Nationwide

Building Society

Interim Results

For the period ended **30 September 2018**

Contents

Introduction
Unless otherwise stated, the income statement analysis compares the period from 5 April 2018 to 30 September 2018 to the corresponding six months of 2017 and balance sheet analysis at 30 September 2018 with comparatives at 4 April 2018.

Underlying profit
Profit before tax shown on a statutory and underlying basis is set out on page 9. Statutory profit before tax of £516 million has been adjusted to derive an underlying profit before tax of £460 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 that 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. The components of underlying profit have changed in the period to more accurately reflect underlying performance. For more information see page 9 of the Financial Review.

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 medium-term 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.

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 its management as well as financial statements.

Nationwide reports strong trading and announces intention to launch current account for small businesses

Intends to launch a business banking current account, bringing Nationwide's service and value to small businesses

Helped 1 in 5 first time buyers; grew member deposits by £5.1bn; more people chose Nationwide for current accounts than any other high street brand[1]

Returned £330m to members in member financial benefit

Profitability in line with expectations as Society invests for the future

- Underlying profit of £460m (H1 2017/18: £589m) and statutory profit of £516m (H1 2017/18: £628m), in line with expectations
- Profits are after a charge of £135m from asset write-offs and incremental technology spend as Society increases investment to meet members' future needs
- Costs flat, excluding asset write-offs and additional technology investment; on track for £100m sustainable saves in 2018/19
- UK leverage ratio of 5.0% (4 April 2018: 4.9%); CET1 ratio at 31.7% (4 April 2018: 30.5%)

Investing and innovating for members

- Over the next five years, Society to invest an additional £1.3bn in technology (announced in September), taking total investment in the Society to £4.1bn over this period
- Intention to launch business banking current account, bringing leading service, scale and mutuality to small businesses
- Remain committed to £350m in ongoing investment programme in branch network

Rewarded members with £330m in member financial benefit

- Members benefited from better rates, fees and incentives including an additional £250m (H1 2017/18: £180m) in deposit interest compared to the market average
- Members chose to do more with us: engaged members increased to 9.1m (March 2018: 8.9m) and committed members to 3.3m (March 2018: 3.2m)[2]

No 1 for service and trust

- Number one for customer satisfaction among our high street peer group with a lead of 4.2% (March 2018: 4.6%)[3]
- Joint fifth in the Institute of Customer Service's UK Customer Satisfaction Index of all sectors, up from joint seventh
- The UK's most trusted financial brand[4]

Provided members with average deposit rates more than 50% higher than the market average[5]

- Grew member deposits[6] by £5.1bn (H1 2017/18: £1.8bn)
- 595,000 people opened the new Single Access and Loyalty ISAs (H1 2017/18: 535,000); Nationwide attracted 66% market share of the growth in ISA deposits
- Market share of stock of deposits maintained at over 10%

Helped more people into a home, including a record 40,500 first time buyers

- Total gross mortgage lending up to £17.3bn (H1 2017/18: £16.7bn)
- Maintained share of stock of lending in a competitive mortgage market at 13.0% (March 2018: 12.9%)
- 1 in 5 first time buyers chose a Nationwide mortgage - a record 40,500 (H1 2017/18: 39,500)

More people opened current accounts with the Society than any other high street brand[1]

- 399,000 new current accounts opened by Nationwide (H1 2017/18: 427,000), maintaining market share of openings[1]
- 1 in 5 of all switchers moved to Nationwide; market share of switchers increased to 21.5% (H1 2017/18: 20.2%)[7]
- Market share of stock of main standard and packaged current accounts maintained at 7.9%[8]

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[1] Sources: CACI (Apr-Aug 2018) and eBenchmarkers (Apr-Sep 2018).
[2] Engaged members are those who have their main personal current account with us, a mortgage with a balance greater than £5,000, or a savings account with a balance greater than £1,000. Before 2018/19, the savings threshold was £5,000. On the previous measure, there were 8.1 million engaged members at 31 March 2018. Committed members are those with an engaged membership product plus at least one other product.
[3] © GfK 2018, Financial Research Survey (FRS), 12 months ending 30 September 2018 and 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, NatWest, Santander and TSB).
[4] Source: Nationwide Brand and Advertising tracker - compiled by Independent Research Agency, based on all consumer responses, 12 months ending September 2018. Financial brands included Nationwide, Barclays, Co-operative Bank, First Direct, Halifax, HSBC, Lloyds, NatWest, TSB and Santander.
[5] Market average interest rates are based on Bank of England whole of market average interest rates, adjusted to exclude Nationwide's balances.
[6] Member deposits includes current account credit balances.
[7] Source: CASS BACS Payments Schemes monthly CASS switching market data (Apr-Sep 2018).
[8] Source: CACI (Aug 2018).

Joe Garner, Chief Executive, Nationwide Building Society, said:

"Nationwide Building Society exists to serve our members, communities and society. In the last six months, we have continued to grow strongly, our members have continued to benefit from competitive rates, attractive products and leading service, and we have improved our already robust financial position. The strength of our business means we are well placed to invest confidently in the future of the Society, and we have committed to invest an additional £1.3 billion over the next five years to transform our technology estate and capabilities. This will take our total investment over the next five years to £4.1 billion and will ensure the Society makes the most of the opportunities ahead. We will develop new propositions, further enhance our service, simplify our operations and build new skills for the future.

"This conscious decision to increase our investment is underpinned by the continued strength of our performance over the last six months. We continue to lead our high street peer group for customer satisfaction by a significant margin[1]. We protected savers and rewarded loyal members, delivering £330 million in member financial benefit through better rates, fees and incentives than the market average over the half year. The special rate ISA, available exclusively to our loyal members, contributed to a £5.1 billion rise in deposits. We continued to support first time buyers, helping a record 40,500 into a home of their own – 1 in 5 of all first time homeowners. And more people are choosing Nationwide for their everyday finances, with almost 400,000 current accounts opened with us so far this year.

"Our success in the personal current account market, where we have grown accounts by 70% in the last five years, has given us the confidence to accelerate our entry into the business banking market. The funding available from the Banking Competition Remedies remains important to us as it will allow us to bring our proposition to market faster and with greater impact. 50,000 members a year ask us to provide business banking, and we believe we can offer a compelling mutual alternative to Britain's currently underserved 5.6 million small businesses. Nationwide is here for the long term and we believe we can make a lasting difference in this market, as we have in the personal current account market, thanks to the combination of leading service and good value we can offer. This is the logical next step in bringing mutuality to more people.

"Our first half profits were lower than last year because we have chosen to increase our investment in the future of our Society. As a mutual, we do not judge our success by profit growth alone, but by how we manage our profits to serve our members' interests. We do that by maintaining the high-quality service and excellent value products our members prize today, while also investing in building new propositions, services, and skills, so we can meet members' future needs."

Mark Rennison, Chief Financial Officer, Nationwide Building Society, said:

"These results show that Nationwide is built to last and continues to provide a secure home for members' money. Trading was strong in the first six months and we have strengthened our CET 1 capital ratio to 31.7%, and UK leverage ratio to 5.0%. This performance gives us the confidence to increase our investment in our future, which will allow us to pursue new opportunities for the benefit of our members. As a building society we do not aim to maximise profit and our decision to increase investment was in the full knowledge that it would impact on our profitability. If we exclude the charge we've recognised for asset write-offs and incremental technology spend, profits are in line with last year and we have held costs flat while servicing rising business volumes. We have continued to make the Society more efficient and are not only on track to deliver our targeted sustainable saves but have also set a more ambitious target for saves by 2023.

"As a mutual we take decisions on rates that are in the long-term interests of our membership, rather than pursuing short-term gain. We anticipate this, and the competitive market, will lead to further pressure on margins in the second half of the year. Despite the uncertain political and economic environment, our financial strength gives us confidence that we can continue to be there for our members in the months and years ahead in the same way that we have always been."

[1] © GfK 2018, Financial Research Survey (FRS), 12 months ending 30 September 2018 and 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, NatWest, Santander and TSB).

Financial summary

	Half year to 30 September 2018		Half year to 30 September 2017	
Financial performance	£m		£m	
Total underlying income	1,590		1,639	
Underlying profit before tax (note i)	460		589	
Statutory profit before tax	516		628	
Mortgage lending	£bn	%	£bn	%
Group residential – gross/*market share (note ii)*	17.3	*12.9*	16.7	*13.2*
Group residential – net/*market share (note ii)*	3.6	*13.7*	3.9	*15.2*
	%		%	
Average loan to value of new business (by value)	71		71	
Deposit balances	£bn	%	£bn	%
Member deposits balance movement/*market share* (notes ii and iii)	5.1	*17.9*	1.8	*4.5*
Key ratios	%		%	
Cost income ratio – underlying basis (note i)	69.2		58.9	
Cost income ratio – statutory basis	67.2		57.7	
Net interest margin	1.27		1.34	

	30 September 2018		5 April 2018 (note iv)		4 April 2018	
Balance sheet	£bn	%	£bn	%	£bn	%
Total assets	238.3		228.9		229.1	
Loans and advances to customers	195.0		191.5		191.7	
Member deposits/*market share* (notes ii and iii)	153.1	*10.1*	148.0	*10.0*	148.0	*10.0*
Asset quality	%				%	
Residential mortgages						
Proportion of residential mortgage accounts 3 months+ in arrears	0.42				0.43	
Average indexed loan to value (by value)	56				56	
Consumer banking						
Proportion of customer balances with amounts past due more than 3 months (excluding charged off balances) (note v)	1.53				1.56	
Key ratios	%		%		%	
Capital						
Common Equity Tier 1 ratio (note vi)	31.7		30.4		30.5	
UK leverage ratio (note vii)	5.0		4.9		4.9	
CRR leverage ratio (note viii)	4.6		4.6		4.6	
Other balance sheet ratios						
Liquidity coverage ratio	131.9				130.3	
Wholesale funding ratio (note ix)	28.6				28.2	

Notes:

i. Underlying profit represents management's view of underlying performance. In order to provide a more meaningful presentation of performance the following items are excluded from statutory profit to arrive at underlying profit:
   a. FSCS costs arising from institutional failures
   b. Gains from derivatives and hedge accounting.

   Comparatives have been restated to reflect changes to the definition of underlying profit. Further information can be found in the Financial review.

ii. The calculation of market share for mortgage lending and deposit balances has been refined to better reflect the position at the reporting date, with comparatives restated accordingly. Market data is available at calendar month ends and therefore market share for the half year is for the period 1 April to 30 September.

iii. Member deposits include current account credit balances.

iv. Balances as at 5 April 2018 reflect the impact of applying IFRS 9: Financial Instruments. Further information can be found in note 2 to the Financial statements.

v. 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.

vi. The Common Equity Tier 1 (CET1) ratio has been calculated under CRD IV on an end point basis. For 30 September 2018 and 5 April 2018, IFRS 9 transitional arrangements have been applied.

vii. 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. For 30 September 2018 and 5 April 2018, IFRS 9 transitional arrangements have been applied.

viii. 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. For 30 September 2018 and 5 April 2018, IFRS 9 transitional arrangements have been applied.

ix. The wholesale funding ratio includes all balance sheet sources of funding (including securitisations).

Chief Executive's review

Our purpose, **building society, nationwide,** describes our aspirations to grow the Society for the benefit of our members, customers, colleagues, and society more generally. It is underpinned by five strategic cornerstones that describe what we aim to do and how we will do it.

Built to last – strong finances and a low risk profile

We are financially stronger than ever, with our UK leverage ratio at 5.0%, and our CET1 capital ratio at 31.7%. Our loan book remains low risk, with the average loan to value ratio for new lending stable at 71%.

Our financial and trading strength has put us in a very strong position to increase investment in technology by £1.3 billion, taking our total planned investment in the Society to £4.1 billion in the coming five years. This investment will impact profitability over the medium term. Underlying profit for H1 2018/19 of £460 million (H1 2017/18: £589 million) is in line with our expectations and includes a charge of £135 million associated with this investment. Excluding this charge, profits are in line with last year and we delivered flat costs of £965 million (H1 2017/18: £966 million).

As we've said in the past, our aim is not to maximise profits, but manage our profits in our members' interests – through a balance of maintaining our financial strength, rewarding members, and investing to meet their future needs. We have consciously continued to protect savers and reward loyal members in the first half of the year which has reduced margins, in line with expectations. We expect this to continue into the second half of the year as we balance the needs of our members in a competitive market.

Building thriving membership – attracting more people to mutuality

We continue to be true to our founding purpose of helping people into homes of their own: record numbers of first time buyers chose a mortgage with Nationwide, benefiting from a package that includes £500 cashback and a free valuation. We're testing a retirement interest only mortgage with our members alongside our existing equity release mortgage for people in later life. We've made it quicker and easier for members to remortgage online and also enhanced our buy-to-let proposition. As a result, our gross prime mortgage lending was broadly in line with last year at £15.2 billion (H1 2017/18: £15.0 billion). We increased gross buy-to-let lending to £2.1 billion (H1 2017/18: £1.7 billion).

We continued to reward members by launching good value products including our Loyalty ISA and a new children's account, with rates of up to 3.5%. Our commitment to supporting savers helped us increase member deposits by £5.1 billion (H1 2017/18: £1.8 billion) and meant that, over the past six months, we attracted almost 18% of the growth in deposits in the UK (H1 2017/18: 4.5%). We also rewarded members with £250 million additional deposit interest (H1 2017/18: £180 million), with average deposit rates more than 50% higher than the market average[1].

More people chose to open a current account with us in the first half of the year than with any other high street brand[2], and we attracted more than one in five current account switchers[3]. Our stock of all current accounts continues to grow and now stands at 7.6 million and we've grown our share of main standard and packaged current accounts from 6% five years ago to around 8% today.

Building legendary service – number 1 for service and trust

The quality of our service is a fundamental part of our relationship with our members. We believe it's a major factor in attracting new members and keeping existing ones, which is why we work hard to give our members outstanding service whenever they engage with us. We have been number 1 for customer satisfaction among our high street peer group for more than six years[4] and are recognised as the most trusted financial brand in the UK[5]. We also improved our performance in the Institute of Customer Service's UK Customer Satisfaction Index from joint seventh to joint fifth between January and July 2018.

We know that members' expectations of service are constantly rising, and we must rise to meet them. This was an important factor in our decision to invest in our technology for the future. However, we know our members value the personal service they get in branches, which is why our £4.1 billion investment also includes £350 million to enhance our branch network.

[1] Market average interest rates are based on Bank of England whole of market average interest rates, adjusted to exclude Nationwide's balances.
[2] Sources: CACI (Apr-Aug 2018) and eBenchmarkers (Apr-Sep 2018).
[3] Source: CASS BACS Payments Schemes monthly CASS switching market data (Apr-Sep 2018).
[4] © GfK 2018, Financial Research Survey (FRS), lead held over period 12 months ending 31 March 2013 to 12 months ending 30 September 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, 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 (Lloyds TSB prior to Apr 15), NatWest and Santander).
[5] Source: Nationwide Brand and Advertising tracker - compiled by Independent Research Agency, based on all consumer responses, 12 months ending September 2018. Financial brands included Nationwide, Barclays, Co-operative Bank, First Direct, Halifax, HSBC, Lloyds, NatWest, TSB and Santander.

Chief Executive's review (continued)

Building PRIDE – recognising and investing in our people

Everything we achieve as a Society is down to the hard work and commitment of our colleagues. We place great importance on the culture of the Society and the behaviours and values that underpin it; Nationwide believes fundamentally in inclusion and was proud to be one of the first businesses to sign the Race at Work Charter.

As part of our technology investment we will be creating up to 1,000 new roles.

Building a national treasure – reflecting the social purpose that lies at the heart of our mutuality

We continue to invest in our communities through our social investment programme. We've moved from pilot to implementation in our £20 million, five-year community funding programme, which centres on helping people into a place fit to call home, with 34 projects chosen by our members receiving a total of almost £1 million in the last six months. In Swindon, we continue to work in partnership with the borough council to help to develop a community of up to 250 homes. We are committed to help raise standards in the private rented sector, confirming our support for indefinite tenancies in the government's consultation. In October, we launched our Open Banking for Good challenge to find solutions to financial capability issues using the functionality of Open Banking.

Outlook

Looking ahead, the economic outlook remains mixed. While the UK economy has continued to grow, with employment at or close to historic highs and wages rising in real terms, obvious challenges remain. Most notably uncertainties, including those surrounding Brexit, appear to be holding back investment and dampening activity in the housing market. Despite this, we expect the economy to grow in the quarters ahead – more slowly at first, and at a faster pace as the level of uncertainty eases. We expect the housing market to mirror trends in the wider economy. Against this backdrop, the Society is strong and secure, with a growing membership and business, and is well placed to support our members with the products and services they need to manage their financial lives.

Financial review

In summary

Underlying profit: £460m (H1 2017/18: £589m)

Statutory profit: £516m (H1 2017/18: £628m)

UK leverage ratio: 5.0% (4 April 2018: 4.9%)

As the world's largest building society, Nationwide's aim is to strike a balance between the value we return to members through good value products and services, the profits we retain to fund future growth and sustain strong capital ratios and the level of investment that we make for the benefit of members. We therefore do not aim to maximise profit.

Decisions to distribute value to members, invest in the Society and retain profits are guided by our Financial Performance Framework. We remain committed to this framework and expect to continue our recent track record of improving capital ratios, excluding the impact of any capital calls we choose to make and proposed regulatory changes.

Trading performance for the period has been robust with one of the strongest ever gross lending performances in the first half of the financial year at £17.3 billion (H1 2017/18: £16.7 billion), and a growth in member deposits of £5.1 billion (H1 2017/18: £1.8 billion), as we continued to offer our members competitive products.

Underlying profit for the period has reduced by 22% to £460 million (H1 2017/18: £589 million). This is principally due to a charge of £135 million driven by asset write-offs and additional investment in technology, in line with our recent technology strategy announcement.

We continue to make good progress on our efficiency programme and are on track to deliver £100 million of sustainable saves this year. To date we have delivered over half our previous target of £300 million of sustainable saves by 2022 and have now revised our target to £500 million to be delivered by 2023.

Nationwide's UK leverage ratio is 5.0%, well in excess of current and anticipated regulatory requirements.

On 5 April 2018 we implemented IFRS 9: Financial Instruments. The total impact on members' interests and equity, net of deferred tax, was a reduction of £162 million. There has been no restatement of comparatives following adoption of IFRS 9. Where useful for the interpretation of balances or movements, we have highlighted the impact on the Group's balance sheet and members' interests and equity at 5 April 2018.

Financial review (continued)

Income statement

Underlying and statutory results	Half year to 30 September 2018 £m	Half year to 30 September 2017 £m
Net interest income	1,495	1,514
Net other income	95	125
Total underlying income	1,590	1,639
Underlying administrative expenses	(1,100)	(966)
Impairment losses (note i)	(45)	(59)
Underlying provisions for liabilities and charges	15	(25)
Underlying profit before tax (note ii)	460	589
Financial Services Compensation Scheme (FSCS)	9	3
Gains from derivatives and hedge accounting (note iii)	47	36
Statutory profit before tax	516	628
Taxation	(129)	(157)
Profit after tax	387	471

Net Interest Margin: 1.27% (H1 2017/18: 1.34%)

Underlying Cost Income Ratio: 69.2% (H1 2017/18: 58.9%)

Statutory Cost Income Ratio: 67.2% (H1 2017/18: 57.7%)

Notes:

i. Under IFRS 9, the recognition and measurement of expected credit losses differs from under IAS 39. As prior period amounts have not been restated, impairment losses on loans and advances in the comparative period remain in accordance with IAS 39 and are therefore not directly comparable with impairment losses recorded for the current period.

ii. Underlying profit represents management's view of underlying performance. In order to provide a more meaningful presentation of performance the following items are excluded from statutory profit to arrive at underlying profit:
- FSCS costs arising from institutional failures, which are included within provisions for liabilities and charges.
- Gains from derivatives and hedge accounting, which are presented separately within total income.

iii. 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.

The components of underlying profit have been changed in the period to reflect more appropriately ongoing business performance. Underlying profit now includes the bank levy and FSCS management expenses, which were previously excluded. The impact of this change at the half year is not significant, with H1 2017/18 comparatives restated to increase the previously reported underlying profit by £1 million to £589 million. The impact of this change for the full financial year will be more significant, as the bank levy expense (£45 million in 2017/18), which is incurred in the second half of the year, will be reported within underlying profit.

Total income and margin

Net interest margin for the period was 1.27% compared to 1.34% for H1 2017/18 and 1.31% for our last full financial year. Gradual pressure on margin continues to be driven by intense competition in retail lending markets generally, and particularly in relation to both prime and buy to let mortgages. Attractive new business pricing, combined with a base rate change in the period, has encouraged product switching and refinancing, with £10.5 billion of prime mortgage customer balances switching to a new Nationwide product in the period (H1 2017/18: £8.7 billion) and legacy base mortgage rate (BMR) balances continuing to run off. BMR balances at 30 September 2018 were £20.7 billion (30 September 2017: £26.3 billion; 4 April 2018: £22.7 billion).

The decline in mortgage margins has been only partially offset by a reduction in our cost of funding as we have continued to manage savings pricing in line with our commitment to provide good long-term value for members. During the period depositors have continued to earn average rates more than 50% higher than market average[1].

Net other income has decreased to £95 million (H1 2017/18: £125 million), predominantly due to the prior period including a one-off gain of £26 million from the sale of our investment in VocaLink.

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

Financial review (continued)

Member financial benefit

We provide value to members through the highly competitive mortgage, savings and banking products that we offer as a direct result of being a member-owned business. The calculation method used to quantify member financial benefit is described in full in the Financial review section of the Annual Report and Accounts 2018. In summary, we quantify the financial benefit of being a member by comparing the following to industry benchmarks:

- interest rates on mortgages, unsecured lending and retail deposits; and
- the fees we charge and incentives we provide to members.

