Nationwide Building Society

Interim Management Statement
Q3 2016/17

10 February 2017

Nationwide Building Society today publishes its Interim Management Statement covering the period from 5 April 2016 to 31 December 2016 ("Q3 2016/17").

Nationwide Building Society Chief Executive, Joe Garner, said:

"Our performance in the third quarter reflects a continuation of our strong trading performance announced at the half year. In a period of sustained economic uncertainty our commitment to serve our members remains steadfast and true to our core purpose. We continue to take conscious decisions to support our members, delivering market-leading service and highly competitive products, which has led to a financial performance in line with our expectations.

"More people are choosing Nationwide Building Society for their everyday banking needs. We opened 570,000[1] new current accounts in the first nine months of the year, taking us to a 7.4%[2] market share of main standard and packaged accounts. We have also been gainers in current account switching, attracting 17.1% of total switchers.

"We continue to be ranked number one for customer service amongst our high street peer group, with a lead of 6.0%[3], reflecting the importance we place on putting our members first.

"Looking forward, our financial strength and focus on providing the very best in customer service means we are well placed to continue to support our members."

Nationwide Building Society Finance Director, Mark Rennison, said:

"We have continued to trade strongly during the third quarter of the year, building on the success of the first six months. Our trading performance in the nine months to 31 December 2016 demonstrates our commitment to support members during these uncertain economic times to buy homes and save for the future. Gross mortgage lending has increased in the period by 11.0% to £26.2 billion, a market share of 14.3% and member deposit balances have increased by £6.4 billion[4], a 10.2% market share of balance growth.

"Our profit performance has reduced in line with our expectations and reflects in part the continued margin pressure due to the prevailing low interest rate environment and the conscious decisions we have taken to support our members. Statutory profit before tax in the nine months is £946 million, a decrease of 16% on the same period last year.

"Our capital and liquidity ratios remain strong, underpinning the security we provide to all our members."

[1] Number of new current accounts includes basic bank accounts.
[2] Based on market data as at November 2016 (comparative based on market data as at February 2016).
[3] © GfK 2016, Financial Research Survey (FRS), 3 months ending 31 December 2016 vs 30 September 2016, 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 >6% (Barclays, Halifax, HSBC, Lloyds Bank (inc C&G), NatWest and Santander).
[4] Member deposits include current account credit balances.

Trading performance

	9 months ended 31 December 2016		9 months ended 31 December 2015	
	£bn	**%**	£bn	%
Gross residential mortgage lending/*market share*	**26.2**	***14.3***	23.6	*13.5*
Net residential mortgage lending/*market share*	**8.2**	***29.3***	6.7	*22.3*
Member deposits balance movement[4]/*market share*	**6.4**	***10.2***	*4.9*	*9.3*
Number of new current accounts opened[1]	**570,000**		419,000	

	At 31 December 2016		At 4 April 2016	
	£bn	**%**	£bn	%
Residential lending balances[5]	**170.5**		162.1	
Member deposit balances[4]	**145.1**		138.7	
Current account stock market share[2]		**7.4**		7.1

We have continued to help more members get onto or move up the housing ladder in the last nine months. Gross mortgage lending for the nine months to 31 December 2016 was up 11.0% on the comparative period at £26.2 billion, representing a market share of 14.3%. Gross mortgage lending includes £22.5 billion of prime residential mortgages (Q3 2015/16: £19.0 billion) and £3.7 billion of buy to let (BTL) lending (Q3 2015/16: £4.6 billion). Our strong performance reflects competitive products and propositions, with our best rates provided exclusively to our existing mortgage members.

Net mortgage lending of £8.2 billion (Q3 2015/16: £6.7 billion) includes £0.9 billion of BTL lending (Q3 2015/16: £2.2 billion). Following the underwriting criteria changes made earlier in the year for BTL lending and the increase in stamp duty impacting the BTL market, the flow of advances slowed. This, combined with higher maturities compared to the same period last year, has resulted in a decrease in net BTL lending.

Mortgage lending has largely been supported by strong retail funding flows with member balances growing by £6.4 billion[4] in the period, resulting in a market share of balance growth of 10.2% (Q3 2015/16: 9.3%). Member deposits increased as we continue to support members, protecting our savings rates where possible in the current low base rate environment.

As well as strong mortgage and savings growth, more people than ever before are choosing Nationwide Building Society for their everyday banking, attracted by the breadth, value and quality of our current account range. In a very competitive market, we increased our market share of main standard and packaged accounts stock to 7.4%[2] (4 April 2016: 7.1%). During the period we opened 570,000[1] new current accounts, 36% more than the same period last year, and were a net beneficiary of the current account switching service, attracting 17.1% of all switchers. We are proud to have extended our product range with the launch in August of our first student current account, FlexStudent, which has seen 11,500 accounts opened in the period to 31 December 2016.

[5] Residential lending balances are stated net of impairment provisions.

