').



Notes to the financial statements *continued*

1. Statement of accounting policies *continued*

(b) Available for sale assets

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. If any such evidence exists for available for sale assets, the cumulative loss, measured as the difference between the current amortised cost and the current fair value, less any impairment loss on that asset previously recognised, is recognised in impairment losses/recoveries on investment securities in the income statement.

A subsequent decline in the fair value of an available for sale asset is recognised in the income statement when there is further objective evidence of impairment as a result of further decreases in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised in other comprehensive income.

If the fair value of an available for sale asset increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement to the extent it reverses the previously recognised impairment. Any gain in fair value in excess of the original impairment is recognised in other comprehensive income. On disposal, where sales proceeds exceed the carrying amount of an impaired asset, the proportion of the gain which offsets the previously recognised impairment loss is recognised as a credit in impairment losses/recoveries on investment securities in the income statement.

Impairment losses recognised in the income statement on available for sale equity shares are not reversed through the income statement.

Financial liabilities

Borrowings, including shares, deposits, debt securities in issue and subordinated liabilities are recognised initially at fair value, being the issue proceeds net of premiums, discounts and transaction costs incurred.

With the exception of deposits relating to the sale of protected equity bonds (PEBs), which are measured at fair value, all borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is adjusted for the amortisation of any premiums, discounts and transaction costs. The amortisation is recognised in interest expense and similar charges using the effective interest rate method.

Derivative financial liabilities are classified as fair value through the income statement.

Permanent interest-bearing shares (subscribed capital) are classified as financial liabilities.

Financial liabilities are derecognised when the obligation is discharged, cancelled or has expired.

Borrowings that are designated as hedged items are subject to measurement under the hedge accounting requirements described in the derivatives and hedge accounting policy below.

The financial liabilities of dormant shares and deposit accounts are extinguished when balances have been transferred to the Government backed unclaimed asset scheme under the terms of the Dormant Accounts and Building Society Accounts Act 2008 with no impact on the income statement.

Fair value of assets and liabilities

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

Level 1 – Valuation using quoted market prices

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

Level 2 – Valuation technique using observable inputs

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

Level 3 – Valuation technique using significant unobservable inputs

Assets and liabilities are classified as Level 3 if their valuation incorporates significant inputs that are not based on observable market data ('unobservable inputs'). A valuation input is considered observable if it can be directly observed from transactions in an active market, or if there is compelling external evidence demonstrating an executable exit price. An input is deemed significant if it is shown to contribute more than 10% to the valuation of a financial instrument. Unobservable input levels are generally determined based on observable inputs of a similar nature, historical observations or other analytical techniques.

Protected equity bonds (PEBs)

Certain non-derivative financial liabilities relating to the sale of PEBs by the Group on behalf of Legal & General, included within other deposits, have been designated at fair value upon initial recognition. Changes in fair value are recognised through the income statement in gains/losses from derivatives and hedge accounting. The changes in the fair value of the PEBs are economically matched using equity-linked derivatives, which do not meet the requirements for hedge accounting. Recording changes in fair value of both the derivatives and the related liabilities through the income statement most closely reflects the economic reality of the transactions. In so doing, this accounting treatment eliminates a measurement inconsistency that would otherwise arise from valuing the PEBs at amortised cost and the derivatives at fair value.



Notes to the financial statements *continued*

1. Statement of accounting policies *continued*

In measuring fair value, separate debit valuation adjustments are made for own credit risk to the extent not already included in the PEBs valuation. Income received from Legal & General upon inception of a PEB transaction is deferred and recognised in interest expense and similar charges in the income statement on an effective interest basis over the term of the product where it partially offsets interest incurred on the equity-linked derivatives.

Derivatives and hedge accounting

Derivatives are entered into to reduce exposures to fluctuations in interest rates, exchange rates, market indices and credit risk, and are not used for speculative purposes.

(a) *Derivative financial instruments*

Derivatives are carried at fair value with movements in fair values recorded in the income statement. Derivative financial instruments are principally valued by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from third parties. For collateralised positions the Group uses discount curves based on overnight indexed swap rates, and for non-collateralised positions the Group uses discount curves based on term Libor rates.

In the first instance fair values are calculated using mid prices. With the exception of derivatives hedging liabilities relating to the sale of PEBs, an adjustment is then made to derivative assets and liabilities to value them on a bid and offer basis respectively. The bid-offer adjustment is calculated on a portfolio basis and reflects the costs that would be incurred if substantially all residual net portfolio market risks were closed out using available hedging instruments or by disposing of or unwinding actual positions. The methodology for determining the bid-offer adjustments involves netting between long and short positions and the grouping of risk by type, in accordance with hedging strategy. Bid-offer spreads are derived from market sources such as broker data and are reviewed periodically. The derivatives hedging PEBs are not traded in an active market and are therefore valued at mid price.

In measuring fair value, separate credit valuation and debit valuation adjustments are made for counterparty or own credit risk to the extent not already included in the valuation.

All derivatives are classified as assets where their fair value is positive and liabilities where their fair value is negative. Where there is the legal right and intention to settle net, then the derivative is classified as a net asset or liability, as appropriate.

Where cash collateral is received, to mitigate the risk inherent in amounts due to the Group, it is included as a liability within either deposits from banks or other deposits, depending on the counterparty. Similarly, where cash collateral is given, to mitigate the risk inherent in amounts due from the Group, it is included as an asset in either loans and advances to banks or loans and advances to customers. Where securities collateral is received the securities are not recognised in the accounts as the Group does not obtain the risks and rewards of the securities. Where securities collateral is given, the securities have not been derecognised as the Group has retained substantially all the risks and rewards of ownership.

(b) *Embedded derivatives*

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

(c) *Hedge accounting*

When transactions meet the criteria specified in IAS 39, the Group can apply two types of hedge accounting: either hedges of the changes in fair value of the financial asset or liability or hedges of the variability in cash flows of the financial asset or liability:

Fair value hedge accounting

In a micro hedge relationship, the carrying value of the underlying asset or liability ('the hedged item') is adjusted to reflect changes in fair value attributable to the risk being hedged. This creates an offset to the fair value movement of the derivative ('the hedging instrument'). In the case of a portfolio hedge, this fair value adjustment is recorded at a portfolio level in the fair value adjustment for portfolio hedged risk category on the balance sheet. Changes in the fair value of hedged items and hedging instruments are recorded in the income statement.

Cash flow hedge accounting

In a cash flow hedge accounting relationship, the portion of the derivative's fair value movement that is deemed to be an effective hedge is deferred to the cash flow hedge reserve, instead of being immediately recognised in the income statement. The ineffective portion of the derivative fair value movement is recognised immediately in the income statement. Amounts deferred to the cash flow hedge reserve are subsequently recycled to the income statement. This recycling occurs when the underlying asset or liability being hedged impacts the income statement, for example when interest payments are recognised.

To qualify for hedge accounting the hedge relationship must be clearly documented at inception and the derivative must be expected to be highly effective in offsetting the hedged risk. Prospective and retrospective effectiveness must be tested throughout the life of the hedge relationship.

Termination of hedge accounting

The Group discontinues hedge accounting when:

- i) it is evident from testing that a derivative is not, or has ceased to be, highly effective as a hedge
- ii) the derivative expires, or is sold, terminated or exercised
- iii) the underlying item matures or is sold or repaid
- iv) the forecast transactions are no longer deemed to be highly probable.



Notes to the financial statements *continued*

1. Statement of accounting policies *continued*

The Group may also decide to cease hedge accounting even though the hedge relationship continues to be highly effective by ceasing to designate the financial instrument as a hedge.

In fair value hedge accounting relationships, if the derivative no longer meets the criteria for hedge accounting, the cumulative fair value hedge adjustment is amortised over the period to maturity of the previously designated hedge relationship. If the underlying item is sold or repaid, the unamortised fair value adjustment is immediately recognised in the income statement.

In cash flow hedge accounting relationships, if the derivative no longer meets the criteria for hedge accounting, the cumulative gain or loss from the effective portion of the movement in the fair value of the derivative remains in other comprehensive income until the cash flows from the underlying hedged item are recognised in the income statement. If the underlying item is sold or repaid, the cumulative gain or loss in other comprehensive income is immediately recognised in the income statement.

Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported on the balance sheet if, and only if, there is a currently enforceable legal right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise an asset and settle the liability simultaneously.

Sale and repurchase agreements (including securities borrowing and lending) and collateralised total return swaps

Investment and other securities may be lent or sold subject to a commitment to repurchase them at a pre-determined price (a repo) or a right to continue to receive all future cash flows and changes in capital value on collateral pledged (a total return swap). Such securities are retained on the balance sheet when substantially all the risks and rewards of ownership (typically, the interest rate risk and credit risk on the asset) remain within the Group, and the counterparty liability is included separately on the balance sheet as appropriate.

Similarly, where the Group borrows or purchases securities subject to a commitment to resell them (a reverse repo) or settle all future cash flows and changes in capital value to a third party on collateral held (a reverse total return swap) but does not acquire the risks and rewards of ownership, the transactions are treated as collateralised loans, and the securities are not included on the balance sheet.

The difference between sale and repurchase price is accrued over the life of the agreements using the effective interest rate method.

Equity instruments

Issued financial instruments are classified as equity instruments where the contractual arrangement with the holder does not result in the Group having a present obligation to deliver cash, another financial asset or a variable number of equity instruments. Where the Group does have a present obligation, the instrument is classified as a financial liability.

The proceeds of the issuance of equity instruments are included in equity. Costs incurred that are incremental and directly attributable to the issuance are deducted from the proceeds (net of applicable tax).

Distributions to holders of equity instruments are recognised when they become irrevocable and are deducted, net of tax where applicable, from the general reserve.

Foreign currency translation

The consolidated financial statements are presented in sterling, which is the functional currency of the Society. Items included in the financial statements of each of the Group's entities are measured using their functional currency. Foreign currency transactions are translated into sterling using the exchange rates prevailing at the dates of the transactions.

Monetary items denominated in foreign currencies are retranslated at the rate prevailing at the balance sheet date. Foreign exchange gains and losses resulting from the retranslation and settlement of these items are recognised in the income statement as disclosed in note 7.

Cash flow hedge accounting is applied to derivatives which are economically hedging foreign currency items.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months maturity from the date of acquisition, included within cash and loans and advances to banks on the balance sheet.

Contingent liabilities

Contingent liabilities are possible obligations whose existence is dependent on the outcome of uncertain future events, or those where the outflow of resources is uncertain or cannot be measured reliably.

During the ordinary course of business the Group is subject to threatened or actual legal proceedings. All such material cases are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of incurring a liability. The Group does not disclose amounts in relation to contingent liabilities associated with such claims where the likelihood of any payment is remote or where such disclosure could be seriously prejudicial to the conduct of the claims.

IFRS disclosures

The audited sections in the Business and Risk Report for 'Credit risk' and 'Financial risk' and the Report of the directors on remuneration form an integral part of these financial statements. These disclosures (where marked as 'audited') are covered by the Independent auditors' report for this Annual Report and Accounts.



Notes to the financial statements *continued*

2. Judgements in applying accounting policies and critical accounting estimates

The Group has to make judgements in applying its accounting policies which affect the amounts recognised in the accounts. In addition, estimates and assumptions are made that could affect the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, actual results reported in future periods may differ from those estimates. The most significant areas where judgements and estimates are made are disclosed in the following notes:

Area of significant judgement and estimate	Note
Impairment provisions on loans and advances	10
Provisions for customer redress	27
Retirement benefit obligations (pensions)	30

3. Interest receivable and similar income

	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
On residential mortgages	4,532	4,843	3,409	3,639
On other loans:				
Connected undertakings	-	-	756	901
Other	798	774	784	753
On investment securities	201	372	201	370
On other liquid assets	95	59	95	59
Net expense on financial instruments hedging assets	(808)	(998)	(808)	(998)
Total	4,818	5,050	4,437	4,724

Included within interest receivable and similar income is interest income on impaired financial assets of £30 million in the Group and £15 million in the Society (2017: Group £33 million, Society £16 million).

4. Interest expense and similar charges

	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
On shares held by individuals	1,140	1,390	1,140	1,390
On subscribed capital	15	34	15	34
On deposits and other borrowings:				
Subordinated liabilities	175	128	175	128
Connected undertakings	-	-	34	74
Other	320	450	320	454
On debt securities in issue	712	767	669	686
Net income on financial instruments hedging liabilities	(563)	(684)	(397)	(527)
Interest on net defined benefit pension liability (note 30)	8	5	8	5
Total	1,807	2,090	1,964	2,244

Interest on deposits and other borrowings includes an expense of £210 million (2017: £327 million) in relation to the redemption and maturity of Protected Equity Bond (PEB) deposits which have returns linked to the performance of specified stock market indices. The PEBs, all of which had matured at 4 April 2018, were economically hedged using equity-linked derivatives. Net income on financial instruments hedging liabilities includes income of £206 million (2017: £308 million) in relation to the associated derivatives. Further details are included in note 22.

Notes to the financial statements *continued*

5. Fee and commission income and expense

Group	2018			2017		
	Income	Expense	Net	Income	Expense	Net
	£m	£m	£m	£m	£m	£m
Current account and savings	246	(187)	59	229	(156)	73
General insurance	76	-	76	81	-	81
Protection and investments	65	-	65	78	-	78
Mortgage	16	(2)	14	10	-	10
Credit card	42	(45)	(3)	37	(42)	(5)
Other fees and commissions	4	(10)	(6)	11	(23)	(12)
Fee and commission	449	(244)	205	446	(221)	225

The Society's fee and commission income and expense is as shown above for the Group, except that it excludes £4 million (2017: £4 million) of mortgage income.

6. Other operating expense/income

	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Gains on disposal of investment	26	100	26	100
Other expense	(110)	-	(112)	-
Total	(84)	100	(86)	100

On 28 April 2017, the Group disposed of shares in Vocalink Holdings Limited, resulting in a gain on disposal of £26 million. On 21 June 2016, the Group disposed of its share in Visa Europe Limited, resulting in a gain on disposal of £100 million.

Other expense includes a £116 million loss from a debt buy-back exercise during the year, together with the net amount of rental income, profits or losses on the sale of property, plant and equipment and increases or decreases in the valuations of branches and non-specialised buildings which are not recognised in other comprehensive income.

Notes to the financial statements *continued*

7. Losses/gains from derivatives and hedge accounting

The Group only uses derivatives for the hedging of risks; however, income statement volatility can still arise due to hedge accounting ineffectiveness or because hedge accounting is either not applied or is not achievable. The overall impact of derivatives will remain volatile from period to period as new derivative transactions replace those which mature to ensure that interest rate and other market risks are continually managed. This volatility does not reflect the economic reality of the Group's hedging strategy.

	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Derivatives designated as fair value hedges	1,049	161	988	179
Fair value movement attributable to hedged risk	(1,135)	(100)	(981)	(129)
(Losses)/gains from fair value hedge accounting (note i)	(86)	61	7	50
Derivatives designated as cash flow hedges	(242)	(352)	(109)	(101)
Deferral to cash flow hedge reserve	259	348	76	72
Ineffectiveness from cash flow hedge accounting (note ii)	17	(4)	(33)	(29)
Derivatives economically hedging mortgage commitments	54	(25)	54	(25)
Fair value movement attributable to mortgage commitments	(4)	33	(4)	33
Net gain from mortgage pipeline (note iii)	50	8	50	8
Fair value gains/(losses) from other derivatives (note iv)	5	(19)	(39)	(43)
Foreign exchange differences (note v)	13	20	(11)	83
Total	(1)	66	(26)	69

Notes:

- i. Gains or losses from fair value hedges can arise where there is an IFRS hedge accounting relationship in place and either:
 - the relationship passed all the monthly effectiveness tests but the fair value movement of the derivative was not exactly offset by the change in fair value of the asset or liability being hedged (referred to as hedge ineffectiveness); or
 - the relationship failed a monthly effectiveness test which, for that month, disallows recognition of the change in fair value of the underlying asset or liability being hedged and in following months leads to the amortisation of existing balance sheet positions.
- ii. In cash flow hedge accounting the effective portion of the fair value movement of designated derivatives is deferred to the cash flow hedge reserve. The fair value movement is subsequently recycled to the income statement when amounts relating to the underlying hedged asset or liability are recognised in the income statement. The ineffective portion of the fair value movement is recognised immediately in the income statement.
- iii. The mortgage pipeline in the above table includes interest rate swaps used to economically hedge expected new mortgage business, as well as some firm mortgage commitments which the Group has elected to fair value in order to reduce the accounting mismatch.
- iv. Other derivatives are those used for economic hedging but which are not in an IAS 39 hedge accounting relationship because hedge accounting is not currently in place.
- v. Gains or losses arise from the retranslation of foreign currency monetary items not subject to effective hedge accounting.

