Annual Report and Accounts

2017

15 million members building society, nationwide

Nationwide Building Society

We are owned by our 15 million members

We help people save, buy homes and manage their daily finances

We support each other and our communities

We are building society, nationwide

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Strategic Report

Strategic Report

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The Strategic Report on pages 1 to 29 has been approved by the board of directors and signed on its behalf by

Joe Garner
Chief Executive
22 May 2017

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2017 highlights

Building society, nationwide

Nationwide's purpose is to use the power of mutuality as a force for good for our members, and for society; we describe this as building society, nationwide. To guide us, we refreshed our strategy during the year, organised around five cornerstones. These define what we stand for, what we will do and how we will do it, and we will use them to report on our performance. Read about our 2017 highlights below. More information is included in the Strategic review.

Built to **Last**

Being safe, secure, sustainable and dependable

Underlying profit	Statutory profit	Common Equity Tier 1 (CET1) ratio	UK leverage ratio	Underlying cost income ratio[1]
£1,030 million	**£1,054 million**	**25.4%**	**4.4%**	**60.2%**
2016 £1,337 million	2016 £1,279 million	2016 23.2%	2016 4.4%	2016 53.9%

	2013	2014	2015	2016	2017
Underlying profit (£ million)	433	952	1,227	1,337	**1,030**
Statutory profit (£ million)	168	677	1,044	1,279	**1,054**

Building **Thriving Membership**

Delivering real value to our members

Record membership	Member financial benefit[3]	Record current accounts opened	Record gross mortgage lending	Member deposit balance growth
15 million members of which **7.8 million** engaged members[2]	**£505 million** value returned to members	**795,000** UK's top choice provider[4]	**£33.7 billion**	**£5.8 billion**
2016 7.4 million[2]	2016 £397 million	2016 590,000	2016 £32.6 billion	2016 £6.3 billion

Building **Legendary Service**

Providing service that is heartfelt, easy, lifelong and personal

Customer satisfaction	Growth in digital channel	Investment in branches
No.1 for customer satisfaction over high street peer group[5]	**73% increase** in mobile log-ons	**Nationwide NOW** (our state of the art video technology) now installed in **421 branches**

Building a **National Treasure**

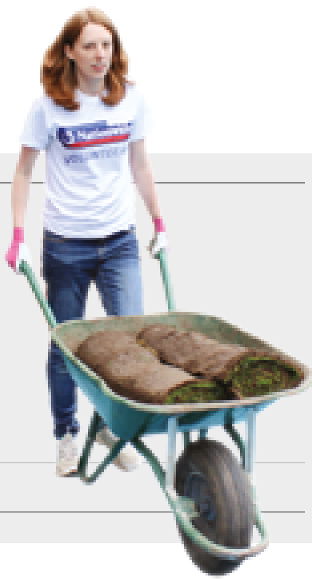
Leading by example and making a difference

UK's most trusted financial brand[6]	**Which? Banking Brand of the Year 2017**	**£5 million channelled into community and charity support**

Building **PRIDE**

Shared values, shared culture, doing the right thing

Employee engagement	Employee enablement	Community involvement
78% 5% above average score of high performing organisations worldwide	**72%** In line with high performing organisations worldwide	**75%** of employees getting involved in fundraising, volunteering or payroll giving
2016 80%	2016 77%	2016 76%



1 Our underlying cost income ratio demonstrates how efficiently we are running Nationwide. A lower percentage indicates greater efficiency.

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

3 More information about member financial benefit can be found in the Financial review.

4 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 March 2017. Financial brands included Nationwide, Barclays, Co-operative Bank, First Direct, Halifax, HSBC, Lloyds, NatWest, TSB and Santander.

5 © GfK 2017, Financial Research Survey (FRS), 3 months ending 31 March 2017, proportion of extremely/very satisfied customers minus proportion of extremely/very/fairly dissatisfied customers summed across current account, mortgage and savings. High street peer group defined as providers with main current account market share >6% (Barclays, Halifax, HSBC, Lloyds Bank (inc C&G), NatWest and Santander).

6 Source: Nationwide Brand and Advertising tracker – compiled by Independent Research Agency, based on responses from existing customers of each brand, 3 months ending March 2017. Financial brands included Nationwide, Barclays, Co-operative Bank, First Direct, Halifax, HSBC, Lloyds, NatWest, TSB and Santander.

Chairman's statement

David Roberts

Dear fellow member

As a member as well as your Chairman, I want to start by thanking Nationwide's people for what they did for us last year. Thanks to them, this was another successful year for our Society. We maintained our financial strength and our strong balance sheet. We continued to invest in our future. And we both grew our membership to an all-time high, and returned real value to you.

As a mutual, you are our owners and I believe we have a responsibility to be clear to you about what we do and why we do it. We were born with a social purpose, which we express today as 'building society, nationwide', rooted in the belief that we achieve more together than we can alone. I am confident that this means we think and behave differently.

Nationwide's core business with current and future members is to help them buy their homes, manage their daily finances and provide a safe place for their savings, all while returning the value that mutuality provides. To make sure we deliver well and live up to our purpose, we refreshed our strategy last year, informed by talking to members and employees.

Around for over
130 years

We've been around for over 130 years and we aspire to prepare the Society for the next 130. The commitments we make to members can last for decades. We even have young members joining who, if we stay true to this purpose, could be with us in the 22nd century. So as your Chairman, my starting point is that the Society must be 'built to last': this is the foundation stone that underpins the strategy. We should be a beacon of stability and confidence for members, no matter what.

Perhaps that is even more relevant in the context of the uncertainty we see today, whether from geopolitical risk or, closer to home, with Brexit and Britain's relationship with the wider world high on the agenda.

So the most important thing we can do is run a stable, low-risk organisation. After that, in order to best serve our members, we need to care for, develop and invest in our people. Because it's our people that actually deliver to you. I'm therefore enormously proud we have people like Anne from our Leamington Spa branch who, when I met her, had served members there for 42 years.

When I meet our people they tell me Nationwide is a great place to work. And when I ask why, they say it's because they enjoy it, they're trusted and they're treated well. Fundamentally because they feel that they're asked to do the right thing. Of course, we're not perfect. And 22,000 suggestions through our 'Big Conversation' have generated lots of ideas on how we can do things better, and we are using these to improve our service to members (more from our Chief Executive, Joe Garner, on that later in this Report).

The BIG Conversation

Ultimately the logic of our strategy is that, if we're a safe Society which has good engagement with its people, who then deliver a great service, then we will do a good job for members. That breeds success and allows Nationwide to invest ever more into membership and also wider society, which takes us towards the aspiration of becoming a 'national treasure'. This logic informs the cornerstones on which we have built the strategy. You can read more about this in Joe's statement and the Strategic review.

Chairman's statement *continued*

Being a mutual is not a guarantee of success on its own. We do not have to follow a shareholder agenda, and the singular pursuit of profits this tends to demand, but nor do we face conventional shareholder scrutiny, so we need to ensure the Board provides an equivalent level of challenge and scrutiny to the business. By combining the best of the public company world in terms of governance and ambition, and the alignment with members that exists within a mutual, we have a powerful and special proposition.

So, our goal is not to maximise profit, rather we aim to make sufficient profit. Sufficient to ensure the safety and stability that is in members' interests, building capital strength and resilience. Sufficient to invest in the business infrastructure – the branches and technologies that allow us to be more efficient and to serve members better – as well as products and service. Then beyond that, any surplus we generate we can return to our members in the form of improved rates and loyalty rewards.

Balancing these interests is a key part of management and the subject of keen oversight by your Board. That balance changes depending on the needs of members, the state of the economy and the Board's view of what is coming. So in a challenging environment, it might be prudent to increase the capital we put aside or reduce the level of investment. Or we might make a decision to support members and give back extra value through rewards, as we did last year through initiatives such as 'recommend a friend', and by striving to offer savings rates higher than our main competitors. This year we have quantified the financial rewards to members, and it is over half a billion pounds. More on this is included in the Financial review.

Our mutuality informs how we behave. We apply the highest standards of corporate governance, adopting the standards applicable to a FTSE-listed business. We choose to have an excellent pension scheme because that is consistent with our sense of fairness to employees. And we choose not to pay our most senior executives as much as they would get in businesses of comparable size, because that is appropriate for a member-based business.

We also approach dealing with people in financial difficulty differently. For example, we have helped more than 2,000 members affected by life-limiting situations through a specialist support service, applying financial flexibility and human understanding.

At Nationwide's AGM in 2007, members voted to spend at least 1% of our profits each year on social investment programmes – either directly, or through the independent charity we established 20 years ago, the Nationwide Foundation. We're proud of our success in helping people into better homes and to start saving, and we believe the social impact of what we do is additive to the Society in terms of trust and our reputation. As we embark on a new social investment programme in 2017, we are looking at ways to involve you more, including letting members decide what we support.

If we are serious about 'building society, nationwide', then we also need to engage with some of the big issues of the day. We do this through social investment and also through employee volunteering, as we know our people like to get involved.

Nationwide's success means we have the privilege to try new things. For example, we recently returned a branch to Glastonbury in Somerset, meeting the call of a community whose bank branches had closed. We can partner with the local community where others may not, to seek to create a viable model. If it works, we will look at other locations.

The Government is currently thinking through how corporate governance should improve, especially for private companies. As a large private member-owned business, we believe we can offer a useful perspective on how to engage members and employees to get their views, given the priority we give this and the actions we already have in place to make it happen.

Diversity is an important attribute of our society, and something we strive to reflect in our people, the management team and our Board. We continued to improve our gender and minority representation in the Society and we have also broadened the experience of the Board by welcoming two new independent non executive directors, Kevin Parry and Baroness Usha Prashar. I am also delighted to announce that Gunn Waersted will shortly be joining our Board as non executive director. Although there is still more to do, I am pleased to note that as a consequence of an open, meritocratic selection process, almost 40% of our Board and over half of our non executive directors will now be women.

I started by thanking employees. Let me end by thanking you, Nationwide's members. It is your collective power that makes Nationwide a force for good. I very much look forward to meeting as many of you as possible this year.

We are
building society, nationwide

For more information on our diversity agenda, including employee gender information, see the Directors' report and the Nomination and Governance Committee report.

Chief Executive's review

Joe Garner

Why being a building society matters

Our building society has an extraordinary past. Nationwide was born of a social purpose and the belief that people can achieve more together than alone. That speaks to an equally extraordinary future. We are unashamedly ambitious for a future in which we are seen to be genuinely 'building society, nationwide'. After a year as your Chief Executive, I am more convinced than ever that Nationwide's mutual purpose remains as relevant today as it was when we were founded 130 years ago.

Nationwide's strong trading and financial performance in 2016/17 puts us in a good position. Membership is at a record high, as more people choose Nationwide for mortgages, savings and current accounts than ever before. We are proud to be, for the first time, the UK's top choice for current accounts.

Nationwide has a strong reputation for outstanding service, where we lead our high street peer group for customer satisfaction by 5%[1], delivered by loyal and committed people. As a result, membership grew to over 15 million.

£505 million
of member financial benefit

Nationwide is in robust financial health, having achieved profits of over £1 billion for the third consecutive year. As a mutual, profits are not the only barometer of our success, but they are important because they allow us to maintain our financial strength, to invest with confidence, and to return value to you, our members, through pricing and service. During the year, we therefore took conscious decisions on interest rates, fees and incentives, that delivered a financial benefit of £505 million to our members, alongside the high standards of service we are known for. For more information see our Financial review.

Financially strong and sustainable

Nationwide remains safe and secure as shown by a strong capital position and balance sheet. We have improved the Society's common equity tier 1 ratio to 25.4% (2016: 23.2%), and the UK leverage ratio remains robust at 4.4%.

