Nationwide Building Society

Interim Management Statement
Q3 2017/18

9 February 2018

Nationwide Building Society today publishes its Interim Management Statement covering the period from 5 April 2017 to 31 December 2017 ('Q3 2017/18').

Key highlights

- Underlying profit increased to £883m (Q3 2016/17: £866m); Statutory profit was £886m (Q3 2016/17: £946m)
- Profits include £26m one-off gain from VocaLink disposal (Q3 2016/17: £100m one-off gain from Visa Europe disposal)
- Capital strength improved with CET1 ratio of 30.5% (4 April 2017: 25.4%) and UK leverage ratio of 4.9% (4 April 2017: 4.4%)
- No. 1 for customer satisfaction amongst our high street peer group with a lead of 2.9%[1]
- UK's top choice for current accounts[2], with more people opening with Nationwide than with any other provider[3]. Openings up 8% in the period to 617,000 accounts
- Gross mortgage lending of £24.1bn (Q3 2016/17: £26.2bn); total market share of 12.2% (Q3 2016/17: 14.3%) in competitive market conditions
- Member deposit balances[4] increased by £2.3bn (Q3 2016/17: £6.4bn); market share of balances broadly flat at 10.0% at 31 December 2017 (4 April 2017: 10.1%) in a subdued market

Nationwide Building Society Chief Executive, Joe Garner, said:

"The Society continued to trade strongly in the period. Our mutual commitment to member value and leading service shapes our decision making. It means we continue to support loyal savings members with rates on average 50% higher than the market average[5]. We are also proud to maintain our position as no. 1 for customer satisfaction amongst our high street peer group, with an overall lead of 2.9% over our nearest competitor and 7.6% over the peer group average[1].

"Nationwide is top choice[2] for current accounts on the high street and more people are switching to us than any other provider[6]. As we anticipated, a subdued buy to let mortgage market, plus sustained competition, slowed the pace of growth in our mortgage book. With third quarter mortgage reservations significantly stronger than for the same period last year, we expect a strong final quarter for our gross lending.

"By choosing Nationwide, our members have helped the Society generate a substantial surplus, and our underlying profit for the year to date increased to £883 million. Members understandably expect their Society to remain safe and secure, so we've further enhanced our already strong financial position. Our capital and leverage ratios strengthened over the period, and are well ahead of regulatory requirements at 30.5% and 4.9% respectively.

"Supporting the financial lives of our members is a founding purpose of our building society. We also aim to play our part in helping to solve Britain's housing shortage, in line with our founding principles and our expertise. We've launched a range of initiatives to support both renters and buyers, including most recently a commitment to build around 250 homes as part of an innovative, sustainable housing development in Swindon, just three miles from our head office.

"Looking ahead, we expect the economy to continue to grow but only modestly. Consumer spending, which has been a key driver of growth, has slowed noticeably, and almost three quarters of those surveyed in our Brexit Consumer Panel expressed concern about the rising cost of goods and services. Modest economic growth is also likely to hold back the housing market and house price growth. Overall, we expect house prices to be broadly flat in 2018 with perhaps a marginal gain of around 1%. We expect competition in the mortgage market to continue and we will prioritise quality over volumes in the long-term interests of our members."

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[1] © GfK 2017, Financial Research Survey (FRS), 12 months ending 31 December 2017 (comparatives reference 12 months to 31 March 2017), proportion of extremely/very satisfied customers minus proportion of extremely/very/fairly dissatisfied customers summed across current account, mortgage and savings. High street peer group defined as providers with main current account market share >4% (Barclays, Halifax, HSBC, Lloyds Bank (inc C&G), NatWest, Santander and TSB).
[2] Source: Nationwide Brand and Advertising tracker - compiled by Independent Research Agency. 'Top choice' is most considered i.e. 'first choice' or 'seriously considered' current account provider amongst non-customers, based on responses from non-customers of each brand, 3 months ending December 2017. Financial brands included Nationwide, Barclays, Co-operative Bank, First Direct, Halifax, HSBC, Lloyds, NatWest, TSB and Santander.
[3] Source: eBenchmarkers April 2017 to November 2017, CACI April 2017 to November 2017 and internal sources.
[4] Member deposits include current account credit balances.
[5] Market average interest rates are based on Bank of England whole of market average interest rates for retail deposits adjusted to exclude Nationwide's balances.
[6] BACS Payments Schemes CASS switching market data (latest participant movement data for switches completing in the 3 months to June 2017).