Losses of £86 million (2017: gains of £61 million) from fair value hedge accounting include losses of £42 million (2017: gains of £47 million) from macro hedges, due to hedge ineffectiveness and the amortisation of existing balance sheet amounts, and losses of £44 million relating to micro hedges (2017: gains of £14 million) which arise due to a combination of hedge ineffectiveness, disposals and restructuring, and the amortisation of existing balance sheet amounts.

For the mortgage pipeline the income statement includes the full fair value movement of forward starting interest rate swaps economically hedging the pipeline. To alleviate an accounting mismatch, the Group only elects to fair value certain underlying mortgage business within the pipeline.

The deferral of fair value movements to the cash flow hedge reserve, and the transfer of amounts from the cash flow hedge reserve to the income statement, are shown in the consolidated statement of comprehensive income.

Notes to the financial statements *continued*

8. Administrative expenses

	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Employee costs:				
Wages and salaries	524	517	518	511
Bonuses	61	75	61	75
Social security costs	66	64	65	64
Pension costs (note 30)	173	137	171	136
	824	793	815	786
Other administrative expenses	758	790	738	764
Bank levy (note 27)	45	42	45	42
	1,627	1,625	1,598	1,592
Depreciation, amortisation and impairment	397	396	397	396
Total	2,024	2,021	1,995	1,988
Other administrative expenses include:				
Property operating lease rental	30	39	31	39
Other property costs	76	78	76	78
Postage and communications	79	83	79	83
Computer costs	180	177	180	177
Marketing and advertising	39	43	39	43
Money transmission and other bank costs	42	40	41	40
Legal, professional and consultancy	86	59	85	59
Training, education and other staff related costs (note i)	101	143	100	141
Other (note i)	125	128	107	104
Total	758	790	738	764

Note:

i. Prior year comparatives have been restated to align with the current year presentation of certain expenses.

The bonus expense within employee costs in the above table includes £6 million (2017: £5 million) of long-term bonuses which will be paid more than one year from the balance sheet date.

Executive directors and certain senior executives are entitled to bonus payments under the Directors' Performance Award (DPA) scheme. Under this scheme, awards are based on current year results but are paid over a period of up to seven years, with part of the awards linked to the value of Nationwide's core capital deferred shares (CCDS). The payment of deferred elements remains subject to further discretion by the Remuneration Committee. These bonuses are recognised in the income statement over the period from the start of the performance year until all relevant criteria have been met.

Notes to the financial statements *continued*8. Administrative expenses *continued*

The table below shows actual and expected charges to the income statement in respect of all DPA bonuses for each relevant scheme year:

Income statement charge for long-term bonuses				
	Group and Society			
	Actual 2016/17	Actual 2017/18 (note i)	Expected 2018/19 (note ii)	Expected 2019/20 and beyond (note ii)
	£m	£m	£m	£m
Directors Performance Award:				
2014/15	1.7	1.2	0.4	0.5
2015/16	3.7	2.0	1.0	1.1
2016/17	8.8	3.6	1.4	2.7
2017/18	-	8.8	3.2	4.1
Income statement charge for long-term bonuses	14.2	15.6	6.0	8.4

Notes:

- In the year ended 4 April 2018, £6 million (2017: £5 million) was recognised in the income statement in relation to awards linked to share based payments, being amounts dependent on the performance of the Group's CCDS. This payment is deferred and therefore included in accruals and deferred income on the balance sheet.
- The amount expected is an estimate based on past performance together with current assumptions of future leaver rates and future CCDS performance. From 2016/17 the period over which bonuses are recognised in the income statement was extended based on a change to the bonus deferral period from five to seven years.

Directors' emoluments, including details of the bonus scheme, are shown as part of the Report of the directors on remuneration in accordance with Schedule 10A, paragraphs 1 to 9 of the Building Societies Act 1986.

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

External auditors' remuneration				
	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Audit fees for the Group and Society statutory audit	3.3	2.2	3.3	2.2
Fees payable for other services:				
Audit of Group subsidiaries	0.4	0.3	-	-
Audit-related assurance services	0.7	1.3	0.7	1.3
Total audit and audit-related assurance services	4.4	3.8	4.0	3.5
Other non-audit services	1.1	0.5	1.1	0.5
Total	5.5	4.3	5.1	4.0

Audit fees for the year ended 4 April 2018 includes amounts related to a new treasury platform and to the implementation of IFRS 9 Financial Instruments in the year ending 4 April 2019, the estimated impacts of which are disclosed in note 1.

The Group's policy in relation to the use of its auditors on non-audit engagements sets out the types of services they are generally precluded from performing. All non-audit services, where the fee is expected to exceed a de minimis limit, are subject to pre-approval by the Audit Committee.

Fees for 'other non-audit services' above relate primarily to work undertaken in relation to an issuance of core capital deferred shares during the period.

Notes to the financial statements *continued*

9. Employees

	Group		Society	
	2018	2017	2018	2017
The average number of persons employed during the year was:				
Full time	14,247	14,746	14,211	14,671
Part time	4,240	4,015	4,235	4,002
Total	18,487	18,761	18,446	18,673
Society:				
Central administration	11,098	11,154	11,098	11,154
Branches	7,348	7,519	7,348	7,519
Subsidiaries	41	88	-	-
Total	18,487	18,761	18,446	18,673

Central administration employee numbers include employees engaged in direct customer facing operations in administrative centres. At 4 April 2018 there were no employees within subsidiaries following the closure of the Group's Isle of Man and Republic of Ireland operations.

10. Impairment provisions on loans and advances to customers

The following provisions have been deducted from the appropriate asset values in the Group balance sheet:

2018	Prime residential	Specialist residential	Consumer banking	Commercial and other lending	Total
Group	£m	£m	£m	£m	£m
At 5 April 2017	34	110	269	25	438
Charge for the year	3	8	97	(1)	107
Amounts written off during the year	(2)	(9)	(73)	(17)	(101)
Amounts recovered during the year	1	1	10	9	21
Unwind of discount	-	(1)	(5)	(1)	(7)
At 4 April 2018	36	109	298	15	458

2017	Prime residential	Specialist residential	Consumer banking	Commercial and other lending	Total
Group	£m	£m	£m	£m	£m
At 5 April 2016	25	77	281	60	443
Charge for the year	11	47	78	(5)	131
Amounts written off during the year	(2)	(15)	(101)	(32)	(150)
Amounts recovered during the year	1	1	15	3	20
Unwind of discount	(1)	-	(4)	(1)	(6)
At 4 April 2017	34	110	269	25	438

Notes to the financial statements *continued*10. Impairment provisions on loans and advances to customers *continued*

The Group impairment provision of £458 million at 4 April 2018 (2017: £438 million) comprises individual provisions of £31 million (2017: £45 million) and collective provisions of £427 million (2017: £393 million).

The Society's impairment provisions on loans and advances to customers are shown in the table below:

2018	Prime residential	Consumer banking	Commercial and other lending	Total
Society	£m	£m	£m	£m
At 5 April 2017	34	269	25	328
Charge for the year	3	97	(1)	99
Amounts written off during the year	(2)	(73)	(17)	(92)
Amounts recovered during the year	1	10	9	20
Unwind of discount	-	(5)	(1)	(6)
At 4 April 2018	36	298	15	349

2017	Prime residential	Consumer banking	Commercial and other lending	Total
Society	£m	£m	£m	£m
At 5 April 2016	25	281	59	365
Charge for the year	11	78	(5)	84
Amounts written off during the year	(2)	(101)	(31)	(134)
Amounts recovered during the year	1	15	3	19
Unwind of discount	(1)	(4)	(1)	(6)
At 4 April 2017	34	269	25	328

The Society impairment provision of £349 million at 4 April 2018 (2017: £328 million) comprises individual provisions of £16 million (2017: £28 million) and collective provisions of £333 million (2017: £300 million).

In addition to the Society's impairment loss on loans and advances to customers shown above, the Society's income statement charge includes a £2 million (2017: £18 million) provision release in relation to a loan to a subsidiary undertaking.

Notes to the financial statements *continued*10. Impairment provisions on loans and advances to customers *continued***Critical accounting estimates and judgements****Impairment provisions on loans and advances**

Impairment is measured as the difference between an asset's carrying amount and the present value of management's estimate of future cash flows. In determining the required level of impairment provisions, the Group uses outputs from statistical models combined with management judgement.

Key assumptions included in the measurement of impairment include the probability of default and the amount of eventual loss given default. Assumptions are based on observed historical data and updated as management considers appropriate to reflect current conditions. The impairment provision will therefore be affected by unexpected changes outside of these assumptions.

For prime and specialist residential mortgages, the estimate of future house price index (HPI) movements is a key assumption in estimating the eventual loss. The Group does not take account of projected future HPI increases in establishing provisions, other than in relation to the future maturity of interest only mortgages. If no HPI growth were assumed for interest only mortgages provisions would increase by £7 million. If a 10% HPI decrease were assumed for all residential mortgages, including interest only mortgages, provisions would further increase by an estimated £20 million.

Provisions are held in relation to up to date accounts where a loss event has occurred but is not yet identified through evidence of arrears, based on an emergence period. The emergence period represents the estimated period of time between a loss event occurring and an account entering arrears. If this period is increased by one month the estimated provision increase would be less than £1 million for prime and specialist residential mortgages, and an estimated £5 million for consumer banking.

For consumer banking, the estimate of future recoveries is a key assumption in estimating the eventual loss. The Group uses a combination of both historical data and management judgement in estimating the level and timing of future recoveries. A 10% change in expected future recoveries would result in an estimated £20 million change in the provision.

11. Taxation

Tax charge in the income statement				
	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Current tax:				
UK corporation tax	246	300	151	223
Adjustments in respect of prior years	(12)	(3)	(32)	(2)
Total current tax	234	297	119	221
Deferred tax:				
Current year credit	(7)	(1)	(11)	(11)
Adjustments in respect of prior years	9	3	10	3
Effect of corporation tax rate change	-	(2)	-	(2)
Effect of deferred tax provided at different tax rates	(4)	-	(3)	(5)
Total deferred taxation	(2)	-	(4)	(15)
Tax charge	232	297	115	206

Notes to the financial statements *continued*11. Taxation *continued*

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

Reconciliation of tax charge				
	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Profit before tax	977	1,054	452	671
Tax calculated at a tax rate of 19% (2017: 20%)	186	211	86	134
Adjustments in respect of prior years	(3)	-	(22)	1
Banking surcharge	43	62	43	62
Expenses not deductible for tax purposes/(income not taxable):				
Depreciation on non-qualifying assets	1	-	1	-
Bank levy	8	8	8	8
Effect of results of LLP structured entity (note i)	-	-	2	(12)
Customer redress	-	19	-	19
Other	1	(1)	-	1
Effect of corporation tax rate change	-	(2)	-	(2)
Effect of deferred tax provided at different tax rates	(4)	-	(3)	(5)
Tax charge	232	297	115	206

Note:

- i. The Society is liable for tax on the results of Nationwide Covered Bonds LLP, the profit or loss of which is reported within that entity.

The tax on items through other comprehensive income is as follows:

Tax (credit)/charge on items through other comprehensive income				
	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Available for sale investment securities	11	18	11	16
Cash flow hedges	(68)	(101)	(19)	(18)
Property revaluation	1	(2)	1	(2)
Retirement benefit obligations	7	(92)	8	(92)
Other items through the general reserve, including effect of corporation tax rate change	-	1	-	-
Total	(49)	(176)	1	(96)

The Group tax charge through the available for sale reserve of £11 million (2017: charge of £18 million) is made up of a charge of £8 million (2017: charge of £14 million) through current tax and a charge of £3 million (2017: charge of £4 million) through deferred tax.

Deferred tax

Deferred tax is determined using tax rates and laws that are expected to apply in the period when the deferred tax asset is realised or deferred tax liability is settled based on rates enacted or substantively enacted at the balance sheet date, including the banking surcharge where applicable.

The Finance (No. 2) Act 2015 introduced a surcharge of 8% on banking profits from 1 January 2016 and reduced the corporation tax rate from 20% to 19% with effect from 1 April 2017. The Finance Act 2016 was enacted on 15 September 2016 and reduces the corporation tax rate from 19% to 17% from 1 April 2020.

Notes to the financial statements *continued*11. Taxation *continued*

The movements on the deferred tax account are as follows:

Movements in deferred taxation				
	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
At 5 April	3	(151)	72	(16)
Deferred tax charge in the income statement:				
Accelerated capital allowances	-	13	1	13
Effect of corporation tax rate change	-	2	-	2
Effect of deferred tax provided at different tax rates	4	-	3	5
Other items	(2)	(15)	-	(5)
Taxation on items through the income statement	2	-	4	15
Deferred tax charge in other comprehensive income:				
Available for sale investment securities	(2)	(19)	(2)	(19)
Cash flow hedges	48	70	13	14
Property revaluation	1	-	1	-
Other provisions	-	14	-	14
Retirement benefit obligations	(15)	42	(15)	42
Effect of corporation tax rate change	-	5	-	-
Effect of deferred tax provided at different tax rates	12	42	(1)	22
Taxation on items through other comprehensive income	44	154	(4)	73
At 4 April	49	3	72	72

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

Deferred tax assets and liabilities				
	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Deferred tax assets				
Accelerated capital allowances	(16)	(21)	(16)	(21)
Property revaluation	1	1	-	-
Available for sale investment securities	(30)	(23)	(30)	(23)
Cash flow hedges	39	19	39	19
Retirement benefit obligations	92	112	92	112
Provisions for loan impairment	1	1	-	-
Other provisions	11	14	10	11
	98	103	95	98
Deferred tax liabilities				
Property revaluation	(12)	(12)	(12)	(12)
Cash flow hedges	(34)	(82)	-	-
Other provisions	(3)	(6)	(11)	(14)
	(49)	(100)	(23)	(26)
Net deferred tax asset	49	3	72	72

The majority of deferred tax assets are anticipated to be recoverable after one year. The Group considers that there will be sufficient future trading profits in excess of profits arising from the reversal of existing taxable temporary differences to utilise the deferred tax assets.