As anticipated, statutory profit reduced by 17.6% in the year to £1,054 million, due to a number of factors. Net interest income reduced due to the prevailing low interest rate environment, competition in the mortgage market and the conscious decisions we have taken to protect rates for savers while passing on the base rate decrease to mortgage borrowers. There has also been a growth in underlying costs, mainly reflecting ongoing expenditure on strategic investment, together with growth in business volumes. The impact of these has been partially offset by a gain of £100 million from the disposal of the Society's stake in Visa Europe during the period.

Strategic investment in the Society is greater than ever before, reflecting our commitment to investing in new products and better service propositions for members. We also continue to invest in strengthening our resilience and control environment to keep our members' money safe. As a responsible employer, we have supported our people by increasing pension contributions.

These increases to costs have led to a deterioration in our underlying cost income ratio to 60.2% (2016: 53.9%). In the coming year, we will keep our costs broadly flat by implementing efficiency initiatives, such as our 'right first time' programme to reduce errors and duplication across the business, and our plans to automate more manual processes. We will continue to invest where we believe it is in the long term interests of our members.

We have a stable and low-risk business model, which is fundamentally about looking after our members' deposits and putting them to work funding other members' mortgages. During the year, we identified several parts of the business that were not a good fit with our core purpose. We have begun to exit these responsibly. We will stop offering car insurance to new customers from June 2017 and will be writing to customers to let them know how their policy will be managed in future. We are also winding down our commercial lending business, will exit the Nationwide International deposit-taking business, and will no longer offer inheritance tax planning advice. While we recognise these customer needs, we believe it is not in the interests of our Society to provide services which are not core to our business.

Nationwide's financial strength, improved efficiency, and a tighter focus on our core business will ensure we can continue to invest in new products, good value pricing, and the service quality members value.

[1] © GfK 2017, Financial Research Survey (FRS), 3 months ending 31 March 2017, proportion of extremely/very satisfied customers minus proportion of extremely/very/fairly dissatisfied customers summed across current account, mortgage and savings, high street peer group defined as providers with main current account market share >6% (Barclays, Halifax, HSBC, Lloyds Bank (inc C&G), NatWest and Santander).

Chief Executive's review *continued*

Record membership as more people choose Nationwide

Nationwide's membership reached an all-time high, with over 15 million members, including a record 7.8 million engaged members who hold a core product with us.

15 million
members

More than 2.2 million members hold mortgages with us, representing a market share of 12.9% and, as the UK's second largest mortgage lender, we remain committed to helping people own their own home. In the year, we lent more to help people onto or up the housing ladder than ever before, with total mortgage lending of £33.7 billion, up 3%. We also helped 75,000 first-time buyers into their first home, representing 1 in 5 of all first-time buyers in the UK and a new record (2016: 57,200). In March, we launched a new Family Deposit Mortgage that allows homeowners to raise funds from their existing property to help another family member buy a home and we are already processing the first applications.

We also support the growing private rented sector through our dedicated buy to let subsidiary, The Mortgage Works (UK) plc. We have tightened our criteria on lending to make sure our borrowers can meet future repayments. This move, combined with the softening of lending which followed changes to Stamp Duty in March 2016, resulted in a planned fall in buy to let lending to £4.6 billion, a decline of 36%.

UK's top choice
for current accounts

We are the UK's third largest savings provider, accounting for £1 in every £10 of savings in Britain. With interest rates still at record lows, we remain committed to encouraging the nation to keep saving. We kept average deposit interest rates over a third higher than the market average in the last year, leading to £5.8 billion growth in member balances. Following the base rate cut in the summer, we maintained rates on our Help to Buy ISA, Flexclusive Regular Saver and Regular Saver accounts. As part of our overall desire to support savers, over the last year our members benefited from £380 million in additional interest compared to the market average. 1.7 million members have signed up to SavingsWatch, our email and text alert service for rate changes and new products.

Which?
Banking Brand of the Year 2017

Nationwide achieved a new milestone, becoming the UK's top choice for current accounts. A combination of strong growth and good retention took our market share of main standard and packaged current accounts to 7.5% at February, up from 7.1% last year. A record 795,000 Nationwide current accounts were opened over the year, an increase of 35% over the previous year. This included 147,000 new youth accounts, a market share of 14.3% in the youth market. A further 169,000 people chose FlexPlus, our award-winning account. We strongly support financial inclusion by providing customers access to a full banking service with our FlexBasic account. We also continue to benefit from high switching rates through the Current Account Switch Service, with some 165,000 current account holders switching to Nationwide – an 18% share of the total personal switcher market. We are delighted to have recently become Which? 'Banking Brand of the Year 2017'.

We continued to provide a full range of personal banking services and saw steady growth in credit cards issued, personal loans and home insurance.

No 1 for service

If there is one thing that sets us apart, it is Nationwide's high standard of service. We are ranked number one for customer satisfaction amongst our high street peer group, with a lead of 5%[2] over the nearest competitor thanks to the culture of care I see everywhere at Nationwide. As service expectations of our members tend only to rise, we are constantly seeking ways to serve members even better.

We are working hard to provide a truly seamless service across mobile, branch and telephone channels, so that members can choose when, where and how to transact with us. It is 20 years this year since we launched our internet bank – the first in the UK – and we still combine digital convenience with a human touch. In the last year mobile log-ons grew by 73%, and we aim to double the number of members who are active via mobile channels.

At the same time, our branches remain busy: over half of all new current accounts are still opened in a branch. We still see a vital role for the branch network, despite the continued withdrawal of financial services providers from high streets over the last two decades.

We are exploring ways to ensure branches remain financially viable in a future where members may use them less. For example, we're testing using Nationwide NOW, our state of the art video technology, to connect customers to mortgage, personal banking and financial consultants in selected branches, as well as contact centres, using our branch consultants' time more efficiently. Similarly, we're piloting a new community branch in Glastonbury, which opened in April, to test the viability of combining personal service and the latest technology to serve communities left without a bank.

Great place to work

Our employees provide the foundations on which our member service and propositions thrive, so we try very hard to make Nationwide Building Society a great place to work. Our success is reflected in our very high employee engagement score which, at 78%, is above the average score of high performing organisations worldwide. In the previous year we improved our employee pension scheme by increasing our employer contributions, helping to ensure that employees will have a living pension.

[2] © GfK 2017, Financial Research Survey (FRS), 3 months ending 31 March 2017, proportion of extremely/very satisfied customers minus proportion of extremely/very/fairly dissatisfied customers summed across current account, mortgage and savings, high street peer group defined as providers with main current account market share >6% (Barclays, Halifax, HSBC, Lloyds Bank (inc C&G), NatWest and Santander).

Chief Executive's review *continued*

Our reputation as a good employer reflects the very special culture and ethos of Nationwide, which is encapsulated in our PRIDE values:

pride stands for:

Putting our members and their money first
Rising to the challenge
Inspiring trust
Doing the right thing in the right way
Excelling at relationships

Leading by example and making a difference

Since our origins in the 19th century right through to the present day, our aim has been to support communities by helping people save and live in better homes. We continue to invest at least 1% of our pre-tax profits to support good causes, in line with our purpose. This funding supports both our own social investment programme and the Nationwide Foundation, the independent charity we established 20 years ago to provide decent, affordable homes for people in housing need.

Our five-year *Living on your Side* social investment programme drew to a close in April and, I am proud to report, achieved all its objectives. Over five years, we helped 958,000 people into a home of their own, enabled over one million people to start saving, and channelled more than £21 million into community and charity support.

We employ over
18,000 people
across more than
700 locations

As housing in Britain remains a challenge, we want to play our part in addressing this by targeting a range of housing issues with our new social investment programme. This will be launched in 2017 and will focus on an aspiration that everyone has a place fit to call home. It will also include a new social ambition to find local solutions to national housing issues. We will also support the growing number of people who rent by championing the rights of tenants and high standards for landlords.

You can read more about our successes in the 'Social investment' section of this report.

A refreshed purpose and strategy

Our business model of looking after our members' deposits and using them to fund other members' mortgages, is broadly unchanged since we were founded. Our belief in the power of mutuality is a constant.

But the world around us is changing like never before, and we have a responsibility to review our Society's strategy periodically to ensure we're able to respond to these changes. Technology is profoundly reshaping customer needs, expectations and relationships. Political upheavals have shown that many people feel the system is not working for them. Economically, the continued era of low interest rates and increasing competition creates new challenges for us to respond to. By refreshing our Society's strategy, we have prepared ourselves to meet these challenges and embrace the opportunities we see ahead.

Collaboration has been a force for good throughout Nationwide's history, which is why we started our strategy refresh with a huge listening exercise, giving our people and our members the chance to contribute to our future. Almost all of our 18,000 colleagues had the chance to contribute through a five-week 'Big Conversation' last summer. We've also listened to you, our members, at TalkBack events, through our 5,000-strong online Member Connect community, and through our everyday interactions across the Society.

This huge collaborative effort has led to a reinvigorated sense of Nationwide's purpose, which we describe as 'building society, nationwide' – helping people improve the quality of their lives. It has also helped to shape a refreshed strategy, which will allow us to deliver value for members in an efficient and compelling way.

To do this, we have organised our strategy around five cornerstones that define what we stand for, what we will do and how we will do it:

Built to Last – being safe, secure, sustainable and dependable

Building PRIDE – shared values, shared culture, doing the right thing

Building Legendary Service – providing service that is heartfelt, easy, lifelong and personal

Building Thriving Membership – delivering real value for our members

Building a National Treasure – leading by example and making a difference

For each cornerstone, we have developed a set of key performance indicators (KPIs). These will ensure that we remain tightly focused on our purpose and also provide you, as members, with the ability to assess the Society's performance. You can find more detail about the cornerstones and our new KPIs in the Strategic review.

Mutuality is as
relevant today
as when we were
founded in 1884

Chief Executive's review *continued*

Outlook

Nationwide is a domestic, consumer-facing business, which means consumer confidence matters to us. This is why, alongside our macro-economic analysis, we have asked consumers how they are feeling on an individual level.

£380 million
extra interest earned by members from our better pricing

Our research shows that confidence among consumers has held up well since last year's referendum, thanks to the strong performance of the UK economy. It also showed that consumers are alert to the economic uncertainties ahead, with the Brexit negotiations, low interest rates and inflation registering as concerns. However, households remain relatively optimistic about their own finances, and are going about their daily lives as normal.

Spending most commonly cited by consumers as possible future concerns are the food, utility and other household bills that make up a good proportion of monthly outgoings, and we anticipate that a combination of rising inflation and modest wage growth is likely to squeeze household budgets. Unsurprisingly, consumers said that if they needed to trim their spending in the future, they would cut back on leisure activities first, and see their mortgage and rent payments as most protected.

UK's second
largest mortgage lender

In the housing market, if the economy slows as we expect, there will be a cooling effect in the form of lower sales and house price growth – and in fact the first signs of this are already showing through in market data. However, the continued shortage of homes in the UK will support house prices, which we expect to rise by 2% in 2017, with some scope for a further softening in 2018 to 2019. In the medium-term, we expect house prices to rise broadly in line with earnings.

It's clear that consumers are alive to the economic uncertainties that lie ahead, as are we. In this environment, we believe the benefits of mutuality will become only clearer. Last year, we protected our members through enhanced pricing, putting an additional £505 million into members' pockets. We anticipate that the financial benefit will vary from year to year depending on market conditions, and expect it to reduce next year. However, Nationwide's financial strength, stable and low risk business model, and strong trading performance all mean we are well placed to continue to support the UK economy, and our members, in the uncertain times ahead. In the medium term, I believe people will always want to save for their future, manage their daily finances and have a place to call home, so the fundamentals of Nationwide's business remain as relevant as ever.