Financial performance

	9 months ended 31 December 2016		9 months ended 31 December 2015	
	£m	**%**	£m	%
Underlying profit before tax	**866**		1,129	
Statutory profit before tax	**946**		1,123	
Statutory profit after tax	**684**		852	
Net interest margin		**1.33**		1.56
Underlying cost income ratio		**57.6**		53.1
Statutory cost income ratio		**56.1**		53.3

	At 31 December 2016		At 4 April 2016	
	£bn	**%**	£bn	%
Total assets	**224.9**		208.9	
Loans and advances to customers	**187.0**		178.8	
Common Equity Tier 1 (CET1) ratio[6]		**24.4**		23.2
Leverage ratio[6]		**4.0**		4.2
Modified UK leverage ratio[7]		**4.3**		4.4
Liquidity coverage ratio		**136.3**		142.6
Wholesale funding ratio		**26.9**		24.8

Underlying profit represents management's view of underlying performance and is presented to aid comparability across reporting periods. For more detail on how we define underlying profit please see page 5.

Underlying profit before tax for the nine month period ended 31 December 2016 has reduced 23% to £866 million, driven by a reduction in net interest income, growth in underlying costs and an increase in impairment charges. This has been partially offset by a gain of £100 million from the disposal of our investment in Visa Europe during the period.

Statutory profit before tax is down 16% to £946 million. This includes £68 million (Q3 2015/16: £10 million) of derivative and hedge accounting gains which are excluded from underlying profit. Profitability for the period continues to be in line with our expectations and our Financial Performance Framework which ensures that we balance the value we distribute to members with ongoing investment and maintenance of our financial strength.

As anticipated, our net interest margin in the period of 1.33% was lower than the same period last year (Q3 2015/16: 1.56%) due to the impact of sustained levels of competition in the mortgage market combined with continued natural attrition of the residential base mortgage rate (BMR) balances[8] and the impact of medium term interest rate expectations. We expect that our net interest margin will modestly decline during the remainder of the year.

The underlying cost income ratio has increased from 53.1% to 57.6%. The movement reflects a reduction in net interest income combined with incremental expenditure on strategic investment to enhance efficiency and service for our members and increased employee costs, including our investment in a 'Living Pension' for our employees. Whilst sharpening our focus on efficiency, we will continue to invest where we believe it is right for our members.

We continue to review compliance with ongoing and emerging regulatory matters, including consumer credit legislation, and have recognised a net provision charge of £55 million in the nine month period in respect of potential customer redress. Current provisions reflect latest experience and the estimated impact of industry consultation.

[6] The capital ratios provided have been calculated under CRD IV on an end point basis. The leverage ratio is calculated using the CRR definition of Tier 1 for the capital amount and the delegated act definition of the exposure measure.
[7] The modified UK leverage ratio is shown on the basis of measurement announced by the PRA and excludes central bank reserves from the leverage exposure measure.
[8] BMR balances relate to our mortgages reserved on or before 29 April 2009 which revert to a rate guaranteed to be no more than 2% above the Bank of England base rate.

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 increased 2% to 71%, primarily due to our strategy to increase lending to the first time buyer market.

The number of cases more than three months in arrears as a percentage of the total book remains broadly consistent with the position reported at 4 April 2016, being 0.34% for prime lending and 0.93% for specialist lending.

Whilst the underlying performance of the portfolios remains stable, we continue to review the appropriateness of provision assumptions in the current low interest environment and as a result impairment losses on loans and advances in the nine month period were £111 million (Q3 2015/16: £9 million). The lower charge in the prior period includes a net impairment write back in relation to the commercial portfolio of £34 million.

We are participating in the Bank of England's Term Funding Scheme which provides cash secured against eligible collateral with a flexible four year maturity. As at 31 December 2016 we had drawn £2.0 billion of funding from the Scheme, with a further £1.5 billion drawn since that date.

The Group's capital position has remained strong, with consolidated CET1 and leverage ratios as at 31 December 2016 of 24.4% and 4.0% respectively (4 April 2016: 23.2% and 4.2% respectively)[6]. The leverage ratio decreased due to a higher pension deficit as profits have broadly offset the increase in leverage exposure. Further information on our capital position can be found in Appendix 1.

The Group's modified UK leverage ratio[7], on the basis of measurement announced by the Prudential Regulation Authority (PRA) in August 2016, was 4.3% at 31 December 2016 (4 April 2016: 4.4%).

The Basel Committee on Banking Supervision is expected to publish a package on the remaining Basel III reforms in 2017. These include revisions to the standardised approach for credit and operational risks and the Internal Rating Based (IRB) framework. The revised standardised approach is expected to be used as a basis for a floor for minimum capital requirements, although the calibration of this has not yet been published. In addition, a PRA consultation on residential risk weights, proposing revised expectations for IRB models, was published in July 2016. These proposals and reforms will lead to higher risk weights in the medium to long term. Whilst final proposals are not yet available, our current view is that these will not lead to a material increase in capital requirements for the Group as we expect the UK leverage ratio framework to remain our binding requirement.