Notes to the financial statements *continued*12. Classification and measurement *continued*

Classification of financial assets and liabilities					
2017	Available for sale	Loans and receivables	Fair value through income statement	Liabilities at amortised cost	Total
Group	£m	£m	£m	£m	£m
Financial assets					
Cash	-	13,017	-	-	13,017
Loans and advances to banks	-	2,587	-	-	2,587
Investment securities (note i)	9,831	-	-	-	9,831
Derivative financial instruments	-	-	5,043	-	5,043
Fair value adjustment for portfolio hedged risk	-	746	-	-	746
Loans and advances to customers	-	187,371	-	-	187,371
Other financial assets (note ii)	-	-	7	-	7
Total financial assets	9,831	203,721	5,050	-	218,602
Other non-financial assets					3,068
Total assets					221,670
Financial liabilities					
Shares	-	-	-	144,542	144,542
Deposits from banks	-	-	-	8,734	8,734
Other deposits	-	-	810	5,649	6,459
Due to customers	-	-	-	2,376	2,376
Fair value adjustment for portfolio hedged risk	-	-	-	8	8
Debt securities in issue	-	-	-	40,339	40,339
Derivative financial instruments	-	-	3,182	-	3,182
Subordinated liabilities (note i)	-	-	-	2,940	2,940
Subscribed capital (note i)	-	-	-	279	279
Total financial liabilities	-	-	3,992	204,867	208,859
Other non-financial liabilities (note i)					1,678
Total liabilities					210,537

Notes:

- i. Comparatives have been restated as detailed in note 1.
- ii. Other financial assets relate to the fair value of certain mortgage commitments included within other assets on the balance sheet.

Further information on the fair value of financial assets and liabilities is included in notes 21 to 23.

Amounts classified as due to customers do not confer membership rights.

Notes to the financial statements *continued*

13. Investment securities

	Group and Society	
	2018	2017 (note i)
	£m	£m
Government and supranational investment securities	9,592	6,897
Other debt investment securities	3,450	2,900
Investments in equity shares	4	34
Total	13,046	9,831

Note:

- i. Comparatives have been restated as detailed in note 1. In addition, £33 million has been reclassified from Investments in equity shares to Other debt investment securities to better reflect the nature of the investment.

At 4 April 2018 £30 million of investment securities (2017: £32 million) had been pledged as collateral under UK payment schemes.

At 4 April 2018 the Group holds £403 million collateral under either reverse sale and repurchase agreements or reverse total return swaps (2017: £nil).

Investments in equity shares include investments of £3 million (2017: £33 million) carried at fair value which relate to the Group's participation in industry wide banking and credit card service operations.

Further information on investment securities is included in the 'Treasury assets' section of the Business and Risk Report.

14. Loans and advances to customers

	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Prime residential mortgages	144,013	137,970	143,567	137,427
Specialist residential mortgages	33,141	33,149	663	733
Consumer banking	3,809	3,680	3,809	3,680
Commercial and other lending	9,658	11,202	9,164	10,690
	190,621	186,001	157,203	152,530
Fair value adjustment for micro hedged risk	1,043	1,370	1,043	1,370
Total	191,664	187,371	158,246	153,900

Loans and advances to customers in the table above are shown net of impairment provisions held against them. The fair value adjustment for micro hedged risk relates to commercial lending.

Notes to the financial statements *continued*14. Loans and advances to customers *continued***Maturity analysis**

The following table shows the residual maturity of loans and advances to customers, based on their contractual maturity:

Residual maturity of loans and advances to customers				
	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Repayable:				
On demand	2,158	2,013	2,158	2,011
In not more than three months	2,211	2,196	2,038	2,050
In more than three months but not more than one year	5,729	5,734	5,585	5,559
In more than one year but not more than five years	30,545	29,322	28,932	27,823
In more than five years	150,436	147,174	118,839	115,415
	191,079	186,439	157,552	152,858
Impairment provision on loans and advances (note 10)	(458)	(438)	(349)	(328)
Fair value adjustment for micro hedged risk	1,043	1,370	1,043	1,370
Total	191,664	187,371	158,246	153,900

The maturity analysis is produced on the basis that where a loan is repayable by instalments, each such instalment is treated as a separate repayment. The analysis is based on contractual maturity rather than actual redemption levels experienced, which are likely to be materially different. Arrears are spread across the remaining term of the loan.

Asset backed funding

Certain prime residential mortgages have been pledged to the Group's asset backed funding programmes or utilised as whole mortgage loan pools for the Bank of England's (BoE) Term Funding Scheme (TFS). The programmes have enabled the Group to obtain secured funding.

Mortgages pledged and the nominal values of the notes in issue are as follows:

Mortgages pledged to asset backed funding programmes					
2018	Mortgages pledged	Notes in issue			
		Held by third parties	Held by the Group		Total notes in issue
			Drawn	Undrawn	
Group	£m	£m	£m	£m	£m
Covered bond programme	21,000	15,322	-	-	15,322
Securitisation programme	8,711	3,659	-	337	3,996
Whole mortgage loan pools	22,831	-	17,000	-	17,000
Total	52,542	18,981	17,000	337	36,318

Mortgages pledged to asset backed funding programmes					
2017	Mortgages pledged	Notes in issue			
		Held by third parties	Held by the Group		Total notes in issue
			Drawn	Undrawn	
Group	£m	£m	£m	£m	£m
Covered bond programme	19,322	14,927	-	-	14,927
Securitisation programme	10,412	3,622	-	448	4,070
Whole mortgage loan pools	16,136	-	10,747	2,101	12,848
Total	45,870	18,549	10,747	2,549	31,845

Note:

The prior year values for notes in issue for whole mortgage loan pools has been restated to show the nominal amounts on a consistent basis with the current year presentation.



Notes to the financial statements *continued*

14. Loans and advances to customers *continued*

The securitisation programme notes are issued by Silverstone Master Issuer plc and are not included in the accounts of the Society. Silverstone Master Issuer plc is fully consolidated into the accounts of the Group.

At 4 April 2018 the whole mortgage loan pools are pledged at the BoE under the TFS. In the prior year, whole mortgage loan pools were pledged at the BoE under the TFS and Funding for Lending Scheme (FLS). Notes are not issued when pledging the mortgage loan pools at the BoE. Instead, the whole loan pool is pledged to the BoE and drawings are made directly against the eligible collateral, subject to a haircut. At 4 April 2018, £22.8 billion (2017: £16.1 billion) of pledged collateral provided a post-haircut drawdown capacity of £17.5 billion (2017: £12.8 billion), of which £17.0 billion (2017: £10.7 billion) of drawdowns were made. At 4 April 2018 there are no amounts undrawn following the closure of the BoE TFS and FLS.

Mortgages pledged include £8.7 billion (2017: £9.1 billion) in the covered bond and securitisation programmes that are in excess of the amount contractually required to support notes in issue.

Mortgages pledged are not derecognised from the Group or Society balance sheets as the Group has retained substantially all the risks and rewards of ownership. The Group and Society continue to be exposed to the liquidity risk, interest rate risk and credit risk of the mortgages. No gain or loss has been recognised on pledging the mortgages to the programmes.

Notes in issue which are held by third parties are included within debt securities in issue (note 18).

Notes in issue, held by the Group and drawn are whole mortgage loan pools securing amounts drawn under the TFS. At 4 April 2018 the Group had outstanding TFS drawings of £17.0 billion (2017: £6.0 billion).

Notes in issue, held by the Group and undrawn, are debt securities issued by the programmes to the Society and mortgage loan pools that have been pledged to the BoE but not utilised.

In accordance with accounting standards, notes in issue and held by the Group are not recognised in the Group's or Society's balance sheets.

The Society established the Nationwide Covered Bond programme in November 2005. Mortgages pledged provide security for issues of covered bonds made by the Society. During the year ended 4 April 2018, €1.1 billion (£0.9 billion sterling equivalent) of notes were issued, and £0.8 billion sterling equivalent of notes matured.

The Society established the Silverstone Master Trust securitisation programme in July 2008. Notes are issued under the programme and the issuance proceeds are used to purchase, for the benefit of note holders, a share of the beneficial interest in the mortgages pledged by the Society. The remaining beneficial interest in the pledged mortgages of £5.2 billion (2017: £7.0 billion) stays with the Society and includes its required minimum seller share in accordance with the rules of the programme. The Group is under no obligation to support losses incurred by the programme or holders of the notes and does not intend to provide such further support. The entitlement of note holders is restricted to payment of principal and interest to the extent that the resources of the programme are sufficient to support such payment and the holders of the notes have agreed not to seek recourse in any other form. During the year ended 4 April 2018 a total of £0.8 billion sterling equivalent of notes matured. During the year ended 4 April 2018 £0.9 billion sterling equivalent notes were issued across sterling and US dollars.

The following table sets out the carrying value and fair value of the transferred assets and liabilities for the Silverstone Master Trust:

	Carrying value			Fair value		
	Transferred assets	Associated liabilities	Total	Transferred assets	Associated liabilities	Total
	£m	£m	£m	£m	£m	£m
At 4 April 2018	8,711	(3,996)	4,715	8,428	(4,030)	4,398
At 4 April 2017	10,412	(4,088)	6,324	10,030	(4,126)	5,904

The Society holds cash deposited by the Nationwide Covered Bond programme of £0.4 billion (2017: £0.4 billion) and by the Silverstone programme of £0.4 billion (2017: £0.4 billion).

Notes to the financial statements *continued*

15. Derivative financial instruments

All of the Group's derivative financial instruments are held for risk mitigation purposes, although not all of the derivatives are designated as hedging instruments as defined by IAS 39 Financial Instruments: Recognition and Measurement. The table below provides an analysis of the notional amount and fair value of derivatives by instrument type:

Derivatives by instrument type						
	2018			2017		
	Contract/ notional amount	Fair value		Contract/ notional amount	Fair value	
		Assets	Liabilities		Assets	Liabilities
	£m	£m	£m	£m	£m	£m
Society:						
Interest rate swaps	203,850	1,390	2,599	162,270	1,484	3,863
Cross currency interest rate swaps	29,055	1,692	1,109	27,272	2,269	929
Caps, collars and floors	-	-	-	135	-	-
Forward foreign exchange	1,635	2	27	1,651	16	4
Forward rate agreements	-	-	-	401	-	1
Swaptions	202	-	3	240	-	5
Interest rate futures	1,300	-	-	3,075	-	-
Equity index swaps	-	-	-	577	233	-
Bond forwards	200	-	1	-	-	-
Index linked swaps	295	24	7	280	20	-
	236,537	3,108	3,746	195,901	4,022	4,802
Subsidiaries:						
Interest rate swaps	13,863	927	69	12,808	1,179	31
Cross currency interest rate swaps	13,753	1,646	82	12,851	1,547	54
	27,616	2,573	151	25,659	2,726	85
Intra Group derivative elimination	(33,318)	(1,560)	(1,560)	(31,383)	(1,705)	(1,705)
Group	230,835	4,121	2,337	190,177	5,043	3,182

Contract/notional amount is the amount on which payment flows are derived and does not represent amounts at risk.

The table below provides an analysis of the fair value of derivatives, split between those designated in effective hedging relationships and those which, whilst being economic hedges, are not subject to hedge accounting:

Group	2018		2017	
	Fair value		Fair value	
	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m
Designated as fair value hedges	718	1,641	693	2,823
Designated as cash flow hedges	3,260	541	3,985	249
Not subject to hedge accounting	143	155	365	110
Total	4,121	2,337	5,043	3,182

Society	2018		2017	
	Fair value		Fair value	
	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m
Designated as fair value hedges	640	1,845	611	2,823
Designated as cash flow hedges	79	379	168	121
Not subject to hedge accounting	2,389	1,522	3,243	1,858
Total	3,108	3,746	4,022	4,802

Notes to the financial statements *continued*15. Derivative financial instruments *continued*

Derivative assets and liabilities have remaining contractual maturities as follows:

Derivatives maturities						
Group	2018			2017		
	Contract/ notional amount	Fair value		Contract/ notional amount	Fair value	
		Assets	Liabilities		Assets	Liabilities
	£m	£m	£m	£m	£m	£m
Derivatives have remaining maturities as follows:						
In not more than one year	75,114	318	92	75,054	386	181
In more than one year	155,721	3,803	2,245	115,123	4,657	3,001
Total	230,835	4,121	2,337	190,177	5,043	3,182

Derivatives maturities						
Society	2018			2017		
	Contract/ notional amount	Fair value		Contract/ notional amount	Fair value	
		Assets	Liabilities		Assets	Liabilities
	£m	£m	£m	£m	£m	£m
Derivatives have remaining maturities as follows:						
In not more than one year	75,196	357	82	75,489	441	262
In more than one year	161,341	2,751	3,664	120,412	3,581	4,540
Total	236,537	3,108	3,746	195,901	4,022	4,802

Cash flow hedge accounting is used primarily for derivatives which economically hedge foreign currency debt issuances. The following table shows the maturity profile of the cash flows designated as hedged items. These cash flows will impact the income statement in the same period in which they are expected to occur and will be offset by cash flows arising from derivative positions.

Maturity of cash flow hedge accounting cash flows					
2018	In 0 to 5 years	In 5 to 10 years	In 10 to 20 years	In more than 20 years	Total
	£m	£m	£m	£m	£m
Hedged forecast cash flows expected to occur:					
Group					
Forecast receivable cash flows	850	473	181	7	1,511
Forecast payable cash flows	(16,131)	(9,428)	(3,200)	(306)	(29,065)
Society					
Forecast receivable cash flows	311	162	-	-	473
Forecast payable cash flows	(2,043)	(5,129)	-	-	(7,172)

Maturity of cash flow hedge accounting cash flows					
2017	In 0 to 5 years	In 5 to 10 years	In 10 to 20 years	In more than 20 years	Total
	£m	£m	£m	£m	£m
Hedged forecast cash flows expected to occur:					
Group					
Forecast receivable cash flows	408	307	164	11	890
Forecast payable cash flows	(18,250)	(7,609)	(2,395)	(348)	(28,602)
Society					
Forecast receivable cash flows	44	49	-	-	93
Forecast payable cash flows	(1,462)	(1,339)	-	-	(2,801)

Notes to the financial statements *continued*

16. Deposits from banks

Deposits from banks are repayable from the balance sheet date in the ordinary course of business as follows:

	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Accrued interest	2	2	2	2
Repayable:				
On demand	2,076	2,497	888	1,326
In not more than three months	274	123	274	123
In more than three months but not more than one year	52	84	52	84
In more than one year but not more than five years	17,000	6,028	17,000	6,028
Total	19,404	8,734	18,216	7,563

For the Group and Society, deposits from banks include £17.0 billion (2017: £6.0 billion) drawn down against the Bank of England Term Funding Scheme (TFS) which is repayable within more than one year but not more than five years.

17. Other deposits

Other deposits are repayable from the balance sheet date in the ordinary course of business as follows:

	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Accrued interest	2	4	2	4
Repayable:				
On demand	2,294	2,314	3,711	3,883
In not more than three months	1,308	1,639	1,308	1,639
In more than three months but not more than one year	1,708	2,476	1,708	2,476
In more than one year but not more than five years	11	26	11	26
Total	5,323	6,459	6,740	8,028

Other deposits comprise wholesale and commercial deposits. At 4 April 2017, other deposits also included £810 million relating to the sale of PEBs by the Group on behalf of Legal & General. These matured during the year ended 4 April 2018.

The Society's other deposits for the year ended 4 April 2018 include £1,417 million (2017: £1,569 million) of deposits from subsidiary undertakings.

Notes to the financial statements *continued*

18. Debt securities in issue

	Group		Society	
	2018	2017	2018	2017
	£m	£m	£m	£m
Certificates of deposit and commercial paper	5,413	7,065	5,413	7,065
Fixed and floating rate notes	23,969	28,240	23,980	28,253
Other debt securities	3,959	3,920	301	290
	33,341	39,225	29,694	35,608
Fair value adjustment for micro hedged risk	777	1,114	40	264
Total	34,118	40,339	29,734	35,872
Debt securities in issue are repayable from the balance sheet date in the ordinary course of business as follows:				
Accrued interest	157	178	148	168
Residual maturity repayable:				
In not more than one year	8,489	9,932	7,712	9,154
In more than one year	24,695	29,115	21,834	26,286
	33,341	39,225	29,694	35,608
Fair value adjustment for micro hedged risk	777	1,114	40	264
Total	34,118	40,339	29,734	35,872

In March 2018, the Society re-purchased approximately £4 billion of the fixed and floating rate notes. This followed the issuance of new senior non-preferred debt instruments, which will help to meet forthcoming minimum requirements for own funds and eligible liabilities (MREL). Further information on the new bonds issued, which are classified as subordinated liabilities, is included in note 19.