Building society, nationwide

Nationwide is your Society, and we are custodians of it. I hope this statement has given you a sense of what we achieved on your behalf last year and the strength of our Society to achieve its purpose of **building society, nationwide**.

Strategic review

Our mutual difference

We are a building society, a mutually-owned organisation. For over 130 years, mutuality has shaped who we are, defined what we do and informed how we do it. We were founded on the belief that ordinary people can achieve more together than they can on their own. Our first purpose was to help working people save so that they could buy their own home. It's a purpose that has been a golden thread throughout our history, and is as important today as it was when we were founded in 1884.

Nationwide does many of the things that banks do, but we stand apart from the banks because of our ownership structure and social purpose. We are owned by our members, individuals who are seeking to provide for themselves and their families. And we have a social purpose at our heart, which is to improve the lives of ordinary people. Both these things mean we think and behave differently.

We approach profitability from the perspective of our members. It is in their interests that we remain financially strong, so that their money is safe, which is why the first thing we do is invest some of our profits in maintaining strong capital ratios and a conservative leverage ratio. To fulfil our social purpose, we must retain existing members and attract new ones, which is why another part of our profits is invested in developing and growing our business. Finally, we need to deliver tangible value to the members who own us, so we choose to forgo an element of our profitability, investing this in better value products and services for our members than they might find in a shareholder-owned bank.

As a Society, we know that our members value Nationwide's rounded approach to serving their interests. They value the leading service we provide through our branch network, as well as our phone and digital services, and we continue to invest in our people and our networks so that we retain our service lead over our high street peer group[1]. We are extremely fortunate to have talented and dedicated people who regularly provide first class service. Most of our people are also members, and therefore owners of the Society, so they have a vested interest in serving other members as they would like to be served themselves.

Our members also appreciate the highly competitive savings and mortgage products we can offer as a direct result of being a member-owned business. In 2016/17, our differentiated pricing, member reduced fees and incentives put an additional £505 million into members' pockets. We have quantified our mutual pricing advantage, as we want members to really understand the financial as well as the non-financial benefits they gain from mutuality. More on this is included in our Financial review.

[1] © GfK 2017, Financial Research Survey (FRS), 3 months ending 31 March 2017 vs 31 March 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).

Strategic review *continued*

Our business model

Our business model is straightforward: we provide a secure home for members to grow their savings, which in turn enables us to offer mortgages to buy their own homes. Complementing this, we provide current accounts enabling our members to take care of their day to day banking needs. We have a prudent attitude to risk and our business model is focused on the provision of retail financial services.

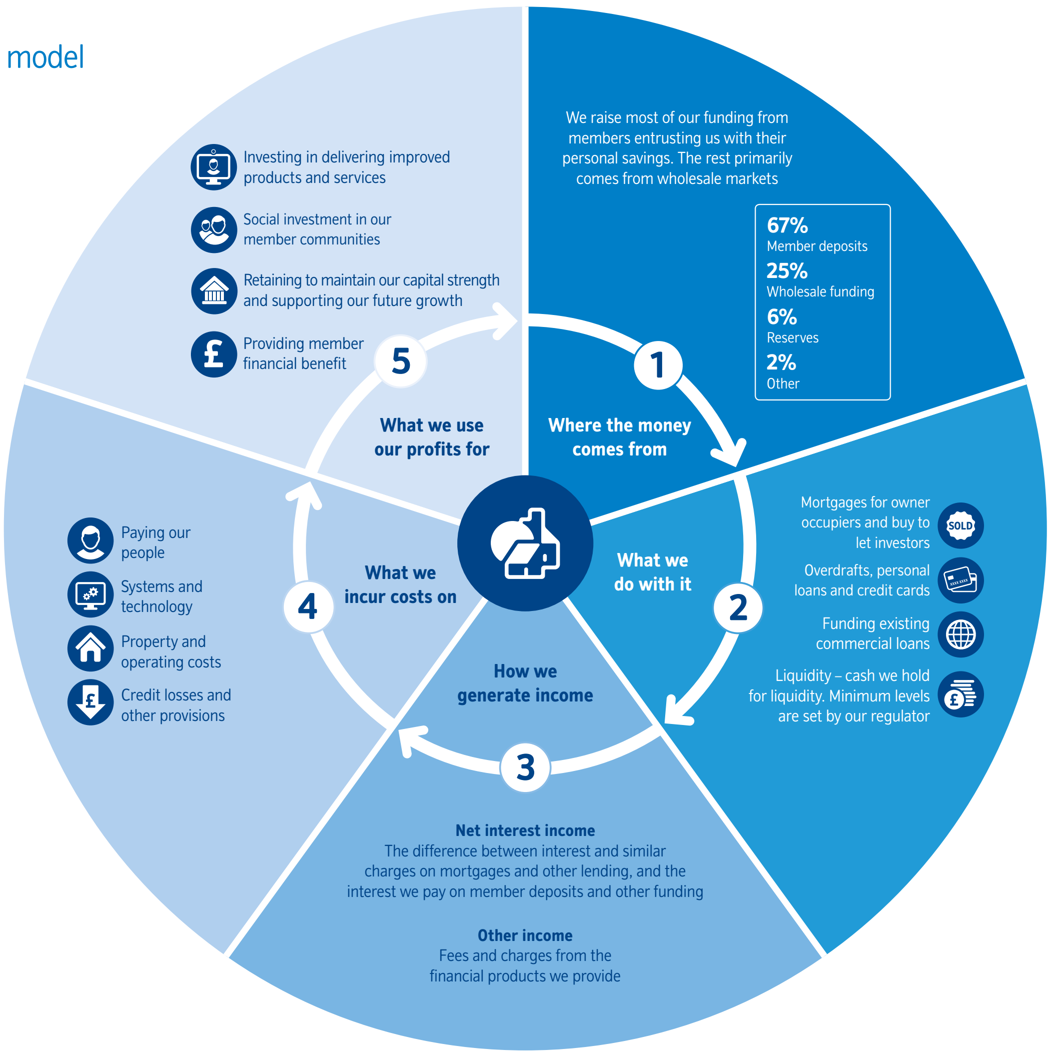
Our members are able to manage their money how they want, when they want, through our nationwide network of nearly 700 branches, by phone, online and through our mobile banking service. We believe in offering people the choice of the latest technology together with the personal touch so many value in a digital age.

We are bound by laws requiring at least 75% of business assets to be loans secured on residential property and at least 50% of our total funding to come from members in the form of retail deposits. This requirement minimises the Society's risk exposure and ensures that our stakeholders' and members' interests are aligned.

Nationwide is the UK's second largest provider of mortgages and third largest provider of savings, with 12.9% market share of total retail mortgage balances and 10.1% market share of total retail deposit balances. Since beginning to offer current accounts in 1987, our market share of main standard and packaged current accounts has grown to 7.5% (2016: 7.1%).

In addition to our core products we offer a range of financial services to fulfil our members' needs, including a competitive range of credit cards, personal loans, home insurance, protection products and financial planning services. Following our strategic review during 2016/17 we concluded that our commercial real estate (CRE) business was not key to our members' interests and stopped new CRE lending. We continue to service existing CRE customers, registered social landlords and project finance customers. A strategic decision was also made to exit the Nationwide International deposit-taking business.

Our business model at a glance



Strategic review *continued*

Our strategy

During the year we undertook a strategic review and we are now embarking upon the next evolution of our strategy, centred around our core purpose of building society, nationwide.

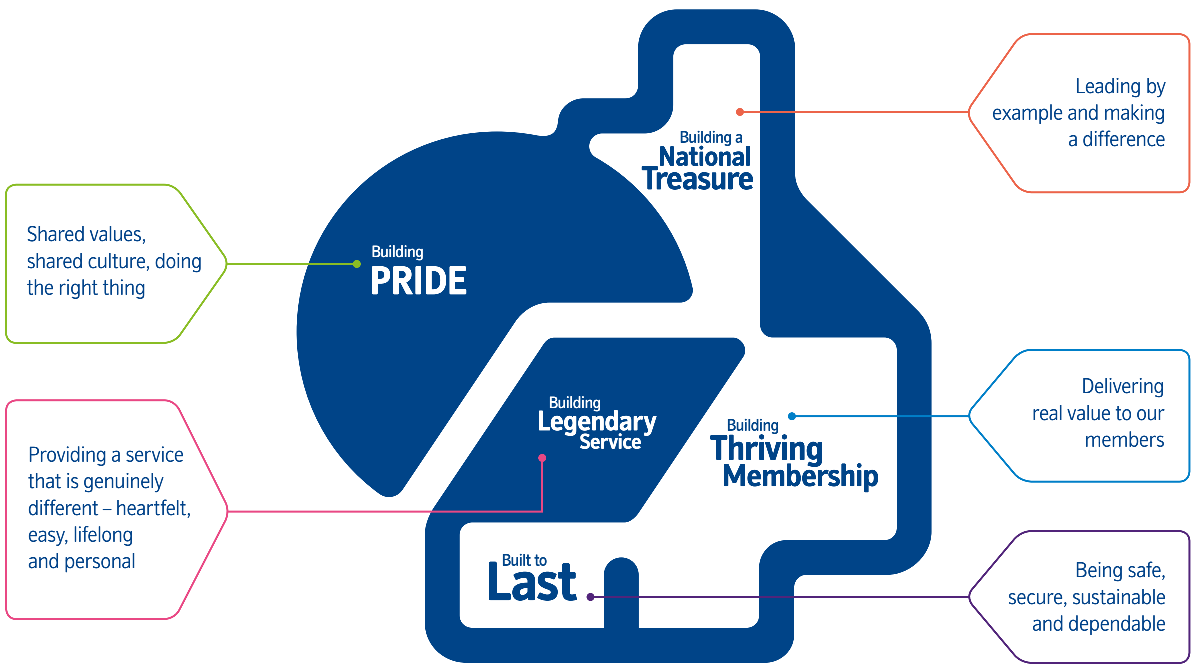
Our refreshed strategy is founded upon a rigorous re-evaluation of our strengths and our assessment of the way in which the financial services industry has evolved in recent years. We have engaged our members through live 'TalkBacks', suggestion schemes and through our 5,000 strong online 'Member Connect' community. Most recently we engaged employees through the 'Big Conversation', an opportunity for all our people to share their views on how the Society is run.

This led us to look at what activities we should engage in, starting with those where we can leverage the power of mutuality. With this in mind, we believe that our founding focus on mortgages and savings remains as relevant today as it was when we were founded in the 19th century. Additionally, we believe that increasing the size of our current account base remains a logical extension of our purpose by fulfilling our members' day to day financial needs and strengthening our mutual relationship. We will continue to offer a broad range of financial services that complements our core products of mortgage, savings and current accounts.

Our strategy refresh will make sure we are delivering the services and customer experience our members want in 2017 and beyond. Our core purpose is 'building society, nationwide' and we have defined five interconnected cornerstones which support our purpose and strategy. Our strategic targets and KPIs have been reviewed and amended in line with our strategy refresh.

Building society, nationwide

Strategic cornerstones



Strategic review *continued*

Our strategic cornerstones

Built to Last

Members want us to keep their money safe by being secure and dependable. They want us to be built to last by:

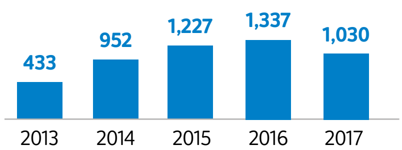
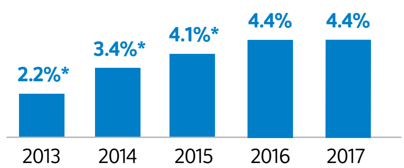
- generating a level of profit sufficient to meet regulatory capital and future business investment requirements
- focusing on how we spend members' money through driving a culture of efficiency
- maintaining a prudent approach to risk management, operating at all times within Board risk appetite
- supporting member expectations of 'always on' through the resilience of our operations.