Trading performance

	9 months ended 31 December 2017		9 months ended 31 December 2016	
	£bn	%	£bn	%
Gross residential mortgage lending/*market share*	24.1	*12.2*	26.2	*14.3*
Net residential mortgage lending/*market share*	3.9	*11.2*	8.2	*29.3*
Member deposits balance movement[4]/*market share*	2.3	*5.9*	6.4	*10.2*
Number of new current accounts opened	617,000		570,000	

	At 31 December 2017		At 4 April 2017	
	£bn	%	£bn	%
Residential lending balances[7]	175.3		171.1	
Member deposit balances[4] /*market share*	146.8	*10.0*	144.5	*10.1*
Market share of main standard and packaged current accounts[8]		*7.8*		7.5

Residential mortgages include prime and specialist loans, with the specialist portfolio largely comprising buy to let (BTL) lending. Gross mortgage lending period on period has grown at a slower pace as a result of sustained competition and a reduction in BTL mortgage advances. In the period, gross mortgage lending reduced to £24.1 billion (Q3 2016/17: £26.2 billion) with approximately 90% (Q3 2016/17: 86%) of advances in the prime portfolio: £21.6 billion (Q3 2016/17: £22.5 billion). Following the affordability criteria changes we made last year, and the impacts of the stamp duty increase and regulation on the BTL market, gross BTL mortgage lending for the period reduced to £2.5 billion (Q3 2016/17: £3.7 billion).

Net mortgage lending has decreased during the period reflecting lower gross mortgage advances and increased prime mortgage redemptions due to ongoing market competition. Net lending for prime mortgages was £4.3 billion (Q3 2016/17: £7.3 billion), and for specialist mortgages was a net redemption of £0.4 billion (Q3 2016/17: net lending £0.9 billion).

Mortgage lending has been substantially funded by growth in retail deposits, with member deposits increasing by £2.3 billion to £146.8 billion (4 April 2017 £144.5 billion). The growth is primarily attributable to a £2.7 billion increase in current account balances as we continue to grow our base of engaged members. This includes growth in balances from existing account holders, as well as 617,000 new current accounts opened during the period (Q3 2016/17: 570,000). We continued to benefit from high switching rates through the Current Account Switch Service, attracting 19.5 % of all switchers in the period. In total, our market share of main standard and packaged current accounts has increased to 7.8% at November 2017 (February 2017: 7.5%).

Our savings range remains competitively positioned in the market and continues to reflect our mutual principle of providing products that represent good long-term value to our members. In a highly competitive market, driven in large part by providers making short-term offers, Nationwide's market share of UK household deposits remained broadly stable at 10.0% (4 April 2017: 10.1%).

[7] Residential lending balances are stated net of impairment provisions.
[8] Based on market data as at November 2017 (comparative based on market data as at February 2017).

Financial performance

	9 months ended 31 December 2017		9 months ended 31 December 2016	
	£m	%	£m	%
Underlying profit before tax	883		866	
Statutory profit before tax	886		946	
Statutory profit after tax	664		684	
Net interest margin		1.33		1.33
Underlying cost income ratio		59.6		57.6
Statutory cost income ratio		59.7		56.1

	At 31 December 2017		At 4 April 2017	
	£bn	%	£bn	%
Total assets	232.8		221.7	
Loans and advances to customers	190.4		187.4	
Common Equity Tier 1 (CET1) ratio[9]		30.5		25.4
UK leverage ratio[10]		4.9		4.4
CRR leverage ratio[11]		4.5		4.2
Liquidity coverage ratio		146.7		124.0
Wholesale funding ratio		29.3		27.1

Underlying profit represents management's view of underlying performance and is presented to aid comparability across reporting periods, as explained on page 5.

Underlying profit before tax was £883 million (Q3 2016/17: £866 million), including a gain of £26 million from the sale of our investment in VocaLink (Q3 2016/17: £100 million one-off gain from the sale of our investment in Visa Europe). Statutory profit before tax of £886 million (Q3 2016/17: £946 million) includes £1 million (Q3 2016/17: £68 million) of derivative and hedge accounting gains[12] which are excluded from underlying profit.