Debt securities in issue in the Group includes £18,981 million (2017: £18,549 million), and in the Society includes £15,322 million (2017: £14,927 million) secured on certain loans and advances to customers. Further information is given in note 14.

Certificates of deposit and commercial paper include £1 million (2017: £619 million) which was in the course of settlement, with the associated receivable included in other assets on the balance sheet.

Notes to the financial statements *continued*

19. Subordinated liabilities

	Next call date	Maturity date	Group	
			2018	2017 (note i)
			£m	£m
Senior non-preferred				
3.766% senior non-preferred notes (\$1,000m)	8 March 2023	8 March 2024	713	-
1.5% senior non-preferred notes (€1,000m)	8 March 2025	8 March 2026	875	-
4.302% senior non-preferred notes (\$750m)	8 March 2028	8 March 2029	534	-
Tier 2 Eligible				
8.625% subordinated notes (£125m)	-	29 March 2018	-	125
6.75% subordinated notes (€750m)	-	22 July 2020	686	672
6.5% callable reset subordinated notes (£30m)	-	1 September 2022	-	30
4.125% subordinated notes (€1,250m)	-	20 March 2023	-	1,072
4% subordinated notes (\$1,250m)	-	14 September 2026	886	1,007
2% subordinated notes (€1,000m)	25 July 2024	25 July 2029	889	-
4.125% subordinated notes (\$1,250m)	18 October 2027	18 October 2032	904	-
			5,487	2,906
Fair value hedge accounting adjustments (note ii)			42	45
Unamortised premiums and issue costs			(32)	(11)
Total			5,497	2,940

Notes:

- i. Comparatives have been restated to include £35 million of accrued interest as detailed in note 1.
- ii. Subordinated liabilities within the Society are as shown for the Group, except that in 2017 the Group figures were lower by £5 million due to the inclusion of amounts relating to cash flow hedge accounting undertaken at Group level.

On 8 March 2018, to help meet forthcoming minimum requirements for own funds and eligible liabilities (MREL), the Group issued senior non-preferred notes, which are a class of subordinated liability that are senior to the existing Tier 2 eligible notes. The Group issued €1.0 billion, \$1.0 billion and \$750 million of senior non-preferred notes.

In addition to the above, on 25 July 2017 the Group issued €1.0 billion of Tier 2 subordinated notes and on 18 October 2017 issued \$1.25 billion of Tier 2 subordinated notes. On 1 September 2017 the Group redeemed £30 million of Tier 2 subordinated notes at par, on 20 March 2018 it redeemed €1.25 billion of Tier 2 subordinated notes at par and on 29 March 2018 it redeemed £125 million of Tier 2 subordinated notes at par.

The senior non-preferred notes rank *pari passu* with each other and behind the claims against the Society of all depositors, creditors and investing members other than holders of Tier 2 subordinated notes, permanent interest-bearing shares (PIBS), Additional Tier 1 (AT1) capital and core capital deferred shares (CCDS) of the Society.

The Tier 2 subordinated notes rank *pari passu* with each other and behind the claims against the Society of all depositors, creditors and investing members other than holders of PIBS, AT1 capital and CCDS of the Society.

The interest rate risk arising from the issuance of fixed rate subordinated liabilities has been mitigated through the use of interest rate swaps. The foreign exchange risk arising from the issuance of foreign currency subordinated liabilities has been mitigated through the use of cross currency swaps.

Notes to the financial statements *continued*

20. Subscribed capital

	Notes	Next call date	Group and Society	
			2018	2017 (note i)
			£m	£m
7.25% permanent interest-bearing shares	ii	5 December 2021	34	34
6.25% permanent interest-bearing shares	ii	22 October 2024	45	45
5.769% permanent interest-bearing shares	ii	6 February 2026	84	84
7.859% permanent interest-bearing shares	ii	13 March 2030	39	39
6.875% permanent interest-bearing shares	ii	10 January 2019	10	10
Floating rate (3 month Libor + 1.5%) permanent interest-bearing shares	iii		3	3
Floating rate (6 month Libor + 2.4%) permanent interest-bearing shares	iv		10	10
			225	225
Fair value hedge accounting adjustments			40	57
Unamortised premiums and issue costs			(2)	(3)
Total			263	279

Notes:

- i. Comparatives have been restated to include £3 million of accrued interest as detailed in note 1.
- ii. Repayable, at the option of the Society, in whole on the initial call date or every fifth anniversary thereafter. If not repaid on a call date then the interest rate is reset at a margin to the yield on the then prevailing five year benchmark gilt rate.
- iii. Repayable at the option of the Society, at every interest payment date.
- iv. Only repayable in the event of winding up the Society.

All permanent interest-bearing shares (PIBS) are denominated in sterling and only repayable with the prior consent of the PRA.

PIBS rank equally with each other and the Group's AT1 instruments. They are deferred shares of the Society and rank behind the claims against the Society of all noteholders, depositors, creditors and investing members of the Society, other than the holders of CCDS.

The interest rate risk arising from the issuance of fixed rate PIBS has been mitigated through the use of interest rate swaps.

Notes to the financial statements *continued*

21. Fair value hierarchy of financial assets and liabilities held at fair value

As the majority of the Group's assets and liabilities are held within the Society, the disclosures in notes 21 to 24 are on a consolidated basis.

The following tables show the Group's financial assets and liabilities that are held at fair value by fair value hierarchy, balance sheet classification and product type:

2018	Fair values based on			Total £m
	Level 1	Level 2	Level 3	
	£m	£m	£m	
Financial assets				
Government and supranational investments	9,592	-	-	9,592
Other debt investment securities (note i)	1,007	1,282	41	2,330
Investments in equity shares (note ii)	-	-	3	3
Total investment securities	10,599	1,282	44	11,925
Interest rate swaps	-	1,654	-	1,654
Cross currency interest rate swaps	-	2,441	-	2,441
Forward foreign exchange	-	2	-	2
Equity index swaps	-	-	-	-
Index linked swaps	-	24	-	24
Total derivative financial instruments	-	4,121	-	4,121
Total financial assets	10,599	5,403	44	16,046
Financial liabilities				
Interest rate swaps	-	(2,002)	(4)	(2,006)
Cross currency interest rate swaps	-	(293)	-	(293)
Forward foreign exchange	-	(27)	-	(27)
Bond Forwards	-	(1)	-	(1)
Swaptions	-	(3)	-	(3)
Index linked swaps	-	(7)	-	(7)
Total derivative financial instruments	-	(2,333)	(4)	(2,337)
Total financial liabilities	-	(2,333)	(4)	(2,337)

Notes to the financial statements *continued*21. Fair value hierarchy of financial assets and liabilities held at fair value *continued*

2017	Fair values based on			Total £m
	Level 1	Level 2	Level 3	
	£m	£m	£m	
Financial assets				
Government and supranational investments	6,897	-	-	6,897
Other debt investment securities (note iii)	931	1,936	33	2,900
Investments in equity shares (notes ii and iii)	-	-	33	33
Total investment securities	7,828	1,936	66	9,830
Interest rate swaps	-	1,859	-	1,859
Cross currency interest rate swaps	-	2,915	-	2,915
Forward foreign exchange	-	16	-	16
Equity index swaps	-	-	233	233
Index linked swaps	-	20	-	20
Total derivative financial instruments	-	4,810	233	5,043
Other financial assets (note iv)	-	7	-	7
Total financial assets	7,828	6,753	299	14,880
Financial liabilities				
Interest rate swaps	-	(3,096)	(5)	(3,101)
Cross currency interest rate swaps	-	(71)	-	(71)
Forward foreign exchange	-	(4)	-	(4)
Forward rate agreements	-	(1)	-	(1)
Swaptions	-	(5)	-	(5)
Total derivative financial instruments	-	(3,177)	(5)	(3,182)
Other deposits – PEBs (note v)	-	-	(810)	(810)
Total financial liabilities	-	(3,177)	(815)	(3,992)

Notes:

- i. Other debt investment securities shown above exclude £1,120 million (2017: £nil) of held to maturity investment securities which are held at amortised cost. Further details are included in note 13.
- ii. Investments in equity shares above exclude £1 million of investments in equity shares which are held at cost.
- iii. £33 million has been reclassified from Level 3 investments in equity shares to Level 3 other debt investment securities to better reflect the nature of the investment.
- iv. Other financial assets represent the fair value of certain mortgage commitments included within other assets in the balance sheet.
- v. Other deposits comprise PEBs which are held at fair value through the income statement. The remaining other deposits are held at amortised cost and are included in note 23.

The Group's Level 1 portfolio comprises liquid securities for which traded prices are readily available.

Asset valuations for Level 2 investment securities are sourced from consensus pricing or other observable market prices. None of the Level 2 investment securities are valued using models. Level 2 derivative assets and liabilities are valued from discounted cash flow models using yield curves based on observable market data.

More detail on the Level 3 portfolio is provided in note 22.

Notes to the financial statements *continued*

22. Fair value of financial assets and liabilities held at fair value – Level 3 portfolio

Transfers between fair value hierarchies

Instruments move between fair value hierarchies primarily due to increases or decreases in market activity or changes to the significance of unobservable inputs to valuation. There were no significant transfers between the Level 1 and Level 2 portfolios during the year.

The main constituents of the Level 3 portfolio are as follows:

Investment securities

The Level 3 items in this category include investments of £44 million (2017: £66 million) in industry wide banking and credit card service operations.

Derivative financial instruments

The equity linked derivatives which economically matched Protected Equity Bonds (PEBs) have all matured during the year. Fair value changes were recognised within gains/losses from derivatives and hedge accounting. Upon maturity the gain/loss was transferred to interest expense and similar charges. The remaining Level 3 item is a derivative economically hedging a small and closed portfolio of equity release mortgages.

Other deposits – PEBs

The PEBs matured in full during the year ended 4 April 2018.

The tables below set out movements in the Level 3 portfolio, including transfers in and out of Level 3.

Movements in Level 3 portfolio			
	Investment securities	Net derivative financial instruments	Other deposits - PEBs
	£m	£m	£m
At 5 April 2017	66	228	(810)
Gains/(losses) recognised in the income statement:			
Net interest income/(expense)	-	206	(210)
(Losses)/gains from derivatives and hedge accounting	-	(232)	233
Other operating income	26	-	-
(Losses)/gains recognised in other comprehensive income:			
Fair value movement taken to members' interests and equity	(18)	-	-
Settlements	-	(206)	787
Disposals	(30)	-	-
At 4 April 2018	44	(4)	-

Movements in Level 3 portfolio			
	Investment securities	Net derivative financial instruments	Other deposits - PEBs
	£m	£m	£m
At 5 April 2016	125	431	(1,885)
Gains/(losses) recognised in the income statement:			
Net interest income/(expense)	-	308	(327)
(Losses)/gains from derivatives and hedge accounting	-	(205)	201
Other operating income	100	-	-
Losses recognised in other comprehensive income:			
Fair value movement taken to members' interests and equity	(66)	-	-
Settlements	-	(306)	1,201
Acquisitions	25	-	-
Disposals	(118)	-	-
At 4 April 2017	66	228	(810)

Notes to the financial statements *continued*22. Fair value of financial assets and liabilities held at fair value – Level 3 portfolio *continued***Level 3 portfolio sensitivity analysis of valuations using unobservable inputs**

The fair value of financial instruments is, in certain circumstances, measured using valuation techniques based on market prices that are not observable in an active market or significant unobservable market inputs.

Reasonable alternative assumptions can be applied for sensitivity analysis, taking account of the nature of valuation techniques used, as well as the availability and reliability of observable proxy and historic data. The following table shows the sensitivity of the Level 3 fair values to reasonable alternative assumptions (as set out in the table of significant unobservable inputs below) and the resultant impact of such changes in fair value on the income statement or members' interests and equity:

Sensitivity of Level 3 fair values			
2018	Fair value	Members' interests and equity	
		Favourable changes	Unfavourable changes
		£m	£m
Investment securities	44	25	(35)
Net derivative financial instruments (note i)	(4)	-	-
Total	40	25	(35)

Sensitivity of Level 3 fair values			
2017	Fair value	Members' interests and equity	
		Favourable changes	Unfavourable changes
		£m	£m
Investment securities	66	12	(24)
Net derivative financial instruments (note i)	228	-	-
Other deposits – PEBs	(810)	-	-
Total	(516)	12	(24)

Note:

- i. The derivative financial instruments balance is an economic hedge of a closed equity release mortgage portfolio. The fair value is an unadjusted amount sourced from a third party and so there is no quantitative information available to disclose a sensitivity analysis.

The Level 3 portfolio at 4 April 2018 did not include any impaired assets (2017: £nil). The sensitivity analysis on fair values in the tables above therefore does not impact on the income statement.

Alternative assumptions are considered for each product and varied according to the quality of the data and variability of the underlying market.

The following table discloses the significant unobservable inputs underlying the above alternative assumptions for assets and liabilities recognised at fair value and classified as Level 3, along with the range of values for those significant unobservable inputs. Where sensitivities are described the inverse relationship will also generally apply.

Significant unobservable inputs								
2018	Total assets	Total liabilities	Valuation technique	Significant unobservable inputs	Range (note i)		Weighted average (note ii)	Units
	£m	£m						
Investment securities	44	-	Discounted cash flows	Discount rate	10.00	12.00	11.00	%
				Share conversion	-	100.00	66.45	%
Net derivative financial instruments	-	(4)						
Other deposits – PEBs	-	-						

Notes to the financial statements *continued*22. Fair value of financial assets and liabilities held at fair value – Level 3 portfolio *continued*

Significant unobservable inputs								
2017	Total assets	Total liabilities	Valuation technique	Significant unobservable inputs	Range (note i)		Weighted average (note ii)	Units
	£m	£m						
Investment securities	66	-	Discounted cash flows	Discount rate	6.41	7.75	7.08	%
				Share conversion	-	100.00	77.76	%
Net derivative financial instruments	228	-						
Other deposits – PEBs (note iii)	-	(810)						

Notes:

- i. The range represents the values of the highest and lowest levels used in the calculation of favourable and unfavourable changes as presented in the previous table.
- ii. Weighted average represents the input values used in calculating the fair values for the above financial instruments.
- iii. Changes in fair values of the equity index swaps included in net derivative financial instruments will be largely offset by the change in fair value of the PEBs deposits. Any resultant impact is deemed by the Group to be insignificant; therefore these sensitivities have been excluded from the table above.

Some of the significant unobservable inputs used in fair value measurement are interdependent. Where this is the case, a description of those interrelationships is included below.

Discount rate

The discount rate is used to determine the present value of future cash flows. The level of the discount rate takes into account the time value of money, but also the risk or uncertainty of future cash flows. Typically, the greater the uncertainty, the higher the discount rate. A higher discount rate leads to a lower valuation and vice versa.

Share conversion

Where the conversion of a security into an underlying instrument is subject to underlying security market pricing and contingent litigation risk, share conversion is factored into the fair value. The higher the share conversion, the higher the valuation and vice versa.