Measuring success

We have developed a financial performance framework based on the fundamental principle of maintaining our capital at a prudent level in excess of regulatory leverage ratio requirements. The framework provides parameters which will allow us to calibrate future performance and help ensure we achieve the right balance between distributing value to members, investing in the business and maintaining financial strength.

We believe that generating underlying profit of approximately £0.9 billion to £1.3 billion per annum over the medium term is appropriate. This is based on our current assumptions around the size of the mortgage market and maintaining a leverage ratio of at least 4%. Our target reduced from a profit range of £1.0 billion to £1.5 billion set in 2016, reflecting our expectation of a slightly smaller mortgage market in future years than was anticipated a year ago.

Our financial performance will be supported by a renewed focus on efficiency. We will continue to put our members and their money first by making careful choices on how best to allocate our resources. Whilst previously cost income ratio was a main measure, we have now set a target to deliver £300 million of sustainable cost savings by 2022. This will be delivered across a range of initiatives, including 'right first time' member service, third party procurement reviews, process automation and digitised service delivery, as well as targeted restructuring activity.

Measure	Performance		Strategic target
Underlying profit (£m)		Underlying profit for the year of £1.0 billion is within our target range	Underlying profit: £0.9 billion – £1.3 billion per annum
UK leverage ratio[1] (%)	 *CRR leverage ratio basis	Our leverage ratio ended the year at 4.4% on a UK leverage basis	Leverage ratio of at least 4%[1]

[1] Nationwide has been granted permission to report a UK leverage ratio on the basis of measurement announced by the PRA in August 2016. Minimum leverage requirements are monitored by the PRA on this basis. It is calculated using the Capital Requirements Regulation (CRR) definition of Tier 1 for the capital amount and the Delegated Act definition of the exposure measure, excluding eligible central bank reserves. Prior years (2013-2015) are reported on a CRR basis and include eligible central bank reserves.

Strategic review *continued*

Building PRIDE

PRIDE is the symbol of our culture and values. It guides us to serve our members to the best of our ability and support our people in doing the right thing. It means:

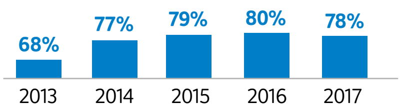
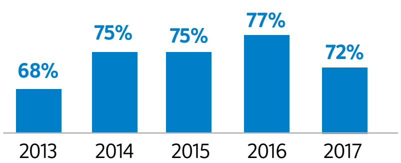
- **P** Putting our members and their money first
- **R** Rising to the challenge
- **I** Inspiring trust
- **D** Doing the right thing in the right way
- **E** Excelling at relationships

We will equip our people by:

- developing our leaders and high potential talent to enable a more empowered and agile workforce
- growing our capabilities across the business to equip all of our people to make decisions in the interests of members
- inspiring them and invigorating our culture through our PRIDE values.

Measuring success

We are and intend to remain one of the UK's best places to work, which is in keeping with our mutual ethos of care and is the backbone behind the service our members receive. Having highly engaged and enabled employees is a key source of competitive advantage as we strive to have industry leading levels of customer satisfaction and grow our business. We measure engagement and enablement through our annual employee survey called ViewPoint, conducted for the last eight years by global management consulting firm Korn Ferry Hay Group (formerly Hay Group).

Measure	Performance		Strategic target
Employee engagement & enablement	Engagement (HP benchmark 2017 = 73%) 	We scored 78% for employee engagement, which is above the HP benchmark	Cross-industry High Performance (HP) benchmarks for engagement and enablement
	Enablement (HP benchmark 2017 = 72%) 	Employee enablement, at 72%, is in line with the HP benchmark	

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Strategic review *continued*

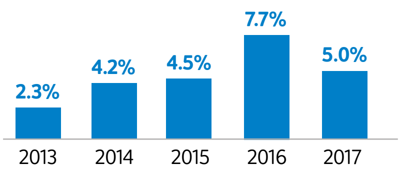
Building Legendary Service

Our ambition is for members to experience our service as heartfelt, easy, lifelong and personal. We aim to have industry leading service levels by:

- investing in our high street presence to transform the branch experience
- using technology to enhance the experience through both branches and mobile
- deploying the people and technology to enable our members to interact with us whenever and however they choose
- delivering on our members' expectations by getting it right first time.

Measuring success

Delivering leading levels of member satisfaction is a key point of differentiation to our peers and an important driver in helping to grow our membership. We measure our service satisfaction performance using an independent survey conducted by market research experts GfK. Our performance is currently benchmarked against a peer group of high street banks with a main current account market share greater than 6%. We will continue to benchmark ourselves against this measure. However, we have expanded the peer group that we are comparing ourselves against to include those with a main current account market share greater than 4%. We have done this to recognise the increased competition we face from challenger organisations, and to ensure that we continue to focus on our members' satisfaction and further support us in building society, nationwide. We have recognised this change to our peer group in our targets for 2017/18, setting ourselves a strategic target of 1st position with a lead of 2%, based on the average for the financial year.

Measure	Performance		Strategic target
Service satisfaction (lead over peer group)		We ended the year with our lead over our nearest high street peer group competitor standing at 5.0%[1]	2017/18: (based upon revised peer group): 1st with a lead of 2% (based on the average for the financial year)

[1] © GfK 2017, Financial Research Survey (FRS), 3 months ending 31 March 2017, proportion of extremely/very satisfied customers minus proportion of extremely/very/fairly dissatisfied customers summed across current account, mortgage and savings. High street peer group defined as providers with main current account market share >6% (Barclays, Halifax, HSBC, Lloyds Bank (inc C&G), NatWest and Santander). Prior to April 2015, Lloyds Bank and TSB combined as Lloyds TSB Group (including Lloyds Bank, TSB and C&G).

Strategic review *continued*

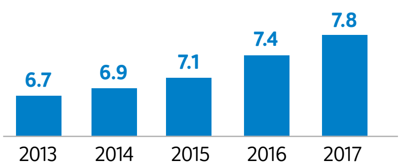
Building Thriving Membership

The more members we have, the more we can help them achieve their goals, whether that's owning a home or saving for the future. We will deliver real value to our thriving membership by:

- delivering a membership proposition that recognises loyalty by rewarding our most committed members
- building our relationships with young families through enhanced products and services
- building depth in our core products of mortgages, savings and current accounts.

Measuring success

Growing our base of engaged members allows us to bring the benefits of mutuality to a wider population. We measure our performance through our number of engaged members, defined as those who hold a mortgage or savings account with us (with a balance greater than £5,000) or who hold their main personal current account with us.

Measure	Performance		Strategic target
Engaged members (million)		Engaged members grew by 380,000 during the year to 7.8 million, largely driven by growth in current account members	10 million engaged members by 2022

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Strategic review *continued*

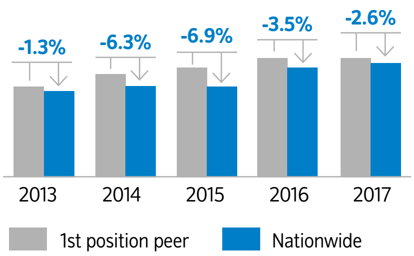
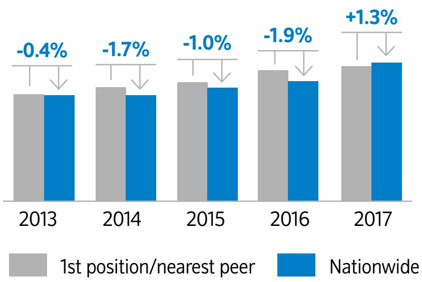
Building a National Treasure

Our ambition is to be considered a 'national treasure' in British society, in particular for our members and for the public to trust us and to believe that Nationwide makes a difference to people's lives. We will strengthen our position as one of the most trusted and respected organisations in the UK by:

- leading by example, being the voice championing the interests of our members and the acknowledged expert in our field
- improving awareness of the Nationwide brand and our mutual difference
- engaging with our members through their preferred channels of communication
- aligning our social investment agenda with our purpose of building society, nationwide, through a focus on housing initiatives.

Measuring success

Our brand is the sum of how our members and others perceive us. A strong brand, effective both in digital and traditional media, is essential to attract new members as they work their way through life. We measure our performance through an independent specialist market research agency. Two headline measures drawn from that survey, prompted brand consideration and trust, provide a view of our progress towards being seen as a 'national treasure'.

Measure	Performance		Strategic target
Prompted brand consideration (all consumers)		We ended the year in 3rd position for prompted brand consideration amongst all consumers[1]	1st with a lead of 4% by 2022
Trust (all consumers)		We ended the year in 1st position for trust amongst all consumers[1]	2017/18: 1st with a lead of 3%

[1] Source: Independent research agency.

Financial review

Mark Rennison

Overall performance

Financial performance for the year ended 4 April 2017 was in line with the expectations indicated when announcing our 2015/16 financial results. Statutory profit before tax was £1,054 million (2016: £1,279 million) and underlying profit was £1,030 million (2016: £1,337 million), reflecting our continued focus on offering value on our products and better service for our members, whilst maintaining capital strength.

An advantage of being a building society is that Nationwide can choose to forgo an element of profitability in order to deliver more value to our members, whilst ensuring we maintain financial strength and safeguard our members' money. In 2016 we introduced a financial performance framework with parameters which enable us to calibrate future performance to achieve the right balance between distributing value to members and maintaining financial strength. Despite the reduction in profitability, 2016/17 underlying profit remains comfortably within the target range set by our financial performance framework.

Our underlying cost income ratio has deteriorated to 60.2% (2016: 53.9%) primarily due to increased costs against broadly flat total underlying income. The rise in costs reflects ongoing expenditure on strategic investment to enhance propositions and service for our members, and increased staff costs, including our investment in a 'Living Pension' for our employees. We have also incurred one-off costs during the year relating to restructuring and asset write downs, reflecting the pace of change of technology and changing member needs. These one-off costs, along with other in-flight initiatives and our target to deliver £300 million of sustainable cost savings by 2022, will result in lower cost growth in future periods.

Impairment losses have increased following a review of the secured and unsecured lending portfolios to ensure that the evidence of impairment and latent risks during the low interest rate environment are adequately represented in the model assumptions, and that appropriate provisions are held for interest only loans where borrowers may be unable to repay capital balances at maturity.

Total assets have grown by £12.7 billion to £222 billion as at 4 April 2017, largely due to a £9.1 billion increase in residential mortgages. Of this, £8.0 billion relates to prime mortgages and reflects a strong trading performance aligned to our strategic objective of increasing our market share of prime mortgages. The remainder of the balance sheet growth is driven by an increase in high quality liquid assets as we replace off-balance sheet Funding for Lending Scheme (FLS) liquidity with on-balance sheet Term Funding Scheme (TFS).

Capital levels have remained strong with Common Equity Tier 1 (CET1) ratio and UK leverage ratios of 25.4% and 4.4% respectively (2016: 23.2% and 4.4% respectively). The UK leverage ratio remains unchanged as profits have broadly offset the increase in the defined benefit pension deficit and balance sheet growth driven by increases in mortgage balances.

We expect the prolonged low interest rate environment and competition in the mortgage market to continue in the period ahead. Notwithstanding this, our positive trading performance, financial strength and high quality balance sheet mean that we are well placed to deliver long term value to our members. We will also continue to focus on driving our efficiency agenda to reduce cost growth in future periods.