During the period we have provided members with a financial benefit of £330 million (H1 2017/18: £245 million), including £250 million (H1 2017/18: £180 million) relating to higher interest paid to depositors. In addition, since making personal loans a member only proposition, we have increased the level of member financial benefit by offering our lowest ever rates. This reflects our ongoing commitment to delivering long-term value to members despite strong levels of competition in our core markets.

Administrative expenses

Administrative expenses include the impact of incremental expenditure and write-offs associated with our recent Technology Strategy announcement. The strategy incorporates £1.3 billion of incremental expenditure to be incurred over 5 years targeting the simplification of our technology estate alongside investment in digital service and data capabilities. During the period we have recognised a charge of £135 million comprising direct expenditure of £31 million in connection with the programme and asset write-offs and impairments of £104 million.

Excluding this charge, the remainder of our cost base at £965 million was flat by comparison with £966 million reported in H1 2017/18. Our continued focus on efficiency has allowed us to absorb inflation, volume growth and the impact of prior year investment. We are on track to deliver £100 million of in year sustainable saves and have now delivered over half of our original target of £300 million sustainable saves by 2022; we have therefore revised our target to £500 million sustainable saves by 2023.

Following a recent High Court case concerning industry-wide inequalities in the calculation of Guaranteed Minimum Pensions (GMP), a one-off charge is expected to be recognised in the second half of the year in respect of past service costs. The exact impact is currently being assessed but is not expected to be material. Further details are included in note 24.

Impairment losses on loans and advances to customers

Impairment losses have decreased by £14 million to £45 million (H1 2017/18: £59 million) largely due to the prior period including additional retail impairments from updates to provision assumptions to reflect economic conditions.

Impairment losses / (reversals)	**Half year to 30 September 2018 £m**	Half year to 30 September 2017 £m
Residential lending	4	12
Consumer banking	38	52
Retail lending	**42**	64
Commercial and other lending	3	(5)
Impairment losses on loans and advances	**45**	59

Note:
Under IFRS 9, the recognition and measurement of expected credit losses differs from under IAS 39. As prior period amounts have not been restated, impairment losses in the comparative period are therefore not necessarily comparable to impairment losses recorded for the current period.

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. During the period there has been a release of £15 million (H1 2017/18: £25 million charge), reflecting latest estimates of the liabilities. More information is included in note 17.

Financial review (continued)

Taxation

The tax charge for the period of £129 million (H1 2017/18: £157 million) represents an effective tax rate of 25.1% (H1 2017/18: 25.0%) which is higher than the statutory UK corporation tax rate of 19% (H1 2017/18: 19%). The effective tax rate is higher due to the banking surcharge, equivalent to £25 million (H1 2017/18: £33 million), and the effect of non-taxable customer redress releases and disallowable expenses of £1 million credit and £7 million charge respectively (H1 2017/18: £1 million charge and £4 million charge). Further information is provided in note 9.

Balance sheet

Total assets have increased by £9.2 billion during the period to £238.3 billion (4 April 2018: £229.1 billion) with £3.6 billion of net mortgage lending (H1 2017/18: £3.9 billion). Mortgage lending has been funded by a strong growth in retail deposit balances, with member deposits growing by £5.1 billion to £153.1 billion (4 April 2018: £148.0 billion) and our market share of UK deposits increasing to 10.1% (31 March 2018: 10.0%). Of the growth in member deposits, £1.9 billion is attributable to current account balances, with our share of current account switchers increasing to 21.5% during the period (H1 2017/18: 20.2%).

Liquidity coverage ratio: 131.9%
(4 April 2018: 130.3%)

Assets	30 September 2018 £m	%	5 April 2018 (note i) £m	%	4 April 2018 £m	%
Residential mortgages (note ii)	180,967	*93*	177,303		177,299	*92*
Commercial and other lending	10,369	*5*	10,711		10,716	*6*
Consumer banking	4,316	*2*	4,107		4,107	*2*
	195,652	*100*	192,121		192,122	*100*
Impairment provisions	(635)		(629)		(458)	
Loans and advances to customers	195,017		191,492		191,664	
Other financial assets	40,373		34,806		34,841	
Other non-financial assets	2,946		2,639		2,593	
Total assets	238,336		228,937		229,098	
Asset quality						
Residential mortgages (note ii):	%				%	
Proportion of residential mortgage accounts 3 months+ in arrears	0.42				0.43	
Average indexed loan to value (by value)	56				56	
Consumer banking:						
Proportion of customer balances with amounts past due more than 3 months (excluding charged off balances) (note iii)	1.53				1.56	

Notes:
i. Balances as at 5 April 2018 reflect the impact of applying IFRS 9: Financial Instruments.
ii. Residential mortgages include prime and specialist loans, with the specialist portfolio primarily comprising buy to let lending.
iii. 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

Total gross mortgage lending during the period has increased to £17.3 billion (H1 2017/18: £16.7 billion), of which gross prime lending increased to £15.2 billion (H1 2017/18: £15.0 billion) and gross specialist lending increased to £2.1 billion (H1 2017/18: £1.7 billion). This represents one of our strongest gross lending performances in the first half of a financial year, reflecting the competitively priced products and good long-term value that we continue to offer members.

Net mortgage lending was £3.6 billion (H1 2017/18: £3.9 billion) largely driven by a rise in redemptions due to sustained market competition.

Arrears performance improved marginally during the period, with cases more than three months in arrears improving to 0.42% of the total portfolio (5 April 2018: 0.43%). Impairment provisions have remained largely unchanged at £234 million (5 April 2018: £235 million).

Financial review (continued)

Commercial and other lending

During the period commercial and other lending balances decreased by £0.3 billion to £10.4 billion (5 April 2018: £10.7 billion). Given deleveraging activity in previous financial years, the overall portfolio is increasingly weighted towards registered social landlords, with balances of £6.5 billion (5 April 2018: £6.8 billion). Commercial real estate balances decreased by £0.2 billion during the period to £1.6 billion (5 April 2018: £1.8 billion) as we actively reduced this portfolio. Impairment provisions have remained stable at £30 million (5 April 2018: £29 million).

Consumer banking

The asset quality of the portfolio remains strong. Impairment provisions have increased to £371 million (5 April 2018: £365 million), as a result of book growth.

Other financial assets

Other financial assets total £40.4 billion (5 April 2018: £34.8 billion), primarily comprising liquidity and investment assets held by our Treasury function of £36.0 billion (5 April 2018: £30.8 billion) and derivatives with positive fair values of £4.5 billion (5 April 2018: £4.1 billion). Derivatives relate primarily to interest rate and foreign exchange contracts which economically hedge financial risks inherent in core lending and funding activities.

The Liquidity Coverage Ratio has increased to 131.9% (4 April 2018: 130.3%) largely due to strong member deposit inflows increasing the liquid asset buffer.

Members' interests, equity and liabilities	**30 September 2018**	5 April 2018 (note i)	4 April 2018
	£m	£m	£m
Member deposits	**153,071**	148,003	148,003
Debt securities in issue	**35,253**	34,118	34,118
Other financial liabilities	**35,860**	33,173	33,173
Other liabilities	**1,523**	1,402	1,401
Total liabilities	**225,707**	216,696	216,695
Members' interests and equity	**12,629**	12,241	12,403
Total members' interests, equity and liabilities	**238,336**	228,937	229,098

Wholesale funding ratio: 28.6%
(4 April 2018: 28.2%)

Note:
i. Balances as at 5 April 2018 reflect the impact of applying IFRS 9: Financial Instruments.

Member deposits

Member deposits have increased by £5.1 billion to £153.1 billion (4 April 2018: £148.0 billion) as we continue to offer competitive savings and current account propositions which provide good long-term value. We have continued to attract inflows from both new and existing members through the introduction of successful products such as our Single Access ISA and Loyalty ISA. Nationwide's share of the balance growth in the UK deposit market for the period is 17.9% (H1 2017/18: 4.5%).

Of this balance growth, £1.8 billion relates to net inflows into current account products, with in-credit balances on those accounts amounting to £21.6 billion (4 April 2018: £19.8 billion). During the period our share of current account switchers increased to 21.5% (H1 2017/18: 20.2%).

Debt securities in issue and other financial liabilities

Debt securities in issue of £35.3 billion (5 April 2018: £34.1 billion) are used to raise funding in wholesale markets to finance core activities. Other financial liabilities have increased by £2.7 billion to £35.9 billion (5 April 2018: £33.2 billion) as a result of capital funding issuances and liquidity financing transactions. Further details are included in the Liquidity and funding risk section of the Business and risk report.

Members' interests and equity

The more significant movements in the period are retained profit after tax, net remeasurement of pension obligations and the impact of adopting IFRS 9: Financial Instruments at 5 April 2018. Further details on the impact of transition to IFRS 9 are included in note 2.

Financial review (continued)

Statement of comprehensive income

(note i)	Half year to 30 September 2018 £m	Half year to 30 September 2017 £m
Profit after tax	387	471
Net remeasurement of pension obligations	155	71
Net movement in cash flow hedge reserve	(65)	(114)
Net movement in available for sale reserve	(10)	(15)
Total comprehensive income	467	413

Note:
i. Movements are shown net of the related taxation.

Further information on gross movements in the pension obligation and movements in the cash flow hedge reserve are included in notes 19 and 6 respectively.

Capital structure

Capital resources have continued to strengthen during the period with the CET1 ratio increasing to 31.7% (4 April 2018: 30.5%) and the UK leverage ratio to 5.0% (4 April 2018: 4.9%). Both are comfortably in excess of minimum regulatory capital requirements and Nationwide's strategic target of maintaining a UK leverage ratio of greater than 4.5%.

Capital structure (note i)	**30 September 2018** £m	5 April 2018 (note iv) £m	4 April 2018 £m
Capital resources			
Common Equity Tier 1 (CET1) capital	10,423	9,915	9,925
Total Tier 1 capital	11,415	10,907	10,917
Total regulatory capital	14,511	13,930	13,936
Risk weighted assets (RWAs)	32,868	32,579	32,509
UK leverage exposure	227,646	221,982	221,992
CRR leverage exposure	246,193	236,458	236,468
CRD IV capital ratios:	%	%	%
CET1 ratio	31.7	30.4	30.5
UK leverage ratio (note ii)	5.0	4.9	4.9
CRR leverage ratio (note iii)	4.6	4.6	4.6

Notes:
i. Data in the table is reported under CRD IV on an end point basis with IFRS 9 transitional arrangements applied.
ii. 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.
iii. 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. Further details are provided in the Solvency risk section of the Business and risk report.
iv. Figures have been adjusted to reflect the impact of applying IFRS 9 from 5 April 2018. Further information is provided in the Report on Transition to IFRS 9: Financial Instruments, which can be found at nationwide.co.uk.

CET1 capital resources have increased by £0.5 billion since 5 April 2018, primarily due to profit after tax for the period of £387 million and net remeasurement of pension obligations of £155 million. Risk weighted assets (RWAs) have remained relatively stable with a reduction in commercial exposures being offset by increases for counterparty credit risk and other exposures. These movements have resulted in the CET1 ratio increasing to 31.7%.

Lending growth has been more than offset by profits for the period, with Tier 1 resources growing more quickly than leverage exposure. This resulted in the UK leverage ratio increasing to 5.0%. CRR leverage ratio has remained stable at 4.6%.

Detailed information on Nationwide's capital instruments can be found within the Interim Pillar 3 Disclosure 2018, at **nationwide.co.uk**

Business and risk report

Contents

Introduction

This report provides information on developments during the period in relation to Nationwide's business, the risks it is exposed to and how it manages those risks. This information supports, and should be read in conjunction with, the material found in the Business and Risk Report in the Annual Report and Accounts 2018. Where there has been no change to the approach to managing risks, or there has been no material change to the relevant risk environment from that disclosed at year end, this information has not been repeated in the 2018/19 Interim Results.

Principal risks

Effective risk management is fundamental to the success of Nationwide's business and has an important part to play in delivering the Society's purpose of building society, nationwide, by making sure it is 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 managing appropriately the risks that arise from its activities. The principal types of risk inherent within the business remain unchanged from those set out in the Business and risk report in the Annual Report and Accounts 2018, namely:

- Credit risk
- Liquidity and funding risk
- Solvency risk
- Pension risk
- Operational risk
- Model risk
- Conduct and compliance risk
- Market risk
- Business risk

Information on key developments and updated quantitative disclosures for the principal risks above are included within this report except for model risk, business risk and market risk where there have been no significant developments during the period.

Top and emerging risks

The top and emerging risks to the delivery of Nationwide's strategy are identified through the processes outlined in the Business and risk report section of the Annual Report and Accounts 2018. These top and emerging risks to Nationwide's strategy are summarised in the table below, along with details of key movements and developments during the period.

Risk	Update
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.	We have seen an increase in the frequency and sophistication of cyber attacks being made against the Society. This is not unique to Nationwide, and reflects the increased activity, sophistication and severity of attacks across the UK. We continue to evaluate our cyber security and resilience against the emerging threat landscape, updating our defensive capabilities accordingly.
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.	Operational resilience is a key concern for our members, and remains a challenge across the industry. We continued to monitor operational resilience closely in the first half of the year. In September, we announced an increase in investment in the Society of £1.3 billion, taking our total planned investment to £4.1 billion over the next five years. This investment will allow us to simplify our existing technology infrastructure, further improving our efficiency and resilience, whilst delivering new technologies to support future growth and the service we offer to members.
Regulatory change - The risk that we are unable to comply with complex changes required by regulation which come into force.	Regulation has continued to evolve over the first half of the year; however, there has been no material change to the overall regulatory environment and Nationwide's response as disclosed in the Annual Report and Accounts 2018.
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.	Whilst pressure in the competitive environment remains heightened, there have been no material changes from the position disclosed in the Annual Report and Accounts 2018.
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, caused by events such as Brexit, or other economic or political factors.	Whilst economic conditions have thus far remained stable, significant potential economic headwinds remain in the environment as we head towards the Brexit date of 29 March 2019. We continue to monitor closely and plan proactively for the possibility of a disorderly Brexit, assessing the impacts on Nationwide and the mitigating actions available to the Society across a range of potential scenarios.

Credit risk – Overview

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 concentration risk and refinance risk.

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

With effect from 5 April 2018 Nationwide has adopted IFRS 9: *Financial Instruments* which replaces IAS 39 *Financial Instruments: Recognition and Measurement*. Under IFRS 9, impairment provisions on financial assets are calculated on an expected credit loss (ECL) basis for assets held at amortised cost and fair value through other comprehensive income (FVOCI). ECL impairment provisions are based on an assessment of the probability of default, exposure at default and loss given default, discounted to give a net present value. The Credit risk section of this report summarises for portfolios:

- the maximum exposure to credit risk;
- the stage distribution of loans and provisions (explained on page 18);
- credit quality;
- other risk factors and concentrations, including loan to values, regional exposures, arrears and forbearance.

Further information on the move to IFRS 9 is provided in our Report on Transition to IFRS 9: Financial Instruments, which can be found on **nationwide.co.uk**

In the consolidated interim financial statements there has been no restatement of comparative information for the year ended 4 April 2018, which is reported on an IAS 39 basis. However, to support the understanding of the current year IFRS 9 disclosures, certain comparative balances within the Credit risk section of this Business and risk report are shown as at 5 April 2018 (the effective date of the adoption of IFRS 9). These 5 April 2018 comparatives include financial asset balance sheet carrying values that have been changed by IFRS 9, and the stage distribution of gross lending and ECL provisions.

The stage distribution of gross lending and provisions for loans and advances to customers is presented for assets held at amortised cost, and certain tables below therefore exclude loans and advances to customers classified as fair value through profit or loss (FVTPL).

The table below shows the classification of assets on the Group's balance sheet following the adoption of IFRS 9.

Classification and measurement	**30 September 2018 (IFRS 9 basis) £m**	5 April 2018 (IFRS 9 basis) £m	4 April 2018 (IAS 39 basis) £m
Loans and advances to customers – Amortised cost (note i)	**194,771**	191,245	191,664
Loans and advances to customers – FVTPL	**246**	247	-
Investment securities – FVOCI	**12,415**	11,881	11,926
Investment securities – Amortised cost (note i)	**1,748**	1,120	1,120
Investment securities – FVTPL	**61**	45	-
Fair value adjustment for portfolio hedged risk	**(204)**	(144)	(109)

Note:
i. Balances are stated net of impairment provisions.

Credit risk – Overview (continued)

Maximum exposure to credit risk

Maximum exposure to credit risk	30 September 2018					
	Gross balances £m	Less: impairment provisions £m	Carrying value £m	Commitments (note i) £m	Maximum credit risk exposure £m	% of total credit risk exposure %
Amortised cost loans and advances to customers:						
Residential mortgages	180,778	(234)	180,544	12,768	193,312	78
Consumer banking	4,316	(371)	3,945	27	3,972	2
Commercial and other lending (note ii)	9,347	(30)	9,317	987	10,304	4
Fair value adjustment for micro hedged risk (note ii)	965	-	965	-	965	-
	195,406	(635)	194,771	13,782	208,553	84
FVTPL loans and advances to customers:						
Residential mortgages (note iii)	189	-	189	-	189	-
Commercial and other lending	57	-	57	-	57	-
	246	-	246	-	246	-
Other items:						
Cash	18,423	-	18,423	-	18,423	7
Loans and advances to banks	3,396	-	3,396	-	3,396	1
Investment securities – FVOCI	12,415	-	12,415	-	12,415	5
Investment securities – Amortised cost	1,748	-	1,748	-	1,748	1
Investment securities – FVTPL	61	-	61	-	61	-
Derivative financial instruments	4,534	-	4,534	-	4,534	2
Fair value adjustment for portfolio hedged risk (note ii)	(204)	-	(204)	-	(204)	-
	40,373	-	40,373	-	40,373	16
Total	236,025	(635)	235,390	13,782	249,172	100

Maximum exposure to credit risk	5 April 2018					
	Gross balances £m	Less: impairment provisions £m	Carrying value £m	Commitments (note i) £m	Maximum credit risk exposure £m	% of total credit risk exposure %
Amortised cost loans and advances to customers:						
Residential mortgages	177,114	(235)	176,879	12,205	189,084	79
Consumer banking	4,107	(365)	3,742	42	3,784	2
Commercial and other lending (notes ii and iv)	9,611	(29)	9,582	943	10,525	4
Fair value adjustment for micro hedged risk (note ii)	1,042	-	1,042	-	1,042	-
	191,874	(629)	191,245	13,190	204,435	85
FVTPL loans and advances to customers:						
Residential mortgages (note iii)	189	-	189	-	189	-
Commercial and other lending	58	-	58	-	58	-
	247	-	247	-	247	-
Other items:						
Cash	14,361	-	14,361	-	14,361	6
Loans and advances to banks (note iv)	3,422	-	3,422	-	3,422	1
Investment securities – FVOCI	11,881	-	11,881	-	11,881	5
Investment securities – Amortised cost	1,120	-	1,120	700	1,820	1
Investment securities – FVTPL	45	-	45	-	45	-
Derivative financial instruments	4,121	-	4,121	-	4,121	2
Fair value adjustment for portfolio hedged risk (note ii)	(144)	-	(144)	-	(144)	-
	34,806	-	34,806	700	35,506	15
Total	226,927	(629)	226,298	13,890	240,188	100

Notes:

i. In addition to the amounts shown above, Nationwide has, as part of its retail operations, revocable commitments of £9,700 million (5 April 2018: £9,517 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.

ii. The fair value adjustment for portfolio hedged risk and the fair value adjustment for micro hedged risk (which relates to 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.

iii. FVTPL residential mortgages includes equity release loans.

iv. Comparative values for commitments have been restated to reclassify the commitment value in respect of one counterparty from loans and advances to banks to commercial and other lending.

Credit risk – Overview (continued)

Commitments

Irrevocable undrawn commitments to lend are within the scope of IFRS 9 provision requirements. The commitments in the table above consist of overpayment reserves and separately identifiable irrevocable commitments for the pipeline of residential mortgages, personal loans, commercial loans and investment securities. These commitments are not recognised on the balance sheet, and the total associated provision of £0.3 million (5 April 2018: £0.6 million) is included within provisions for liabilities and charges.

Revocable commitments relating to overdrafts and credit cards are included in ECL based provisions, with the allowance for future drawdowns made as part of the exposure at default element of the ECL calculation.

Impairment losses for the period

Impairment losses / (reversals) for the period	**Half year to 30 September 2018 (IFRS 9 basis) £m**	Half year to 30 September 2017 (IAS 39 basis) £m
Residential mortgages	4	12
Consumer banking	38	52
Commercial and other lending	3	(5)
Total impairment losses	45	59

As impairment provisions are calculated on a different basis under IFRS 9 from IAS 39, the losses shown above are not directly comparable.

Stage distribution

Impairment provisions are calculated using a three stage approach depending on changes in credit risk since original recognition of the assets:

- an asset that is not credit impaired on initial recognition is classified in stage 1, with a provision equal to a 12 month ECL (losses arising on default events expected to occur within 12 months);
- where a loan's credit risk increases significantly, it will be moved to stage 2. The provision recognised will be equal to the loan's lifetime ECL (losses on default events expected to occur at any point during the life of the asset); and
- if a loan meets the definition of credit impaired, it will be moved to stage 3 with a provision equal to its lifetime ECL.