Net interest income was higher than for the same period last year, with net interest margin remaining consistent at 133bps. Net interest margin benefited from lower funding costs period on period, partially offset by a decrease in average mortgage margins. Sustained competition in retail lending markets has resulted in more borrowers switching to competitively priced products. Our legacy base mortgage rate (BMR) balances have progressively declined period on period in line with both recent experience and our expectations. We are anticipating market conditions to remain highly competitive, and the run-off of BMR balances to continue, and consequently we expect our reported margin to trend lower during the remainder of the year and into 2018/19.

Our underlying cost income ratio was 59.6% (Q3 2016/17: 57.6%) as a result of increased costs and broadly unchanged total income. The rise in costs is primarily due to higher defined benefit pension costs and an increase in depreciation. We remain committed to a lower trajectory of cost growth in the future and, compared to the same period last year, cost growth has slowed to 3% (Q3 2016/17: 5% growth). We anticipate full year costs will be broadly flat year on year, in line with the expectations communicated in our 2016/17 financial results.

We continue to review compliance with ongoing and emerging regulatory matters, including consumer credit legislation, and have recognised a net provision charge of £25 million in the nine month period in respect of potential customer redress, in line with the position reported in our half-year results. This reflects updated assumptions for provisions previously recognised and includes a £28 million charge in relation to PPI, driven by an increase in the anticipated number of future complaints we expect to receive ahead of the Financial Conduct Authority's August 2019 deadline.

[9] Common Equity Tier 1 (CET1) ratio has been calculated under CRD IV on an end point basis.
[10] 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.
[11] 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.
[12] 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 currently applied or is not currently achievable. This volatility is largely attributable to accounting rules which do not fully reflect the economic reality of the hedging strategy.

Asset quality remains strong, with an average loan to value (LTV) of loan stock for total residential lending of 55% at the end of the period, consistent with that reported at the year end. The average LTV of new lending in the period was 71%, unchanged from the same period last year.

The number of cases more than three months in arrears as a percentage of the total book improved marginally to 0.34% (4 April 2017: 0.36%) for prime lending and 0.83% (4 April 2017: 0.89%) for specialist lending.

Impairment losses on loans and advances have decreased to £79 million (Q3 2016/17: £111 million). The charge in the period is primarily driven by updates to provisions on consumer banking to reflect current economic conditions.

Capital and leverage ratios have remained comfortably in excess of regulatory requirements with a CET1 ratio of 30.5% (4 April 2017: 25.4%) and a UK leverage ratio of 4.9% (4 April 2017: 4.4%). The improvement in both our CET1 and UK leverage ratios was mainly due to profits after tax in the period and the issuance of CCDS which raised £0.8 billion in September 2017. The CRR leverage ratio also increased to 4.5% (4 April 2017: 4.2%). Further information on our capital position can be found in Appendix 1.

In December 2017, the Basel Committee published the final reforms to the Basel III framework, including revisions to the standardised approach for credit and operational risks, and the introduction of a risk-weighted asset (RWA) output floor (effective on a transitional basis from 2022 and fully implemented in 2027). The PRA's revised expectations for IRB models for residential mortgages will be effective in 2020. Whilst both of these amendments are expected to result in an increase in RWAs and therefore a reduction in the CET1 ratio, we do not believe these will lead to a material increase in our overall regulatory capital requirements as the UK leverage ratio framework is expected to remain our binding requirement.

Outlook

While UK activity remained resilient in the immediate aftermath of the Brexit vote, there were signs of slowdown in 2017. Household spending, a key driver of growth, lost some momentum. Retail sales and car registrations have slowed and consumer confidence has also softened. Economic activity is being supported to some degree by strong global growth. We continue to expect the UK economy to grow at a modest pace, with annual growth of 1% to 1.5% in 2018 and 2019. Subdued economic activity and the ongoing squeeze on household budgets is likely to exert a modest drag on housing market activity and house price growth.

The sustained low interest rate environment and competition in core markets will maintain pressure on margins. Our mutual model, combined with our financial strength, means we are able to focus on taking a long-term view for the benefit of members, rather than pursuing actions to drive short-term profitability. We will continue to focus on supporting members and investing in new propositions, service enhancements and efficiency, whilst maintaining our capital strength.