£1,030 million underlying profit before tax

Financial review *continued*

Income statement

Underlying and statutory results

	Year to 4 April 2017 £m	Year to 4 April 2016 £m
Net interest income	**2,960**	3,086
Net other income	**325**	247
Total underlying income	**3,285**	3,333
Underlying administrative expenses	**(1,979)**	(1,796)
Impairment losses	**(140)**	(73)
Underlying provisions for liabilities and charges	**(136)**	(127)
Underlying profit before tax (note i)	**1,030**	1,337
Transformation costs (note ii)	**-**	(10)
Bank levy (note ii)	**(42)**	(41)
FSCS (note ii)	**-**	(46)
Gains from derivatives and hedge accounting (notes ii and iii)	**66**	39
Statutory profit before tax	**1,054**	1,279
Taxation	**(297)**	(294)
Profit after tax	**757**	985

Notes:

i. Underlying profit represents management's view of underlying performance and is presented to aid comparability across reporting periods.

ii. Within the statutory results presented in the financial statements:
   a. transformation costs and bank levy are included within administrative expenses
   b. Financial Services Compensation Scheme (FSCS) costs are included within provisions for liabilities and charges
   c. gains from derivatives and hedge accounting 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 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.

Total income and margin

	Year to 4 April 2017 £m	Year to 4 April 2016 £m
Net interest income	**2,960**	3,086
Other income	**325**	247
Total underlying income	**3,285**	3,333
Gains from derivatives and hedge accounting	**66**	39
Total statutory income	**3,351**	3,372
Weighted average total assets	**222,901**	203,623
Net interest margin (NIM) %	**1.33**	1.52

£1,054 million statutory profit before tax

Financial review *continued*

Net interest income has reduced by £126 million to £2,960 million (2016: £3,086 million). This reduction is primarily due to ongoing competition in the mortgage market and our continued focus on delivering long term value to our members, combined with the ongoing natural run off of our residential base and standard mortgage rate balances. The competitive rates available across the market have led to more members switching to competitively priced products (£17.0 billion of members' balances switched to lower priced Nationwide mortgages) and higher redemptions. This reduction in back book balances, together with lower margins on new business pricing, has resulted in downward pressure on our NIM. As anticipated our NIM for the year of 1.33% was lower than the previous year's NIM of 1.52%.

The longer-term impact on the UK economy of the EU referendum vote is uncertain and, with interest rates expected to continue to remain at historically low levels for a prolonged period, we expect NIM to remain broadly stable for the year ahead.

Margin pressure resulting from increased competition for new mortgage lending has led to savings rates continuing to fall across the industry. In line with our mutual principles we have chosen to forgo an element of profitability through resisting lowering savings rates where possible and offering competitive products.

Following the decision by the Bank of England to cut the bank rate to 0.25%, we committed to protecting members who save regularly, or are building a deposit to buy their own home, resulting in several products being protected from the bank rate decrease. We have also applied a 0.10% rate floor to all variable products.

Other income has increased by 32% to £325 million (2016: £247 million) primarily due to a one-off gain of £100 million from the disposal of our investment in Visa Europe during the year. Excluding this gain, underlying other income has reduced, primarily due to a reduction of £15 million in income from credit card transactions, following the introduction of regulatory caps in December 2015, and a decrease of £7 million in other income received from mortgages. Whilst the number of active current accounts has increased, the associated net fee income is broadly flat as we continue to support the financial inclusion of customers by offering the benefits of our FlexBasic account, which has no fees for certain transactions.

Administrative expenses

	Year to 4 April 2017 £m	Year to 4 April 2016 £m
Employee costs	**793**	736
Other administrative expenses	**790**	735
Depreciation, amortisation and impairment	**396**	325
Total underlying administrative expenses	**1,979**	1,796
Bank levy	**42**	41
Transformation costs	**-**	10
Total statutory administrative expenses	**2,021**	1,847
	%	%
Cost income ratio – underlying basis	**60.2**	53.9
Cost income ratio – statutory basis	**60.3**	54.8

Underlying administrative expenses increased by 10% (£183 million) due to increases in employee costs and strategic investment in propositions and service for members, as well as restructuring costs to drive efficiency and the costs of servicing higher business volumes. The underlying cost income ratio has increased to 60.2% (2016: 53.9%). At a statutory level, administrative expenses increased by 9% (£174 million).

60.2%
underlying
cost income ratio

Our cost trajectory reflects significant business growth and investment over recent years. Mortgage balances have grown 18% over the last three years and we have 42% more main current accounts today than in 2014.

During 2016/17 employee costs increased by £57 million, reflecting an annual pay award averaging 2.1% and higher full year costs from enhancements made in 2015/16 to the defined contribution pension scheme in line with our commitment to provide a 'Living Pension'. Average employee numbers increased by 4% year on year to build greater capacity to meet additional business volumes, deliver our investment strategy and further strengthen control functions.

Notwithstanding the fact that cost growth in recent years is the result of conscious decisions to support the Society's strategy and the service provided to members, we recognise the need to improve efficiency, and that cost increases significantly ahead of inflation are not sustainable in the continuing low interest rate environment we face. We will continue our focus on operational efficiency, exploiting the benefits of past and ongoing investment while continuing to prioritise the needs of our members.

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Financial review *continued*

We have launched an efficiency programme which targets £300 million of sustainable cost savings to be delivered by 2022. This includes investing £43 million in 2016/17 in improving longer term efficiency, including accelerating automation and digitised service delivery, costs associated with organisational simplification, the announced closure of our Isle of Man and Republic of Ireland operations, and our withdrawal from the commercial real estate (CRE) sector. We have allocated approximately £100 million of spend over the next three years to support the programme, and anticipate that our focus on efficiency will enable us to achieve broadly flat costs in 2017/18 and lower cost growth in future.

To support the long term interests of our members, we continue to invest in propositions, service and resilience. During the period, investment has focused on service improvements for members, both in branch and through digital channels, including updating our savings point of sale systems to allow real time online account opening, delivery of in-house credit risk assessments for prime mortgages, upgrades to our Banking App for smartphones and tablets, and the roll out of further video links in branches which allow members greater flexibility to speak face to face with advisors in another location. We have also invested in IT resilience and ensuring compliance with UK and EU regulatory requirements.

Following a review of amounts capitalised for assets in use or in the course of development, asset write downs of £31 million (2016: £2 million) were recognised in the year, along with an increased depreciation charge of £15 million due to adjustments to asset lives, reflecting the pace of change of technology and changing member needs.

Impairment losses/(reversals)	**Year to 4 April 2017 £m**	Year to 4 April 2016 £m
Residential lending	**58**	18
Consumer banking	**78**	96
Retail lending	**136**	114
Commercial lending	**(5)**	(34)
Other lending	**-**	1
Impairment losses on loans and advances	**131**	81
Impairment losses/(reversals) on investment securities	**9**	(8)
Total	**140**	73

Impairment losses have increased by £67 million to £140 million (2016: £73 million) driven by additional residential mortgage impairments as a result of enhancements to our credit loss provisioning methodology, combined with lower levels of net recoveries in the CRE portfolio.

Residential lending impairment charges of £58 million (2016: £18 million) include £45 million (2016: £27 million) as a result of enhancements to the provisioning methodology and assumptions to ensure provisions continue to reflect appropriately the incurred losses within each portfolio. These enhancements reflect the extended period for arrears to arise from trigger events and the risks associated with the ability of borrowers to repay capital balances at the maturity of interest only loans. Excluding these methodology changes, the underlying impairment charge of £13 million (2016: £9 million release) reflects the stabilisation of mortgage arrears at 0.45%, compared with a fall from 0.49% to 0.45% in the prior year, and a more modest benefit from house price inflation.

Consumer banking impairment charges have decreased by £18 million to £78 million (2016: £96 million). Of this charge, £7 million (2016: £29 million) represents a reassessment of impairment assumptions to reflect latent risks during the current low interest rate environment. Excluding this, the consumer banking charge has remained relatively consistent, reflecting both stable arrears performance and gross lending balances.

Commercial lending impairments relate exclusively to CRE lending, with no arrears in our registered social landlords and project finance portfolios. The net impairment reversal of £5 million (2016: £34 million) is a result of continued CRE market improvements in terms of both asset values and liquidity.

Provisions for liabilities and charges	**Year to 4 April 2017 £m**	Year to 4 April 2016 £m
Underlying provisions for liabilities and charges – Customer redress	**136**	127
FSCS levy	**-**	46
Total statutory provisions for liabilities and charges	**136**	173

Financial review *continued*

We hold provisions for customer redress to cover the costs of remediation and redress in relation to past sales of financial products and post sales administration, including compliance with consumer credit legislation and other regulatory requirements. The charge for the year primarily relates to customer redress provisions recognised in respect of PPI and Plevin, including the cost of administering these claims. When assessing the adequacy of our PPI provision we have considered the implications of the guidance published by the Financial Conduct Authority (FCA) in its March 2017 policy statement (PS17/03), including the expected impact of the Plevin case. More information on customer redress is included in note 30.

There is no net charge for the year in respect of the Financial Services Compensation Scheme (FSCS) (2016: £46 million charge). This reflects the substantial repayment of the loan from HM Treasury to FSCS as a result of the securitisation of Bradford & Bingley plc assets, and our £13 million share of recoveries from Icelandic banks. More information on FSCS is included in note 30.

Taxation

The tax charge for the year of £297 million (2016: £294 million) represents an effective tax rate of 28% (2016: 23%) which is higher than the statutory UK corporation tax rate of 20% (2016: 20%). The effective rate is increased due to the banking surcharge which is payable at a rate of 8% from 1 January 2016, equivalent to £62 million (2016: £22 million), and by the tax effect of disallowable bank levy and customer redress costs of £8 million and £19 million (2016: £8 million and £7 million) respectively. Further information is provided in note 11.

Member financial benefit

As a building society, we know that our members value the highly competitive savings and mortgage products we can offer as a direct result of being a member-owned business. We measure our member financial benefit by considering our differentiated interest rate pricing, reduced fees and incentives, compared to industry benchmarks.

The financial benefit measured has given our members an additional £505 million (2016: £397 million) in their pockets for the year. We have chosen to quantify our member financial benefit, as we want members to understand the financial as well as the non-financial benefits they gain from mutuality.

The increase in member financial benefit compared with the prior year primarily reflects the discretionary actions we took during the year to protect savings rates in a declining interest rate environment. Prudent management of the Society requires us to manage savings flows and our cost of retail funding in the context of wider market conditions, and in particular demand for lending. Therefore the benefit we provide to members is dependent on a variety of external market and competitive factors, as well as maintaining a balance between profits we retain and member benefit we provide.

Member financial benefit

Member financial benefit is delivered in the form of differentiated pricing and incentives, which we quantify as:

Our interest rate differential + member reduced fees + incentives

Interest rate differential

We measure how our average interest rates compare against the market.

For our two largest member segments, **prime mortgages** and **retail deposits**, we compare the average member interest rate for these portfolios against relevant industry benchmarks. A CACI benchmark is used for prime mortgages and Bank of England benchmark for retail deposits[1], both on a 12-month rolling basis. The differentials derived in this way are then applied to member balances for mortgages and deposits.

For unsecured lending, a similar comparison is made. The differential of Nationwide's average new business lending rate against the Bank of England's average new business lending rate is applied to the total interest bearing balances of **credit cards** and **personal loans**. These are also measured on a 12-month rolling average basis.

Member reduced fees and incentives

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

- Prime mortgages: the differential on incentives and fees for members compared to the market
- 'Recommend a friend': the amount paid to existing members, when they recommend a new current account member to the Society
- FlexPlus account: this current account is considered market leading against major banking competitors, with a high level of benefits for a relatively smaller fee. The difference between the monthly account fee of £10 and the market average of £16 is included in the member financial benefit measure.