For loans and advances to customers held at amortised cost, the stage distribution of portfolios, including provision coverage ratios, is shown in the individual credit risk sections for residential mortgages, consumer banking and commercial and other lending. The provision coverage ratio is calculated by dividing the provisions by the gross balances for each main lending portfolio. Loans remain on the balance sheet, net of associated provisions, until they are deemed no longer recoverable, when such loans are written off. The definition, assumptions and timing for write-off of loans have not changed with the adoption of IFRS 9.

Other assets in scope for impairment provisions are shown below:

Analysis of other assets in scope for impairment provisions	**30 September 2018**		5 April 2018	
	Gross balances £m	**Provisions £m**	Gross balances £m	Provisions £m
Loans and advances to banks	3,396	-	3,422	-
Investment securities – FVOCI	12,415	-	11,881	-
Investment securities – Amortised cost	1,748	-	1,120	-

The credit quality of loans and advances to banks and investment securities continues to be low risk and stable. All items within the table above are classified as stage one, except for £12 million of FVOCI investment securities in stage two, with no assets in stage three.

For financial assets classified as FVTPL, no provisions are calculated as credit risk is reflected in the carrying value of the asset; no additional provision information is therefore disclosed in respect of these assets.

Credit risk – Residential mortgages

Lending and new business

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 principally of buy to let mortgages originated under The Mortgage Works (UK) plc (TMW) brand. Total balances across these portfolios have grown by 2.1% during the period to £181 billion (4 April 2018: £177 billion) and credit performance has remained stable.

Residential mortgage lending	30 September 2018		5 April 2018		4 April 2018	
	£m	%	£m	%	£m	%
Prime	147,507	82	143,869	81	144,049	81
Specialist:						
Buy to let	30,631	17	30,439	17	30,438	17
Other (note i)	2,640	1	2,806	2	2,812	2
Amortised cost loans and advances to customers:	180,778	100	177,114	100	177,299	100
FVTPL loans and advances to customers (note ii)	189		189			
Total residential mortgages	180,967		177,303		177,299	

Notes:

i. Other includes self-certified, near prime and sub prime lending, all of which were discontinued in 2009.

ii. As a result of their contractual cash flow characteristics, certain residential mortgages (including equity release loans) were reclassified from amortised cost to FVTPL on transition to IFRS 9 on 5 April 2018, and remeasured at fair value as disclosed in the above table.

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 £144 billion to £148 billion over the period, with new lending to first time buyers comprising 38% (30 September 2017: 37%) of all new lending. Nationwide continues to operate with a commitment to responsible lending and a focus on championing good conduct and fair outcomes.

The following table shows residential mortgage lending balances carried at amortised cost, the stage allocation of the loans, impairment provisions and the resulting provision coverage ratios:

Residential mortgages product and staging analysis 30 September 2018	Stage 1	Stage 2 total	Stage 2 <30 DPD (note i)	Stage 2 >30 DPD	Stage 3	Stage 3 POCI (note ii)	Total
	£m	£m	£m	£m	£m	£m	£m
Gross balances							
Prime	140,034	6,741	6,481	260	732	-	147,507
Specialist	20,532	12,044	11,816	228	522	173	33,271
Total	160,566	18,785	18,297	488	1,254	173	180,778
Provisions							
Prime	6	23	20	3	11	-	40
Specialist	9	152	132	20	33	-	194
Total	15	175	152	23	44	-	234
Provisions as a % of total balance	%	%	%	%	%	%	%
Prime	0.00	0.33	0.31	0.95	1.45	-	0.03
Specialist	0.04	1.26	1.12	8.66	6.29	-	0.58
Total	0.01	0.93	0.83	4.71	3.51	-	0.13

Credit risk – Residential mortgages (continued)

Residential mortgages product and staging analysis 5 April 2018	Stage 1 £m	Stage 2 total £m	Stage 2 <30 DPD (note i) £m	Stage 2 >30 DPD £m	Stage 3 £m	Stage 3 POCI (note ii) £m	Total £m
Gross balances							
Prime	134,864	8,289	8,035	254	716	-	143,869
Specialist	21,783	10,783	10,574	209	499	180	33,245
Total	156,647	19,072	18,609	463	1,215	180	177,114
Provisions							
Prime	6	29	25	4	12	-	47
Specialist	11	142	131	11	35	-	188
Total	17	171	156	15	47	-	235
Provisions as a % of total balance	%	%	%	%	%	%	%
Prime	0.00	0.35	0.31	1.53	1.67	-	0.03
Specialist	0.05	1.32	1.24	5.33	7.01	-	0.57
Total	0.01	0.90	0.84	3.25	3.84	-	0.13

Notes:
i. Days past due, a measure of arrears status.
ii. Purchased or originated credit impaired (POCI) loans. The gross balance for POCI is net of the lifetime ECL of £6 million (£7 million at 5 April 2018).

At 30 September 2018, 89% (5 April 2018: 88%) of the residential mortgage portfolio is in stage 1. Of the £18,785 million (5 April 2018: £19,072 million) stage 2 balances, 2.6% (5 April 2018: 2.4%) are in arrears by 30 days or more. The majority are in stage 2 due to non-arrears factors, including interest only loans where it anticipated that a borrower may not have a means of capital repayment or the ability to refinance the loan at maturity. The movements in stage 2 balances and associated provisions for prime and specialist loans since 5 April 2018 are a result of refinements to models and staging criteria, with stable underlying credit performance.

Stage 3 loans in the residential mortgage portfolio (excluding POCI), equate to 1% (5 April 2018: 1%) of the total residential mortgage exposure. Of the total value of residential mortgage balances in stage 3 at 30 September 2018 (excluding POCI), £678 million (5 April 2018: £686 million) is more than 90 days past due.

The stage 3 POCI loans were recognised on the balance sheet when the Derbyshire Building Society was acquired in December 2008. These mainly interest-only residential loans were 90 days or more in arrears when they were acquired and so have been classified as credit impaired on acquisition.

Total provisions and provision coverage across the residential mortgage portfolio have remained stable, with movements in prime and specialist loans since 5 April 2018 resulting from model refinements and updates to the probabilities applied to economic scenarios in modelling ECLs.

Credit quality

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 geographically diversified.

Nationwide adopts robust credit management policies and processes designed to recognise and manage the risks arising from the portfolio.

The table below shows the loan balances and provisions for amortised cost residential mortgages, by probability of default (PD) range. The PD distributions shown are based on 12 month PD at the reporting date.

Credit risk – Residential mortgages (continued)

Loan balance and provisions by PD
30 September 2018

PD range	Gross balances Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Provisions Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Provision coverage %
0.00 to <0.15%	152,736	11,376	82	164,194	10	66	-	76	0.05
0.15 to < 0.25%	4,206	1,758	23	5,987	2	17	-	19	0.31
0.25 to < 0.50%	1,892	1,153	34	3,079	1	12	-	13	0.41
0.50 to < 0.75%	971	1,112	18	2,101	1	7	-	8	0.37
0.75 to < 2.50%	634	1,459	58	2,151	1	22	-	23	1.07
2.50 to < 10.00%	127	1,118	134	1,379	-	19	1	20	1.44
10.00 to < 100%	-	809	182	991	-	32	3	35	3.58
100% (default)	-	-	896	896	-	-	40	40	4.47
Total	**160,566**	**18,785**	**1,427**	**180,778**	**15**	**175**	**44**	**234**	**0.13**

Loan balance and provisions by PD
5 April 2018

PD range	Gross balances Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Provisions Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Provision coverage %
0.00 to <0.15%	147,728	10,781	81	158,590	13	63	-	76	0.05
0.15 to < 0.25%	4,969	1,733	22	6,724	2	14	-	16	0.24
0.25 to < 0.50%	2,317	1,461	38	3,816	1	11	-	12	0.31
0.50 to < 0.75%	1,014	1,205	16	2,235	-	9	-	9	0.43
0.75 to < 2.50%	619	1,719	57	2,395	1	21	-	22	0.90
2.50 to < 10.00%	-	1,332	125	1,457	-	26	1	27	1.82
10.00 to < 100%	-	841	166	1,007	-	27	2	29	2.87
100% (default)	-	-	890	890	-	-	44	44	4.93
Total	156,647	19,072	1,395	177,114	17	171	47	235	0.13

The provisions allocated to the lowest PD ranges primarily reflect provisions recognised for interest only loans where it is anticipated that a borrower may not have a means of capital repayment or the ability to refinance the loan at maturity.

Over the period, the quality of the residential mortgage portfolios has remained strong, benefiting from low interest rates, with 98% (5 April 2018: 98%) of the portfolio having a PD of less than 2.5%.

In addition to the amortised cost loans shown above, there are £189 million (5 April 2018: £189 million) residential mortgages classified at FVTPL which have an average 12 month PD of 2.17% (5 April 2018: 2.07%).

Credit risk – Residential mortgages (continued)

Distribution of new business by borrower type (by value)

New business by borrower type was similar to the prior period:

Distribution of new business by borrower type (by value) (note i)	Half year to 30 September 2018 %	Half year to 30 September 2017 %
Prime:		
First time buyers	38	37
Home movers	26	31
Remortgagers	23	21
Other	1	1
Total prime	88	90
Specialist:		
Buy to let new purchases	3	2
Buy to let remortgagers	9	8
Total specialist	12	10
Total new business	100	100

Note:
i. All new business measures exclude further advances and product switchers.

LTV and credit risk concentration

Loan to value (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 (note i)	30 September 2018 %	4 April 2018 %
Prime	56	55
Specialist	57	58
Group	56	56

Average LTV of new business (note ii)	Half year to 30 September 2018 %	Half year to 30 September 2017 %
Prime	73	72
Specialist (buy to let)	59	61
Group	71	71

Notes:
i. The average LTV of loan stock includes both amortised cost and FVTPL balances although there have been no new FVTPL advances during the half year to 30 September 2018.
ii. The LTV of new business excludes further advances and product switchers.

LTV distribution of new business	Half year to 30 September 2018 %	Half year to 30 September 2017 %
0% to 60%	31	27
60% to 75%	32	31
75% to 80%	6	8
80% to 85%	7	13
85% to 90%	20	17
90% to 95%	4	4
Over 95%	-	-
Total	100	100

The average LTV of both new lending and the stock of lending have remained stable at 71% and 56% respectively. The maximum LTV for new prime residential borrowers is 95%.

Credit risk – Residential mortgages (continued)

Residential mortgage balances by LTV and region

Geographical concentration by stage

The following table shows the residential mortgages, excluding FVTPL balances, by LTV and region across stages 1 and 2 (non-credit impaired) and stage 3 (impaired):

Residential mortgage balances by LTV and region 30 September 2018	Greater London £m	Central England £m	Northern England £m	South East England £m	South West England £m	Scotland £m	Wales £m	Northern Ireland £m	Total £m	%
Stage 1 and 2 loans										
Fully collateralised										
LTV ratio:										
Up to 50%	26,201	11,424	7,456	8,822	6,096	3,160	1,468	949	65,576	
50% to 60%	11,339	6,434	4,483	4,417	3,302	1,773	840	386	32,974	
60% to 70%	9,361	6,755	6,396	3,796	3,321	2,560	1,336	389	33,914	
70% to 80%	7,056	4,893	5,405	3,024	2,458	2,425	1,072	431	26,764	
80% to 90%	5,628	2,602	3,177	2,275	1,746	1,257	656	279	17,620	
90% to 100%	888	185	404	385	162	128	66	83	2,301	
	60,473	32,293	27,321	22,719	17,085	11,303	5,438	2,517	179,149	99.1
Not fully collateralised										
Over 100% LTV	4	3	21	2	2	7	1	162	202	0.1
Collateral value	*3*	*3*	*18*	*2*	*1*	*6*	*1*	*139*	*173*	
Negative equity	*1*	*-*	*3*	*-*	*1*	*1*	*-*	*23*	*29*	
Stage 1 and 2 residential mortgages	60,477	32,296	27,342	22,721	17,087	11,310	5,439	2,679	179,351	99.2
Stage 3 loans										
Fully collateralised										
LTV ratio:										
Up to 50%	248	85	63	63	43	21	13	12	548	
50% to 60%	108	51	39	36	26	14	10	5	289	
60% to 70%	39	60	57	34	23	24	10	5	252	
70% to 80%	14	44	57	13	16	17	10	4	175	
80% to 90%	5	11	49	1	2	12	10	4	94	
90% to 100%	1	1	22	1	-	3	3	5	36	
	415	252	287	148	110	91	56	35	1,394	0.8
Not fully collateralised										
Over 100% LTV	-	1	7	-	-	1	1	23	33	-
Collateral value	*-*	*1*	*6*	*-*	*-*	*1*	*1*	*19*	*28*	
Negative equity	*-*	*-*	*1*	*-*	*-*	*-*	*-*	*4*	*5*	
Stage 3 residential mortgages	415	253	294	148	110	92	57	58	1,427	0.8
Total residential mortgages	60,892	32,549	27,636	22,869	17,197	11,402	5,496	2,737	180,778	100
Total geographical concentrations	34%	18%	15%	13%	9%	6%	3%	2%	100%	

Credit risk – Residential mortgages (continued)

Residential mortgage balances by LTV and region 5 April 2018	Greater London £m	Central England £m	Northern England £m	South East England £m	South West England £m	Scotland £m	Wales £m	Northern Ireland £m	Total £m	%
Stage 1 and 2 loans										
Fully collateralised										
LTV ratio:										
Up to 50%	27,017	10,490	6,962	8,789	5,846	2,911	1,396	943	64,354	
50% to 60%	11,577	5,968	4,133	4,527	3,250	1,624	803	393	32,275	
60% to 70%	9,030	6,848	6,182	3,698	3,326	2,388	1,279	397	33,148	
70% to 80%	6,453	4,974	5,604	2,820	2,423	2,511	1,105	409	26,299	
80% to 90%	4,989	2,824	3,411	1,977	1,594	1,461	679	276	17,211	
90% to 100%	508	318	458	308	172	286	67	87	2,204	
	59,574	31,422	26,750	22,119	16,611	11,181	5,329	2,505	175,491	99.1
Not fully collateralised										
Over 100% LTV	4	4	24	2	2	12	1	179	228	0.1
Collateral value	*3*	*3*	*20*	*2*	*2*	*11*	*1*	*153*	*195*	
Negative equity	*1*	*1*	*4*	*-*	*-*	*1*	*-*	*26*	*33*	
Stage 1 and 2 residential loans	59,578	31,426	26,774	22,121	16,613	11,193	5,330	2,684	175,719	99.2
Stage 3 loans										
Fully collateralised										
LTV ratio:										
Up to 50%	257	76	59	65	38	17	11	12	535	
50% to 60%	98	47	36	36	25	15	9	6	272	
60% to 70%	39	55	55	33	23	20	11	5	241	
70% to 80%	7	41	53	11	18	19	10	4	163	
80% to 90%	4	20	53	2	2	10	10	6	107	
90% to 100%	1	2	28	-	1	5	4	4	45	
	406	241	284	147	107	86	55	37	1,363	0.8
Not fully collateralised										
Over 100% LTV	-	1	5	-	-	1	1	24	32	-
Collateral value	*-*	*1*	*5*	*-*	*-*	*1*	*1*	*19*	*27*	
Negative equity	*-*	*-*	*-*	*-*	*-*	*-*	*-*	*5*	*5*	
Stage 3 residential mortgages	406	242	289	147	107	87	56	61	1,395	0.8
Total residential mortgages	59,984	31,668	27,063	22,268	16,720	11,280	5,386	2,745	177,114	100
Total geographical concentrations	34%	18%	15%	13%	9%	6%	3%	2%	100%	

Over the period, the geographical distribution across the UK has remained stable, with the highest concentration continuing to be in Greater London, at 34% of the total.

The proportion of loan balances with LTV greater than 80% has remained stable at 11% across the stage 1 and 2 balances, whilst the proportion of stage 3 balances with LTV greater than 80% has reduced slightly over the period, from 13% to 11%.

The value of partially collateralised loans has reduced to £235 million (5 April 2018: £260 million).

In addition to the amortised cost balances in the table above, there are £189 million (5 April 2018: £189 million) FVTPL residential mortgages which have an average LTV of 39.8% (5 April 2018: 39.8%). The geographical distribution is similar to the amortised cost balances, with the largest proportion in Greater London, at 33% (5 April 2018: 33%).

Credit risk – Residential mortgages (continued)

Number of cases more than 3 months in arrears as % of total book

Arrears remain significantly lower than the industry average as shown in the following table:

Number of cases more than 3 months in arrears as % of total book	30 September 2018 %	4 April 2018 %
Prime	0.34	0.34
Specialist	0.79	0.83
Total	0.42	0.43
UKF industry average	0.78	0.81

Note: 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.

The proportion of loans in arrears across prime and specialist lending remains low, reflecting the favourable economic conditions and low interest rate environment, supported by robust credit management policies and processes designed to recognise and manage the risks arising, or likely to arise, from the portfolio.

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.

Residential mortgages by payment status

The following table shows the payment status of residential mortgages.

Residential mortgages by payment status	30 September 2018			
	Prime £m	Specialist £m	Total £m	%
Not past due	145,964	32,155	178,119	98.4
Past due up to 3 months	1,357	761	2,118	1.2
Past due 3 to 6 months	169	157	326	0.2
Past due 6 to 12 months	117	109	226	0.1
Past due over 12 months	81	69	150	0.1
Possessions	8	20	28	-
Total residential mortgages	147,696	33,271	180,967	100

Residential mortgages by payment status	4 April 2018			
	Prime £m	Specialist £m	Total £m	%
Not past due	142,383	32,197	174,580	98.5
Past due up to 3 months	1,294	685	1,979	1.1
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
Possessions	8	23	31	-
Total residential mortgages	144,049	33,250	177,299	100

Total balances subject to arrears represent 1.6% (4 April 2018: 1.5%) of the total residential mortgage lending.

Interest only mortgages

Interest only balances for prime residential mortgages relate primarily to historical balances which were originally advanced as interest only mortgages or where a change in terms to an interest only basis was agreed. 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.

Credit risk – Residential mortgages (continued)

The majority of the specialist portfolio comprises buy to let loans, of which 89% are advanced on an interest only basis as at 30 September 2018.

Interest only mortgages – term to maturity (note i)	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 book
30 September 2018	£m	£m	£m	£m	£m	£m	%
Prime	67	301	338	1,552	10,273	12,531	8.5
Specialist	138	165	218	1,303	27,784	29,608	89.0
Total	**205**	**466**	**556**	**2,855**	**38,057**	**42,139**	**23.3**
4 April 2018	£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

Notes:
i. Balances subject to forbearance with agreed term extensions are presented based on the latest agreed contractual term.

Interest only loans that are 'term expired (still open)' are not considered to be past due where contractual interest payments continue to be met, pending renegotiation of the facility. Under IFRS 9 these are now treated as impaired and form part of the stage 3 balance from three months after the maturity date. Previously, term expired (still open) loans were not categorised as impaired unless in litigation or more than 3 months in arrears on the contractual interest payments.

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 Annual Report and Accounts 2018 sets out further details of concession events included within forbearance.

The table below provides details of residential mortgages held at amortised cost subject to forbearance, which are all assessed as in either stage 2 or stage 3:

Balances subject to forbearance (note i)	30 September 2018			5 April 2018		
	Prime £m	Specialist £m	Total £m	Prime £m	Specialist £m	Total £m
Past term interest only (note ii)	122	145	267	130	136	266
Interest only concessions	519	62	581	511	66	577
Capitalisation	45	54	99	45	59	104
Term extensions (within term)	35	14	49	35	14	49
Permanent interest only conversions	4	38	42	5	24	29
Total forbearance	725	313	1,038	726	299	1,025
Impairment provisions on forborne loans	5	13	18	5	11	16

Notes:
i. Where more than one concession event has occurred, balances are reported under the latest event.
ii. Includes interest only mortgages where a customer is unable to renegotiate the facility within six months of maturity and no legal enforcement is pursued. Should a concession event such as a term extension occur within the six-month period, this will also be classed as forbearance.

In addition to the amortised cost balances, there are £189 million FVTPL balances (5 April 2018: £189 million), of which £18 million (5 April 2018: £19 million) are forborne, with the majority within the past term interest only category.

Consistent with the European Banking Authority reporting definitions, loans that meet the regulatory forbearance exit criteria are not reported as forborne.

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 5.1% during the period to £4,316 million (4 April 2018: £4,107 million), and the performance has remained stable.

We continue to monitor carefully the composition and performance of the unsecured portfolios, in light of the growth in consumer credit balances observed across the industry, and are aware of the pressure that some 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.

Consumer banking gross balances	30 September 2018		5 April 2018		4 April 2018	
	£m	%	£m	%	£m	%
Overdrawn current accounts	232	5	277	7	277	7
Personal loans	2,236	52	2,031	49	2,031	49
Credit cards	1,848	43	1,799	44	1,799	44
Total consumer banking	**4,316**	**100**	4,107	100	4,107	100

All consumer banking loans continue to be classified and measured as amortised cost under IFRS 9.