Additional information

The financial information on which this Interim Management Statement is based is unaudited and has been prepared in accordance with Nationwide Building Society's previously stated accounting policies described in the Annual Report and Accounts 2017.

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Underlying profit

Profit before tax shown on a statutory and underlying basis is set out on page 3. Statutory profit before tax of £886 million has been adjusted for a number of items to derive an underlying profit before tax of £883 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 would potentially require exclusion of non-recurring items even though they are closely related to (or even a direct consequence of) the Group's core business activities.

Nationwide has developed a financial performance framework based on the fundamental principle of maintaining its capital at a prudent level in excess of regulatory requirements. The framework provides parameters which allow it to calibrate future performance and help ensure that it achieves the right balance between distributing value to members, investing in the business and maintaining financial strength. The most important of these parameters is underlying profit which is a key component of Nationwide's capital. In this context, Nationwide currently believes that generating underlying profit of approximately £0.9 billion to £1.3 billion per annum over the medium-term is an appropriate target for capital planning purposes. This range is based on our current assumptions as to the size of the mortgage market, and maintaining a UK leverage ratio in excess of 4%. This range, which will vary from time to time, should not be construed as a forecast of the likely level of Nationwide's underlying profit for any financial year or period within a financial year.

Forward looking statements

Certain statements in this document are forward looking with respect to plans, goals and expectations relating to the future financial position, business performance and results of Nationwide. Although Nationwide believes that the expectations reflected in these forward-looking statements are reasonable, Nationwide can give no assurance that these expectations will prove to be an accurate reflection of actual results. By their nature, all forward looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of Nationwide including, amongst other things, UK domestic and global economic and business conditions, market related risks such as fluctuation in interest rates and exchange rates, inflation/deflation, the impact of competition, changes in customer preferences, risks concerning borrower credit quality, delays in implementing proposals, the timing, impact and other uncertainties of future acquisitions or other combinations within relevant industries, the policies and actions of regulatory authorities, the impact of tax or other legislation and other regulations in the jurisdictions in which Nationwide operates. As a result, Nationwide's actual future financial condition, business performance and results may differ materially from the plans, goals and expectations expressed or implied in these forward-looking statements. Due to such risks and uncertainties Nationwide cautions readers not to place undue reliance on such forward-looking statements.

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

This document does not constitute or form part of an offer of securities for sale in the United States. Securities may not be offered or sold in the United States absent registration or an exemption from registration. Any public offering to be made in the United States will be made by means of a prospectus that may be obtained from Nationwide and will contain detailed information about Nationwide and management as well as financial statements.

Appendix 1 – Capital position

Capital structure and ratios

Common Equity Tier 1 (CET1) capital resources have increased by approximately £1.4 billion as a result of the issuance of CCDS in September 2017, which raised £0.8 billion, profit after tax for the period of £0.7 billion, offset by an increased deduction for intangible assets of £0.1 billion. Risk weighted assets (RWAs) decreased over the period by approximately £1.1 billion primarily due to the continued run-off of the commercial portfolio. These movements have strengthened our CET1 ratio to 30.5% (4 April 2017: 25.4%).

Tier 2 capital has increased by £1.6 billion, in line with plans to meet pending Minimum Requirement for Own Funds and Eligible Liabilities (MREL) requirements, following the issuance of qualifying Tier 2 subordinated debt in July 2017 and October 2017, of €1 billion and $1.25 billion respectively (£1.8 billion equivalent in aggregate). The residual offsetting movement was primarily due to regulatory amortisation.

	31 December 2017 £m	4 April 2017 £m
Common Equity Tier 1 capital before regulatory adjustments	11,336	9,915
Total regulatory adjustments to Common Equity Tier 1	(1,429)	(1,360)
Common Equity Tier 1 capital	9,907	8,555
Additional Tier 1 capital before regulatory adjustments	992	992
Total regulatory adjustments to Additional Tier 1 capital	-	-
Additional Tier 1 capital	992	992
Total Tier 1 capital	10,899	9,547
Tier 2 capital before regulatory adjustments	4,225	2,582
Total regulatory adjustments to Tier 2 capital	-	-
Tier 2 capital	4,225	2,582
Total capital	15,124	12,129
Ratios:	%	%
Common Equity Tier 1	30.5	25.4
Tier 1	33.5	28.4
Total capital	46.5	36.1

Note: Data in the table is reported under CRD IV on an end point basis, being full implementation with no transitional provisions.