[1] Adjusted to exclude Nationwide's balances.

Financial review *continued*

Balance sheet

Total assets have increased 6% year on year to reach £222 billion at 4 April 2017 (2016: £209 billion). This increase primarily reflects our focus on mortgage pricing for members and growing our market share of prime mortgages, with prime mortgage balances increasing by £8.0 billion. The remainder of the balance sheet growth relates to £1.1 billion in relation to specialist lending and a £3.4 billion increase in other financial assets.

Mortgage lending has been partially supported by strong strategic growth in retail funding flows, with member deposits growing by £5.8 billion, and our market share of UK deposits at 10.1% at 4 April 2017 (2016: 10.2%). Of the growth in member balances, £2.7 billion is attributable to current account balances as we have continued to increase our market share of main standard and packaged current accounts, to 7.5% at February 2017 from 7.1% last year. This growth in member deposits reflects our renewed focus on growing our base of engaged members, allowing us to bring the benefit of mutuality to a wider population.

Assets

	4 April 2017		4 April 2016	
	£m	**%**	£m	%
Residential mortgages	**171,263**	***91***	162,164	*91*
Commercial lending	**12,580**	***7***	13,197	*7*
Consumer banking	**3,949**	***2***	3,869	*2*
Other lending (note i)	**17**	**-**	20	-
	187,809	***100***	179,250	*100*
Impairment provisions	**(438)**		(443)	
Loans and advances to customers	**187,371**		178,807	
Other financial assets	**31,231**		27,782	
Other non-financial assets	**3,068**		2,350	
Total assets	**221,670**		208,939	
Asset quality		**%**		%
Residential mortgages:				
Proportion of residential mortgage accounts 3 months+ in arrears		**0.45**		0.45
Average indexed loan to value of residential mortgage book (by value)		**55**		55
Impairment provisions as a percentage of non-performing balances		**5.3**		3.2
Consumer banking:				
Non-performing loans as percentage of total balances (excluding charged off balances) (note ii)		**4**		4
Impairment provisions as a percentage of non-performing balances (including charged off balances) (note ii)		**86**		81
Other key ratios				
Return on assets		**0.34**		0.47
Liquidity coverage ratio		**124.0**		142.6

Notes:

i. Other lending balance consists of deferred consideration relating to an investment in Visa Inc, collateral to support repurchase transactions and a residual portfolio of secured loans relating to a European commercial loan facility held by one of Nationwide's subsidiaries, Cromarty CLO Ltd.

ii. 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.

Financial review *continued*

0.45%
residential mortgage accounts 3 months+ in arrears

Residential mortgages

Residential mortgages include prime and specialist loans, with the specialist portfolio primarily comprising buy to let (BTL) lending. Gross mortgage lending in the period increased 3% to £33.7 billion (2016: £32.6 billion), representing a market share of 14.0% (2016: 13.7%).

Mortgage balances grew by £9.1 billion (2016: £9.3 billion) of which £8.0 billion was prime lending (2016: £5.4 billion) and £1.1 billion related to specialist lending (2016: £3.9 billion).

The average loan to value (LTV) of new lending in the period, weighted by value, increased to 71% (2016: 69%) primarily due to our strategy to increase lending to the first time buyer market as we recognise the importance of helping people take their initial steps onto the housing ladder. Modest house price growth has resulted in the average LTV of our portfolio remaining flat at 55% (2016: 55%). Residential mortgage arrears have remained flat at 0.45% (2016: 0.45%).

Non-performing balances have reduced by £485 million to £2,694 million (2016: £3,179 million), with particular improvement in those balances past due up to three months. However, the impairment provision balance has increased to £144 million (2016: £102 million). This increase in provisions reflects an update to our credit loss provisioning methodology and assumptions to ensure that provisions appropriately reflect incurred losses within the portfolio. This update included focusing on the credit risk associated with maturing interest only loans and the period for evidence of impairment losses to emerge on up to date loans. This provision increase, combined with a reduction in non-performing balances, resulted in an increase in impairment provisions as a percentage of non-performing balances to 5.3% (2016: 3.2%).

The growth of the BTL portfolio has slowed following a decision taken in May 2016 to increase the minimum interest cover ratio for new lending from 125% to 145% and reduce the maximum LTV from 80% to 75%. Despite the anticipated impact of this decision on BTL portfolio growth, these steps were taken in response to forthcoming income tax changes which will materially affect cash flow and affordability for some landlords.

Commercial lending

Total commercial lending balances are £12.6 billion (2016: £13.2 billion) and, as a result of deleveraging activity undertaken in recent years, our overall portfolio is increasingly weighted towards registered social landlords with balances of £7.5 billion (2016: £7.6 billion). This portfolio is fully performing and remains stable, reflecting its low risk nature. The commercial portfolio also includes loans made under the Government's Private Finance Initiative (PFI) amounting to £1.1 billion (2016: £1.2 billion) and CRE loans of £2.6 billion (2016: £3.0 billion) which have reduced during the period through deleveraging and run-off. The remaining balance of £1.4 billion (2016: £1.4 billion) relates to fair value adjustments where we have hedged loans to mitigate their associated financial risks, typically interest rate risk.

Following the wider strategy review, it was concluded that the commercial lending business was no longer core to the Society's vision for the future and balances will continue to reduce through managed run-off.

Consumer banking

Consumer banking comprises personal loans of £2.0 billion (2016: £1.9 billion), credit cards of £1.7 billion (2016: £1.7 billion) and current account overdrafts of £0.2 billion (2016: £0.2 billion). During the year we have focused on enhancing our consumer banking proposition to create a more cohesive and engaging relationship with our members. The asset quality of the portfolio remains strong, benefiting from proactive risk management practices and continued low interest rates.

Other financial assets

Other financial assets total £31.2 billion (2016: £27.8 billion) and comprise liquidity and investment assets held by our Treasury function amounting to £25.4 billion (2016: £23.1 billion), derivatives with positive fair values of £5.0 billion (2016: £3.9 billion) and fair value adjustments and other assets of £0.8 billion (2016: £0.8 billion).

Derivatives largely comprise interest rate and foreign exchange derivatives, taken out to economically hedge financial risks inherent in our core lending and funding activities.

Levels of on-balance sheet liquid assets have increased due to the replacement of the off-balance sheet FLS liquidity with on-balance sheet TFS drawdowns. The increase in total liquidity is more than offset by higher liquidity requirements, resulting in our Liquidity Coverage Ratio (LCR) reducing from 142.6% as at 4 April 2016 to 124.0%. This increase in requirements reflects the inclusion of additional stressed derivative collateral outflows in the LCR calculation following the finalisation of EU rules during the year, and the impact of one-off items. On a like-for-like basis our LCR would remain broadly consistent with last year's.

Financial review *continued*

27.1% wholesale funding ratio

Liabilities	4 April 2017 £m	4 April 2016 £m
Member deposits	**144,542**	138,715
Debt securities in issue	**40,339**	36,085
Other financial liabilities	**23,940**	21,637
Other liabilities	**1,716**	1,572
Total liabilities	**210,537**	198,009
Members' interests and equity	**11,133**	10,930
Total members' interests, equity and liabilities	**221,670**	208,939
	%	%
Wholesale funding ratio (note i)	**27.1**	24.8

Note:
i. The wholesale funding ratio includes all balance sheet sources of funding (including securitisations) but excludes Funding for Lending Scheme (FLS) drawings which, as an asset swap, are not included on Nationwide's balance sheet, reflecting the substance of the arrangement. Off-balance sheet FLS drawings have reduced from £8.5 billion at 4 April 2016 to £4.8 billion.

Member deposits

Member deposits have increased by £5.8 billion to £144.5 billion (2016: £138.7 billion) and our market share of all UK deposits at 4 April 2017 was 10.1% (2016: 10.2%).

Current account credit balances have increased to £17.5 billion (2016: £14.8 billion). We increased our market share of main standard and packaged accounts to 7.5% at February 2017 (2016: 7.1%).

Debt securities in issue

Debt securities in issue of £40.3 billion (2016: £36.1 billion) are used to raise funding in wholesale markets in order to finance core activities. The increase in outstanding amounts partially reflects increased issuance activity in the wholesale markets during the period to support increased liquidity. The wholesale funding ratio has increased to 27.1% (2016: 24.8%) as a result of this wholesale issuance activity, as well as the draw down of TFS which is included in other financial liabilities.

Other financial liabilities

Other financial liabilities include customer and bank deposits (including TFS drawdown) of £17.5 billion (2016: £15.9 billion), derivatives and fair value adjustments of £3.2 billion (2016: £3.5 billion), subordinated debt of £2.9 billion (2016: £1.8 billion) and permanent interest bearing shares (PIBS) of £0.3 billion (2016: £0.4 billion).

During the year a strategic decision was taken to exit the Nationwide International business. This resulted in a £3.6 billion decrease in balances, representing the majority of the deposits associated with this business. These outflows have been managed in an orderly manner with the funding being replaced by additional member deposits and the use of wholesale funding where appropriate.

Statement of comprehensive income

Statement of comprehensive income	Year to 4 April 2017 £m	Year to 4 April 2016 £m
Profit after tax	**757**	985
Net remeasurement of pension obligations	**(255)**	51
Net movement in cash flow hedge reserve	**(247)**	301
Net movement in available for sale reserve	**52**	(34)
Other items	**2**	(4)
Total comprehensive income	**309**	1,299

Movements in the table above are shown net of related taxation.

The remeasurement of pension obligations of £255 million expense (2016: £51 million income) reflects £1,298 million of actuarial losses (2016: £164 million actuarial gains), partly offset by £951 million relating to positive movements in the Fund's assets greater than the discount rate (2016: £122 million return less than the discount rate). Further information on gross movements in the pension obligation is included in note 33.

The movement in cash flow hedge reserve of £247 million expense (2016: £301 million income) relates to a gross movement before tax of £348 million, driven by significant changes in derivative valuations caused by movements in foreign exchange rates. Further information is included in note 7.

Financial review *continued*

Capital structure

Capital structure	4 April 2017 £m	4 April 2016 £m
Capital resources (note i)		
Common Equity Tier 1 (CET1) capital	**8,555**	8,013
Total Tier 1 capital	**9,547**	9,005
Total regulatory capital	**12,129**	10,654
Risk weighted assets (RWAs)	**33,641**	34,475
UK leverage exposure	**215,894**	204,346
CRR leverage exposure	**228,428**	213,181
CRD IV capital ratios	**%**	%
CET1 ratio	**25.4**	23.2
UK Leverage ratio (note ii)	**4.4**	4.4
CRR leverage ratio (note iii)	**4.2**	4.2

Notes:
i. Data in the table is reported under CRD IV on an end point basis.
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 CRR leverage ratio is calculated using the Capital Requirements Regulation 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.

CET1 capital resources have increased over the period by approximately £0.5 billion mainly due to £757 million of profit after tax for the period. Risk weighted assets (RWAs) reduced over the period by approximately £0.8 billion due to continued run-off of the commercial book and lower residential lending RWAs, as a result of house price inflation which more than offset portfolio growth.

The movements described above have resulted in an increase in the CET1 ratio to 25.4% (2016: 23.2%).

The UK leverage ratio is 4.4% at 4 April 2017 (2016: 4.4%) as profits have broadly been offset by an increase in the defined benefit pension deficit and balance sheet growth, which was driven by increases in mortgage balances. The CRR leverage ratio is 4.2% (2016: 4.2%).

We continue to monitor regulatory developments that could lead to an increased level of capital requirements. Whilst there are a number of areas where potential requirements are yet to be finalised, regulatory announcements during the financial year mean that we have a clearer understanding of the expected impact. However, we will remain engaged in the development of the regulatory approach to ensure we are prepared for any change. Whilst these amendments may result in increases to RWAs, we do not believe there will be a material increase in overall capital requirements.