The following table shows consumer banking balances by stage, with the corresponding impairment provisions and resulting provision coverage ratios:

Consumer banking product and staging analysis				
30 September 2018	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**
Gross balances				
Overdrawn current accounts	103	94	35	232
Personal loans	1,942	177	117	2,236
Credit cards	1,352	371	125	1,848
Total	3,397	642	277	4,316
Provisions				
Overdrawn current accounts	2	20	31	53
Personal loans	10	20	103	133
Credit cards	13	59	113	185
Total	25	99	247	371
Provisions as a % of total balance	**%**	**%**	**%**	**%**
Overdrawn current accounts	1.98	20.85	90.22	22.88
Personal loans	0.53	11.16	87.91	5.93
Credit cards	0.92	16.06	90.81	10.03
Total	0.74	15.42	89.17	8.60
5 April 2018	£m	£m	£m	£m
Gross balances				
Overdrawn current accounts	149	94	34	277
Personal loans	1,803	116	112	2,031
Credit cards	1,312	365	122	1,799
Total	3,264	575	268	4,107
Provisions				
Overdrawn current accounts	2	23	30	55
Personal loans	10	18	96	124
Credit cards	13	62	111	186
Total	25	103	237	365
Provisions as a % of total balance	%	%	%	%
Overdrawn current accounts	1.34	24.19	90.52	19.97
Personal loans	0.57	15.16	86.31	6.11
Credit cards	1.03	17.09	90.64	10.36
Total	0.78	17.86	88.45	8.90

Credit risk - Consumer banking (continued)

As at 30 September 2018, 79% (5 April 2018: 79%) of the consumer banking portfolio remains in stage 1. Of the £642 million stage 2 balances, £16 million (5 April 2018: £16 million) is in arrears by 30 days or more. The remainder is in stage 2 due to non-arrears factors such as increased probability of default since origination. Overdrawn current account stage 2 balances represent 40% (5 April 2018: 34%) of the total overdrawn balances, but relate to 8% of the total number of current accounts (5 April 2018: 8%).

The increase in stage 2 personal loan balances since 5 April 2018 is largely attributable to a refinement of PD calculations leading to some loans with relatively low PDs being transferred to stage 2, with limited provision impact. The credit quality of the portfolio remains stable.

Consumer banking stage 3 gross balances and provisions include charged off balances. These are in relation to accounts which are closed to future transactions and are held on the balance sheet for an extended period (up to 36 months) whilst recovery activities take place. Excluding these charged off balances and related provisions, the provision coverage ratio is 4.5% (5 April 2018: 4.8%).

Credit quality

Nationwide adopts robust credit management policies and processes designed to recognise and manage the risks arising from the portfolio.

The following table shows gross balances and provisions for consumer banking balances held at amortised cost, by PD range. The PD distributions shown are based on 12 month probability of default at the reporting date.

Consumer banking gross balances and provisions by PD

30 September 2018	Gross balances				Provisions				Provisions coverage
PD range	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage3 £m	Total £m	%
0.00 to <0.15%	936	4	-	940	1	-	-	1	0.16
0.15 to < 0.25%	337	5	-	342	1	-	-	1	0.28
0.25 to < 0.50%	500	17	-	517	2	1	-	3	0.49
0.50 to < 0.75%	308	18	-	326	2	1	-	3	0.76
0.75 to < 2.50%	913	130	-	1,043	9	9	-	18	1.66
2.50 to < 10.00%	394	316	-	710	9	38	-	47	6.73
10.00 to < 100%	9	152	4	165	1	50	2	53	32.54
100% (default)	-	-	273	273	-	-	245	245	89.66
Total	3,397	642	277	4,316	25	99	247	371	8.60

5 April 2018	Gross balances				Provisions				Provisions coverage
PD range	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	%
0.00 to <0.15%	998	3	-	1,001	1	-	-	1	0.15
0.15 to < 0.25%	314	5	-	319	1	-	-	1	0.32
0.25 to < 0.50%	465	17	-	482	2	1	-	3	0.58
0.50 to < 0.75%	292	17	-	309	2	1	-	3	0.90
0.75 to < 2.50%	838	116	-	954	9	9	-	18	1.93
2.50 to < 10.00%	347	282	1	630	9	41	-	50	7.86
10.00 to < 100%	10	135	5	150	1	51	3	55	36.92
100% (default)	-	-	262	262	-	-	234	234	89.26
Total	3,264	575	268	4,107	25	103	237	365	8.90

The credit quality of the consumer banking portfolios has remained strong, benefiting from low interest rates, with 90% of the portfolio (5 April 2018: 90%) having a PD of less than 10%.

Credit risk - Consumer banking (continued)

Consumer banking balances by payment due status

Credit risk in the consumer banking portfolios is primarily monitored and reported based on arrears status which is set out below:

Consumer banking by payment due status	Overdrawn current accounts	Personal loans	Credit cards	Total
30 September 2018	£m	£m	£m	£m
Not past due	189	2,080	1,701	3,970
Past due up to 3 months	11	46	33	90
Past due 3 to 6 months	4	8	11	23
Past due 6 to 12 months	4	17	2	23
Past due over 12 months	3	14	-	17
Charged off (note i)	21	71	101	193
Total	232	2,236	1,848	4,316
4 April 2018	£m	£m	£m	£m
Not past due	235	1,882	1,656	3,773
Past due up to 3 months	12	43	33	88
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
Charged off (note i)	20	68	97	185
Total	277	2,031	1,799	4,107

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.

Whilst total balances subject to arrears, excluding charged off balances, have increased to £153 million (4 April 2018: £149 million) as the portfolios have continued to grow over recent periods, balances subject to arrears as a percentage of total consumer banking lending have reduced to 3.5% (4 April 2018: 3.6%).

Forbearance

Nationwide is committed to supporting customers facing financial difficulty by working with them to find a solution through proactive arrears management and forbearance. The Annual Report and Accounts 2018 sets out further details of concession events included within forbearance.

The table below provides details of consumer banking balances subject to forbearance. These are all assessed as either stage 2 or stage 3 loans:

Balances subject to forbearance (note i)	Overdrawn current accounts	Personal loans	Credit cards	Total
30 September 2018	£m	£m	£m	£m
Payment concession	17	-	2	19
Interest suppressed payment concession	6	34	15	55
Balance re-aged/re-written	-	-	4	4
Total forbearance	23	34	21	78
Impairment provisions on forborne loans	13	29	15	57
5 April 2018	£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 provisions on forborne loans	13	27	16	56

Note:
i. Where more than one concession event has occurred, balances 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.

Credit risk – Commercial and other lending

Summary

The commercial and other lending portfolio comprises the following:

Commercial and other lending balances	30 September 2018 £m	5 April 2018 £m	4 April 2018 £m
Registered social landlords (note i)	6,469	6,816	6,820
Commercial real estate (CRE)	1,574	1,810	1,868
Project finance (note ii)	867	906	906
Other lending	437	79	79
Commercial and other lending balances at amortised cost	9,347	9,611	9,673
Fair value adjustment for micro hedged risk (note iii)	965	1,042	1,043
Commercial lending balances – FVTPL (note iv)	57	58	-
Total	10,369	10,711	10,716

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.
iv. As a result of their contractual cash flow characteristics, certain commercial loans were reclassified from amortised cost to FVTPL on transition to IFRS 9 on 5 April 2018, and remeasured at fair value.

The project finance and commercial real estate portfolios are closed to new business, whilst the registered social landlord market was re-opened to limited new business in September 2018.

Credit risk in the CRE portfolio continues to reduce as the managed exit of this business continues. Over the period, total balances across the commercial portfolios have decreased, and the performance of the portfolios has remained stable.

Other lending includes £409 million of collateral with a central counterparty (4 April 2018: £71 million), £19 million (4 April 2018: £nil) of reverse repos and £9 million (4 April 2018: £8 million) of deferred consideration receivable relating to the disposal of Visa Europe.

Credit risk – Commercial and other lending (continued)

The following table shows commercial and other lending balances carried at amortised cost on the balance sheet, with the stage allocation of the exposures, impairment provisions and resulting provision coverage ratios:

Commercial and other lending product and staging analysis	Stage 1	Stage 2	Stage 3	Total
30 September 2018	£m	£m	£m	£m
Gross balances				
Registered social landlords	6,388	81	-	6,469
CRE	1,378	169	27	1,574
Project finance	828	14	25	867
Other lending	437	-	-	437
Total	9,031	264	52	9,347
Provisions				
Registered social landlords	1	-	-	1
CRE	4	2	11	17
Project finance	-	-	12	12
Other lending	-	-	-	-
Total	5	2	23	30
Provisions as a % of total balance	%	%	%	%
Registered social landlords	0.01	0.14	-	0.01
CRE	0.31	1.27	41.47	1.06
Project finance	0.02	0.52	50.35	1.46
Other lending	0.03	-	-	0.03
Total	0.06	0.76	44.23	0.32

5 April 2018	£m	£m	£m	£m
Gross balances				
Registered social landlords	6,725	91	-	6,816
CRE	1,587	186	37	1,810
Project finance	818	88	-	906
Other lending	79	-	-	79
Total	9,209	365	37	9,611
Provisions				
Registered social landlords	1	-	-	1
CRE	5	3	13	21
Project finance	-	7	-	7
Other lending	-	-	-	-
Total	6	10	13	29
Provisions as a % of total balance	%	%	%	%
Registered social landlords	0.01	0.15	-	0.01
CRE	0.32	1.19	36.99	1.15
Project finance	0.02	8.37	-	0.83
Other lending	0.14	-	-	0.14
Total	0.07	2.74	35.55	0.30

Credit risk – Commercial and other lending (continued)

As at 30 September 2018, 97% (5 April 2018: 96%) of the commercial and other lending balances remain in stage 1. Of the £264 million stage 2 loans, £1 million (5 April 2018: £2 million) is in arrears by 30 days or more. The remainder are in stage 2 due to non-arrears factors such as placement on a watchlist pending full repayment of the balance at or post maturity.

The stage 3 loans in the CRE portfolio total £27 million (5 April 2018: £37 million), equating to 2% (5 April 2018: 2%) of the total CRE exposure.

Within the registered social landlord portfolio, there are no stage 3 assets, and only 1% (5 April 2018: 1%) of the exposure is in stage 2. Against a backdrop of a long history of zero defaults, the risk profile of the portfolio remains low.

The majority of loans in the project finance portfolio are secured on projects which are now operational and benefiting from secure long-term cash flows.

There is no significant exposure to credit risk on the other lending balances.

Credit quality

Nationwide adopts robust credit management policies and processes designed to recognise and manage the risks arising from the portfolio.

The following table shows the CRE portfolio by risk grade and the provision coverage for each category. The table includes balances held at amortised cost only.

CRE gross balances by risk grade and provision coverage 30 September 2018	**Stage 1 £m**	**Stage 2 £m**	**Stage 3 £m**	**Total £m**	**Provision coverage %**
Strong	856	13	-	869	0.5
Good	433	79	-	512	0.2
Satisfactory	89	29	-	118	0.3
Weak	-	48	-	48	2.0
Impaired	-	-	27	27	37.8
Total	**1,378**	**169**	**27**	**1,574**	**1.1**

CRE gross balances by risk grade and provision coverage 5 April 2018	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Provision coverage %
Strong	912	20	-	932	0.5
Good	614	79	-	693	0.1
Satisfactory	61	32	-	93	1.2
Weak	-	55	-	55	2.0
Impaired	-	-	37	37	36.0
Total	1,587	186	37	1,810	1.1

The risk grades in the table above are based upon supervisory slotting criteria, under which exposures are classified into categories depending on the underlying credit risk, with the assessment based upon financial strength, asset characteristics, the strength of the sponsor and the security. The credit quality in the CRE portfolio shown above remains stable, with 95% (5 April 2018: 95%) of the portfolio continuing to be rated as satisfactory or better.

Risk grades for the project finance portfolio are also based upon supervisory slotting criteria, with 97% of the exposure rated strong or good.

The residential social landlord portfolio is risk graded using a PD model. The credit quality remains high, with an average 12 month PD of 0.05% across the portfolio.

In addition to the above, £57 million (5 April 2018: £58 million) of commercial lending balances are classified as FVTPL, of which £53 million (5 April 2018: £53 million) relates to CRE loans, with a risk grade of satisfactory.

Credit risk – Commercial and other lending (continued)

Credit risk concentrations: by LTV and region

The following table includes both amortised cost and FVTPL CRE balances.

CRE lending balances by LTV and region	30 September 2018			4 April 2018		
	London	Rest of UK (note ii)	Total	London	Rest of UK (note ii)	Total
(note i)	£m	£m	£m	£m	£m	£m
Fully collateralised						
LTV ratio (note iii):						
Less than 25%	101	76	177	258	56	314
25% to 50%	622	306	928	705	242	947
51% to 75%	240	223	463	301	233	534
76% to 90%	1	43	44	9	46	55
91% to 100%	-	4	4	-	4	4
	964	652	1,616	1,273	581	1,854
Not fully collateralised:						
Over 100% LTV	-	11	11	-	14	14
Collateral value	-	*5*	*5*	-	*7*	*7*
Negative equity	-	*6*	*6*	-	*7*	*7*
Total CRE loans	964	663	1,627	1,273	595	1,868
Geographical concentration	59%	41%	100%	68%	32%	100%

Notes:
i. A CRE loan may be secured on assets located in different regions; balances are therefore attributed to the region where the majority of the exposure arises. This can lead to re-categorisation occurring between periods if the asset mix changes.
ii. Includes lending to borrowers based in the Channel Islands.
iii. 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 (IPD) monthly index is used.

The LTV distribution of the CRE portfolio remains stable, with 96% (4 April 2018: 96%) of the portfolio having an LTV of 75% or less.

The changes to the regional distribution of the CRE portfolio reflect the managed reduction of the portfolio.

Credit risk concentration by industry sector

Credit risk exposure by industry sector is unchanged from the year ended 4 April 2018, continuing to be spread across the retail, office, residential, industrial and leisure sectors. Of the £1,627 million (4 April 2018: £1,868 million) CRE exposures, 45% (4 April 2018: 45%) relates to the residential sector.

CRE balances by payment due status

Of the £1,627 million (4 April 2018: £1,868 million) CRE exposure, £65 million relates to balances with arrears (4 April 2018: £52 million). Of the balances with arrears, £8 million (4 April 2018: £24 million) have arrears greater than 3 months.

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.

The table below provides details of commercial loans that are currently subject to forbearance by concession event. The Annual Report and Accounts 2018 sets out further details of concession events included within forbearance.

Lending subject to forbearance (note i)	30 September 2018 £m	5 April 2018 £m
Refinance	73	78
Modifications:		
Capital concession	11	8
Security amendment	6	9
Extension at maturity	22	42
Breach of covenant	108	139
Total	220	276
Total impairment provision on forborne loans	22	19

Note:
i. 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 forborne.

Amortised cost balances subject to forbearance have reduced, reflecting the managed exit activity.

In addition to the amortised cost balances included in the table above, there are £57 million FVTPL commercial and other lending balances (5 April 2018: £58 million), of which £42 million (5 April 2018: £42 million) are forborne due to capital concessions.

Credit risk - Treasury assets

Summary

The treasury portfolio is held primarily for liquidity management and, in the case of derivatives, for market risk management. The table below shows the classification of treasury asset balances following the adoption of IFRS 9.

Treasury asset balances (note i)	IFRS 9 classification	30 September 2018 £m	5 April 2018 (IFRS 9) £m	4 April 2018 (IAS 39) £m
Cash	Amortised cost	18,423	14,361	14,361
Loans and advances to banks	Amortised cost	3,396	3,422	3,422
Investment securities	FVOCI	12,415	11,881	11,926
Investment securities	FVTPL	61	45	-
Investment securities	Amortised cost	1,748	1,120	1,120
Liquidity and investment portfolio		36,043	30,829	30,829
Derivative instruments (note ii)	FVTPL	4,534	4,121	4,121
Treasury assets		40,577	34,950	34,950

Notes:
i. Treasury assets are subject to credit risk; however for assets classified as FVTPL, provisions are not separately calculated as credit risk is reflected in the carrying value of the asset.
ii. Derivatives are classified as assets where their fair value is positive and liabilities where their fair value is negative. At 30 September 2018, derivative liabilities were £1,826 million (4 April 2018: £2,337 million).

The increase in cash is driven by an increased flow into savings products. Investment securities held at amortised cost have grown due to the purchase, as part of a consortium, of residential mortgage backed securities under a programme to securitise Bradford and Bingley plc residential mortgage assets.

Credit risk - Treasury assets (continued)

Investment activity, in line with the Board's risk appetite, remains restricted to high quality liquid securities. In addition, the Society invests in highly rated liquid assets that are eligible for accessing central bank funding operations. 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 is managed and controlled by the Treasury Credit Risk function in accordance with Nationwide's risk governance frameworks, details of which are provided in the Annual Report and Accounts 2018.

A monthly review is undertaken of the current and expected future performance of all treasury assets and this is used in determining provision requirements for the portfolio. At 30 September 2018 no treasury assets were impaired.

Liquidity and investment portfolio

The liquidity and investment portfolio of £36,043 million (4 April 2018: £30,829 million) comprises liquid assets and other securities. The size of the portfolio reflects operational and strategic liquidity requirements. An analysis of the on-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)		**AAA**	**AA**	**A**	**Other**	**UK**	**US**	**Europe**	**Other**
30 September 2018	**£m**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Liquid assets:									
Cash and reserves at central banks	**18,423**	**-**	**100**	**-**	**-**	**100**	**-**	**-**	**-**
Government bonds	**9,624**	**24**	**76**	**-**	**-**	**71**	**15**	**14**	**-**
Supranational bonds	**842**	**91**	**9**	**-**	**-**	**-**	**-**	**-**	**100**
Covered bonds	**819**	**100**	**-**	**-**	**-**	**47**	**-**	**25**	**28**
Residential mortgage backed securities (RMBS)	**648**	**100**	**-**	**-**	**-**	**60**	**-**	**40**	**-**
Asset backed securities (other)	**302**	**100**	**-**	**-**	**-**	**49**	**-**	**51**	**-**
Liquid assets total	**30,658**	**16**	**84**	**-**	**-**	**85**	**5**	**6**	**4**
Other securities (note ii):									
RMBS FVOCI	**126**	**20**	**25**	**55**	**-**	**100**	**-**	**-**	**-**
RMBS amortised cost	**1,748**	**85**	**6**	**7**	**2**	**100**	**-**	**-**	**-**
Other investments	**115**	**-**	**31**	**49**	**20**	**20**	**49**	**31**	**-**
Other securities total	**1,989**	**76**	**8**	**13**	**3**	**95**	**3**	**2**	**-**
Loans and advances to banks (note iii)	**3,396**	**-**	**55**	**45**	**-**	**86**	**6**	**7**	**1**
Total	**36,043**	**18**	**77**	**5**	**-**	**86**	**5**	**6**	**3**

Liquidity and investment portfolio by credit rating (note i)		AAA	AA	A	Other	UK	US	Europe	Other
4 April 2018	£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)	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

Notes:

i. 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.
ii. Includes RMBS (UK Buy to let and UK Non-conforming) not eligible for the Liquidity Coverage Ratio (LCR).
iii. Loans and advances to banks includes derivative collateral and reverse repo balances.

Credit risk - Treasury assets (continued)

Country exposures

The following table summarises the exposure (shown at the balance sheet carrying value) to institutions outside the UK. None of these exposures is in default, and Nationwide has not incurred any impairment on these assets in the period.

Country exposures 30 September 2018	Government bonds £m	Mortgage backed securities £m	Covered bonds £m	Supra-national bonds £m	Loans to banks £m	Other assets £m	Total £m
Belgium	135	-	-	-	-	-	135
Finland	272	-	25	-	-	-	297
France	-	-	-	-	-	36	36
Germany	572	-	-	-	216	154	942
Ireland	-	-	-	-	1	-	1
Netherlands	247	256	-	-	-	-	503
Spain	-	-	-	-	2	-	2
Total Eurozone	1,226	256	25	-	219	190	1,916
USA	1,472	-	-	-	217	57	1,746
Rest of world (note i)	82	-	405	842	58	-	1,387
Total	2,780	256	430	842	494	247	5,049

Country exposures 4 April 2018	Government bonds £m	Mortgage backed securities £m	Covered bonds £m	Supra-national bonds £m	Loans to banks £m	Other assets £m	Total £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

Note:
i. Rest of world exposure is to Australia, Canada, Denmark, Norway, Sweden and Switzerland.

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 period. The fair value of derivative assets at 30 September 2018 was £4.5 billion (4 April 2018: £4.1 billion). To comply with EU regulatory requirements, Nationwide, as a direct member of a central counterparty (CCP), has central clearing capability which it uses to clear standardised derivatives.

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.

Credit risk - Treasury assets (continued)

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. In the event of a default, or other predetermined event, outstanding transactions with the same counterparty can be offset and settled on a net basis. Under CSA arrangements, netting benefits of £1.5 billion (4 April 2018: £2.0 billion) were available and £3.1 billion of collateral (4 April 2018: £2.2 billion) was held. Only cash is held as collateral.

The following table shows the exposure to counterparty credit risk for derivative contracts after netting benefits and collateral:

Derivative credit exposure	**30 September 2018**				4 April 2018			
Counterparty credit quality	**AA**	**A**	**BBB**	**Total**	AA	A	BBB	Total
	£m	**£m**	**£m**	**£m**	£m	£m	£m	£m
Gross positive fair value of contracts	1,393	2,846	295	4,534	1,584	2,266	271	4,121
Netting benefits	(411)	(764)	(276)	(1,451)	(532)	(1,156)	(271)	(1,959)
Net current credit exposure	982	2,082	19	3,083	1,052	1,110	-	2,162
Collateral (cash)	(976)	(2,004)	(11)	(2,991)	(1,051)	(1,106)	-	(2,157)
Net derivative credit exposure	6	78	8	92	1	4	-	5

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 nor manage the 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 policies, 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. Further details are included within the Annual Report and Accounts 2018.

Liquidity and funding levels continued to be within Board risk appetite and regulatory requirements throughout the period. 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 30 September 2018 was above the regulatory minimum of 100% and increased to 131.9% (4 April 2018: 130.3%) due to strong retail deposit performance increasing the liquid asset buffer.

Nationwide also monitors its position against the longer term funding metric, the Net Stable Funding Ratio (NSFR). Based on current interpretations of expected regulatory requirements and guidance, the NSFR at 30 September 2018 was 134.4% (4 April 2018: 131.0%) which exceeds the expected 100% minimum future requirement.