Notes to the financial statements *continued*

23. Fair value of financial assets and liabilities measured at amortised cost

The following table summarises the carrying value and fair value of financial assets and liabilities measured at amortised cost on the Group's balance sheet:

Fair value of financial assets and liabilities					
2018	Carrying value	Fair values based on			Total fair value
		Level 1	Level 2	Level 3	
	£m	£m	£m	£m	£m
Financial assets					
Loans and advances to banks	3,422	-	3,422	-	3,422
Held to maturity investment securities (note i)	1,120	-	1,128	-	1,128
Loans and advances to customers:					
Residential mortgages	177,154	-	-	176,479	176,479
Consumer banking	3,809	-	-	3,666	3,666
Commercial and other lending	10,701	-	71	9,570	9,641
Total	196,206	-	4,621	189,715	194,336
Financial liabilities					
Shares	148,003	-	147,901	-	147,901
Deposits from banks	19,404	-	19,404	-	19,404
Other deposits (note ii)	5,323	-	5,323	-	5,323
Due to customers	402	-	402	-	402
Debt securities in issue	34,118	15,124	19,683	-	34,807
Subordinated liabilities	5,497	-	5,521	-	5,521
Subscribed capital	263	-	258	-	258
Total	213,010	15,124	198,492	-	213,616

Fair value of financial assets and liabilities					
2017	Carrying value	Fair values based on			Total fair value
		Level 1	Level 2	Level 3	
	£m	£m	£m	£m	£m
Financial assets					
Loans and advances to banks	2,587	-	2,587	-	2,587
Loans and advances to customers:					
Residential mortgages	171,119	-	-	170,542	170,542
Consumer banking	3,680	-	-	3,546	3,546
Commercial and other lending	12,572	-	5	11,296	11,301
Total	189,958	-	2,592	185,384	187,976
Financial liabilities					
Shares	144,542	-	144,664	-	144,664
Deposits from banks	8,734	-	8,736	-	8,736
Other deposits (note ii)	5,649	-	5,651	-	5,651
Due to customers	2,376	-	2,377	-	2,377
Debt securities in issue	40,339	15,399	25,837	-	41,236
Subordinated liabilities (note iii)	2,940	-	3,053	-	3,053
Subscribed capital (note iii)	279	-	244	-	244
Total	204,859	15,399	190,562	-	205,961

Notes:

- i. On 25 April 2017, the Group purchased residential mortgage backed securities under a programme to securitise Bradford & Bingley plc residential mortgage assets. These financial assets have been classified as held to maturity investment securities and are held at amortised cost.
- ii. Other deposits exclude PEBs which are held at fair value through the income statement and which are included in note 21.
- iii. Comparatives have been restated as detailed in note 1.

Notes to the financial statements *continued*23. Fair value of financial assets and liabilities measured at amortised cost *continued*

The fair values of loans and advances to customers are further analysed, between those impaired and those not impaired, as follows:

Fair value of loans and advances to customers						
2018	Impaired		Not impaired		Total	
	Carrying value	Fair value	Carrying value	Fair value	Carrying value	Fair value
	£m	£m	£m	£m	£m	£m
Residential mortgages	695	666	176,459	175,813	177,154	176,479
Consumer banking	37	24	3,772	3,642	3,809	3,666
Commercial and other lending	17	14	10,684	9,627	10,701	9,641
Total	749	704	190,915	189,082	191,664	189,786

Fair value of loans and advances to customers						
2017	Impaired		Not impaired		Total	
	Carrying value	Fair value	Carrying value	Fair value	Carrying value	Fair value
	£m	£m	£m	£m	£m	£m
Residential mortgages	713	705	170,406	169,837	171,119	170,542
Consumer banking	37	37	3,643	3,509	3,680	3,546
Commercial and other lending	25	17	12,547	11,284	12,572	11,301
Total	775	759	186,596	184,630	187,371	185,389

Loans and advances to banks

The fair value of loans and advances to banks is estimated by discounting expected cash flows at a market discount rate. The carrying amount is considered a reasonable approximation of fair value.

Held to maturity investment securities

The fair value of held to maturity investment securities is sourced from consensus pricing or other observable market prices.

Loans and advances to customers

The fair value of loans and advances to customers is estimated by discounting expected cash flows at rates that reflect current rates for similar lending.

Consistent modelling techniques are used across the different loan books. The estimates take into account expected future cash flows and future lifetime expected losses, based on historic trends and discount rates appropriate to the loans, to reflect a hypothetical exit price value on an asset by asset basis. Variable rate loans are modelled on estimated future cash flows, discounted at current market interest rates. Variable rate retail mortgages are discounted at the currently available market standard variable interest rate (SVR) which, for example, in the case of the Group's residential base mortgage rate (BMR) mortgage book, generates a fair value lower than the amortised cost value as those mortgages are priced below the SVR.

For fixed rate loans, discount rates have been based on the expected funding and capital cost applicable to the book. When calculating fair values on fixed rate loans, no adjustment has been made to reflect interest rate risk management through internal natural hedges or external hedging via derivatives.

Shares, deposits and amounts due to customers

The estimated fair value of shares, deposits and amounts due to customers with no stated maturity, including non-interest-bearing deposits, is the amount repayable on demand. For items without quoted market prices the estimated fair value represents the discounted amount of estimated future cash flows based on expectations of future interest rates, customer withdrawals and interest capitalisation. For variable interest rate items, estimated future cash flows are discounted using current market interest rates for new debt with similar remaining maturity. For fixed rate items, the estimated future cash flows are discounted based on market offer rates currently available for equivalent deposits.

Debt securities in issue

The estimated fair values of longer dated liabilities are calculated based on quoted market prices where available or using similar instruments as a proxy for those liabilities that are not of sufficient size or liquidity to have an active market quote. For those notes for which quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity.

Subordinated liabilities and subscribed capital

The fair value of subordinated liabilities and subscribed capital is determined by reference to quoted market prices of similar instruments.

Notes to the financial statements *continued*

24. Offsetting financial assets and financial liabilities

The Group has financial assets and liabilities for which there is a legally enforceable right to set off the recognised amounts, and there is an intention to settle on a net basis, or realise the asset and liability simultaneously. In accordance with IAS 32 'Financial Instruments: Presentation', where the right to set off is not unconditional in all circumstances this does not result in an offset of balance sheet assets and liabilities.

In accordance with IFRS 7 'Financial Instruments: Disclosures' the following table shows the impact on financial assets and financial liabilities relating to transactions where:

- there is an enforceable master netting arrangement or similar agreement in place and an unconditional right to offset is in place ('amounts offset'),
- there is an enforceable master netting arrangement or similar agreement in place but the offset criteria are otherwise not satisfied ('master netting arrangements'), and
- financial collateral is paid and received ('financial collateral').

Offsetting financial assets and financial liabilities						
2018	Gross amounts recognised	Amounts offset (note i)	Net amounts reported on the balance sheet	Master netting arrangements	Financial collateral	Net amounts after offsetting under IFRS 7
	£m	£m	£m	£m	£m	£m
Financial assets						
Derivative financial assets	4,288	(167)	4,121	(1,959)	(2,157)	5
Reverse repurchase agreements	403	-	403	-	(403)	-
Total financial assets	4,691	(167)	4,524	(1,959)	(2,560)	5
Financial liabilities						
Derivative financial liabilities	2,506	(169)	2,337	(1,959)	(333)	45
Repurchase agreements	945	-	945	-	(945)	-
Total financial liabilities	3,451	(169)	3,282	(1,959)	(1,278)	45

Offsetting financial assets and financial liabilities						
2017	Gross amounts recognised	Amounts offset (note i)	Net amounts reported on the balance sheet	Master netting arrangements	Financial collateral	Net amounts after offsetting under IFRS 7
	£m	£m	£m	£m	£m	£m
Financial assets						
Derivative financial assets	5,067	(24)	5,043	(2,216)	(2,799)	28
Total financial assets	5,067	(24)	5,043	(2,216)	(2,799)	28
Financial liabilities						
Derivative financial liabilities	3,210	(28)	3,182	(2,216)	(921)	45
Total financial liabilities	3,210	(28)	3,182	(2,216)	(921)	45

Note:

- i. Amounts offset for derivative financial assets of £167 million (2017: £24 million) include cash collateral netted of £3 million (2017: £3 million). Amounts offset for derivative financial liabilities of £169 million (2017: £28 million) include cash collateral netted of £5 million (2017: £7 million). Excluding the cash collateral netted, the remaining amounts represent £164 million (2017: £21 million) of derivative financial assets and derivative financial liabilities which are offset.

Master netting arrangements consist of agreements such as an ISDA Master Agreement, global master repurchase agreements and global master securities lending agreements, whereby outstanding transactions with the same counterparty can be offset and settled net, either unconditionally or following a default or other predetermined event.

Financial collateral on derivative financial instruments consists of cash settled, typically daily or weekly, to mitigate the credit risk on the fair value of derivative contracts. Financial collateral on repurchase agreements typically comprises highly liquid securities which are legally transferred and can be liquidated in the event of counterparty default.

The net amounts after offsetting under IFRS 7 presented above show the exposure to counterparty credit risk for derivative contracts after netting benefits and collateral, and are not intended to represent the Group's actual exposure to credit risk. This is due to a variety of credit mitigation strategies which are employed in addition to netting and collateral arrangements.

Notes to the financial statements *continued*

25. Intangible assets

2018	Computer software		Total computer software	Other intangible assets	Goodwill	Total
	Externally acquired	Internally developed				
Group	£m	£m	£m	£m	£m	£m
Cost						
At 5 April 2017	591	1,371	1,962	40	12	2,014
Additions	187	181	368	-	-	368
Disposals	(19)	(31)	(50)	(40)	-	(90)
At 4 April 2018	759	1,521	2,280	-	12	2,292
Accumulated amortisation and impairment						
At 5 April 2017	155	590	745	39	-	784
Amortisation charge	53	189	242	1	-	243
Impairment in the year	-	13	13	-	-	13
Disposals	(19)	(31)	(50)	(40)	-	(90)
At 4 April 2018	189	761	950	-	-	950
Net book value						
At 4 April 2018	570	760	1,330	-	12	1,342

2017	Computer software		Total computer software	Other intangible assets	Goodwill	Total
	Externally acquired	Internally developed				
Group	£m	£m	£m	£m	£m	£m
Cost						
At 5 April 2016	449	1,301	1,750	40	12	1,802
Additions	189	84	273	-	-	273
Disposals	(47)	(14)	(61)	-	-	(61)
At 4 April 2017	591	1,371	1,962	40	12	2,014
Accumulated amortisation and impairment						
At 5 April 2016	154	420	574	37	-	611
Amortisation charge	48	153	201	2	-	203
Impairment in the year	-	31	31	-	-	31
Disposals	(47)	(14)	(61)	-	-	(61)
At 4 April 2017	155	590	745	39	-	784
Net book value						
At 4 April 2017	436	781	1,217	1	12	1,230

Computer software capitalised during the year primarily relates to the Group's investment in infrastructure, new applications and software costs to meet the future strategic and regulatory needs of the business. The total cost at 4 April 2018 includes £281 million (2017: £248 million) of assets in the course of construction which, to the extent that they are not yet ready for use by the business, have no amortisation charged against them. For all other computer software capitalised the estimated useful lives of individual assets is predominantly 5 years.

Goodwill is held at cost less accumulated impairment. Goodwill is not amortised but is tested for impairment at least annually.

An impairment loss of £13 million (2017: loss of £31 million) was recognised in the year in respect of certain development work relating to internal systems which has now been superseded.

The Society's intangible assets are as shown above for the Group, except that they exclude £12 million (2017: £12 million) of goodwill relating to the acquisition of The Mortgage Works (UK) plc, which is only recognised at Group level.

Notes to the financial statements *continued*

26. Property, plant and equipment

2018	Branches and non-specialised buildings	Specialised administration buildings	Short leasehold buildings	Investment properties	Plant and machinery	Equipment, fixtures, fittings and vehicles	Total
Group	£m	£m	£m	£m	£m	£m	£m
Cost or valuation							
At 5 April 2017	219	182	34	8	222	853	1,518
Additions	-	-	-	-	30	145	175
Revaluation	2	-	-	1	-	-	3
Disposals	(1)	-	-	-	-	(84)	(85)
At 4 April 2018	220	182	34	9	252	914	1,611
Accumulated depreciation and impairment							
At 5 April 2017	-	81	25	-	132	421	659
Depreciation charge	-	2	1	-	21	117	141
Disposals	-	-	-	-	-	(76)	(76)
At 4 April 2018	-	83	26	-	153	462	724
Net book value							
At 4 April 2018	220	99	8	9	99	452	887

2017	Branches and non-specialised buildings	Specialised administration buildings	Short leasehold buildings	Investment properties	Plant and machinery	Equipment, fixtures, fittings and vehicles	Total (note i)
Group	£m	£m	£m	£m	£m	£m	£m
Cost or valuation							
At 5 April 2016	221	189	34	8	172	802	1,426
Additions	-	-	-	-	50	146	196
Revaluation	-	-	-	-	-	-	-
Disposals	(2)	(7)	-	-	-	(95)	(104)
At 4 April 2017	219	182	34	8	222	853	1,518
Accumulated depreciation and impairment							
At 5 April 2016	-	85	24	-	110	376	595
Depreciation charge	-	3	1	-	22	136	162
Disposals	-	(7)	-	-	-	(91)	(98)
At 4 April 2017	-	81	25	-	132	421	659
Net book value							
At 4 April 2017	219	101	9	8	90	432	859

Note:

i. Comparatives have been restated to include investment properties within property, plant and equipment as detailed in note 1.

Group property, plant and equipment at 4 April 2018 includes £2 million (2017: £2 million) of specialised administration buildings held by subsidiary undertakings.

Property, plant and equipment includes £78 million (2017: £17 million) of assets in the course of construction.

Branches and non-specialised buildings are valued annually by independent surveyors. The current use of all branches and non-specialised buildings equates to highest and best use, and there have been no changes to the valuation technique during the year.

IFRS 13 requires that all assets held at fair value are classified according to a hierarchy that reflects the significance of observable market inputs in calculating those fair values. Branches and non-specialised buildings valuations are classified within Level 2 of the fair value hierarchy.

Notes to the financial statements *continued*

27. Provisions for liabilities and charges

	Bank levy	FSCS	Customer redress	Other provisions	Total
Group	£m	£m	£m	£m	£m
At 5 April 2017	16	42	305	24	387
Provisions utilised	(37)	(26)	(110)	(14)	(187)
Charge for the year	45	-	34	6	85
Release for the year	-	(1)	(8)	(3)	(12)
Net income statement charge	45	(1)	26	3	73
At 4 April 2018	24	15	221	13	273
At 5 April 2016	22	84	227	10	343
Provisions utilised	(48)	(42)	(58)	(5)	(153)
Charge for the year	42	15	152	21	230
Release for the year	-	(15)	(16)	(2)	(33)
Net income statement charge	42	-	136	19	197
At 4 April 2017	16	42	305	24	387

The income statement charge for provisions for liabilities and charges of £25 million (2017: £136 million) includes the customer redress net income statement charge of £26 million (2017: £136 million), and the FSCS release of £1 million (2017: £nil).

The income statement charge for bank levy of £45 million (2017: £42 million) and other provisions charge of £3 million (2017: £19 million) are included within administrative expenses in the income statement.

The Group provisions for liabilities and charges include £2 million (2017: £1 million) of customer redress within its subsidiaries; all other amounts relate to the Society.

Financial Services Compensation Scheme (FSCS)

The FSCS, the UK's independent statutory compensation fund for customers of authorised financial services firms, pays compensation if a firm is unable to pay claims against it.

Following the default of a number of deposit takers, the FSCS borrowed funds from HM Treasury, approximately £5 billion of which remains outstanding at 4 April 2018 (2017: £16 billion). This balance relates solely to the failure of Bradford & Bingley plc. The FSCS recovers the interest costs associated with this loan, together with ongoing management expenses, by way of annual levies on member firms.

UK Asset Resolution (UKAR) oversees the management of the closed books of Bradford & Bingley plc. In order to repay the funds borrowed from HM Treasury, on 25 April 2017 UKAR completed the first of two separate sales of Bradford & Bingley plc portfolios. It is anticipated that the second sale transaction will be completed by September 2018.