25.4% CET1 ratio

4.4% UK leverage ratio

Risk overview

Effective risk management is at the heart of the business, supporting the delivery of Nationwide's strategy by ensuring the business is built to last and continues to be safe and sustainable, protecting members' interests.

An enterprise-wide risk management framework ensures that risks are managed effectively. This is underpinned by the three lines of defence model which ensures independent oversight and audit of risk management carried out by the business.

Nationwide's principal risks are:

- **Lending risk**: The risk that a borrower or counterparty fails to pay the interest or to repay the principal on a loan.
- **Financial risk**: The risk of inadequate earnings, cash flow or capital to meet current or future requirements and expectations.
- **Operational risk**: The risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.
- **Conduct and compliance risk**: The risk that members experience unfair outcomes or that Nationwide fails to comply with regulatory requirements.
- **Strategic risk**: The risk of significant loss or damage arising from business decisions that impact the long-term interests of the membership, or from an inability to adapt to external developments.

For each of these principal risks, a formal statement of Board appetite for risk defines how much risk the Board is prepared to take in pursuit of the Society's goals, and establishes a framework for decision making. Performance is reviewed regularly against these statements to ensure that the business operates within risk appetite.

Our principal risks are managed through adopting policies and practices as set out below:

To manage	Policies and practices are in place to ensure that
Lending risk	• Nationwide primarily lends on prime residential mortgages and sets prudent limits to control exposure to other risk portfolios, such as buy to let and unsecured lending. • The commercial portfolios are being actively managed to maturity. As commercial lending is now closed to new business, risk management of these portfolios focuses on refinance, extension and concentration risks. • Treasury credit risk is accepted only to support Nationwide's liquidity strategy, on derivative activities necessary to support our member proposition and to manage legacy positions.
Financial risk	• Financial risks, including liquidity, funding and solvency, are tightly managed whilst allowing Nationwide to meet members' needs when designing products and services. • Where residual financial risks exist, sufficient capital or liquidity is held to mitigate their impact.
Operational risk	• Nationwide operates its business to ensure a minimum level of serious disruption to members, brand and reputation, with systems and services designed to achieve defined levels of availability and performance.
Conduct and compliance risk	• Nationwide's products and services meet customer needs and expectations and perform as represented. • Nationwide builds sustainable partnerships with members and customers by providing the right information at the right time, and value for money products and services. • Nationwide addresses customer detriment and / or dissatisfaction in a timely and fair manner. • Nationwide safeguards personal data, does not exploit asymmetries and does not disadvantage customers or customer segments or take advantage of customer vulnerability. • Nationwide does not conduct or facilitate market abuse or financial crime and does not distort competition.
Strategic risk	• Nationwide does not overcommit by targeting too many strategic priorities at any one time, ensuring the most effective and efficient use of its resources. It is committed to a mutual business model that is focused on the provision of retail financial services, almost exclusively in the UK.

Top and emerging risks

Whilst the Board accepts that the Society's business activities involve some risk, it seeks to protect members by managing the exposures that arise.

Risk management activity has focused on strengthening business resilience and managing conduct and regulatory challenges. As a result, Nationwide's top and emerging risks remain largely unchanged and fall within the following themes:

- macroeconomic environment including the political and economic uncertainty resulting from the Brexit vote
- cyber security, data protection and operational resilience
- the pace of change in the digital and regulatory environments.

Further details of the risks facing Nationwide, its appetite for these risks and the risk management framework are given in the Business and Risk Report.

Social investment

Social investment is about doing what is right by our members and their communities. It goes to the heart of what it means to be a building society. Back in 2012, we asked our members how we could make a lasting difference to their local communities. As a result, we launched 'Living on your side', setting out three ambitious targets to be delivered by 2017.

Our members, colleagues and charity partners have worked together and not only have these targets been met, they have been exceeded, benefiting thousands of communities across the UK.

2012 – 2017

LIVING
On your side

Your Home

Helped **958,000** people into a home of their own, against a target of **750,000**.

Your Money

Empowered **1.2 million** people to start saving, against a target of **1 million**.

Your Community

Invested and unlocked **£21 million** into community and charity support, against a target of **£15 million**.

Your Society

As a mutual, we have remained true to our values and run our business in a responsible and ethical way.

Your Environment | Your Workplace | Your Ethical Business

The Society scored 98% in the Business in the Community Corporate Responsibility Index.

Corporate Citizenship, an external Corporate Responsibility Consultancy, has assured our social investment statements to ISAE 3000 standard. The Assurance Statement is available at **nationwide.co.uk**

A long lasting difference

Nationwide Building Society believes everyone should have a place fit to call home, and this year we are working on a new programme to help make this happen.

Based on feedback from members, we are developing a new social ambition to find local solutions to national housing issues. We will be working with colleagues and members locally to make a long lasting difference to their communities and we will continue to invest at least 1% of our pre-tax profits to support good causes.

What we have done this year

Your Home

226,300 people helped into a home of their own this year against a target of 198,600

Helping people into a home of their own is not just about buying a house, it is about having a safe and comfortable place to call home. We do this by helping first time buyers, providing buy to let lending to support the rental market and working in partnership with charities. In 2016/17:

- We continued our work with housing and homeless charity Shelter to help 17,000 people into a home of their own. Since 2012, 44,000 people have been helped against a target of 16,000. This includes interventions when people are at risk of losing their homes and helping vulnerable people find and keep a home.
- Our partnership with Elderly Accommodation Counsel enabled 5,600 older people to stay in their own homes through our support of its 'Live Safely and Well at Home' campaign and its UK telephone advice service.
- We have been working with military communities to make it easier for them to access a mortgage and a home. This work was recognised when the Society received a 'Gold' award from the MOD in its Employer Recognition Scheme.

*The Nationwide Foundation is a registered charity (1065552) set up in 1997 by Nationwide Building Society.

The Nationwide Foundation

The Nationwide Foundation* increases the availability of decent affordable homes for people in housing need, thus alleviating social and economic disadvantage in the UK.

In 2016/17 the Nationwide Foundation received a donation of £2.8 million from Nationwide Building Society and funded 26 charitable causes. Its funding supported: housing cooperatives, self-build housing, the development of community-led housing, research into the availability of land and the experience of vulnerable tenants in the private rented sector, and bringing empty properties into use.

Your Money

288,000 people helped to start saving with us this year against a target of 290,000*

As one of the UK's largest savings providers, we play an important role in encouraging a savings culture. Through our Talking Numbers programme, we have focused on improving young people's everyday number skills to encourage their savings habits. This has included:

- Developing **nationwideeducation.co.uk** which provides free, independent online resources for children, parents and teachers covering numeracy and financial capability.
- Sponsoring safety education centres in Birmingham, North Wales and Belfast, where students can attend MoneyLIVE workshops where they are taught key life skills such as budgeting, saving and using an ATM. 18,600 young people benefited from MoneyLIVE workshops in 2016/17.
- Funding ten secondary school teachers through education charity Teach First and working with pfeg (Personal Finance Education Group) on a bespoke programme to train primary school teachers to teach financial literacy.

*This figure represents new savers to Nationwide who have not had a savings account with us in the last financial year. Of these, 54% opened children's savings accounts. The remaining 46% were new adult savers, including those taking out a Help to Buy ISA account where money is deposited to help secure a mortgage, and those benefiting from tax-free savings in our Regular Saver ISA.

Helping people to avoid and manage problem debt

This year, we have further developed our partnership with the Money Advice Trust, which helps people tackle debts and manage their money wisely.

We have also referred more members to IncomeMAX, an organisation that provides free advice and advocacy on a range of benefits, grants and utility bill discounts. In the last year, this service identified £400,000 of additional income, benefits and savings for members. We also continue to work closely with the Money Advice Service by helping develop new debt solutions and standards.

Your Community

£5 million channelled into community and charity support against a target of £4.5 million

Through 'Living on your side' we wanted to make a big difference at a community level, not only through donations but also by unlocking the volunteering and fundraising capacity of colleagues and members. In 2016/17:

- 75% of our colleagues were involved in fundraising, volunteering or payroll giving (this was 6% in 2012). £1.7 million was raised for charity by our members and colleagues this year.
- The value of colleagues volunteering their time was £1.2 million (all colleagues are given up to 14 hours to volunteer during work time each year).
- Through the Nationwide Big Local and Community Match programmes, £438,000 was donated to 1,200 local charities or causes in 2016/17.
- 4,200 colleagues are now CPR trained through our partnership with the British Heart Foundation and its 'Nation of Lifesavers' programme.

World's Biggest Coffee Morning

For Macmillan Cancer Support's most recent World's Biggest Coffee Morning, we were a Community Partner, encouraging members of the public to hold their own coffee morning. In total we raised £276,000 for the charity.

Governance

Governance

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Board of directors

Meet your Board of directors who were in office at 4 April 2017, including Joe Garner, Chief Executive Officer, who is seeking election as executive director and Kevin Parry and Baroness Usha Prashar who are seeking election as non executive directors.

Rita Clifton

CBE, MA (Cantab), FRSA (59)

Term of Office
Non executive director since July 2012.

Independent
Yes.

Skills and experience (including directorships):
Rita is an acclaimed brand expert and uses her deep consumer insight to ensure members' needs are central to Board discussions.

Throughout a 20-year career in senior management at Interbrand UK Limited and Saatchi & Saatchi, among others, Rita has advised some of the UK's best known organisations, including British Airways, Barclays, BT, Citigroup, Visa and the British Army. She has demonstrated how brand is integral to long term business strategy and the value of analysing and understanding consumer perceptions and behaviour.

Rita is a member of both the Audit Committee and the Remuneration Committee.

Mai Fyfield

MA, BA (Hons) (47)

Term of Office
Non executive director since June 2015.

Independent
Yes.

Skills and experience (including directorships):
Mai combines her background as an economist with considerable commercial experience to help guide the Board's strategic thinking and consideration of emerging opportunities.

Mai maintains a full-time role as Chief Strategy and Commercial Officer at Sky, where she leads strategy and commercial partnerships across the Sky Group. Before reaching the top of a sector focused on customer experience and service delivery, Mai was an economic advisor to a number of major blue-chip companies.

Mai is a member of the IT Strategy and Resilience Committee.

Joe Garner

MA (Cantab) (47)

Term of Office
Chief Executive Officer since April 2016.

Skills and experience (including directorships):
Joe Garner joined Nationwide as CEO in April 2016, inspired by the Society's principle of mutuality and service ethos.

Consumer-focused organisations have been at the heart of Joe's working life. He spent his early career with consumer products companies, Procter & Gamble and Dixons Carphone. He was then invited to lead larger organisations, first as Head of HSBC's UK retail and commercial businesses from 2010 to 2012. Then, in 2014 he became CEO at Openreach, the UK's digital infrastructure provider. Joe was Chair of the Financial Services Authority Practitioner Panel from 2011 to 2013, and a non executive director of the Financial Ombudsman Service from 2007 to 2010.

Since joining Nationwide, Joe's mission has been to inspire colleagues to remain true to the Society's social purpose; using the power of the collective to improve people's lives. Joe is passionate about the purpose that we share of 'building society, nationwide'.

Joe is Chairman of the British Triathlon Trust. He lives in South London with his wife and son.

Board of directors *continued*

Mitchel Lenson
MBA, BA (Hons), ACIB, FSI (62)

Term of Office
Non executive director since July 2011.

Independent
Yes.

Skills and experience (including directorships):
Mitchel brings an extensive and formidable international background in IT, operations and major programme and change management to Nationwide's Board.