Funding risk

Funding strategy

Nationwide's funding strategy is to remain predominantly retail funded as set out below.

Funding profile

Assets (note i)	**30 September 2018 £bn**	5 April 2018 (note ii) £bn	4 April 2018 £bn	**Liabilities**	**30 September 2018 £bn**	5 April 2018 (note ii) £bn	4 April 2018 £bn
Retail mortgages	**180.7**	177.1	177.2	Retail funding	**153.5**	148.4	148.4
Treasury assets (including liquidity portfolio)	**36.0**	30.8	30.8	Wholesale funding	**62.1**	58.8	58.8
Other retail lending	**4.0**	3.7	3.8	Other liabilities	**3.2**	3.7	3.7
Commercial and other lending	**10.3**	10.7	10.7	Capital and reserves	**19.5**	18.0	18.2
Other assets	**7.3**	6.6	6.6				
	238.3	228.9	229.1		**238.3**	228.9	229.1

Notes:
i. The figures in the above table are stated net of impairment provisions where applicable.
ii. Balances as at 5 April 2018 reflect the impact of applying IFRS 9: Financial Instruments.

Nationwide's loan to deposit ratio[1] at 30 September 2018 was 123.3% (4 April 2018: 125.5%).

[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).

Liquidity and funding risk (continued)

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. Part of 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 the level of encumbrance to ensure sufficient contingent funding capacity is retained.

Wholesale funding has increased by £3.3 billion to £62.1 billion during the period. This is primarily due to increased repo activity and deposits. 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 28.6% at 30 September 2018 (4 April 2018: 28.2%).

The table below sets out Nationwide's wholesale funding by currency.

Wholesale funding by currency	30 September 2018						4 April 2018					
	GBP £bn	EUR £bn	USD £bn	Other £bn	Total £bn	% of total	GBP £bn	EUR £bn	USD £bn	Other £bn	Total £bn	% of total
Repos	1.3	0.4	0.4	-	2.1	3	0.7	0.2	-	-	0.9	2
Deposits	6.2	1.3	0.1	-	7.6	12	5.4	1.4	-	-	6.8	12
Certificates of deposit	2.3	0.1	0.1	-	2.5	4	4.0	0.1	0.2	-	4.3	7
Commercial paper	0.1	-	3.2	-	3.3	5	-	-	1.0	-	1.0	2
Covered bonds	2.8	13.5	-	0.1	16.4	27	2.5	12.6	-	0.2	15.3	26
Medium term notes	2.0	4.6	1.9	0.6	9.1	15	2.0	4.6	1.8	0.6	9.0	15
Securitisations	0.8	1.3	1.3	-	3.4	5	1.1	1.3	1.3	-	3.7	6
TFS	17.0	-	-	-	17.0	28	17.0	-	-	-	17.0	29
Other	0.1	0.6	-	-	0.7	1	0.2	0.6	-	-	0.8	1
Total	32.6	21.8	7.0	0.7	62.1	100	32.9	20.8	4.3	0.8	58.8	100

The residual maturity of the wholesale funding book, on a contractual maturity basis, is set out below.

Wholesale funding – residual maturity	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
30 September 2018	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Repos	2.1	-	-	-	2.1	-	-	2.1
Deposits	5.4	0.6	1.5	0.1	7.6	-	-	7.6
Certificates of deposit	1.1	0.9	0.5	-	2.5	-	-	2.5
Commercial paper	2.1	1.0	0.2	-	3.3	-	-	3.3
Covered bonds	-	-	0.1	1.7	1.8	0.9	13.7	16.4
Medium term notes	-	0.9	0.1	1.5	2.5	0.9	5.7	9.1
Securitisations	-	-	-	0.4	0.4	1.1	1.9	3.4
TFS	-	-	-	-	-	-	17.0	17.0
Other	-	-	-	-	-	-	0.7	0.7
Total	10.7	3.4	2.4	3.7	20.2	2.9	39.0	62.1
Of which secured	2.1	-	0.1	2.1	4.3	2.0	33.3	39.6
Of which unsecured	8.6	3.4	2.3	1.6	15.9	0.9	5.7	22.5
% of total	17.2	5.5	3.9	6.0	32.6	4.6	62.8	100.0

Liquidity and funding risk (continued)

Wholesale funding – residual maturity 4 April 2018	Not more than one month £bn	Over one month but not more than three months £bn	Over three months but not more than six months £bn	Over six months but not more than one year £bn	Subtotal less than one year £bn	Over one year but not more than two years £bn	Over two years £bn	Total £bn
Repos	0.9	-	-	-	0.9	-	-	0.9
Deposits	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

At 30 September 2018, cash, government bonds and supranational bonds included in the liquid asset buffer represented 136% (4 April 2018: 142%) of wholesale funding maturing in less than one year, assuming no rollovers.

Liquidity risk

Liquidity strategy

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.

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. Further details of Nationwide's policies for liquid assets are contained within the Annual Report and Accounts 2018.

Liquid assets

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	**30 September 2018**				4 April 2018			
	GBP £bn	**EUR £bn**	**USD £bn**	**Total £bn**	GBP £bn	EUR £bn	USD £bn	Total £bn
Cash and reserves at central banks	**18.4**	**-**	**-**	**18.4**	14.4	-	-	14.4
Government bonds	**6.4**	**0.4**	**1.3**	**8.1**	6.8	0.8	0.6	8.2
Supranational bonds	**0.6**	**-**	**0.3**	**0.9**	0.4	-	0.3	0.7
Covered bonds	**0.3**	**0.6**	**0.1**	**1.0**	0.6	0.6	-	1.2
RMBS (note i)	**2.2**	**0.2**	**0.1**	**2.5**	1.7	0.3	-	2.0
Asset-backed securities and other securities	**0.1**	**0.2**	**0.1**	**0.4**	0.2	0.1	-	0.3
Total	**28.0**	**1.4**	**1.9**	**31.3**	24.1	1.8	0.9	26.8

Note:
i. Balances include all RMBS held by the Society which can be monetised through sale or repo.

The average combined month end balance during the period of cash and reserves at central banks, and government and supranational bonds, was £25.9 billion (4 April 2018: £27.2 billion).

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) 30 September 2018	Due less than one month (note ii) £m	Due between one and three months £m	Due between three and six months £m	Due between six and nine months £m	Due between nine and twelve months £m	Due between one and two years £m	Due between two and five years £m	Due after more than five years £m	Total £m
Financial assets									
Cash	18,423	-	-	-	-	-	-	-	18,423
Loans and advances to banks	2,843	-	-	-	-	-	-	553	3,396
Investment securities	13	167	100	5	107	458	5,532	7,842	14,224
Loans and advances to customers	3,385	1,317	1,956	1,974	1,905	7,825	23,330	153,325	195,017
Derivative financial instruments	122	174	20	230	36	475	1,800	1,677	4,534
Fair value adjustment for portfolio hedged risk	(2)	(4)	(12)	(24)	(38)	(50)	(122)	48	(204)
Total financial assets	24,784	1,654	2,064	2,185	2,010	8,708	30,540	163,445	235,390
Financial liabilities									
Shares	131,911	1,494	1,735	2,755	4,762	3,207	5,838	1,369	153,071
Deposits from banks	3,403	30	116	-	-	-	17,000	-	20,549
Of which repo	*813*	-	-	-	-	-	-	-	*813*
Of which TFS	-	*28*	-	-	-	-	*17,000*	-	*17,028*
Other deposits	4,117	614	1,392	78	47	-	-	-	6,248
Of which repo	*1,290*	-	-	-	-	-	-	-	*1,290*
Due to customers	391	-	-	-	-	-	-	-	391
Secured funding – ABS and covered bonds	34	8	127	2,056	4	1,936	9,406	6,846	20,417
Senior unsecured funding	3,228	2,727	797	1,047	366	911	2,308	3,452	14,836
Derivative financial instruments	56	4	4	6	7	55	152	1,542	1,826
Fair value adjustment for portfolio hedged risk	(2)	(2)	(3)	(3)	(3)	(5)	(22)	-	(40)
Subordinated liabilities	17	-	17	-	11	691	-	5,893	6,629
Subscribed capital (note iii)	1	1	1	-	-	-	-	254	257
Total financial liabilities	143,156	4,876	4,186	5,939	5,194	6,795	34,682	19,356	224,184
Off-balance sheet commitments (note iv)	13,782	-	-	-	-	-	-	-	13,782
Net liquidity difference	(132,154)	(3,222)	(2,122)	(3,754)	(3,184)	1,913	(4,142)	144,089	(2,576)
Cumulative liquidity difference	(132,154)	(135,376)	(137,498)	(141,252)	(144,436)	(142,523)	(146,665)	(2,576)	-

Liquidity and funding risk (continued)

Residual maturity (note i) 4 April 2018	Due less than one month (note ii) £m	Due between one and three months £m	Due between three and six months £m	Due between six and nine months £m	Due between nine and twelve months £m	Due between one and two years £m	Due between two and five years £m	Due after more than five years £m	Total £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
Of which repo	*266*	-	-	-	-	-	-	-	*266*
Of which TFS	-	*1*	-	-	-	-	*17,000*	-	*17,001*
Other deposits	3,123	481	1,343	315	50	11	-	-	5,323
Of which repo	*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 hedge risk	-	(6)	(6)	(4)	(4)	(8)	(25)	-	(53)
Subordinated liabilities	17	-	49	-	-	-	690	4,741	5,497
Subscribed capital (notes 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)	-

Notes:

i. The analysis excludes certain non-financial assets (including property, plant and equipment, intangible assets, 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.

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 Nationwide's Assets and Liabilities Committee (ALCO). Nationwide uses judgement and past behavioural performance of each asset and liability class to forecast likely cash flow requirements.

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 (further information is included in note 11) and from participation in the Bank of England's Term Funding Scheme (TFS).

Certain unencumbered assets are readily available to secure funding or meet collateral requirements. These include prime mortgages and cash and securities held in the liquid asset 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.

At 30 September 2018, Nationwide had £33,922 million (4 April 2018: £32,633 million) of externally encumbered assets with counterparties other than central banks. Nationwide also had £40,243 million (4 April 2018: £38,886 million) of pre-positioned and encumbered assets held at central banks and £155,129 million (4 April 2018: £149,636 million) of assets neither encumbered nor pre-positioned but capable of being encumbered. Further details of Nationwide's policies for asset encumbrance are contained within the Annual Report and Accounts 2018.

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	October 2018	Negative
Fitch	A+	F1	A	A-	February 2018	Stable

In October 2018, Moody's affirmed Nationwide's Aa3/P-1 long and short term ratings, but changed its outlook to negative from stable. This change in outlook reflects uncertainties embedded in Moody's forward looking view on the loss given failure of the Society's senior debt. There have been no other credit rating changes since April 2018.

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. Further information on solvency risk and how it is managed can be found in the Annual Report and Accounts 2018 and the Annual Pillar 3 Disclosure 2018 at **nationwide.co.uk**

Capital position

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 CRD IV provisions permitted. However, IFRS 9 transitional arrangements are applied. The arrangements allow for transitional relief to be applied against the impact of IFRS 9 on capital resources, to be scaled over a 5-year transition period, with the full impact being applied from 2023 onwards.

The disclosures below are reported on a consolidated Group basis, including all subsidiary entities, unless otherwise stated.

Capital ratios	30 September 2018	5 April 2018 (note i)	4 April 2018
Solvency	%	%	%
Common Equity Tier 1 (CET1) ratio	31.7	30.4	30.5
Total Tier 1 ratio	34.7	33.5	33.6
Total regulatory capital ratio	44.2	42.8	42.9
Leverage	£m	£m	£m
UK leverage exposure	227,646	221,982	221,992
CRR leverage exposure	246,193	236,458	236,468
Tier 1 capital	11,415	10,907	10,917
	%	%	%
UK leverage ratio (note ii)	5.0	4.9	4.9
CRR leverage ratio (note iii)	4.6	4.6	4.6

Notes:

i. Figures have been adjusted to reflect the impact of applying IFRS 9 from 5 April 2018. Further information is provided in our Report on Transition to IFRS 9: Financial Instruments, which can be found on nationwide.co.uk.

ii. The UK leverage ratio is shown on the basis of measurement announced by the Prudential Regulation Authority (PRA). 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.

iii. 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.

Our capital resources have continued to strengthen during the period with the CET1 ratio increasing to 31.7% (5 April 2018: 30.4%) and the UK leverage ratio to 5.0% (5 April 2018: 4.9%). Both are comfortably in excess of minimum regulatory capital requirements and Nationwide's strategic target of maintaining a UK leverage ratio of greater than 4.5%.

CET1 capital resources have increased by £0.5 billion, primarily due to profit after tax for the period of £387 million and a net remeasurement of pension obligations of £155 million.

The total regulatory capital ratio has increased to 44.2% (5 April 2018: 42.8%), also due to higher CET1 capital resources. Additional Tier 1 (AT1) and Tier 2 capital resources have remained stable over the period.

Solvency risk (continued)

Detailed information on Nationwide's capital instruments can be found within the Interim Pillar 3 Disclosure 2018, at **nationwide.co.uk**

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.

Lending growth has been more than offset by profits for the period, with Tier 1 resources growing more quickly than leverage exposure. This resulted in the UK leverage ratio increasing to 5.0%. The CRR leverage ratio has remained stable at 4.6%.

Further details on the leverage exposure can be found in the Group's Interim Pillar 3 Disclosure 2018 at **nationwide.co.uk**

Nationwide's latest Pillar 2A Individual Capital Requirement (ICR) and Total Capital Requirement (TCR) were received in September 2018. The ICR is the Pillar 2A capital requirement while the TCR is the sum of our Pillar 1 and Pillar 2A requirements. These replace the former Internal Capital Guidance (ICG). The ICR equates to circa £2.4 billion, of which at least circa £1.4 billion must be met by CET1 capital. The ICR was equivalent to 7.4% of RWAs as at 30 September 2018 (4 April 2018: 7.1%), largely reflecting the low average risk weight, given that approximately 76% (4 April 2018: 78%) of total assets are in the form of secured residential mortgages.

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	**30 September 2018 £m**	4 April 2018 £m
General reserve	10,265	9,951
Core capital deferred shares (CCDS)	1,325	1,325
Revaluation reserve	68	68
FVOCI reserve	52	
Available for sale reserve		75
Regulatory adjustments and deductions:		
Foreseeable distributions (note i)	(68)	(68)
Prudent valuation adjustment (note ii)	(49)	(32)
Own credit and debit valuation adjustments (note iii)	(1)	(1)
Intangible assets (note iv)	(1,215)	(1,286)
Goodwill (note iv)	(12)	(12)
Excess of regulatory expected losses over impairment provisions (note v)	(1)	(95)
IFRS 9 transitional arrangements (note vi)	59	
Total regulatory adjustments and deductions	(1,287)	(1,494)
Common Equity Tier 1 capital	10,423	9,925
Additional Tier 1 capital securities (AT1)	992	992
Total Tier 1 capital	11,415	10,917
Dated subordinated debt (note vii)	3,086	3,019
Excess of impairment provisions over regulatory expected losses (note v)	71	-
IFRS 9 transitional arrangements (note vi)	(61)	
Tier 2 capital	3,096	3,019
Total regulatory capital	14,511	13,936

Notes:

i. Foreseeable distributions in respect of CCDS and AT1 securities are deducted from CET1 capital under CRD IV.

ii. A prudent valuation adjustment (PVA) is applied in respect of fair valued instruments as required under regulatory capital rules.

iii. 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.

iv. Intangible assets and goodwill do not qualify as capital for regulatory purposes.

v. The net regulatory capital expected loss in excess of accounting impairment provisions is deducted from CET1 capital, gross of tax. The net excess of impairment provisions over regulatory capital expected loss is added to Tier 2 capital, gross of tax. The expected loss amounts for equity exposures and general and specific credit risk adjustments related to these exposures are not included in the calculation, as per Article 159 of CRR. The expected loss amounts for equity exposures are deducted from CET1 capital, gross of tax.

vi. The transitional adjustments to capital resources apply scaled relief for the impact of IFRS 9, over a 5-year transition period. Further information on these adjustments is provided in the Interim Pillar 3 disclosures.

vii. 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.

Solvency risk (continued)

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 minimum requirement for eligible liabilities (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 (6.5% of UK leverage exposure), plus the applicable capital requirement buffers, which are currently expected to amount to 0.75% of UK leverage exposure. In order to meet this pending requirement, Nationwide issued a further £0.7 billion of senior non-preferred notes in July 2018 which are MREL eligible.

At 30 September 2018, total MREL resources were equal to 8.0% of UK leverage ratio exposure (4 April 2018: 7.5%), above the anticipated 2020 requirement described previously.

Risk weighted assets

The table below shows the breakdown of risk weighted asset (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 30 September 2018	Credit Risk (note i) £m	Operational Risk (note ii) £m	Total Risk Weighted Assets £m
Retail mortgages	13,719	3,564	17,283
Retail unsecured lending	5,937	725	6,662
Commercial loans	3,923	210	4,133
Treasury	482	87	569
Counterparty credit risk (note iii)	1,779	-	1,779
Other	2,127	315	2,442
Total	27,967	4,901	32,868

4 April 2018	£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

Notes:
i. This column includes credit risk exposures, counterparty credit risk exposures and deferred tax assets that are below the thresholds for deduction and instead are subject to a 250% risk weight.
ii. RWAs have been allocated according to the business lines within the standardised approach to operational risk, as per article 317 of CRR.
iii. Counterparty credit risk relates to derivative financial instruments and securities financing transactions (SFTs).

Risk weighted assets (RWAs) have increased by £0.4 billion over the period. This is primarily due to an increase of £0.6 billion in RWAs for counterparty credit risk, driven by a relative weakening of sterling against other currencies increasing our derivative exposure, and a £0.4 billion increase in exposure in the 'other' assets category. These were partly offset by a £0.7 billion decrease in commercial RWAs due to the portfolio run off. Details on how RWAs are calculated can be found in the Group's annual Pillar 3 Disclosure 2018 at **nationwide.co.uk**

Regulatory developments

Nationwide is currently required to maintain a minimum leverage ratio of 3.45% following the implementation of a 0.2% countercyclical buffer in June 2018. The countercyclical buffer increases to 0.4% from November 2018. There is also an additional leverage ratio buffer to be implemented in 2019, expected to be 0.35%. 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 rules are subject to a lengthy transitional period. Further information can be found in the Solvency risk section of the Annual Report and Accounts 2018.

Pension risk

Nationwide has funding obligations to defined benefit pension schemes, the most significant being the Nationwide Pension Fund (the Fund). Further information is set out in the Annual Report and Accounts 2018.

The Fund's net defined benefit liability (deficit) which appears within liabilities on the balance sheet, has decreased from £345 million to £83 million in the period. The reduction in the Fund's deficit since 4 April 2018 is largely due to improving market conditions combined with an employer deficit contribution of £61 million agreed as part of the 2016 triennial valuation. Further information is included in note 19.

The Trustees and Nationwide have taken actions which are expected to have a positive long-term impact on the volatility of the Fund's deficit. During the period, the Fund progressed its liability hedging strategy and invested £310 million in index-linked and conventional gilts, to further reduce its exposure to inflation and interest rate risk.

GMP Equalisation

On 5 July 2018, a coalition, formed of Lloyds Banking Group, Lloyds Trade Union and the Lloyds pension scheme trustees began to seek the High Court's input on whether the trustees of their pension schemes should equalise Guaranteed Minimum Pension (GMP) between females and males and, if so, how this should be undertaken.

On 26 October 2018 the verdict from the High Court confirmed that GMPs must be equalised and arrears paid. Although the case is specific to the Lloyds pension schemes, the verdict will impact all defined benefit pension schemes (including the Nationwide Pension Fund) that contracted out of the state second pension between 1978 and 1997, substituting members' state second pensions for GMP. The High Court judgement also commented on the method of equalisation.

The verdict will result in an increase in the Nationwide Pension Fund's retirement benefit obligation; the exact impact is currently being assessed but is not expected to be material. Nationwide will continue to monitor developments in relation to GMP; the increased financial obligation is expected to be recognised as a charge in Q3 2018/19.

Operational risk

Nationwide's recently announced investment in new technology, skills and capabilities will help to ensure that we are able to continue to provide secure and resilient systems and processes that deliver significant benefits for our customers. A transformation of this scale necessarily creates operational risks and these will be closely monitored and managed.

We have seen an increase in the frequency and sophistication of cyber attacks being made against the Society. This is not unique to Nationwide, and reflects the increased activity, sophistication and severity of attacks across the UK. We continue to evaluate our cyber security and resilience against the emerging threat landscape, updating our defensive capabilities accordingly.

Protecting our members from becoming victims of fraud and scams continues to be a priority for Nationwide. Specifically, in the area of Authorised Push Payment scams, we continue to work with industry peers, consumer groups, regulators and the Financial Ombudsman Service (FOS) to create and implement a more effective framework in which to manage the increasing threat of customers being duped into authorising transactions by criminals.

Conduct and compliance risk

The General Data Protection Regulation (GDPR) came into force in May 2018. Following this, consumer awareness about personal data rights has increased and we have experienced a rise in Subject Access Requests, in line with the industry. Nationwide will continue to maintain its focus on meeting the GDPR requirements and safeguarding members' data protection and privacy.

Consolidated interim financial statements

Contents

Consolidated income statement
(Unaudited)

	Notes	Half year to 30 September 2018 £m	Half year to 30 September 2017 £m
Interest receivable and similar income	3	2,541	2,347
Interest expense and similar charges	4	(1,046)	(833)
Net interest income		1,495	1,514
Fee and commission income		214	214
Fee and commission expense		(121)	(120)
Other operating income	5	2	31
Gains from derivatives and hedge accounting	6	47	36
Total income		1,637	1,675
Administrative expenses	7	(1,100)	(966)
Impairment losses on loans and advances to customers	8	(45)	(59)
Provisions for liabilities and charges	17	24	(22)
Profit before tax		516	628
Taxation	9	(129)	(157)
Profit after tax		387	471

The notes on pages 53 to 77 form part of these consolidated interim financial statements.