The balance sheet amount provided by the Group of £15 million (2017: £42 million) comprises £12 million of levies relating to the 2017/18 FSCS scheme year and £3 million relating to the 2018/19 scheme year.

Customer redress

During the course of its business, the Group receives complaints from customers in relation to past sales or conduct. The Group is also subject to enquiries from and discussions with its regulators, governmental and other public bodies, including the Financial Ombudsman Service (FOS), on a range of matters. Customer redress provisions are recognised where the Group considers it is probable that payments will be made as a result of such complaints and other matters.

The Group holds provisions of £221 million (2017: £305 million) in respect of the potential costs of remediation and redress in relation to historic sales of financial products and post sales administration. This includes amounts for past sales of PPI, non-compliance with consumer credit legislation and other regulatory matters.

The net income statement charge for the year mainly reflects updated assumptions for provisions previously recognised. This includes a £28 million charge in relation to PPI, driven primarily by an increase in the anticipated total number of complaints expected to be received in light of the Financial Conduct Authority (FCA) media campaign and complaints deadline of August 2019.

It is considered appropriate for the Group to provide for the estimated total amount required to deal with all ongoing and future PPI complaints. The amount provided at 4 April 2018 therefore reflects the compensation and administrative costs associated with cases that the Group expects to uphold and the cost of processing invalid claims which the Group expects to receive. This estimate will be re-assessed on an ongoing basis in the light of actual claims levels observed.



Notes to the financial statements *continued*

27. Provisions for liabilities and charges *continued*

Other provisions

Other provisions include provisions for severance costs and a number of property related provisions. Provisions are made for the expected severance costs in relation to the Group's restructuring activities where there is a present obligation and it is probable that the expenditure will be made.

Critical accounting estimates and judgements

Customer redress provisions

Judgement is involved in determining whether a present obligation exists for customer redress, and in estimating the probability, timing and amount of any associated cash outflows.

The amount of the provision relating to past sales of PPI is calculated based upon management's best estimate of complaint volumes, average redress payments, referral rates to the Financial Ombudsman Service (FOS), uphold rates internally and with the FOS, complaint handling costs and response rates from customer contact activity relating to previous sales.

At 4 April 2018, the Group held a PPI provision of £159 million (4 April 2017: £212 million). This represents management's best estimate of future costs including the expected impact of Plevin v Paragon Personal Finance Limited. The principal uncertainty in this calculation is the impact of the ongoing FCA media campaign on complaints volumes in advance of the complaints deadline of August 2019.

The table below shows the sensitivity of the PPI provision to changes in complaints volumes, along with other significant assumptions used in calculating the provision.

	Cumulative to 31 March 2018	Future expected	Sensitivity
Claims ('000s of policies) (note i)	377	128	10 = £9m
Average uphold rate (note ii)	41%	48%	5% = £9m
Average redress per claim (note iii)	£1,141	£832	£100 = £12m

Notes:

- Claims include responses to proactive mailing.
- Future expected average uphold rate includes an anticipated increase in the overall uphold rate driven by complaints related to the Supreme Courts' decision in the case of Plevin v Paragon Personal Finance Limited ('Plevin').
- Future expected average redress reflects the expected mix of future claims upheld, including Plevin.

28. Capital and leasing commitments

Capital expenditure contracted for but not accrued is as follows:

	Group and Society	
	2018	2017
	£m	£m
Capital expenditure relating to:		
Intangibles	44	71
Property, plant and equipment	44	16
Total	88	87



Notes to the financial statements *continued*

28. Capital and leasing commitments *continued*

The Group leases various offices, branches and other premises under non-cancellable operating lease arrangements. The leases have various terms, rent escalation clauses, renewal rights, and in some cases contingent rent payable. Future minimum payments under operating leases relating to land and buildings were as follows:

	Group and Society	
	2018	2017
	£m	£m
Leasing commitments at 4 April		
Amounts falling due:		
Within one year	31	32
Between one and five years	98	96
After five years	119	133
Total	248	261

At the balance sheet date, future minimum lease payments receivable under non-cancellable operating leases were as follows:

	Group and Society	
	2018	2017
	£m	£m
Leasing payments receivable as lessor at 4 April		
Amounts falling due:		
Within one year	3	4
Between one and five years	7	7
After five years	3	3
Total	13	14
At the balance sheet date, future minimum sublease payments receivable under non-cancellable subleases	4	4

29. Contingent liabilities

During the ordinary course of business, the Group receives complaints, is subject to threatened or actual legal proceedings, and manages regulatory enquiries, reviews, challenges and investigations. It also receives and reviews allegations of wrongdoing raised by employees and others and provides support and assistance, when it is appropriate to do so, to relevant Law Enforcement Agencies in connection with investigations they may undertake. All such material matters are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of incurring a liability. Where it is concluded that it is more likely than not that a payment will be made a provision is recognised based on management's best estimate of the amount that will be payable. For other matters no provision is recognised but disclosure is made of items which are potentially material, either individually or in aggregate, except in cases where the likelihood of a liability crystallising is considered to be remote. Currently the Group does not expect the ultimate resolution of any such matters to have a material adverse impact on its financial position.

Notes to the financial statements *continued*

30. Retirement benefit obligations

Retirement benefit obligations on the balance sheet		
	Group	
	2018	2017
	£m	£m
Present value of funded obligations	6,108	6,039
Present value of unfunded obligations	12	12
	6,120	6,051
Fair value of fund assets	(5,775)	(5,628)
Deficit at 4 April	345	423

Defined contribution pension schemes

The Group operates two defined contribution pension schemes in the UK – the Nationwide Group Personal Pension Plan (GPP) and the Nationwide Temporary Workers Pension Scheme. New employees are automatically enrolled into one of these schemes, with both schemes being administered by Aviva.

Outside of the UK, there are defined contribution pension schemes for a small number of Society employees in the Isle of Man and Ireland.

Defined benefit pension schemes

The Group has funding obligations to several defined benefit pension schemes, which are administered by boards of trustees. Pension trustees are required by law to act in the interests of all relevant beneficiaries and are responsible for the investment policy of fund assets, as well as the day to day administration.

The Group's largest pension scheme is the Nationwide Pension Fund (the Fund). This is a contributory defined benefit pension scheme, with both final salary and career average revalued earnings (CARE) sections. The Fund was closed to new entrants in 2007 and since that date employees have been able to join the GPP.

Most members of the Fund can draw their pension when they reach the Fund's retirement age of 65. Pension benefits accrued before 1 April 2011 vary in methodology; however most are based on 1/54th of final salary for each year of service. Pension benefits accrued after 1 April 2011 are usually based on 1/60th of average earnings, revalued to age of retirement, for each year of service (also called CARE).

In the event that a Fund member passes away, benefits may be payable in the form of a spouse/dependant's pension, lump sum (paid within 5 years of a Fund member beginning to take their pension), or as a refund of Fund member contributions. Fund members are also able to place redundancy severance into their pension.

Approximately 31% of the Fund's retirement benefit obligations have been accrued by current employees (active Fund members), 37% by former employees (deferred Fund members) and 32% by current pensioners and dependants. The average duration of the Fund's pension obligation is approximately 22 years reflecting the split of the obligation between current employees (27 years), deferred Fund members (25 years) and current pensioners (15 years).

The Group's pension obligations include £2 million (2017: £4 million) recognised in a subsidiary company, Nationwide (Isle of Man) Limited. This obligation relates to a defined benefit scheme providing benefits based on both final salary and CARE which was closed to new entrants in 2009.

The Group's retirement benefit obligations also include £12 million (2017: £12 million) in respect of unfunded legacy defined benefit arrangements.

The amounts recognised in the income statements are as follows:

Retirement benefit obligations recognised in the income statement		
	Group	
	2018	2017
	£m	£m
Defined benefit current service cost	95	60
Defined contribution cost	78	73
Past service cost	5	4
Curtailement gains	(9)	(4)
Administrative expenses	4	4
Included in employee costs (note 8)	173	137
Interest on net defined benefit liability (note 4)	8	5
Total	181	142

Notes to the financial statements *continued*30. Retirement benefit obligations *continued*

Changes in the present value of the net defined benefit liability (including unfunded obligations) are as follows:

	Group	
	2018	2017
	£m	£m
Deficit at 5 April	423	213
Current service cost	95	60
Past service cost	5	4
Curtailement gains	(9)	(4)
Interest on net defined benefit liability	8	5
Return on assets less/(greater) than discount rate	1	(951)
Contributions by employer	(152)	(206)
Administrative expenses	4	4
Actuarial (gains)/losses on defined benefit obligations	(30)	1,298
Deficit at 4 April	345	423

Current service cost represents the increase in liabilities resulting from employees accruing service over the year. This includes salary sacrifice employee contributions.

Past service cost represents the increase in liabilities of the Fund arising from Fund members choosing to pay additional contributions (AVC's, pension credits) to boost their pension benefits.

Curtailement gains are in respect of Fund members made redundant during the year. Liabilities reduce as deferred Fund member pension benefits are linked to the Consumer Price Index (CPI), rather than the Retail Prices Index (RPI) which is used for the pension benefits for active Fund members.

The interest on the net defined benefit liability represents the annual interest accruing on the liabilities over the year, offset by the interest income on assets.

The £1 million relating to the return on assets less than the discount rate (2017: £951 million return greater than the discount rate), is driven by a reduction in long-term expected inflation over the year, partially offset by positive equity returns.

The £152 million of employer contributions includes deficit contributions of £86 million (2017: £149 million), with the remainder relating to employer contributions in respect of future benefit accrual. The Group estimates that its contributions to the defined benefit pension schemes (including deficit contributions under the current deficit recovery plan) during the year ending 4 April 2019 will be £127 million.

The £30 million actuarial gain (2017: £1,298 million loss) on the liabilities shown above is driven by:

- A £153 million gain (2017: £1,441 million loss) from changes in financial assumptions, including a 0.05% increase in the discount rate and a 0.10% decrease in assumed Retail Prices Index inflation, both of which decrease the value of the liabilities.
- A £97 million loss (2017: £144 million gain) due to updating to the latest industry standard actuarial model for projecting future longevity improvements, updating the long-term longevity improvement assumption from 1.25% to 1.50% per annum, and a Trustee decision to amend specific actuarial factors of the Fund as of 1 April 2018. The specific factors allow Fund members to take tax free cash lump sums when they retire on more favourable terms than previously.
- An experience loss on the assumptions of £26 million (2017: £1 million loss) reflecting the difference between the estimated long-term assumptions and the actual observed pension increases and deferred pension revaluations during the year ended 4 April 2018.

Changes in the present value of defined benefit obligations (including unfunded obligations) are as follows:

	Group	
	2018	2017
	£m	£m
At 5 April	6,051	4,657
Current service cost	95	60
Past service cost	5	4
Curtailement gains	(9)	(4)
Interest expense on retirement obligation	144	158
Experience losses on plan assumptions	26	1
Changes in demographic assumptions	97	(144)
Changes in financial assumptions	(153)	1,441
Benefits paid	(136)	(122)
At 4 April	6,120	6,051

Notes to the financial statements *continued*30. Retirement benefit obligations *continued*

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

	Group	
	2018	2017
	£m	£m
At 5 April	5,628	4,444
Interest income on assets	136	153
Return on assets (less)/greater than discount rate	(1)	951
Administrative expenses	(4)	(4)
Contributions by employer	152	206
Benefits paid	(136)	(122)
At 4 April	5,775	5,628

The Group chooses to offer a salary sacrifice arrangement whereby employee contributions are deducted from pay before their salary is paid each month. Therefore, no employee contributions are reported in the table above; instead all employee contributions are reflected in contributions by employer.

In line with UK pensions legislation, a formal actuarial valuation ('Triennial Valuation') of the assets and liabilities of the Fund is carried out at least every three years by independent actuaries. The 31 March 2016 Triennial Valuation of the Fund has been completed and a new schedule of regular and deficit contributions payable by the Group has been agreed with the Trustee of the Fund, with the Group expecting to pay £61 million in deficit contributions into the Fund each July until 2021 (inclusive). The next Triennial Valuation will take place on 31 March 2019.

The major categories of assets held for the pension schemes, stated at fair value, are as follows:

	Group	
	2018	2017
	£m	£m
Listed equities (quoted)	813	812
Government bonds (quoted)	3,350	2,444
Corporate bonds and other credit investments (quoted)	554	949
Infrastructure (unquoted)	324	410
Property (unquoted)	581	403
Private equity investments (unquoted)	317	330
Cash	175	365
Liability relating to repurchase agreement	(469)	(207)
Other assets and liabilities	130	122
Total	5,775	5,628

The defined benefit pension schemes do not invest in the Group's own financial instruments or property.

Assets described as quoted are based on unadjusted prices quoted in an active market and represent Level 1 assets as defined by IFRS 13. All private equity, infrastructure and property investments are Level 3 assets as defined by IFRS 13. These assets have been valued using a combination of industry standard approaches, for example discounted cashflow models.

The Fund's liabilities are partly hedged by matching assets, primarily government bonds and corporate bonds. In addition, the Fund invests in alternative matching assets such as property ground rents and property leases (included in property above) that are expected to generate inflation linked income over the long term.

The Fund also holds return-seeking assets which are primarily listed equities. These are expected to generate a return over and above the Fund's liabilities in the long term, but may create risk and volatility in the short to medium term.

During the year, the Fund diversified its portfolio further by investing in equity derivatives of £190 million, insurance linked securities of £125 million, which are included in 'Listed equities' and 'Other assets and liabilities' respectively in the table above. These investments were supported by the sale of other assets such as equities of £107 million and the utilisation of the repurchase agreement, which totals £469 million at the year ended 4 April 2018 (2017: £207 million).

In addition, the Trustee has implemented a liability hedging plan. Since July 2017, this has involved the purchase of a number of government bonds amounting to £314 million and transacting interest rate swaps amounting to £91 million, included in 'Government bonds (quoted)' in the table above. This will help reduce volatility in the deficit from changes to long-term interest rates and inflation expectations.

The investments are monitored by both the Trustee and the Group to ensure they remain appropriate given the Fund's long-term objectives.

Notes to the financial statements *continued*30. Retirement benefit obligations *continued*

The principal actuarial assumptions used are as follows:

Principal actuarial assumptions		
	2018	2017
	%	%
Discount rate	2.45	2.40
Future salary increases	3.10	3.20
Future pension increases (maximum 5%)	2.90	2.95
Retail price index (RPI) inflation	3.10	3.20
Consumer price index (CPI) inflation	2.10	2.20

The assumptions for mortality rates are based on standard mortality tables which allow for future improvements in life expectancies. The assumptions made are illustrated in the table below:

Life expectancy assumptions		
	2018	2017
	years	years (note i)
Age 60 at 4 April 2018:		
Males	28.0	27.9
Females	29.3	29.1
Age 60 at 4 April 2038:		
Males	29.2	28.8
Females	30.8	29.9

Note:

- i. Comparatives have been restated to present life expectancy assumptions on a consistent basis with estimation methodology as at 4 April 2018. This does not impact the calculation of the defined benefit obligation.

Critical accounting estimates and judgements

Retirement benefit obligations

The key assumptions used to calculate the defined benefit obligation are the discount rate, inflation assumptions (including salary increases) and mortality assumptions. If different assumptions were used, this could have a material effect on the reported obligation. The sensitivity of the results to these assumptions is as follows:

Change in key assumptions at 4 April 2018	
	(Decrease)/increase in deficit from assumption change
	£m
0.1% increase in discount rate	(135)
0.1% increase in inflation assumption	119
1 year increase in life expectancy at age 60 in respect of all members	211

The above sensitivities apply to individual assumptions in isolation. The 0.1% sensitivity to the inflation assumption includes a corresponding 0.1% increase in future salary increases and future pension increases assumptions.