Overview of RWAs (EU OV1)

		RWAs		Minimum capital requirements[13]	
		31 December 2017 £m	4 April 2017 £m	31 December 2017 £m	4 April 2017 £m
1	Credit risk	25,801	26,802	2,064	2,144
2	Of which standardised approach	2,341	2,548	187	204
3	Of which the foundation IRB approach	5,940	6,969	475	557
4	Of which the advanced IRB approach	17,349	17,163	1,388	1,373
5	Of which Equity IRB under the simple risk-weight or the internal models approach	171	122	14	10
6	Counterparty credit risk	1,329	1,221	106	98
7	Of which marked to market	584	546	47	44
9	Of which standardised approach for counterparty credit risk	27	19	2	2
11	Of which risk exposure for contributions to the default fund of a CCP	4	6	-	-
12	Of which CVA	714	650	57	52
13	Settlement risk	-	-	-	-
14	Securitisation exposures in banking book (after cap)	303	434	24	35
15	Of which IRB ratings-based approach	303	434	24	35
19	Market risk[14]	-	-	-	-
23	Operational risk	4,865	4,865	389	389
25	Of which Standardised approach	4,865	4,865	389	389
27	Amounts below the thresholds for deduction (subject to 250% risk weight)	194	319	16	25
29	Total	32,492	33,641	2,599	2,691

RWA flow statements of credit risk exposures (EU CR8)

		IRB credit risk		Standardised credit risk		Counterparty credit risk	
		RWA amounts £m	Capital requirements £m	RWA amounts £m	Capital requirements £m	RWA amounts £m	Capital requirements £m
1	RWA as at 4 April 2017	24,254	1,940	2,548	204	1,221	98
2	Asset size	(606)	(48)	(206)	(17)	133	10
3	Asset quality	(188)	(15)	(1)	-	(25)	(2)
9	RWA as at 31 December 2017	23,460	1,877	2,341	187	1,329	106

IRB credit risk RWAs have reduced by £0.8 billion during the period. A reduction in book size accounted for £0.6 billion of this movement, driven by the continued run-off of the commercial portfolio. The remaining £0.2 billion movement resulted from a marginal improvement in the credit quality of the outstanding commercial exposures.

Leverage ratio

The UK leverage ratio[10] of 4.9% at 31 December 2017 (4 April 2017: 4.4%) has increased due to profits in the period and an increase in Tier 1 capital resources, following the issuance of CCDS. Minimum leverage requirements are monitored by the PRA on this basis, with the current regulatory threshold set at 3.25% following the recalibration to adjust for the impact of excluding central bank holdings from the exposure measure. There is a supplementary leverage ratio buffer of 0.35% to be implemented in 2019. Following the Financial Policy Committee's (FPC) announcement on the countercyclical buffer (June 2018: 0.5%, November 2018: 1%), the equivalent countercyclical leverage ratio buffer will be 0.2% from June 2018, increasing to 0.4% from November 2018. Therefore, the minimum leverage ratio requirement will be 4% by January 2019. We remain confident in the strength of our capital position to meet the increased minimum requirements.

[13] Capital is also held to meet Pillar 2 and capital buffer requirements. Further details on Pillar 2 requirements can be found in the Pillar 3 Disclosure 2017 at nationwide.co.uk
[14] Market risk has been set to zero as permitted by the CRR as exposure is below the threshold of 2% of own funds.

The average UK leverage ratio for the three months to 31 December 2017 is 4.9%, with an average exposure measure of £221,422 million[15].

The CRR leverage ratio increased to 4.5% (4 April 2017: 4.2%). The improvement was driven by the same movements described for the UK leverage ratio, but was partially offset by increased central bank exposures, which are ineligible for deduction under the CRR methodology.

	31 December 2017 £m	4 April 2017 £m
Tier 1 capital	10,899	9,547
UK leverage exposure	222,573	215,894
CRR leverage exposure	242,398	228,428
	%	%
UK leverage ratio[10]	4.9	4.4
CRR leverage ratio[11]	4.5	4.2

[15] The average leverage ratio is calculated using the averages of Tier 1 capital and UK leverage exposure, based on the last day of each month in the quarter.