Consolidated statement of comprehensive income
(Unaudited)

	Notes	Half year to 30 September 2018 £m	Half year to 30 September 2017 £m
Profit after tax		387	471
Other comprehensive income/(expense):			
Items that will not be reclassified to the income statement			
Remeasurements of retirement benefit obligations:			
Retirement benefit remeasurements before tax	19	212	97
Taxation		(57)	(26)
		155	71
Items that may subsequently be reclassified to the income statement			
Cash flow hedge reserve:			
Fair value movements taken to members' interests and equity		1,013	(373)
Amount transferred to income statement		(1,099)	219
Taxation		21	40
	6	(65)	(114)
Fair value through other comprehensive income reserve:			
Fair value movements taken to members' interests and equity		21	
Amount transferred to income statement		(34)	
Taxation		3	
		(10)	
Available for sale reserve:			
Fair value movements taken to members' interests and equity			27
Amount transferred to income statement			(47)
Taxation			5
			(15)
Other comprehensive income/(expense)		80	(58)
Total comprehensive income		467	413

Note:
Half year to 30 September 2018 is prepared on an IFRS 9 basis; comparatives are prepared on an IAS 39 basis. On implementation of IFRS 9 the available for sale reserve was replaced by the fair value through other comprehensive income reserve.

The notes on pages 53 to 77 form part of these consolidated interim financial statements.

Consolidated balance sheet
(Unaudited)

	Notes	30 September 2018 £m	5 April 2018* £m	4 April 2018 £m
Assets				
Cash		18,423	14,361	14,361
Loans and advances to banks		3,396	3,422	3,422
Investment securities		14,224	13,046	13,046
Derivative financial instruments		4,534	4,121	4,121
Fair value adjustment for portfolio hedged risk		(204)	(144)	(109)
Loans and advances to customers	11	195,017	191,492	191,664
Intangible assets		1,258	1,342	1,342
Property, plant and equipment		883	887	887
Accrued income and expenses prepaid		165	164	164
Deferred tax		87	144	98
Other assets		553	102	102
Total assets		238,336	228,937	229,098
Liabilities				
Shares		153,071	148,003	148,003
Deposits from banks		20,549	19,404	19,404
Other deposits		6,248	5,323	5,323
Due to customers		391	402	402
Fair value adjustment for portfolio hedged risk		(40)	(53)	(53)
Debt securities in issue		35,253	34,118	34,118
Derivative financial instruments		1,826	2,337	2,337
Other liabilities		782	345	345
Provisions for liabilities and charges	17	181	274	273
Accruals and deferred income		321	336	336
Subordinated liabilities	12	6,629	5,497	5,497
Subscribed capital	12	257	263	263
Deferred tax		36	49	49
Current tax liabilities		120	53	53
Retirement benefit obligations	19	83	345	345
Total liabilities		225,707	216,696	216,695
Members' interests and equity				
Core capital deferred shares	20	1,325	1,325	1,325
Other equity instruments	21	992	992	992
General reserve		10,265	9,802	9,951
Revaluation reserve		68	68	68
Cash flow hedge reserve		(73)	(8)	(8)
Fair value through other comprehensive income reserve		52	62	
Available for sale reserve				75
Total members' interests and equity		12,629	12,241	12,403
Total members' interests, equity and liabilities		238,336	228,937	229,098

*Balances have been presented under IFRS 9 as detailed in note 2.

The notes on pages 53 to 77 form part of these consolidated interim financial statements.

Consolidated statement of movements in members' interests and equity
For the period ended 30 September 2018
(Unaudited)

	Core capital deferred shares £m	Other equity instruments £m	General reserve £m	Revaluation reserve £m	Cash flow hedge reserve £m	Available for sale reserve £m	FVOCI reserve £m	Total £m
At 4 April 2018	1,325	992	9,951	68	(8)	75		12,403
IFRS 9 transition (note i)	-	-	(149)	-	-	(75)	62	(162)
At 5 April 2018	1,325	992	9,802	68	(8)		62	12,241
Profit for the period	-	-	387	-	-		-	387
Net remeasurements of retirement benefit obligations	-	-	155	-	-		-	155
Net movement in cash flow hedge reserve	-	-	-	-	(65)		-	(65)
Net movement in FVOCI reserve	-	-	-	-	-		(10)	(10)
Total comprehensive income	-	-	542	-	(65)		(10)	467
Distribution to the holders of core capital deferred shares	-	-	(54)	-	-		-	(54)
Distribution to the holders of Additional Tier 1 capital (note ii)	-	-	(25)	-	-		-	(25)
At 30 September 2018	1,325	992	10,265	68	(73)		52	12,629

For the period ended 30 September 2017
(Unaudited)

	Core capital deferred shares £m	Other equity instruments £m	General reserve £m	Revaluation reserve £m	Cash flow hedge reserve £m	Available for sale reserve £m	Total £m
At 5 April 2017	531	992	9,316	67	183	44	11,133
Profit for the period	-	-	471	-	-	-	471
Net remeasurements of retirement benefit obligations	-	-	71	-	-	-	71
Net movement in cash flow hedge reserve	-	-	-	-	(114)	-	(114)
Net movement in available for sale reserve	-	-	-	-	-	(15)	(15)
Total comprehensive income	-	-	542	-	(114)	(15)	413
Issue of core capital deferred shares	794	-	-	-	-	-	794
Distribution to the holders of core capital deferred shares	-	-	(28)	-	-	-	(28)
Distribution to the holders of Additional Tier 1 capital (note ii)	-	-	(25)	-	-	-	(25)
At 30 September 2017	1,325	992	9,805	67	69	29	12,287

Notes:
i. Adjusted on implementation of IFRS 9 as detailed in note 2.
ii. The distribution to the holders of Additional Tier 1 capital is shown net of an associated tax credit of £9 million (H1 2017/18: £9 million).

The notes on pages 53 to 77 form part of these consolidated interim financial statements.

Consolidated cash flow statement
(Unaudited)

	Notes	Half year to 30 September 2018 £m	Half year to 30 September 2017* £m
Cash flows generated from operating activities			
Profit before tax		516	628
Adjustments for:			
Non-cash items included in profit before tax	23	612	533
Changes in operating assets and liabilities	23	3,293	1,702
Taxation		(43)	(86)
Net cash flows generated from operating activities		4,378	2,777
Cash flows generated used in investing activities			
Purchase of investment securities		(4,733)	(3,818)
Sale and maturity of investment securities		3,652	2,633
Purchase of property, plant and equipment		(87)	(59)
Sale of property, plant and equipment		4	5
Purchase of intangible assets		(165)	(184)
Net cash flows generated used in investing activities		(1,329)	(1,423)
Cash flows generated from financing activities			
Issue of core capital deferred shares		-	794
Distributions paid to the holders of core capital deferred shares		(54)	(28)
Distributions paid to the holders of Additional Tier 1 capital		(34)	(34)
Issue of debt securities		11,945	11,158
Redemption of debt securities in issue		(11,603)	(11,077)
Interest paid on debt securities in issue		(197)	(240)
Issue of subordinated liabilities		855	868
Interest paid on subordinated liabilities		(124)	(64)
Redemption on subscribed capital		(3)	-
Interest paid on subscribed capital		(7)	(7)
Net cash flows generated from financing activities		778	1,370
Net increase in cash and cash equivalents		3,827	2,724
Cash and cash equivalents at start of period		17,439	15,243
Cash and cash equivalents at end of period	23	21,266	17,967

*Comparatives have been restated as detailed in note 2.

The notes on pages 53 to 77 form part of these consolidated interim financial statements.

Notes to the consolidated interim financial statements

1 General information and reporting period

Nationwide Building Society ('the Society') and its subsidiaries (together, 'the Group') provide financial services to retail and commercial customers within the United Kingdom.

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.

There were no material changes in the composition of the Group in the half year to 30 September 2018.

These condensed consolidated interim financial statements ('consolidated interim financial statements') have been prepared as at 30 September 2018 and show the financial performance for the period from, and including, 5 April 2018 to this date. They were approved for issue on 21 November 2018.

These consolidated interim financial statements have been reviewed, not audited.

2 Basis of preparation

The consolidated interim financial statements of the Group for the half year ended 30 September 2018 have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority and with International Accounting Standard (IAS) 34 'Interim Financial Reporting' as adopted by the EU. The consolidated interim financial statements should be read in conjunction with the Group's annual financial statements for the year ended 4 April 2018, which were prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU.

Terminology used in these consolidated interim financial statements is consistent with that used in the Annual Report and Accounts 2018. Copies of the Annual Report and Accounts 2018 and Glossary are available on the Group's website at **nationwide.co.uk**

Accounting policies

The accounting policies adopted by the Group in the preparation of these consolidated interim financial statements and those which the Group currently expects to adopt in the Annual Report and Accounts 2019 are consistent with those disclosed in the Annual Report and Accounts 2018, except in relation to the adoption of the following new standards:

- IFRS 9 'Financial Instruments'
- IFRS 15 'Revenue from Contracts with Customers'.

Further information on the impacts of adopting these new standards is set out below, including revised accounting policies in relation to IFRS 9. Additional information on the transition to IFRS 9 can be found in the Nationwide's 'Report on Transition to IFRS 9: Financial Instruments', available on the Society's website at **nationwide.co.uk.** This report also includes a glossary containing definitions of terms relevant to IFRS 9.

In addition, a number of amendments and improvements to accounting standards have been issued by the International Accounting Standards Board (IASB) with an effective date of 1 January 2018. Those relevant to these consolidated interim financial statements, being minor amendments to IFRS 2 'Classification and Measurement of Share-based Payment Transactions' and IAS 40 'Transfers of Investment Property', were adopted with no significant impact for the Group.

Notes to the consolidated interim financial statements (continued)

2 Basis of preparation (continued)

IFRS 9 'Financial Instruments'

As permitted by IFRS 9, comparatives have not been restated following adoption. The impact on the Group's balance sheet and members' interests and equity at 5 April 2018 was as follows:

	As at 4 April 2018	Impact of IFRS 9 Classification	Measurement	Impairment	As at 5 April 2018
	£m	£m	£m	£m	£m
Assets					
Loans and advances to customers	191,664	-	(1)	(171)	191,492
Fair value adjustment for portfolio hedged risk	(109)	-	(35)	-	(144)
Deferred tax	98	-	8	38	144
Assets not impacted by changes arising from IFRS 9	37,445	-	-	-	37,445
Total assets	229,098	-	(28)	(133)	228,937
Total liabilities	216,695	-	-	1	216,696
Members' interests and equity					
Capital and reserves not impacted by changes arising from IFRS 9	2,377	-	-	-	2,377
General reserve (note i)	9,951	13	(28)	(134)	9,802
Fair value through other comprehensive income reserve		62	-	-	62
Available for sale reserve	75	(75)			
Total members' interests and equity	12,403	-	(28)	(134)	12,241
Total members' interests, equity and liabilities	229,098	-	(28)	(133)	228,937

Note:
i. Certain assets previously classified as available for sale have been reclassified as fair value through profit or loss, resulting in an adjustment to the general reserve of £13 million.

The policies for financial assets and impairment of financial assets have changed from 5 April 2018 following the adoption of IFRS 9; the revised policies are set out below.

IFRS 9 also includes updated requirements for the general hedge accounting model, which covers hedge accounting in the instances where a single item or a closed portfolio of items is the hedged risk. The IASB is currently working on a project for open portfolios, otherwise known as macro hedges. Until this project is completed, an entity can choose to continue using IAS 39 for all hedge accounting requirements, or adopt IFRS 9 for general hedge accounting and continue using the IAS 39 approach for macro hedges. The Group is currently using IAS 39 for all of its hedge accounting requirements.

Financial assets

Financial assets comprise cash, loans and advances to banks, investment securities, derivative financial instruments and loans and advances to customers.

Recognition and derecognition

All financial assets are recognised initially at fair value. Purchases and sales of financial assets are accounted for at trade date. Financial assets acquired through a business combination or portfolio acquisition are recognised at fair value at the acquisition date. Financial assets are derecognised when the rights to receive cash flows have expired or where the assets have been transferred and substantially all the risks and rewards of ownership have been transferred.

Notes to the consolidated interim financial statements (continued)

2 Basis of preparation (continued)

IFRS 9 'Financial Instruments' (continued)

The fair value of a financial instrument on initial recognition is normally the transaction price (plus directly attributable transaction costs for financial assets which are not subsequently measured at fair value through profit or loss). On initial recognition, it is presumed that the transaction price is the fair value unless there is observable information available in an active market to the contrary. Any difference between the fair value at initial recognition and the transaction price is recognised immediately as a gain or loss in the income statement where the fair value is based on a quoted price in an active market or a valuation using only observable market data. In all other cases, any gain or loss is deferred and recognised over the life of the transaction, or until valuation inputs become observable.

Modification of contractual terms

An instrument that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement is made on substantially different terms (such as renegotiations of commercial loans). Residential mortgages reaching the end of a fixed interest deal period are deemed repricing events, rather than a modification of contractual terms, as the change in interest rate at the end of the fixed rate period was envisaged in the original mortgage contract.

Where an instrument is renegotiated and not derecognised (for example forbearance), the change is considered a modification of contractual terms. Where this arises, the gross carrying amount of the loan is recalculated as the present value of the renegotiated or modified contractual cash flows, discounted at the loan's original effective interest rate. Any gain or loss on recalculation is recognised immediately in the income statement.

Classification and measurement

The classification and subsequent measurement of financial assets is based on an assessment of the Group's business models for managing the assets and their contractual cash flow characteristics. Financial assets are classified into the following three categories:

(a) Amortised cost

Financial assets held to collect contractual cash flows and where contractual terms comprise solely payments of principal and interest (SPPI) are classified as amortised cost. This category of financial assets includes cash, loans and advances to banks, the majority of the Group's residential and commercial mortgage loans, all unsecured lending, and certain investment securities within a 'hold to collect' business model.

Financial assets within this category are recognised on either the receipt of cash or deposit of funds into one of the Group's bank accounts (for cash and loans and advances to banks), when the funds are advanced to borrowers (for residential, commercial and unsecured lending) or on the trade date for purchases of investment securities. After initial recognition, the assets are measured at amortised cost using the effective interest rate method, less provisions for expected credit losses.

(b) Fair value through other comprehensive income

Financial assets held in a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets, and where contractual terms comprise solely payments of principal and interest, are classified and measured at fair value through other comprehensive income (FVOCI). This category of financial assets includes most of the Group's investment securities which are held to manage liquidity requirements.

Financial assets within this category are recognised on trade date. The assets are measured at fair value using, in the majority of cases, market prices or, where there is no active market, 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 from market participants are not available, discounted cash flow models are used.

Interest on FVOCI assets is recognised in interest receivable and similar income in the income statement, using the effective interest rate method.

Unrealised gains and losses arising from changes in value are recognised in other comprehensive income. Provisions for expected credit losses and foreign exchange gains or losses are recognised in the income statement.

Cumulative gains or losses arising on sale are recognised in the income statement, net of any credit or foreign exchange gains or losses already recognised.

Notes to the consolidated interim financial statements (continued)

2 Basis of preparation (continued)

IFRS 9 'Financial Instruments' (continued)

(c) Fair value through profit or loss

All other financial assets are measured at fair value through profit or loss (FVTPL). Financial assets within this category include derivative instruments and a small number of residential and commercial loans and investment securities with contractual cash flow characteristics which do not meet the SPPI criteria. The contractual terms for these cash flows include contingent or leverage features, or returns based on movements in underlying collateral values such as house prices.

Fair values are based on observable market data, valuations obtained by third parties or, where these are not available, internal models. All interest income and gains or losses arising from the changes in the fair value of these instruments and on disposal are recognised in the income statement.

Hedge accounting is not applied to assets classified as FVTPL.

Impairment of financial assets

Financial assets within the scope of IFRS 9 expected credit loss (ECL) requirements comprise all financial debt instruments measured at either amortised cost or FVOCI. These include cash, loans and advances to banks, and the majority of investment securities and loans and advances to customers. Also within scope are irrevocable undrawn commitments to lend and intra-group lending (the latter being eliminated on consolidation in the Group accounts).

The ECL represents the present value of expected cash shortfalls following the default of a financial instrument or undrawn commitment. A cash shortfall is the difference between the cash flows that are due in accordance with the contractual terms of the instrument and the cash flows that the Group expects to receive.

The allowance for ECLs is based on an assessment of the probability of default, exposure at default and loss given default, discounted at the effective interest rate to give a net present value. The estimation of ECLs is unbiased and probability weighted, taking into account all reasonable and supportable information, including forward looking economic assumptions and a range of possible outcomes. ECLs are typically calculated from initial recognition of the financial asset for the maximum contractual period that the Group is exposed to the credit risk. However, for revolving credit loans such as credit cards and overdrafts, the Group's credit risk is not limited to the contractual period and therefore the expected life of the loan and associated undrawn commitment is calculated based on the behavioural life of the loan.

For amortised cost financial assets recognised in the balance sheet, the allowance for ECLs is offset against the gross carrying value so that the amount presented in the balance sheet is net of impairment provisions. For FVOCI financial assets, any credit losses recognised are offset against cumulative fair value movements within the other comprehensive income reserve. For separately identifiable irrevocable loan commitments, where the related financial asset has not yet been advanced, the provision is presented in provisions for other liabilities and charges in the balance sheet.

Forward looking economic inputs

ECLs are calculated by reference to information on past events, current conditions and forecasts of future economic conditions. Multiple economic scenarios are incorporated into ECL calculation models. These scenarios are based on external sources where available and appropriate, and internally generated assumptions in all other cases. To capture any non-linear relationship between economic assumptions and credit losses, a minimum of three scenarios is used. This includes a central scenario which reflects the Group's view of the most likely future economic conditions, together with an upside and a downside scenario representing alternative plausible views of economic conditions, weighted based on management's view of their probability.

Credit risk categorisation

For the purpose of calculation of ECLs, assets are categorised into three 'stages' as follows:

Stage 1: no significant increase in credit risk since initial recognition

On initial recognition, and for financial assets where there has not been a significant increase in credit risk since the date of advance, provision is made for losses from credit default events expected to occur within the next 12 months. Expected credit losses for these stage 1 assets continue to be recognised on this basis unless there is a significant increase in the credit risk of the asset.

Notes to the consolidated interim financial statements (continued)

2 Basis of preparation (continued)

IFRS 9 'Financial Instruments' (continued)

Stage 2: significant increase in credit risk

Financial assets are categorised as being within stage 2 where an instrument has experienced a significant increase in credit risk since initial recognition. For these assets, provision is made for losses from credit default events expected to occur over the lifetime of the instrument.

Whether a significant increase in credit risk has occurred is ascertained by comparing the probability of default at the reporting date to the probability of default at origination, and is made based on quantitative and qualitative factors. Quantitative considerations take into account changes in the residual lifetime probability of default (PD) of the asset. As a backstop, all assets with an arrears status of more than 30 days past due on contractual payments are considered to be in stage 2.

Qualitative factors that may indicate a significant change in credit risk include concession events that still envisage full repayment of principal and interest, on a discounted basis.

Stage 3: credit impaired (or defaulted) loans

Financial assets are transferred into stage 3 when there is objective evidence that an instrument is credit impaired. Provisions for stage 3 assets are made on the basis of lifetime expected credit losses. Assets are considered credit impaired when:

- contractual payments of either principal or interest are past due by more than 90 days;
- there are other indications that the borrower is unlikely to pay such as signs of financial difficulty, probable bankruptcy, breaches of contract and concession events which have a detrimental impact on the present value of future cashflows; or
- the loan is otherwise considered to be in default.

Interest income on stage 3 credit impaired loans is recognised in the income statement on the loan balance net of the ECL provision. The balance sheet value of stage 3 loans reflects the contractual terms of the assets, and continues to increase over time with the contractually accrued interest.

Purchased or originated credit impaired (POCI) loans

Where loans are credit impaired on origination, or when purchased from third parties, the carrying amount at initial recognition is net of the lifetime ECL at that date. Thereafter, any subsequent change (favourable or unfavourable) in the lifetime ECL is recognised in the income statement. POCI loans are separately disclosed as credit impaired loans and cannot be transferred out of the POCI designation, even if there is a significant improvement in credit quality.

Transfers between stages

Transfers from stage 1 to 2 occur when there has been a significant increase in credit risk and from stage 2 to 3 when credit impairment is indicated as described above.

For assets in stage 2 or 3, loans can transfer back to stage 1 or 2 once the criteria for a significant increase in credit risk or impairment are no longer met. For loans subject to concession events such as forbearance, accounts must first be up to date for a period of 12 months before they can transfer back to stage 1 or 2.

Write-off

Loans remain on the balance sheet net of associated provisions until they are deemed to have no reasonable expectations of recovery. 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 value of impairment losses recorded in the income statement.

Notes to the consolidated interim financial statements (continued)

2 Basis of preparation (continued)

IFRS 15 'Revenue from Contracts with Customers'

The Group has applied IFRS 15 'Revenue from Contracts with Customers' from 5 April 2018. The standard applies to all contracts with customers but does not apply to financial instruments, lease contracts or non-monetary exchanges. IFRS 15 has introduced a principles-based approach for revenue recognition, with revenue being recognised as the related obligations are satisfied.