Notes to the financial statements *continued*

31. Core capital deferred shares (CCDS)

Group and Society	Number of shares	CCDS	Share premium	Total
		£m	£m	£m
At 4 April 2017	5,500,000	6	525	531
Issuance	5,000,000	5	802	807
Issue costs			(13)	(13)
At 4 April 2018	10,500,000	11	1,314	1,325

In September 2017, the Society issued 5,000,000 of £1 core capital deferred shares (CCDS). These CCDS form a single series along with the CCDS previously issued in December 2013. The gross proceeds of the issuance were £807 million (£794 million net of issuance costs).

CCDS are a form of Common Equity Tier 1 (CET1) capital which have been developed to enable the Group to raise capital from the capital markets. Previously issued Tier 1 capital instruments, PIBS, no longer meet the regulatory capital requirements of CRD IV and are being gradually phased out of the calculation of capital resources under transitional rules.

CCDS are perpetual instruments. They rank *pari passu* to each other and are junior to claims against the Society of all depositors, creditors and investing members. Each holder of CCDS has one vote, regardless of the number of CCDS held.

In the event of a winding up or dissolution of the Society and if there were surplus available, the amount that the investor would receive for each CCDS held is limited to the average principal amount in issue, which is currently £129.24 per share.

There is a cap on the distributions that can be paid to holders of CCDS in any financial year. The cap is currently set at £16.06 per share and is adjusted annually in line with CPI.

A final distribution of £28 million (£5.125 per share) for the financial year ended 4 April 2017 was paid on 20 June 2017 and an interim distribution of £54 million (£5.125 per share) in respect of the period to 30 September 2017 was paid on 20 December 2017. These distributions have been recognised in the statement of movements in members' interests and equity.

Since the balance sheet date the directors have declared a distribution of £5.125 per share in respect of the period to 4 April 2018, amounting in aggregate to £54 million. This has not been reflected in these financial statements as it will be recognised in the year ending 4 April 2019, by reference to the date at which it was declared.

32. Other equity instruments

Group and Society	Total
	£m
At 4 April 2018	992
At 4 April 2017	992

Other equity instruments are Additional Tier 1 (AT1) capital instruments. AT1 instruments rank *pari passu* to each other and to PIBS. They are junior to claims against the Society of all depositors, creditors and investing members, other than the holders of CCDS.

AT1 instruments pay a fully discretionary, non-cumulative fixed coupon at an initial rate of 6.875% per annum. The rate will reset on 20 June 2019 and every five years thereafter to the five year mid swap rate plus 4.88%. Coupons are paid semi-annually in June and December.

A coupon of £34 million, covering the period to 19 June 2017, was paid on 20 June 2017 and a coupon of £34 million, covering the period to 19 December 2017, was paid on 20 December 2017. These payments have been recognised in the statement of movements in members' interests and equity.

A coupon payment of £34 million, covering the period to 19 June 2018, is expected to be paid on 20 June 2018 and will be recognised in the statement of movements in members' interests and equity in the financial year ending 4 April 2019.

The coupons paid and declared represent the maximum non-cumulative fixed coupon of 6.875%.

AT1 instruments have no maturity date. They are repayable at the option of the Society on 20 June 2019 and on every fifth anniversary thereafter. AT1 instruments are only repayable with the consent of the PRA.

If the end point CET1 ratio for the Society, on either a consolidated or unconsolidated basis, falls below 7% the AT1 instruments convert to CCDS instruments at the rate of one CCDS share for every £80 of AT1 holding.

Notes to the financial statements *continued*

33. Investments in Group undertakings

The Society's investments in Group undertakings are as follows:

2018	Shares	Loans	Total
	£m	£m	£m
At 5 April 2017	313	31,444	31,757
Additions	3	1,018	1,021
Release of impairment	-	2	2
Disposals, redemptions and repayments	(1)	(1,483)	(1,484)
At 4 April 2018	315	30,981	31,296

2017	Shares	Loans	Total
	£m	£m	£m
At 5 April 2016	313	31,089	31,402
Additions	-	1,280	1,280
Release of impairment	-	18	18
Redemptions and repayments	-	(943)	(943)
At 4 April 2017	313	31,444	31,757

The impairment release of £2 million (2017: £18 million) relates to a Group undertaking that holds a corporate loan portfolio. Loans to Group undertakings of £30,981 million at 4 April 2018 are reported net of a £1 million provision in relation to this Group undertaking.

An amount of £807 million is included within both additions and disposals, redemptions and repayments during the year ended 4 April 2018 in relation to the incorporation and subsequent liquidation of a financing subsidiary.

Subsidiary undertakings

The interests of the Society in its subsidiary undertakings as at 4 April 2018 are set out below:

Subsidiary name	Notes
Principal subsidiaries	
Derbyshire Home Loans Limited	i
E-Mex Home Funding Limited	i
Nationwide Syndications Limited	i
The Mortgage Works (UK) plc	i
UCB Home Loans Corporation Limited	i
Other subsidiaries	
Ashton Employment Limited	
Dunfermline BS Nominees Limited	ii
First Nationwide	ii
Jubilee Mortgages Limited	ii
Monument (Sutton) Limited	ii
Nationwide (Isle of Man) Limited	
Piper Javelin Holding Company Limited	ii
Piper Javelin No 1 Limited	
The Derbyshire (Premises) Limited	ii

Subsidiary name	
Dormant subsidiaries	
at.home nationwide Limited	
Confederation Mortgage Services Limited	
Ethos Independent Financial Services Limited	
Exeter Trust Limited	
LBS Mortgages Limited	
Nationwide Anglia Property Services Limited	
Nationwide Financial Service Limited	
Nationwide Home Loans Limited	
Nationwide Housing Trust Limited	
Nationwide International Limited	
Nationwide Investments (No.1) Limited	
Nationwide Lease Finance Limited	
Nationwide Mortgage Corporation Limited	
Nationwide Overseas (UK) Limited	
Nationwide Property Services (NBS) Limited	
Nationwide Trust Limited	
NBS Fleet Services Limited	
Staffordshire Leasing Limited	

Note:

- Audited accounts are prepared for all of the Group's principal subsidiaries. All principal subsidiaries are regulated entities with the exception of Nationwide Syndications Limited.
- For these companies, the Group has adopted the audit exemption for the year ended 4 April 2018 under Section 479A of the Companies Act 2006. The Society guarantees all outstanding liabilities of the exempted subsidiary undertakings.



Notes to the financial statements *continued*

33. Investments in Group undertakings *continued*

The Society directly or indirectly holds 100% of the ordinary share capital for each subsidiary undertaking. Piper Javelin Holding Company Limited was incorporated on 3 May 2017 and Piper Javelin No 1 Limited was incorporated on 17 May 2017. All of the subsidiary undertakings are limited liability companies, with the exception of First Nationwide which is an unlimited company.

The registered office for all subsidiary undertakings, other than those listed in the table below, is Nationwide House, Pipers Way, Swindon, SN38 1NW.

Subsidiary name	Registered office
Ashton Employment Limited	39/40 Upper Mount Street, Dublin 2, 662881
Dunfermline BS Nominees Limited	Caledonia House, Carnegie Avenue, Dunfermline, KY11 8PJ
Nationwide (Isle of Man) Limited	5-11 St. Georges Street, Douglas, Isle of Man, IM99 1RN

There are no significant restrictions on any of the Society's subsidiaries in paying dividends or repaying loans, subject to their financial and operating performance and availability of distributable reserves.

The Group has no material shares in associates. See note 13 for further details regarding the Group's interests in equity shares.

Subsidiaries by virtue of control

Details of consolidated and unconsolidated structured entities are provided in note 34.



Notes to the financial statements *continued*

34. Structured entities

A structured entity is an entity in which voting or similar rights are not the dominant factor in deciding control. Structured entities are consolidated when the substance of the relationship indicates control.

Consolidated structured entities

Structured entities are assessed for consolidation in accordance with the accounting policy set out in note 1. The following structured entities are consolidated in the Group's results:

Structured entity name	Nature of business	Registered office
Cromarty CLO Limited	Investment in a portfolio of European loans	6th Floor, Pinnacle 2, Eastpoint Business Park, Clontarf, Dublin 3, 662882
Nationwide Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds	Nationwide House, Pipers Way, Swindon, SN38 1NW
Silverstone Master Issuer plc Silverstone Funding (No.1) Limited	Funding vehicle	Wilmington Trust SP Services (London) Limited, Third Floor, 1 King's Arms Yard, London, EC2R 7AF

Further details on the activities of Nationwide Covered Bonds LLP, Silverstone Master Issuer plc and Silverstone Funding (No.1) Limited are given in note 14. As at 4 April 2018 the total assets of Cromarty CLO Limited were less than £1 million (2017: £4 million).

Unconsolidated structured entities

The Group has interests in structured entities which it does not sponsor or control. These largely consist of holdings of mortgage backed securities, covered bonds and CLOs issued by entities that are sponsored by other unrelated financial institutions. The entities are financed primarily by investments from investors, such as the purchase of issued notes.

The Group's direct interests in unconsolidated structured entities comprise primarily investments in asset backed securities which are reported within investment securities on the balance sheet. The total carrying value of these interests at 4 April 2018 is £3,391 million (2017: £2,845 million). Further details on the credit risk that the Group is exposed to in respect of these asset backed securities can be found in the 'Treasury assets' section of the Business and Risk Report.

Management has concluded that the Group has no control or significant influence over these entities and that the carrying value of the interests held in these entities represents the maximum exposure to loss. During the year the Group has not provided any non-contractual financial or other support to these entities and has no current intention of providing any such support. There were no transfers to or from these unconsolidated structured entities during the year.

35. Related party transactions

Subsidiary, parent and ultimate controlling party

The Group is controlled by Nationwide Building Society, the ultimate parent, which is registered in England and Wales. Details of subsidiary undertakings are shown in note 33.

Key management compensation

The directors of the Society are considered to be the key management personnel as defined by IAS 24 'Related Party Disclosures'.

Total compensation for key management personnel for the year was as follows:

Key management personnel compensation		
	2018	2017
	£'000	£'000
Short-term employee benefits	5,388	5,046
Other long-term benefits	1,015	1,012
Share based payments	1,329	1,311
Total key management personnel compensation for the year	7,732	7,369

Other long-term benefits include amounts relating to long-term bonus schemes, some of which will be paid in future periods. Further information on these can be found in note 8. Share based payments include amounts that are dependent on the performance of the CCDS. Further information is included in the Report of the directors on remuneration.

Notes to the financial statements *continued*35. Related party transactions *continued***Transactions with related parties**

A number of transactions are entered into with related parties in the normal course of business. These include derivatives, loans, deposits and the payment and recharge of administrative expenses. Further details of derivative balances outstanding between the Society and its subsidiaries are included in note 15. The outstanding balances for other related party transactions at the year end, and the associated income and expenses for the year are as follows:

Transactions with related parties				
	Society subsidiaries		Key management personnel	
	2018	2017	2018	2017
	£m	£m	£m	£m
Loans payable to the Society				
Loans outstanding at 5 April	31,444	31,089	1.1	1.4
Loans issued during the year	1,018	1,280	0.2	0.2
Loan impairment release	2	18	-	-
Loan repayments during the year	(1,483)	(943)	(0.4)	(0.5)
Loans outstanding at 4 April	30,981	31,444	0.9	1.1
Deposits payable by the Society				
Deposits outstanding at 5 April	1,569	1,162	2.2	6.3
Deposits placed during the year	18	409	10.3	4.6
Deposit repayments during the year	(170)	(2)	(8.7)	(8.7)
Deposits outstanding at 4 April	1,417	1,569	3.8	2.2
Net interest income				
Interest receivable	756	901	-	-
Interest expense	34	74	-	-
Other income and expenses				
Fees and expenses paid to the Society	17	22	-	-
Other balance sheet items				
Accrued income and expenses prepaid due to the Society	1,370	1,122	-	-
Other liabilities payable by the Society	3,207	2,805	-	-

Loans issued during the year and loan repayments during the year include £807 million in relation to the incorporation of a new financing subsidiary which was subsequently liquidated.

Transactions with key management personnel

Transactions with key management personnel are on the same terms and conditions applicable to other employees within the Group.

A register is maintained by the Society containing details of loans, transactions and arrangements made between the Society or its subsidiary undertakings and directors of the Society or persons connected with directors of the Society.

The register will be available for inspection by members at the Annual General Meeting on 19 July 2018 and during normal office hours at the Society's principal office (Nationwide House, Pipers Way, Swindon, SN38 1NW) during the period of 15 days prior to the meeting.

Transactions with Group companies

Transactions with Group companies arise in the normal course of business. Interest on outstanding loans and deposits accrues at a transfer price rate agreed between the Society and its subsidiary undertakings.

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

Notes to the financial statements *continued*

36. Notes to the cash flow statements

	Group		Society	
	2018	2017 (note i)	2018	2017 (note i)
	£m	£m	£m	£m
Non-cash items included in profit before tax				
Net increase/(decrease) in impairment provisions	20	(5)	21	(37)
Net (decrease)/increase in provisions for liabilities and charges	(114)	44	(115)	46
Impairment (recoveries)/losses on investment securities	(2)	9	(2)	9
Depreciation, amortisation and impairment	397	396	397	396
Profit on sale of property, plant and equipment	(1)	(4)	(1)	(4)
Loss on the revaluation of property, plant and equipment	-	1	-	1
Gain on the revaluation of investment properties	(1)	-	(1)	-
Interest on debt securities in issue	712	767	669	686
Interest on subordinated liabilities	175	128	175	128
Interest on subscribed capital	15	34	15	34
Losses/(gains) from derivatives and hedge accounting	1	(66)	26	(69)
Total	1,202	1,304	1,184	1,190
Changes in operating assets and liabilities				
Loans and advances to banks	17	(36)	17	(36)
Net derivative financial instruments and fair value adjustment for portfolio hedged risk	679	(1,602)	569	(595)
Loans and advances to customers	(4,313)	(8,559)	(4,367)	(7,574)
Other operating assets	970	(1,023)	1,175	(2,238)
Shares	3,461	5,827	3,461	5,827
Deposits from banks, customers and others	7,560	1,638	7,391	1,596
Debt securities in issue	(815)	2,469	(583)	2,147
Deferred taxation	(46)	(154)	-	(88)
Retirement benefit obligations	(78)	210	(77)	208
Other operating liabilities	(246)	(137)	160	(1,673)
Total	7,189	(1,367)	7,746	(2,426)
Cash and cash equivalents				
Cash	14,361	13,017	14,361	13,017
Loans and advances to banks repayable in 3 months or less (note ii)	3,078	2,226	3,062	2,206
Total	17,439	15,243	17,423	15,223

Notes:

i. Comparatives have been restated as detailed in note 1.

ii. Cash equivalents include £2,000 million (2017: £1,959 million) of cash collateral posted with bank counterparties.

The Group is required to maintain balances with the Bank of England and certain other central banks which, at 4 April 2018, amounted to £344 million (2017: £361 million). These balances are included within loans and advances to banks on the balance sheet and are not included in the cash and cash equivalents in the cash flow statement as they are not liquid in nature.

Notes to the financial statements *continued*36. Notes to the cash flow statements *continued*

Liabilities arising from financing activities				
Group	Debt securities in issue	Subordinated liabilities	Subscribed capital	Total
	£m	£m	£m	£m
At 5 April 2017 (note i)	40,339	2,940	279	43,558
Issuances	22,298	3,995	-	26,293
Redemptions	(27,737)	(1,251)	-	(28,988)
Foreign exchange	(474)	(201)	-	(675)
Fair value and other movements	(308)	14	(16)	(310)
At 4 April 2018	34,118	5,497	263	39,878

Liabilities arising from financing activities				
Society	Debt securities in issue	Subordinated liabilities	Subscribed capital	Total
	£m	£m	£m	£m
At 5 April 2017 (note i)	35,872	2,945	279	39,096
Issuances	21,389	3,995	-	25,384
Redemptions	(26,970)	(1,251)	-	(28,221)
Foreign exchange	(361)	(201)	-	(562)
Fair value and other movements	(196)	9	(16)	(203)
At 4 April 2018	29,734	5,497	263	35,494

Note:

i. Comparatives have been restated as detailed in note 1.