The results of the 2016 Concurrent Stress Test (CST) announced on 30 November 2016 further demonstrate the financial strength and resilience of the Group. The scenario combined the more severe domestic elements of CST 2014 and global elements of CST 2015, and the results show that we would remain profitable and in excess of the PRA prescribed hurdle rates in each year of such a stress with a low point CET1 ratio of 15.6% after the application of management actions.

Outlook

The UK economy grew at a respectable pace in 2016. However, consistent with the Bank of England view, our expectation is that UK economic growth will slow over the next two years.

The longer term impacts of the EU referendum vote on the UK economy will depend on a range of factors, not least the time it takes to reach trading agreements with EU and non-EU economies and the effectiveness of other actions for improving UK trade prospects.

Measures announced by the Monetary Policy Committee in August, including a reduction in base rate to 0.25%, will provide support for economic activity. A rise in inflation in the quarters ahead is expected to prove transitory and is unlikely to prevent policymakers implementing further stimulus if required. Interest rates are likely to remain at historically low levels for a prolonged period in order to support economic activity.

The sustained low interest rate environment combined with competition in core markets will continue to put pressure on margins and profit. Notwithstanding this, our positive trading performance, strong capital position, high quality balance sheet and lead on customer satisfaction mean we are well placed to deliver long term value to our members and to continue to support the UK housing market.

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 2016.

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Underlying profit
Statutory profit before tax has been adjusted for a number of items, consistent with prior periods, to derive an underlying profit before tax figure. 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.

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 Building Society. Although Nationwide Building Society believes that the expectations reflected in these forward looking statements are reasonable it 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 Building Society 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 Building Society operates. As a result, Nationwide Building Society'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 Building Society cautions readers not to place undue reliance on such forward looking statements.

Nationwide Building Society 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 the Society and will contain detailed information about the Society 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 £0.3 billion. This is the result of profit in the period, which was partly offset by a reduction in reserves due to an increase in the pension deficit. Risk weighted assets (RWAs) decreased over the period by approximately £0.2 billion. These movements have resulted in a CET1 ratio of 24.4% (4 April 2016: 23.2%).

	31 December 2016 £m	4 April 2016 £m
Common Equity Tier 1 capital before regulatory adjustments	**9,758**	9,508
Total regulatory adjustments to Common Equity Tier 1	**(1,404)**	(1,495)
Common Equity Tier 1 capital	**8,354**	8,013
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	**9,346**	9,005
Tier 2 capital before regulatory adjustments	**2,641**	1,649
Total regulatory adjustments to Tier 2 capital	**-**	-
Tier 2 capital	**2,641**	1,649
Total capital	**11,987**	10,654
Ratios:	**%**	%
Common Equity Tier 1	**24.4**	23.2
Tier 1	**27.3**	26.1
Total capital	**35.0**	30.9

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

Capital requirements

	31 December 2016		4 April 2016	
	RWAs £m	**Pillar 1 Capital requirements[9] £m**	RWAs £m	Pillar 1 Capital requirements[9] £m
Credit risk	**27,965**	**2,237**	28,575	2,286
Counterparty credit risk	**812**	**65**	598	48
Market risk[10]	**-**	**-**	-	-
Operational risk	**4,604**	**368**	4,604	368
Credit valuation adjustment	**907**	**73**	698	56
Total	**34,288**	**2,743**	34,475	2,758

Leverage ratio

The Group holds capital to meet a leverage ratio requirement, with the current regulatory threshold set at 3% as the countercyclical leverage ratio buffer is currently 0%. The leverage ratio has decreased to 4.0% (4 April 2016: 4.2%) as a result of a higher pension deficit as profits have broadly offset the increase in leverage exposure.

The average leverage ratio for the three months to 31 December 2016 is 4.0%, with an average exposure measure of £230,874 million[11].

	31 December 2016 £m	4 April 2016 £m
Tier 1 capital	**9,346**	9,005
Leverage exposure	**232,899**	213,181
	%	%
Leverage ratio[6]	**4.0**	4.2

The Group's modified UK leverage ratio[7], on the basis of measurement announced by the Prudential Regulation Authority (PRA) in August 2016, was 4.3% at 31 December 2016 (4 April 2016: 4.4%).

[9] The Group also holds capital to meet Pillar 2 and capital buffer requirements. Details of Pillar 2 requirements as at 4 April 2016 are set out in the Group's Pillar 3 disclosures at **nationwide.co.uk**
[10] Market risk has been set to zero as permitted by the CRR as exposure is below the threshold of 2% of own funds.
[11] The average leverage ratio is calculated using the averages of Tier 1 capital and total exposure, based on the last day of each month in the quarter.