The Group has assessed revenue streams within the scope of IFRS 15 and concluded that the timing of revenue recognition is unchanged under the new standard. There is therefore no transitional impact from adopting this standard.

Adjustments to comparative information

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 within cash flows from financing activities to better reflect the nature of the interest flows. Comparatives have been restated as shown below:

Consolidated cash flow statement extract For the period ended 30 September 2017	Notes	Previously published £m	Adjustment £m	Restated £m
Net cash flows generated from operating activities	23	2,466	311	2,777
Net cash flows generated from financing activities	23	1,681	(311)	1,370

This restatement has no impact on the Group's or Society's net assets or members' interests and equity, or cash and cash equivalents.

Future accounting developments

An overview of pronouncements that will be relevant to the Group in future periods can be found in the Annual Report and Accounts 2018.

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 these consolidated interim financial statements. 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 be based upon amounts which differ from those estimates.

Other than in relation to the implementation of IFRS 9 'Financial Instruments', there have been no changes to the significant judgements and estimates disclosed in the Annual Report and Accounts 2018.

To ensure that expected credit loss (ECL) provisions fulfil IFRS 9 requirements, judgement and estimation is required in a number of areas. The areas where the impact of judgement and estimation are most material are:

- the approach to identifying significant increases in credit risk and the definition of default
- the basis of forward looking information and multiple economic scenarios
- the proportion of interest only mortgages that will redeem or refinance at maturity.

The Group's approach to each of these judgements is described in more detail below.

Notes to the consolidated interim financial statements (continued)

2 Basis of preparation (continued)

Identifying significant increases in credit risk (stage 2)

The identification of significant increases in credit risk is the most judgemental element of the staging criteria. Management monitors the Group's loans to determine whether there have been changes in credit risk. The primary quantitative indicators are the outputs of internal credit risk assessments. For example, for retail exposures, PDs are derived using modelled scorecards, which use external information such as information from credit reference agencies as well as internal information such as known instances of arrears or other financial difficulty. While different approaches are used within each portfolio, the intention is to combine current and historical data relating to the exposure with forward-looking macroeconomic information to determine the likelihood of default.

The credit risk of each loan is evaluated at each reporting date by calculating the residual lifetime PD of each loan. For retail loans, the main indicators of a significant increase in credit risk are either of the following:

- the residual lifetime probability of default (PD) exceeds a benchmark determined by reference to the maximum credit risk that would have been accepted at origination
- the residual lifetime PD has increased by both at least 75bps and a multiple of the original lifetime PD (8x for mortgages, 4x for consumer banking).

These complementary criteria have been reviewed through detailed back-testing, using management performance indicators and actual default experience and found to be effective in capturing events which would constitute a significant increase in credit risk.

Identifying credit impaired loans and the definition of default (stage 3)

The identification of credit impaired loans and the definition of default is another important judgement within the IFRS 9 staging approach. A loan is credit impaired where it has an arrears status of more than 90 days past due, is considered to be in default or it is considered unlikely that the borrower will repay the credit obligations in full, without recourse to actions such as realising security.

Use of forward looking economic information

Forward looking economic information is incorporated into the measurement of provisions in two ways: as an input to the calculation of ECL and as a factor in determining the staging of an asset. Expectations of future economic conditions are incorporated through modelling of multiple economic scenarios (MES).

The use of MES ensures that the calculation of ECL captures a range of possible outcomes. It addresses the risk of non-linearity in the relationship between credit losses and economic conditions, with provisions increasing more in unfavourable conditions (particularly severe conditions) than they reduce in favourable conditions. The IFRS 9 ECL provision reported in the accounts is therefore the probability-weighted sum of the provisions calculated under a range of economic scenarios.

For the retail and commercial portfolios, the Group has adopted the use of three economic scenarios (referred to as the central, upside and downside scenarios). The scenarios and the weightings are derived using external data and statistical methodologies, together with management judgement, to determine scenarios which span an appropriately wide range of plausible economic conditions.

The central scenario represents the most likely economic forecast and is aligned with the central scenario used in the Group's financial planning processes. At 5 April 2018 and 30 September 2018 this scenario is assigned a 50% probability weighting. The upside and downside economic scenarios are less likely and have been given 20% and 30% weightings respectively (5 April 2018 30% and 20% respectively).

Notes to the consolidated interim financial statements (continued)

2 Basis of preparation (continued)

The table below provides a summary of the average values of the key UK economic variables used within the three economic scenarios over the period from October 2018 to September 2023.

Economic variables (average %)

	Central scenario	Upside scenario	Downside scenario
GDP growth	1.6	2.3	0.7
Unemployment	4.4	3.8	5.5
HPI	2.1	5.0	(2.8)
BoE Base Rate	0.9	2.0	0.2

The impact of the economic variables varies according to the portfolio. For example, mortgages are most sensitive to house prices, whereas consumer banking products are more sensitive to unemployment rates.

Due to the net adverse impact of the less likely scenarios, the ECL increases under MES, as outlined in the table below:

Impact of multiple economic scenarios

30 September 2018	Central scenario ECL £m	ECL incorporating MES £m	Difference £m
Residential mortgages	127	234	107
Consumer banking	357	371	14
Commercial and other lending	25	30	5
Total	**509**	**635**	**126**

5 April 2018	Central scenario ECL £m	ECL incorporating MES £m	Difference £m
Residential mortgages	143	235	92
Consumer banking	352	365	13
Commercial and other lending	24	29	5
Total	519	629	110

In addition to the three economic scenarios, allowance has been made to reflect the risks associated with a low probability, severe downside scenario. The quantification of this allowance included consideration of a number of different scenarios and reflects a scenario in which real GDP growth over a five year period is slightly negative, unemployment rises sharply and house prices fall significantly. At 30 September 2018, this additional allowance represents £86 million (5 April 2018: £85 million) of the total £126 million (5 April 2018: £110 million) MES impact.

Performance at maturity of interest only mortgages

The third key area of management judgement and estimation is the allowance for the risk that a proportion of interest only mortgages will not be redeemed at the contractual maturity date, because a borrower does not have a means of capital repayment or has been unable to refinance the loan. Buy to let mortgages are typically advanced on an interest only basis. Interest only balances for prime residential mortgages relate primarily to 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). The impact of the allowance for unredeemed interest only mortgages at contractual maturity in the central scenario amounts to £50 million (5 April 2018: £58 million), with an additional impact of £17 million (5 April 2018: £16 million) arising from multiple economic scenarios.

Interest only loans which are judged to have a significantly increased risk of inability to refinance at maturity are transferred to stage 2.

Going concern

The Group's business activities and financial position, the factors likely to affect its future development and performance, its objectives and policies in managing the financial risks to which it is exposed, and its capital, funding and liquidity positions are discussed in the Business and risk report.

In the light of current and anticipated economic conditions, the directors have assessed the Group's ability to continue as a going concern. The directors confirm they are satisfied that the Group has adequate resources to continue in business and that it is therefore appropriate to adopt the going concern basis in preparing these consolidated interim financial statements.

Notes to the consolidated interim financial statements (continued)

3 Interest receivable and similar income

	Half year to 30 September 2018 £m	Half year to 30 September 2017 £m
On residential mortgages	2,194	2,258
On other loans	357	361
On investment securities	98	101
On other liquid assets	80	33
Net expense on financial instruments hedging assets	(188)	(406)
Total	2,541	2,347

4 Interest expense and similar charges

	Half year to 30 September 2018 £m	Half year to 30 September 2017 £m
On shares held by individuals	639	538
On subscribed capital	7	7
On deposits and other borrowings:		
Subordinated liabilities	108	74
Other	92	227
On debt securities in issue	319	354
Net income on financial instruments hedging liabilities	(122)	(371)
Interest on net defined benefit pension liability (note 19)	3	4
Total	1,046	833

In the half year to 30 September 2017 interest on deposits and other borrowings included an expense of £184 million in relation to the redemption and maturity of Protected Equity Bond (PEB) deposits which had 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 in the half year to 30 September 2017 included £180 million of income in relation to the associated derivatives.

5 Other operating income

	Half year to 30 September 2018 £m	Half year to 30 September 2017 £m
Gains on disposal of investments	-	26
Net other income	2	5
Total	2	31

On 28 April 2017, the Group disposed of shares in VocaLink Holdings Limited, resulting in a gain on disposal of £26 million.

Net other income includes rental income and profits or losses on the sale of property, plant and equipment.

Notes to the consolidated interim financial statements (continued)

6 Gains from derivatives and hedge accounting

The Group has taken the option allowed by IFRS 9 to continue to apply the existing hedge accounting requirements of IAS 39.

The Group only uses derivatives for the hedging of risks; however, income statement volatility can arise due to hedge accounting ineffectiveness or because hedge accounting is either not currently 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.

Gains from derivatives and hedge accounting	Half year to 30 September 2018 £m	Half year to 30 September 2017 £m
Ineffectiveness from fair value hedge accounting (note i)	29	(32)
Ineffectiveness from cash flow hedge accounting (note ii)	23	58
Net gain from mortgage pipeline (note iii)	-	22
Fair value losses from other derivatives (note iv)	(15)	(3)
Foreign exchange retranslation (note v)	10	(9)
Total	47	36

Notes:

i. Gains or losses from fair value hedges can arise where there is a 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, where monthly effectiveness tests are passed, the effective portion of the fair value movement of designated derivatives (being the lower of the fair value movement of the derivative or the hedged item) 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. Includes the fair value movement of both interest rate swaps, which are used to economically hedge expected new mortgage business, and firm mortgage commitments, where the Group has elected to fair value those commitments to reduce the accounting mismatch. The Group has not applied this fair value option for new mortgage business in the current period; therefore, the fair value movements of the interest rate swaps are now reported in 'fair value losses from other derivatives'.

iv. Other derivatives are those used for economic hedging purposes, but which are not currently in a hedge accounting relationship.

v. Gains or losses arise from the retranslation of foreign currency monetary items not subject to effective hedge accounting.

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. The net transfer after taxation of losses of £65 million (H1 2017/18: £114 million) is driven by changes in derivative valuations caused by movements in interest rates and foreign exchange rates.

7 Administrative expenses

	Half year to 30 September 2018 £m	Half year to 30 September 2017 £m
Employee costs:		
Wages, salaries and bonuses	287	290
Social security costs	32	31
Pension costs	86	86
	405	407
Other administrative expenses	382	367
	787	774
Depreciation, amortisation and impairment (note i)	313	192
Total	1,100	966

Note:

i. Includes £104 million (H1 2017/18: £nil) in relation to write-offs and impairments of technology assets.

Notes to the consolidated interim financial statements (continued)

8 Impairment losses on loans and advances to customers

The following tables set out impairment losses and reversals during the period and the closing provision balances which are deducted from the appropriate asset values in the balance sheet:

Impairment losses/(reversals) for the period	Half year to 30 September 2018 £m	Half year to 30 September 2017 (note i) £m
Prime residential	(7)	4
Specialist residential	11	8
Consumer banking	38	52
Commercial and other lending	3	(5)
Total	**45**	59

Impairment provision at the end of the period	30 September 2018 £m	5 April 2018 (note i) £m	4 April 2018 (note i) £m
Prime residential	40	47	36
Specialist residential	194	188	109
Consumer banking	371	365	298
Commercial and other lending	30	29	15
Total	**635**	629	458

Note:
i. 5 April 2018 balances are presented under IFRS 9. Comparatives for the period to 30 September 2017 and as at 4 April 2018 are presented under IAS 39.

Further credit risk information on loans and advances to customers is included in the 'Credit risk' section of the Business and Risk Report.

9 Taxation

Tax charge in the income statement	Half year to 30 September 2018 £m	Half year to 30 September 2017 £m
Current tax:		
UK corporation tax	130	150
Total current tax	130	150
Deferred tax:		
Current period (credit)/charge	(1)	7
Total deferred tax	(1)	7
Tax charge	**129**	157

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	Half year to 30 September 2018 £m	Half year to 30 September 2017 £m
Profit before tax	516	628
Tax calculated at a tax rate of 19%	98	119
Banking surcharge	25	33
Expenses not deductible for tax purposes	6	5
Tax charge	**129**	157

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 consolidated interim financial statements (continued)

10 Classification and measurement

The following table summarises the classification of carrying amounts of the Group's financial assets and liabilities. A table has also been presented showing the classifications applied on transition to IFRS 9 at 5 April 2018 to aid comparability to the position at 30 September 2018. The 4 April 2018 table can be found in note 12 of the Annual Report and Accounts 2018.

Classification of financial assets and liabilities	30 September 2018			
	Amortised cost	Fair value through other comprehensive income	Fair value through profit or loss	Total
Group	£m	£m	£m	£m
Financial assets				
Cash	18,423	-	-	18,423
Loans and advances to banks	3,396	-	-	3,396
Investment securities	1,748	12,415	61	14,224
Derivative financial instruments	-	-	4,534	4,534
Fair value adjustment for portfolio hedged risk	(204)	-	-	(204)
Loans and advances to customers	194,771	-	246	195,017
Total financial assets	218,134	12,415	4,841	235,390
Other non-financial assets				2,946
Total assets				238,336
Financial liabilities				
Shares	153,071	-	-	153,071
Deposits from banks	20,549	-	-	20,549
Other deposits	6,248	-	-	6,248
Due to customers	391	-	-	391
Fair value adjustment for portfolio hedged risk	(40)	-	-	(40)
Debt securities in issue	35,253	-	-	35,253
Derivative financial instruments	-	-	1,826	1,826
Subordinated liabilities	6,629	-	-	6,629
Subscribed capital	257	-	-	257
Total financial liabilities	222,358	-	1,826	224,184
Other non-financial liabilities				1,523
Total liabilities				225,707

Classification of financial assets and liabilities	5 April 2018			
	Amortised cost	Fair value through other comprehensive income	Fair value through profit or loss	Total
Group	£m	£m	£m	£m
Financial assets				
Cash	14,361			14,361
Loans and advances to banks	3,422	-	-	3,422
Investment securities	1,120	11,881	45	13,046
Derivative financial instruments	-	-	4,121	4,121
Fair value adjustment for portfolio hedged risk	(144)	-	-	(144)
Loans and advances to customers	191,245	-	247	191,492
Total financial assets	210,004	11,881	4,413	226,298
Other non-financial assets				2,639
Total assets				228,937
Financial liabilities				
Shares	148,003	-	-	148,003
Deposits from banks	19,404	-	-	19,404
Other deposits	5,323	-	-	5,323
Due to customers	402	-	-	402
Fair value adjustment for portfolio hedged risk	(53)	-	-	(53)
Debt securities in issue	34,118	-	-	34,118
Derivative financial instruments	-	-	2,337	2,337
Subordinated liabilities	5,497	-	-	5,497
Subscribed capital	263	-	-	263
Total financial liabilities	212,957	-	2,337	215,294
Other non-financial liabilities				1,402
Total liabilities				216,696

Further details on the transition to IFRS 9 are included in note 2 and information on the fair value of financial assets and liabilities is included in notes 13 to 15. Amounts classified as due to customers do not confer membership rights.

Notes to the consolidated interim financial statements (continued)

11 Loans and advances to customers

	Loans held at amortised cost				Loans held at FVTPL	Total
	Gross balances	Provisions	Other (note i)	Total		
30 September 2018	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Prime residential mortgages	147,507	(40)	-	147,467	189	147,656
Specialist residential mortgages	33,271	(194)	-	33,077	-	33,077
Consumer banking	4,316	(371)	-	3,945	-	3,945
Commercial and other lending	9,347	(30)	965	10,282	57	10,339
Total	**194,441**	**(635)**	**965**	**194,771**	**246**	**195,017**

	Loans held at amortised cost				Loans held at FVTPL	Total
	Gross balances	Provisions	Other (note i)	Total		
5 April 2018 (note ii)	£m	£m	£m	£m	£m	£m
Prime residential mortgages	143,869	(47)	-	143,822	189	144,011
Specialist residential mortgages	33,245	(188)	-	33,057	-	33,057
Consumer banking	4,107	(365)	-	3,742	-	3,742
Commercial and other lending	9,611	(29)	1,042	10,624	58	10,682
Total	190,832	(629)	1,042	191,245	247	191,492

Notes:
i. Loans held at amortised cost include a fair value adjustment for micro hedged risk for commercial loans hedged on an individual basis.
ii. 5 April 2018 balances are presented under IFRS 9. Adjustments made on transition to IFRS 9 are detailed in note 2.

The table below summarises the movements in gross loans and advances to customers held at amortised cost including the impact of ECL impairment provisions and excluding the fair value adjustment for micro hedged risk:

Reconciliation of movements in gross balances and impairment provisions	**Non-credit impaired**				**Credit impaired (note i)**			
	Subject to 12 month ECL		**Subject to lifetime ECL**		**Subject to lifetime ECL**		**Total**	
	Stage 1		**Stage 2**		**Stage 3**			
	Gross balances £m	**Provisions £m**	**Gross balances £m**	**Provisions £m**	**Gross balances £m**	**Provisions £m**	**Gross balances £m**	**Provisions £m**
At 5 April 2018	169,120	48	20,012	284	1,700	297	190,832	629
Stage transfers:								
Transfer to lifetime ECL (non-credit impaired)	(15,580)	(15)	15,580	15	-	-	-	-
Transfer to credit impaired	(153)	-	(530)	(60)	683	60	-	-
Transfer to 12 month ECL	14,518	114	(14,518)	(114)	-	-	-	-
Transfer from credit impaired	93	2	300	12	(393)	(14)	-	-
Net remeasurement of ECL arising from transfer of stage		(102)		129		8		35
Net movement arising from transfer of stage	(1,122)	(1)	832	(18)	290	54	-	35
New assets originated or purchased	18,819	16	-	-	-	-	18,819	16
Repayments (excluding derecognition) and changes in risk parameters (note ii)	(3,820)	(17)	(107)	19	(34)	10	(3,961)	12
Other items impacting income statement charge/(reversal) (including recoveries)	-	-	-	-	-	(7)	-	(7)
Assets derecognised/full redemptions	(10,003)	(1)	(1,046)	(9)	(140)	(1)	(11,189)	(11)
Income statement charge for the period								45
Decrease due to write-offs	-	-	-	-	(60)	(47)	(60)	(47)
Other provision movements	-	-	-	-	-	8	-	8
At 30 September 2018	**172,994**	**45**	**19,691**	**276**	**1,756**	**314**	**194,441**	**635**
Net carrying amount		**172,949**		**19,415**		**1,442**		**193,806**

Notes:
i. Gross balances of credit impaired loans include £173 million (5 April 2018: £180 million) of purchased or originated credit impaired (POCI) loans, which are presented net of lifetime ECL impairment provisions of £6 million (5 April 2018: £7 million).
ii. Changes in risk parameters include changes to modelling inputs and methodology.

Notes to the consolidated interim financial statements (continued)

11 Loans and advances to customers (continued)

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 and are consistent with those disclosed in note 14 of the Annual Report and Accounts 2018.

Mortgages pledged and the nominal values of the notes in issue are as follows:

Mortgages pledged to asset backed funding programmes

	Mortgages pledged	Notes in issue			
		Held by third parties	Held by the Group		Total notes in issue
			Drawn	Undrawn	
30 September 2018	£m	£m	£m	£m	£m
Covered bond programme	22,211	16,195	-	-	16,195
Securitisation programme	8,001	3,401	-	337	3,738
Whole mortgage loan pools	23,584	-	17,000	-	17,000
Total	53,796	19,596	17,000	337	36,933
4 April 2018					
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 under Nationwide's covered bond programme provide security for issues of covered bonds made by the Group. During the period ended 30 September 2018 £1.4 billion of notes were issued under this programme and £0.8 billion of notes matured.

The securitisation programme notes are issued by Silverstone Master Issuer plc which is fully consolidated into the accounts of the Group. 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 Group. The remaining beneficial interest in the pledged mortgages of £4.9 billion (4 April 2018: £5.2 billion) stays with the Group and includes its required minimum seller share in accordance with the rules of the programme. During the period ended 30 September 2018 no notes were issued and a total of £0.4 billion sterling equivalent of notes matured.

Mortgages pledged include £8.5 billion (4 April 2018: £8.7 billion) in the covered bond and securitisation programmes that are in excess of the amount contractually required to support notes in issue.

The whole mortgage loan pools are pledged at the BoE under the TFS.

12 Subordinated liabilities and subscribed capital

	30 September 2018 £m	4 April 2018 £m
Subordinated liabilities		
Subordinated notes	6,629	5,487
Fair value hedge accounting adjustments	34	42
Unamortised premiums and issue costs	(34)	(32)
Total	6,629	5,497
Subscribed capital		
Permanent interest-bearing shares	222	225
Fair value hedge accounting adjustments	37	40
Unamortised premiums and issue costs	(2)	(2)
Total	257	263

Notes to the consolidated interim financial statements (continued)

12 Subordinated liabilities and subscribed capital (continued)

As part of the ongoing funding strategy, the Group issued $1 billion (£761 million) and Norwegian Kroner 1 billion (£94 million) of subordinated notes during the period. £3 million of permanent interest-bearing shares (PIBS) were repaid in full during the period.

All of the Group's subordinated notes and PIBS are unsecured. The Group may, with the prior consent of the Prudential Regulation Authority (PRA), repay the PIBS and redeem the subordinated notes early.

Subordinated liabilities comprise senior non-preferred notes and Tier 2 subordinated notes.

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, 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 PIBS rank pari passu with each other and the AT1 instruments, behind claims against the Society of the subordinated noteholders, depositors, creditors and investing members, but ahead of claims by the holders of CCDS.

13 Fair value hierarchy of financial assets and liabilities held at fair value

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 in note 1 of the Annual Report and Accounts 2018.

Details of those financial assets and liabilities not measured at fair value are included in note 15.