37. Capital management

The Group is subject to the regulatory capital requirements applied by its regulator the Prudential Regulation Authority (PRA). Regulatory capital comprises the Group's general reserve, revaluation reserve, core capital deferred shares, other equity instruments, permanent interest-bearing shares (PIBS) and subordinated debt, subject to various adjustments and transitional arrangements required by the capital rules.

During the year the Group complied with the capital requirements applied by the PRA. Further unaudited details about the Group's capital position can be found in the 'Solvency risk' section of the Business and Risk Report.

38. Registered office

Nationwide is a building society, incorporated and domiciled in the United Kingdom. The address of its registered office is:

Nationwide Building Society
 Nationwide House
 Pipers Way
 Swindon
 SN38 1NW



Other Information

Stuart, member since 2017

Other Information

- 233** Annual business statement
 - Statutory percentages
 - Other percentages
 - Information relating to directors
 - Directors' service contracts
 - Directors' share options
- 236** Underlying profit
- 236** Forward looking statements
- 236** Glossary
- 237** Index



Helping our members step-by-step

Stuart became a member at the beginning of last year following a job move from Peterborough to the heart of Wiltshire.

Nationwide has a branch in his local town, Amesbury. But there was another provider's branch there too.

"The fact that Nationwide is a member-owned organisation swung it for me. I like the fact that members can help shape the Society's products and services and I've signed up to their online community, Member Connect so that I can have my say."

Stuart has his current account with us as well as a Loyalty Saver account. He also has a Help to Buy ISA.

"My fiancée and I are getting married this year. And after that we'd love to buy a place of our own."

The wedding is going to be slightly unusual. "We're both massively into horse riding so we're planning to do the trip from church to reception on horseback." His fiancée's dress has even been designed to make that possible.

We're designed to help people buy their own homes. In 2017/18 we helped over 76,000 first time buyers do exactly that. Hopefully, we'll be able to do that for Stuart and his fiancée soon.



Annual business statement

For the year ended 4 April 2018

1. Statutory percentages

Statutory percentages		
	2018	Statutory limit
	%	%
Lending limit	6.25	25.00
Funding limit	28.98	50.00

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986 as amended by the Building Societies Act 1997 and the Modification of the Lending Limit and Funding Limit Calculations Order 2004.

The lending limit measures the proportion of business assets not in the form of loans fully secured on residential property and is calculated as $(X-Y)/X$ where:

X = business assets, being the total assets of the Group plus impairment provisions on loans and advances to customers less liquid assets, property, plant and equipment, intangible fixed assets and investment properties as shown in the Group balance sheet.

Y = the principal of, and interest accrued on, loans owed to the Group which are fully secured on residential property.

The funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals and is calculated as $(X-Y)/X$ where:

X = shares and borrowings, being the aggregate of:

- i) the principal value of, and interest accrued on, shares in the Society,
- ii) the principal of, and interest accrued on, sums deposited with the Society or any subsidiary undertaking of the Society excluding offshore deposits in an EEA subsidiary, and
- iii) the principal value of, and interest accrued under, bills of exchange, instruments or agreements creating or acknowledging indebtedness and accepted, made, issued or entered into by the Society or any such undertaking, less any amounts qualifying as own funds.

Y = the principal value of, and interest accrued on, shares in the Society held by individuals otherwise than as bare trustees (or, in Scotland, simple trustees) for bodies corporate or for persons who include bodies corporate.

The statutory limits are as laid down under the Building Societies Act 1986 as amended by the Building Societies Act 1997 and ensure that the principal purpose of a building society is that of making loans which are secured on residential property and are funded substantially by its members.

2. Other percentages

Other percentages		
	2018	2017
	%	%
As a percentage of shares and borrowings:		
• Gross capital	8.8	7.1
• Free capital (note i)	7.9	6.3
• Liquid assets	14.9	12.5
Profit for the financial year as a percentage of mean total assets	0.33	0.35
Management expenses as a percentage of mean total assets	0.90	0.94

Note:

- i. Comparatives have been restated as detailed in note 1 of the financial statements.

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

- 'Shares and borrowings' represent the total of shares, deposits from banks, other deposits, amounts due to customers and debt securities in issue
- 'Gross capital' represents the aggregate of general reserve, revaluation reserve, available for sale reserve, cash flow hedge reserve, CCDS, Additional Tier 1 capital, subscribed capital and subordinated liabilities
- 'Free capital' represents the aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment and intangible assets
- 'Liquid assets' represent the total of cash, loans and advances to banks and investment securities
- 'Mean total assets' represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year
- 'Management expenses' represent administrative expenses including depreciation, amortisation and impairment of property, plant and equipment and intangible assets.

Annual business statement *continued*

3. Information relating to directors at 4 April 2018

Information relating to directors at 4 April 2018			
Name and date of birth	Occupation	Date of appointment	Other directorships
D L Roberts BSc (Hons), MBA, PhD (Honorary), CFifs Chairman 12 September 1962	Non Executive Director	1 September 2014	Campion Willcocks Limited Beazley Furlonge Limited Beazley plc (Chairman) NHS Improvement (Associate Non Executive Director) NHS England (Vice Chairman)
R A Clifton CBE, MA (Cantab), FRSA 30 January 1958	Non Executive Director	1 July 2012	The Henley Festival Trust (Trustee) BrandCap Limited Rita Clifton Limited ASOS plc Ascential plc
R M Fyfield MA, BA (Hons) 3 May 1969	Non Executive Director	2 June 2015	
J D Garner MA (Cantab) 23 June 1969	Executive Director	5 April 2016	UK Finance British Triathlon Foundation Trust (Chairman & Trustee)
M A Lenson MBA, BA (Hons), ACIB, FSI 17 September 1954	Non Executive Director	18 July 2011	Eclipse Film Partners No. 39 LLP (Designated Member) The Invicta Film Partnership No. 37 LLP (Designated Member) The Currency Cloud Group Limited Elysian Fuels 1 LLP (In liquidation) Elysian Fuels 2 LLP (In liquidation)
K A H Parry OBE, MA (Cantab), FCA 29 January 1962	Non Executive Director	23 May 2016	Daily Mail and General Trust plc Intermediate Capital Group plc KAH Parry Limited Royal National Children's Springboard Foundation (Chairman) Standard Life Aberdeen plc Standard Life Investments (Holdings) Limited Aberdeen Asset Management plc
L M Peacock BA (Hons) 26 December 1953	Non Executive Director	18 July 2011	Standard Life Aberdeen plc Standard Life Assurance Limited (Chairman) Standard Life Savings Limited Standard Life Investments (Holdings) Limited Serco Group plc Elevate Portfolio Services Limited Aberdeen Asset Management plc The Westminster Society for People with Learning Disabilities (Chair) Hawkins Residents Limited
Baroness U K Prashar CBE PC 29 June 1948	Non Executive Director	18 January 2017	British Council (Deputy Chair and Trustee) UK Community Foundations (Honorary President)
T P Prestedge 12 February 1970	Executive Director	28 August 2007	Nationwide Anglia Property Services Limited Dunfermline BS Nominees Limited Monument (Sutton) Limited The Derbyshire (Premises) Limited The Nationwide Foundation

Annual business statement *continued*3. Information relating to directors at 4 April 2018 *continued*

Information relating to directors at 4 April 2018			
Name and date of birth	Occupation	Date of appointment	Other directorships
M M Rennison BA (Hons), FCA 9 August 1960	Executive Director	1 February 2007	Confederation Mortgage Services Limited Exeter Trust Limited First Nationwide LBS Mortgages Limited Nationwide Anglia Property Services Limited Nationwide Housing Trust Limited Nationwide Investments (No.1) Limited Nationwide Lease Finance Limited Nationwide Mortgage Corporation Limited Nationwide Syndications Limited NBS Fleet Services Limited Staffordshire Leasing Limited Arkose Funding Limited Piper Javelin No.1 Limited Piper Javelin Holding Company Limited
C S Rhodes BSc (Hons), ACA 17 March 1963	Executive Director	20 April 2009	at.home Nationwide Limited Derbyshire Home Loans Limited E-Mex Home Funding Limited Jubilee Mortgages Limited The Mortgage Works (UK) plc UCB Home Loans Corporation Limited The Lending Standards Board Limited National Numeracy (Trustee)
T J W Tookey BSc (Hons), FCA 17 July 1962	Non Executive Director	2 June 2015	Quilter plc (Executive Director and Chief Financial Officer) Westmoreland Court Management (Beckenham) Limited
G Waersted MBA 16 March 1955	Non Executive Director	1 June 2017	Telenor ASA (Chair) Petoro AS (Chair) Lukris Invest AS

Documents may be served on any of the Directors c/o Addleshaw Goddard, One St Peter's Square, Manchester M2 3DE.

Directors' service contracts

Executive directors' terms and conditions of employment are detailed in their individual contracts or service agreements which include a notice period of 12 months from the Society to the individual and a notice period of six months from the individual to the Society. The notice period offered to any new recruit would be in line with this approach.

Directors' share options

A proportion of executive directors' variable pay is linked to the value of the Society's core capital deferred shares (CCDS), details of which have been provided in the Report of the directors on remuneration. For 2017/18, the Directors' Performance Award (DPA) was the only variable pay plan in which directors participated. 20% of awards under the DPA will be paid upfront in June 2018, 20% is retained until 2019 and the remaining 60% is deferred, payable in five equal amounts between years three and seven following the date of the award. 50% of the upfront portion and 60% of the deferred portion is linked to the value of the Society's CCDS.

No Directors held securities in Nationwide Building Society during the year.



Underlying profit

Profit before tax shown on a statutory and underlying basis is set out on page 26. Statutory profit before tax of £977 million has been adjusted for a number of items to derive an underlying profit before tax of £1,022 million. The purpose of this measure is to reflect management's view of the Group's underlying performance and to assist with like for like comparisons of performance across periods. Underlying profit is not designed to measure sustainable levels of profitability as it potentially requires exclusion of non-recurring items even though they are closely related to (or even a direct consequence of) the Group's core business activities.

Nationwide has developed a financial performance framework based on the fundamental principle of maintaining its capital at a prudent level in excess of regulatory requirements. The framework provides parameters which allow it to calibrate future performance and help ensure that it achieves the right balance between distributing value to members, investing in the business and maintaining financial strength. The most important of these parameters is underlying profit which is a key component of Nationwide's capital. We believe that a level of underlying profit of approximately £0.9 billion to £1.3 billion per annum over the cycle would meet the Board's objective for sustainable capital strength. This range will vary from time to time, and whether our profitability falls within or outside this range in any given financial year or period will depend on a number of external and internal factors, including a conscious decision to return value to members or to make investments in the business. It should not be construed as a forecast of the likely level of Nationwide's underlying profit for any financial year or period within a financial year.

Forward looking statements

Certain statements in this document are forward looking with respect to plans, goals and expectations relating to the future financial position, business performance and results of Nationwide. Although Nationwide believes that the expectations reflected in these forward-looking statements are reasonable, Nationwide can give no assurance that these expectations will prove to be an accurate reflection of actual results. By their nature, all forward looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of Nationwide including, amongst other things, UK domestic and global economic and business conditions, market related risks such as fluctuation in interest rates and exchange rates, inflation/deflation, the impact of competition, changes in customer preferences, risks concerning borrower credit quality, delays in implementing proposals, the timing, impact and other uncertainties of future acquisitions or other combinations within relevant industries, the policies and actions of regulatory authorities, the impact of tax or other legislation and other regulations in the jurisdictions in which Nationwide operates. As a result, Nationwide's actual future financial condition, business performance and results may differ materially from the plans, goals and expectations expressed or implied in these forward-looking statements. Due to such risks and uncertainties Nationwide cautions readers not to place undue reliance on such forward-looking statements.

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

This document does not constitute or form part of an offer of securities for sale in the United States. Securities may not be offered or sold in the United States absent registration or an exemption from registration. Any public offering to be made in the United States will be made by means of a prospectus that may be obtained from Nationwide and will contain detailed information about Nationwide and management as well as financial statements.

Glossary

The glossary for Annual Report and Accounts 2018 is available at: nationwide.co.uk/about/corporate-information/results-and-accounts



Index

Accounting policies, Statement of (note 1)	174
Additional Tier 1 capital (note 32)	225
Administrative expenses (note 8)	190
Annual business statement	233
Audit Committee report	59
Auditors' report, Independent	159
Balance sheets	170
Board of directors	34
Board IT and Resilience Committee report	73
Board Risk Committee report	69
Business and Risk Report	97
Business model	6
Business Risk	151
Capital and leasing commitments (note 28)	219
Capital management (note 37)	231
Cash flow statements	173
Chairman's letter	7
Chief Executive's review	9
Classification and measurement (note 12)	197
Commercial and other lending, credit risk	120
Conduct and compliance risk	155
Consumer banking, credit risk	116
Contingent liabilities (note 29)	220
Core capital deferred shares (CCDS) (note 31)	225
Corporate governance, Report of the directors on	41
Credit risk	105
Customer redress (note 27)	218
Debt securities in issue (note 18)	205
Deposits from banks (note 16)	204
Derivative financial instruments (note 15)	202
Derivatives and hedge accounting, Gains/losses from (note 7)	189
Directors, information relating to	234
Directors' report	94
Directors' service contracts	235
Directors' share options	235

Index *continued*

Employees (note 9)	192
Fair value hierarchy of financial assets and liabilities held at fair value (note 21)	208
Fair value of financial assets and liabilities held at fair value – Level 3 portfolio (note 22)	210
Fair value of financial assets and liabilities measured at amortised cost (note 23)	213
Fee and commission income and expense (note 5)	188
Financial review	26
Financial services compensation scheme (FSCS) (note 27)	218
Forward looking statements	236
Glossary	236
Group directors	34
Highlights, 2018	1
Impairment provisions on loans and advances to customers (note 10)	192
Income statements	168
Intangible assets (note 25)	216
Interest expense and similar charges (note 4)	187
Interest receivable and similar income (note 3)	187
Investments in Group undertakings (note 33)	226
Investment securities (note 13)	199
Judgements in applying accounting policies and critical accounting estimates (note 2)	187
Leasing commitments, Capital and (note 28)	219
Liquidity and funding risk	130
Loans and advances to customers (note 14)	199
Market risk	145
Model risk	152
Nomination and Governance Committee report	77
Notes to the accounts	174
Notes to the cash flow statements (note 36)	230
Offsetting financial assets and financial liabilities (note 24)	215
Operational risk	152
Other deposits (note 17)	204
Other operating expense/income (note 6)	188
Other equity instruments (note 32)	225
Pension risk	149
Principal risks	98
Property, plant and equipment (note 26)	217

*Index continued*

Provisions for liabilities and charges (note 27)	218
Registered office (note 38)	231
Related party transactions (note 35)	228
Remuneration, Report of the directors on	83
Residential mortgages, credit risk	108
Retirement benefit obligations (note 30)	221
Risk management	101
Risk overview	25
Solvency risk	141
Statements of comprehensive income	169
Statements of movements in members' interests and equity	171
Statutory percentages	233
Strategic report	4
Structured entities (note 34)	228
Subordinated liabilities (note 19)	206
Subscribed capital (note 20)	207
Taxation (note 11)	194
Top and emerging risks	104
Treasury assets, credit risk	126

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We also accept calls via BT Text Relay. Just dial **18001** followed by the full telephone number you wish to ring.

Nationwide Building Society

Head Office: Nationwide House, Pipers Way, Swindon, SN38 1NW
nationwide.co.uk

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