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:

	Fair values based on			
30 September 2018	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Government and supranational investments	10,466	-	-	10,466
Other debt investment securities	819	1,129	57	2,005
Investment in equity shares	-	-	5	5
Total investment securities (note i)	11,285	1,129	62	12,476
Interest rate swaps	-	1,320	-	1,320
Cross currency interest rate swaps	-	3,150	-	3,150
Forward foreign exchange	-	32	-	32
Index linked swaps	-	32	-	32
Total derivative financial instruments	-	4,534	-	4,534
Loans and advances to customers (note ii)	-	123	123	246
Total financial assets	11,285	5,786	185	17,256
Financial liabilities				
Interest rate swaps	-	(1,703)	(4)	(1,707)
Cross currency interest rate swaps	-	(98)	-	(98)
Forward foreign exchange	-	(11)	-	(11)
Swaptions	-	(3)	-	(3)
Index linked swaps	-	(7)	-	(7)
Total derivative financial instruments	-	(1,822)	(4)	(1,826)
Total financial liabilities	-	(1,822)	(4)	(1,826)

Notes to the consolidated interim financial statements (continued)

13 Fair value hierarchy of financial assets and liabilities held at fair value (continued)

	Fair values based on			
4 April 2018	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Government and supranational investments	9,592	-	-	9,592
Other debt investment securities	1,007	1,282	41	2,330
Investments in equity shares	-	-	3	3
Total investment securities (note i)	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
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)
Forward rate agreements	-	(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:
i. Investment securities exclude £1,748 million of investment securities held at amortised cost (4 April 2018: £1,120 million of held to maturity investment securities and £1 million of available for sale investments in equity shares).
ii. On transition to IFRS 9, certain loans and advances to customers have been classified as FVTPL. Further information is included in note 2.

The Group's Level 1 portfolio comprises government and other highly rated 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 from models. Level 2 derivative assets and liabilities are valued from discounted cash flow models using yield curves based on observable market data. Level 2 loans and advances to customers are valued based on discounted cashflows or by reference to similar assets in markets which are not active.

Further detail on the Level 3 portfolio is provided in note 14.

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 their valuation. There were no significant transfers between the Level 1 and Level 2 portfolios during the period.

14 Fair value of financial assets and liabilities held at fair value – Level 3 portfolio

On transition to IFRS 9, certain loans and advances to customers have been classified as FVTPL. Level 3 assets in this category include a closed portfolio of residential mortgages and a small number of commercial loans. During the period, a portfolio of residential mortgages was transferred from Level 3 to Level 2 due to changes in the availability of observable market prices.

The remaining constituents of the Level 3 portfolio at 30 September 2018 are consistent with those disclosed in the Group's 2018 Annual Report and Accounts.

Notes to the consolidated interim financial statements (continued)

14 Fair value of financial assets and liabilities held at fair value – Level 3 portfolio (continued)

The tables below set out movements in the Level 3 portfolio:

Movements in Level 3 portfolio	**Investment securities £m**	**Derivative financial instruments £m**	**Other deposits - PEBs (note i) £m**	**Loans and advances to customers £m**
At 4 April 2018	44	(4)	-	
IFRS 9 transition (note ii)	1	-	-	247
At 5 April 2018	45	(4)	-	247
Gains recognised in the income statement, within:				
Net interest income	12	-	-	6
Gains from derivatives and hedge accounting (note iii)	4	-	-	-
Other operating income	-	-	-	-
Additions	1	-	-	-
Settlements/repayments	-	-	-	(7)
Transfers out of Level 3 portfolio	-	-	-	(123)
At 30 September 2018	**62**	**(4)**	**-**	**123**

Movements in Level 3 portfolio	Investment securities £m	Derivative financial instruments £m	Other deposits - PEBs (note i) £m
At 5 April 2017	66	228	(810)
Gains/(losses) recognised in the income statement, within:			
Net interest income/(expense)	-	180	(184)
(Losses)/gains from derivatives and hedge accounting (note iii)	-	(175)	174
Other operating income	26	-	-
Losses recognised in other comprehensive income:			
Fair value movement taken to members' interests and equity	(22)	-	-
Settlements	-	(179)	628
Disposals	(30)	-	-
At 30 September 2017	40	54	(192)

Notes:
i. The PEBs matured in full during the year ended 4 April 2018.
ii. Adjustment on implementation of IFRS 9 as detailed in note 2.
iii. Includes foreign exchange revaluation gains/losses .

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 on 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:

Notes to the consolidated interim financial statements (continued)

14 Fair value of financial assets and liabilities held at fair value – Level 3 portfolio (continued)

Sensitivity of Level 3 fair values		Income statement		Other comprehensive income	
	Fair value	Favourable changes	Unfavourable changes	Favourable changes	Unfavourable changes
30 September 2018	£m	£m	£m	£m	£m
Investment securities (note i)	62	33	(41)	-	-
Derivative financial instruments (note ii)	(4)	-	-	-	-
Loans and advances to customers	123	3	(6)	-	-
Total	**181**	**36**	**(47)**	**-**	**-**
4 April 2018					
Investment securities (note i)	44	-	-	25	(35)
Net derivative financial instruments (note ii)	(4)	-	-	-	-
Total	40	-	-	25	(35)

Notes:

i. On adoption of IFRS 9 the Level 3 investment securities were classified as fair value through profit or loss. The sensitivity analysis on fair values in the table above therefore impacts the income statement in the current period. At 4 April 2018 Level 3 investment securities were available for sale assets, with fair value movements recognised in other comprehensive income.

ii. A sensitivity analysis for Level 3 derivative instruments has not been included due to immateriality.

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 30 September 2018	Total assets £m	Total liabilities £m	Valuation technique	Significant unobservable inputs	Range (note i)		Weighted average (note ii)	Units
Investment securities	62	-	Discounted cash flows	Discount rate	10.00	12.00	11.00	%
				Share conversion	-	100.00	82.18	%
Loans and advances to customers	123	-	Discounted cash flows	Discount rate	2.00	9.00	3.51	%
4 April 2018								
Investment securities	44	-	Discounted cash flows	Discount rate	10.00	12.00	11.00	%
				Share conversion	-	100.00	66.45	%

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.

Significant unobservable inputs used in the fair value measurement of Level 3 assets and liabilities are consistent with those disclosed in the Group's 2018 Annual Report and Accounts.

Notes to the consolidated interim financial statements (continued)

15 Fair value of financial assets and liabilities measured at amortised cost

Valuation methodologies employed in calculating the fair value of financial assets and liabilities measured at amortised cost are consistent with those disclosed in the Group's 2018 Annual Report and Accounts.

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 measured at amortised cost	30 September 2018		4 April 2018	
(note i)	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets				
Loans and advances to banks	3,396	3,396	3,422	3,422
Investment securities (note ii)	1,748	1,744	1,120	1,128
Loans and advances to customers:				
Residential mortgages	180,544	179,835	177,154	176,479
Consumer banking	3,945	3,872	3,809	3,666
Commercial and other lending	10,282	9,344	10,701	9,641
Total	199,915	198,191	196,206	194,336
Financial liabilities				
Shares	153,071	152,996	148,003	147,901
Deposits from banks	20,549	20,549	19,404	19,404
Other deposits	6,248	6,248	5,323	5,323
Due to customers	391	391	402	402
Debt securities in issue	35,253	35,643	34,118	34,807
Subordinated liabilities	6,629	6,492	5,497	5,521
Subscribed capital	257	248	263	258
Total	222,398	222,567	213,010	213,616

Notes:
i. The table above excludes cash for which fair value approximates to carrying value.
ii. The Group holds residential mortgage backed securities under a programme to securitise Bradford & Bingley plc residential mortgage assets. These financial assets are classified as amortised cost in the current period; at 4 April 2018 they were classified as held to maturity investment securities.

16 Offsetting financial assets and financial liabilities

The Group has financial assets and financial 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 of offsetting on financial assets and financial liabilities, 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')

Notes to the consolidated interim financial statements (continued)

16 Offsetting financial assets and financial liabilities (continued)

30 September 2018	Gross amounts recognised £m	Amounts offset (note i) £m	Net amounts reported on the balance sheet £m	Master netting arrangements £m	Financial collateral £m	Net amounts after offsetting under IFRS 7 £m
Financial assets						
Derivative financial assets	4,911	(377)	4,534	(1,451)	(2,991)	92
Reverse repurchase agreements	730	-	730	-	(729)	1
Total financial assets	5,641	(377)	5,264	(1,451)	(3,720)	93
Financial liabilities						
Derivative financial liabilities	2,143	(317)	1,826	(1,451)	(318)	57
Repurchase agreements	2,097	-	2,097	-	(2,097)	-
Total financial liabilities	4,240	(317)	3,923	(1,451)	(2,415)	57
4 April 2018						
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

Note:

i. Amounts offset for derivative financial assets of £377 million (4 April 2018: £167 million) include cash collateral netted of £144 million (4 April 2018: £3 million). Amounts offset for derivative financial liabilities of £317 million (4 April 2018: £169 million) include cash collateral netted of £84 million (4 April 2018: £5 million). Excluding the cash collateral netted, the remaining amounts represent £233 million (4 April 2017: £164 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 posted, typically daily or weekly, to mitigate the mark to market exposures. 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 consolidated interim financial statements (continued)

17 Provisions for liabilities and charges

	Bank levy £m	FSCS £m	Customer redress £m	Other provisions £m	Total £m
At 4 April 2018	24	15	221	13	273
Transition to IFRS 9 (note i)	-	-	-	1	1
At 5 April 2018	24	15	221	14	274
Provisions utilised	(24)	(6)	(39)	(5)	(74)
Charge for the period	-	-	2	6	8
Release for the period	-	(9)	(17)	(1)	(27)
Net income statement charge (note ii)	-	(9)	(15)	5	(19)
At 30 September 2018	**-**	**-**	**167**	**14**	**181**
At 5 April 2017	16	42	305	24	387
Provisions utilised	(15)	(25)	(48)	(4)	(92)
Charge for the period	-	-	31	-	31
Release for the period	(1)	(3)	(6)	(3)	(13)
Net income statement charge (note ii)	(1)	(3)	25	(3)	18
At 30 September 2017	-	14	282	17	313

Notes:

i. On transition to IFRS 9, an Expected Credit Loss provision of £1 million was recognised in respect of separately identifiable irrevocable loan commitments.

ii. Of the net income statement release of £19 million (H1 2017/18: charge of £18 million), a release of £24 million (H1 2017/18: net charge of £22 million) is recognised in provisions for liabilities and charges and a charge of £5 million (H1 2017/18: release of £4 million) is recognised in administrative expenses.

Financial Services Compensation Scheme (FSCS)

The FSCS has confirmed that there will be no further interest costs following the sale of Bradford & Bingley plc asset portfolios and subsequent repayment of the loan to HM Treasury. Interest costs in respect of the 2017/18 and 2018/19 scheme years were included in the provision at 4 April 2018.

The income statement release of £9 million reflects the lower than anticipated interest costs following receipt of additional recoveries from the administration of Bradford & Bingley plc.

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 £167 million (4 April 2018: £221 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 release in the period reflects updated assumptions for provisions previously recognised.

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 for PPI at 30 September 2018 of £116 million (4 April 2018: £159 million) 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. The provision estimate takes into account complaint volumes, average redress payments, referral rates to the Financial Ombudsman Service (FOS), uphold rates, complaint handling costs and response rates from customer contact activity. 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.

Notes to the consolidated interim financial statements (continued)

17 Provisions for liabilities and charges (continued)

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 30 September 2018	Future expected	Sensitivity
Claims ('000s of policies) (note i)	405	102	10 = £9m
Average uphold rate (note ii)	45%	41%	5% = £8m
Average redress per claim (note iii)	£1,073	£948	£100 = £6m

Notes:
i. Claims include responses to proactive mailing.
ii. The cumulative average uphold rate of claims includes responses to past proactive mailings. As a result, future expected average uphold rates are forecast to decline as no further proactive mailing activity is anticipated.
iii. Future expected average redress reflects the expected mix of future claims upheld.

Other provisions

Other provisions include provisions for severance costs, a number of property related provisions and expected credit losses on irrevocable personal loan and mortgage lending commitments.

18 Contingent liabilities

The Group's contingent liability accounting policy is included within the Annual Report and Accounts 2018. 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.

19 Retirement benefit obligations

Retirement benefit obligations on the balance sheet	30 September 2018 £m	4 April 2018 £m
Present value of funded obligations	5,971	6,108
Present value of unfunded obligations	12	12
	5,983	6,120
Fair value of fund assets	(5,900)	(5,775)
Net defined benefit liability	83	345

The Group continues to operate two defined contribution schemes and a number of defined benefit pension arrangements, the most significant being the Nationwide Pension Fund. These pension schemes are principally unchanged from the year ended 4 April 2018; further details are set out in note 30 of the Annual Report and Accounts 2018.

The principal actuarial assumptions used are as follows:

Principal actuarial assumptions	30 September 2018 %	4 April 2018 %
Discount rate	2.65	2.45
Future salary increases	3.20	3.10
Future pension increases (maximum 5%)	2.95	2.90
Retail price index (RPI) inflation	3.20	3.10
Consumer price index (CPI) inflation	2.20	2.10

The assumptions for mortality rates are based on up to date industry standard mortality tables, which allow for future improvements in life expectancies.

Notes to the consolidated interim financial statements (continued)

19 Retirement benefit obligations (continued)

Changes in the present value of the net defined benefit liability (including unfunded obligations) are as follows:

Movements in the net defined benefit liability	30 September 2018 £m	30 September 2017 £m
Deficit at 5 April	345	423
Current service cost	44	48
Past service cost	2	3
Curtailment gains	(5)	(5)
Interest on net defined benefit liability	3	4
Return on assets (greater)/less than discount rate (note i)	(30)	129
Contributions by employer	(96)	(116)
Administrative expenses	2	2
Actuarial gains on defined benefit obligations (note i)	(182)	(226)
Deficit at 30 September	83	262

Note:
i. The net impact before tax on the deficit of actuarial gains and return on assets is an increase of £212 million (H1 2017/18: £97 million) in other comprehensive income.

The £182 million of actuarial gains (H1 2017/18: £226 million) on defined benefit obligations is driven by a 0.20% increase in the discount rate and a 0.10% increase in assumed long term inflation since 4 April 2018, as a result of changes in market conditions.

The £30 million decrease in the deficit from a return on assets greater than the discount rate (H1 2017/18: £129 million deficit increase from a return less than the discount rate), is driven by changes in market conditions positively impacting listed equities.

The £96 million of employer contributions includes a deficit contribution of £61 million in July 2018 (H1 2017/18: £86 million). The remainder relates to employer contributions in respect of future benefit accrual.

20 Core capital deferred shares (CCDS)

	Number of shares	CCDS £m	Share premium £m	Total £m
At 30 September 2018	10,500,000	11	1,314	1,325
At 4 April 2018	10,500,000	11	1,314	1,325

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 was 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 placed on the amount of 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 £54 million (£5.125 per share) for the financial year ended 4 April 2018 was paid on 20 June 2018. This distribution has been recognised in the consolidated 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 30 September 2018, amounting in aggregate to £54 million. This has not been reflected in these interim financial statements as it is recognised by reference to the date at which it was declared. The distribution will be paid on 20 December 2018.

Notes to the consolidated interim financial statements (continued)

21 Other equity instruments

	Total £m
At 30 September 2018	**992**
At 4 April 2018	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 2018, was paid on 20 June 2018. This payment has been recognised in the consolidated statement of movements in members' interests and equity.

A coupon payment of £34 million, covering the period to 19 December 2018, is expected to be paid on 20 December 2018. This is not reflected in these interim financial statements as it is recognised by reference to the date at which it is paid.

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 fully loaded 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.

22 Related party transactions

There were no related party transactions during the period ended 30 September 2018 which were significant to the Group's financial position or performance.

Full details of the Group's related party transactions for the year to 4 April 2018 can be found in note 35 of the Annual Report and Accounts 2018.

Notes to the consolidated interim financial statements (continued)

23 Notes to the consolidated cash flow statement

Non-cash items included in profit before tax (note i)	Half year to 30 September 2018 £m	Half year to 30 September 2017 £m
Net increase in impairment provisions	6	17
Net decrease in provisions for liabilities and charges	(93)	(74)
Depreciation, amortisation and impairment	313	192
Profit on sale of property, plant and equipment	(1)	(1)
Interest on debt securities in issue	319	354
Interest on subordinated liabilities	108	74
Interest on subscribed capital	7	7
Gains from derivatives and hedge accounting	(47)	(36)
Total	612	533

Changes in operating assets and liabilities (note i)		
Loans and advances to banks	(209)	17
Net derivative financial instruments and fair value adjustment for portfolio hedged risk	(869)	(212)
Loans and advances to customers	(3,531)	(3,312)
Other operating assets	(559)	806
Shares	5,068	1,842
Deposits from banks, customers and others	2,059	2,471
Debt securities in issue	671	(43)
Deferred taxation	44	2
Retirement benefit obligations	(262)	(161)
Other operating liabilities	881	292
Total	3,293	1,702

Cash and cash equivalents		
Cash	18,423	15,302
Loans and advances to banks repayable in 3 months or less (note ii)	2,843	2,665
Total	21,266	17,967

Notes:
i. IFRS 9 transition adjustments (as detailed in note 2) have been excluded from movements in balance sheet items.
ii. Cash equivalents include £1,893 million (30 September 2017: £1,924 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 30 September 2018, amounted to £553 million (30 September 2017: £344 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.

24 Event after the reporting period

On 26 October 2018, the High Court issued a judgement in a case between Lloyds Banking Group Pension Trustees Limited, Lloyds Bank plc and other defendants regarding inequalities in the calculation of Guaranteed Minimum Pensions (GMP) between females and males. The judgement concluded that the benefits of females and males in relation to GMPs should be equalised. Although the case is specific to the Lloyds pension schemes, the verdict will impact all defined benefit pension schemes (including the Nationwide Pension Fund) that contracted out of the state second pension between 1978 and 1997, substituting members' state second pensions for GMP. The High Court judgement also commented on the method to be adopted to equalise benefits.

The verdict will result in an increase in the Nationwide Pension Fund's retirement benefit obligation and is expected to be recognised as a charge to the income statement during Q3 2018/19. Work is ongoing to determine the impact, which is not expected to be material.

Responsibility statement

The directors listed below (being all the directors of Nationwide Building Society) confirm that, to the best of their knowledge:

- the consolidated interim financial statements have been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union
- the Interim Results include a fair review of the information required by Disclosure and Transparency Rules 4.2.7R and 4.2.8R, namely:
  - An indication of important events that have occurred in the first six months of the financial year and their impact on the consolidated interim financial statements and a description of the principal risks and uncertainties for the remaining six months of the financial year; and
  - Material related party transactions in the first six months of the financial year and any material changes in the related party transactions described in the Annual Report and Accounts 2018.

Signed on behalf of the Board by

Mark Rennison
Chief Financial Officer

21 November 2018

Board of directors

Chairman	**Executive directors**	**Non executive directors**
David Roberts	Joe Garner	Rita Clifton
	Tony Prestedge	Mai Fyfield
	Mark Rennison	Mitchel Lenson
	Chris Rhodes	Kevin Parry
		Lynne Peacock
		Baroness Usha Prashar
		Tim Tookey
		Gunn Waersted

Independent review report to Nationwide Building Society

Report on the consolidated interim financial statements

Our conclusion

We have reviewed the consolidated interim financial statements (the "interim financial statements") for Nationwide Building Society and its subsidiaries ("the Group") on pages 47 to 77 in the Interim Results of Nationwide Building Society for the six month period ended 30 September 2018 (the "Interim Results"). Based on our review, nothing has come to our attention that causes us to believe that the interim financial statements are not prepared, in all material respects, in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

What we have reviewed

The interim financial statements comprise:

- the consolidated balance sheet as at 30 September 2018;
- the consolidated income statement and consolidated statement of comprehensive income for the period then ended;
- the consolidated cash flow statement for the period then ended;
- the consolidated statement of movements in members' interests and equity for the period then ended; and
- the explanatory notes to the interim financial statements.

The interim financial statements included in the Interim Results have been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

As disclosed in note 2 to the interim financial statements, the financial reporting framework that has been applied in the preparation of the full annual financial statements of the Group is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Responsibilities for the interim financial statements and the review

Our responsibilities and those of the directors

The Interim Results, including the interim financial statements, is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the Interim Results in accordance with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

Our responsibility is to express a conclusion on the interim financial statements in the Interim Results based on our review. This report, including the conclusion, has been prepared for and only for the Group for the purpose of complying with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority and for no other purpose. We do not, in giving this conclusion, 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.

What a review of interim financial statements involves

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity' issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and, consequently, does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

We have read the other information contained in the Interim Results and considered whether it contains any apparent misstatements or material inconsistencies with the information in the interim financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants
London
21 November 2018

Other information

The interim results information set out in this announcement is unaudited and does not constitute accounts within the meaning of section 73 of the Building Societies Act 1986.

The financial information for the year ended 4 April 2018 has been extracted from the Annual Report and Accounts 2018. The Annual Report and Accounts 2018 has been filed with the Financial Conduct Authority and the Prudential Regulation Authority. The Independent Auditors' Report on the Annual Report and Accounts 2018 was unqualified.

Nationwide adopted the British Bankers' Association Code for Financial Reporting Disclosure ('the BBA code') in its Annual Report and Accounts 2018. The code sets out five disclosure principles together with supporting guidance. Full details of the principles are included in the Annual Report and Accounts 2018. These principles have been applied, as appropriate, in the context of these interim results.

A copy of the Interim Results is placed on the website of Nationwide Building Society. The directors are responsible for the maintenance and integrity of information on the Society's 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.

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