He has spent over 30 years in the financial services industry, at JP Morgan, UBS Warburg, Credit Suisse First Boston, and as Group Chief Information Officer at Deutsche Bank. Mitchel is also a non executive director of Currency Cloud, a payments platform.

Mitchel chairs the IT Strategy and Resilience Committee and is a member of the Board Risk Committee.

Kevin Parry
MA (Cantab), FCA (55)

Term of Office
Non executive director since May 2016.

Independent
Yes.

Skills and experience (including directorships):
Kevin is a distinguished director bringing extensive commercial, regulatory and auditing experience, notably in international financial services and professional practice.

He is currently Chairman of Intermediate Capital Group plc, and Senior Independent Director and Chairman of the Audit Committee of Standard Life plc. Kevin is also a non executive director and Chairman of the Audit and Risk Committee of Daily Mail and General Trust plc. He is a former KPMG managing partner and was Chief Financial Officer at Schroders plc. He is chairman of Royal National Children's Foundation, a charity supporting children with difficult home circumstances.

Kevin is chairman of the Audit Committee, and a member of both the Board Risk Committee and the Nomination and Governance Committee.

Lynne Peacock
BA (Hons) (63)

Term of Office
Non executive director since July 2011.

Independent
Yes.

Skills and experience (including directorships):
Lynne has a deep background in financial services and brings an extensive understanding of the challenges and opportunities of mutuality to the Board.

She was formerly CEO of National Australia Bank's UK business and Chief Executive of Woolwich plc, having previously held senior management and board positions at the Woolwich Building Society. Her current work as a non executive director of both Scottish Water and Standard Life plc, and as a Trustee of the Westminster Society for People with Learning Disabilities, brings extra perspective to Nationwide.

Lynne is Nationwide's Senior Independent Director. She chairs the Remuneration Committee and is a member of the Nomination and Governance Committee, the Audit Committee and the Board Risk Committee.

Board of directors *continued*

Baroness Usha Prashar
CBE (68)

Term of Office
Non executive director since January 2017.

Independent
Yes.

Skills and experience (including directorships):
Baroness Prashar has operated at the highest levels of public service, and brings a wealth of policy expertise and insight to inform Nationwide's social purpose and regulatory perspectives.

An active member of the House of Lords, Usha is a Member of the European Union Select Committee and Chairman of the European Union Home Affairs Sub-Committee.

Usha has held non executive director positions at ITV, the Cabinet Office, Unite plc, Channel 4, Energy Saving Trust and Ealing, Hounslow and Hammersmith Health Authority. She has also occupied senior posts at the National Literacy Trust, Royal Commonwealth Society and the Judicial Appointments Commission.

Usha is a member of the Remuneration Committee.

Tony Prestedge
(47)

Term of Office
Executive director since August 2007.

Skills and experience (including directorships):
Tony has held senior positions for a number of organisations across strategy, operations, transformation and technology. He now leads Nationwide across all points of customer contact, including digital, in an era when technology is changing the shape of financial services and customer expectations.

Tony joined the Society and its Board in 2007 as Group Development Director, becoming Chief Operating Officer in 2010. He is as passionate about Nationwide and its commitment to mutuality and service excellence today as the day he started.

Before Nationwide, Tony was a part of the leadership team for Barclays Retail Bank and an Executive Committee member for both UK Personal Banking and Woolwich plc. His roles at Barclays also included Retail Support and Operations Director and Managing Director of the Home Finance business unit, experience that drew Tony to Nationwide.

Tony's goals are to deliver legendary service for Nationwide's 15 million customers at every interaction and across all channels, and to drive forward the Society's digital and mobile strategy.

Mark Rennison
BA, FCA (56)

Term of Office
Executive director since February 2007.

Skills and experience (including directorships):
Mark, a chartered accountant, has 30 years' experience in finance and across financial services. His role is to manage the financial risks faced by the Society.

Mark joined Nationwide as an executive director and Chief Financial Officer in 2007.

With responsibility for Finance and Efficiency, including Treasury and Supply Chain Management, he leads Nationwide's work to maintain its financial strength so that the Society can continue to invest in sustainable growth and member services. He also drives Nationwide's financial efficiency, ensuring an unwavering focus on the fact that every pound the Society spends is our members' money.

Mark is a former partner at PricewaterhouseCoopers LLP, where he worked in the financial services practice, focusing on retail and corporate banking. He also worked extensively with treasury operations, leasing and asset finance businesses.

Mark is a member of the Bank of England's PRA Practitioner Panel.

Board of directors *continued*

Chris Rhodes
BSc (Hons), ACA (54)

Term of Office
Executive director since April 2009.

Skills and experience (including directorships):
Chris has worked in financial services for 29 years, with leadership positions in finance, retail distribution, credit risk and product design.

He joined Nationwide and the Board in 2009 and is responsible for defining member propositions for the Society's 15 million customers.

Chris was previously Director of Retail Distribution for Alliance and Leicester, part of Abbey Santander. His senior positions at Alliance and Leicester also included Retail Operations Director, Group Finance Director, and Deputy Managing Director of Girobank.

Chris is a board member of National Numeracy and the Lending Standards Board.

David Roberts
BSc (Hons), MBA, PhD (Honorary), CFifs (54)

Term of Office
Non executive director and Chairman Elect from September 2014.
Chairman since July 2015.

Independent
Yes (upon appointment as Chairman).

Skills and experience (including directorships):
David combines extensive financial services expertise at major listed companies and member-led firms with broad experience of leading, shaping and developing boards.

David was formerly Group Deputy Chairman of Lloyds Banking Group and Chairman of the Board Risk Committee. He was also previously an Executive Director at Barclays Bank, where he was Chief Executive of International Retail and Commercial Banking, and a member of the Group Executive Committee. David was also Chairman and Chief Executive of Bawag PSK AG, Austria's second largest retail bank, and is former non executive director of BAA plc and Absa Group SA.

He is currently Vice Chairman of NHS England.

As Chairman of the Board since July 2015, David also chairs the Nomination and Governance Committee and is a member of the Remuneration Committee and the IT Strategy and Resilience Committee.

Tim Tookey
BSc (Hons), FCA (54)

Term of Office
Non executive director since June 2015.

Independent
Yes.

Skills and experience (including directorships):
Tim is a chartered accountant and brings enormous financial understanding and risk expertise to the Board.

He has spent over 30 years in finance, including as Chief Financial Officer at Friends Life Group Ltd, and Group Finance Director of Lloyds Banking Group.

Tim is currently an Executive Director of Old Mutual Wealth, and will become their Chief Financial Officer, subject to regulatory approval.

Tim chairs the Board Risk Committee and is a member of the Nomination and Governance Committee, the IT Strategy and Resilience Committee and the Audit Committee.

Board committee membership
as at 4 April 2017

Board Committee	Membership
Audit Committee	Kevin Parry (Chairman)
	Rita Clifton
	Lynne Peacock
	Tim Tookey
Board Risk Committee	Tim Tookey (Chairman)
	Mitchel Lenson
	Kevin Parry
	Lynne Peacock
IT Strategy and Resilience Committee	Mitchel Lenson (Chairman)
	Mai Fyfield
	David Roberts
	Tim Tookey
Nomination and Governance Committee	David Roberts (Chairman)
	Kevin Parry
	Lynne Peacock
	Tim Tookey
Remuneration Committee	Lynne Peacock (Chairman)
	Rita Clifton
	Usha Prashar
	David Roberts
Results Approval Committee	David Roberts (Chairman)
	Joe Garner
	Kevin Parry
	Mark Rennison
	Lynne Peacock

Executive Committee	Joe Garner – Chief Executive Officer (Chairman)
	Tony Prestedge – Chief Relationships and Distribution Officer
	Mark Rennison – Chief Financial Officer
	Chris Rhodes – Chief Products and Propositions Officer
	Debra Bailey – Chief Information Officer
	Richard Beck – Chief Strategy and External Relations Officer
	Sara Bennison – Chief Marketing Officer
	Martin Boyle – Chief Transformation Officer
	Julia Dunn – Chief Risk Officer
	Keith Ford – Chief Legal Officer and Society Secretary
	Graeme Hughes – Director of Intermediaries, Branches and Regulated Advice
	Lee Raybould – Chief Data Officer
	Alison Robb – Chief People Officer
	Janet Chapman (attendee) – Chief Internal Auditor

Executive Committee biographies

Debra Bailey
Chief Information Officer

Debra joined the Society in 2012 to lead Group Services, having spent time in senior roles with Barclays, Woolwich plc and BT. She now leads the Operations and Delivery Community, responsible for Product Operations, IT and Security, ensuring all of our systems and processes run smoothly and efficiently for members and colleagues, and designing and developing IT solutions to meet future business needs.

Richard Beck
Chief Strategy and External Relations Officer

Richard joined the Society in 2016 to lead the Strategic Planning and External Relations Community, charged with developing our strategy and engaging media, government and opinion-formers. He has spent 25 years working across four continents advising companies and their boards on strategy and reputation management, as a former Group General Manager at HSBC, and founder of an international business consultancy.

Sara Bennison
Chief Marketing Officer

Sara started her career in advertising, working across a variety of major brands in the UK and Asia. She joined Nationwide in March 2016 having spent the previous 7 years at Barclays, most recently as Chief Marketing Officer for the Personal and Corporate Bank globally. She is responsible for all Nationwide's marketing, member engagement, social investment and internal communications.

Martin Boyle
Chief Transformation Officer

As leader of the Transformation Community, Martin manages the teams tasked with creating and delivering the Society's very largest, transformative projects that meet Nationwide's ambitions to serve members. He has been with the Society since 2004 when he joined legacy firm Portman Building Society. Before that he had over 20 years of change experience in consulting and retail financial services.

Julia Dunn
Chief Risk Officer

Julia joined Nationwide in September 2013 as Chief Compliance Officer. She now leads the Risk Community, including Compliance, helping to keep the Society safe and secure and our members at the heart of everything we do. A qualified chartered accountant, she previously spent 13 years with the Financial Services Authority, in both supervision and enforcement, and latterly the Financial Conduct Authority as Director of Retail Banking Supervision.

Keith Ford
Chief Legal Officer and Society Secretary

Keith leads the Legal and Secretariat Community, steering the Society's governance and legal affairs, having joined Nationwide in July 2014. Since qualifying as a solicitor in 1991, he has worked at Cheltenham & Gloucester Building Society, and most recently as General Counsel of HSBC in the UK.

Executive Committee biographies *continued*

Graeme Hughes
Director of Intermediaries, Branches and Regulated Advice

Graeme has spent 33 years with Nationwide, since joining as a management trainee in 1984. He has worked in a host of roles at the Society, locally, regionally and in head office, including as a branch manager. He now leads the teams who serve our members in branches nationwide, and our intermediary clients.

Lee Raybould
Chief Data Officer

Lee has worked for Nationwide since 1995 and is a qualified accountant. He has undertaken a number of finance roles, as well as time spent in the commercial lending, strategy and planning and savings areas of the business. He was responsible for the Financial Performance and Reporting function, before being appointed to lead the Society's Data and Analytics Community.

Alison Robb
Chief People Officer

Alison leads the People and Culture Community, responsible for creating teams and communities of colleagues that are best placed to meet our members' needs. A qualified chartered accountant, Alison worked for KPMG and WH Smith before joining Nationwide in 1996. Since joining the Society she has worked across the Finance function, before being appointed Group Director for People, Customer & Commercial in December 2012.

Janet Chapman
Chief Internal Auditor

Janet joined the Society in January 2017 to lead the Internal Audit Community which provides rigorous, constructive and independent challenge to business areas within the Society. Janet joined the Society from Citigroup where she was Chief Auditor for Citi's global institutional businesses.

Directors' report

For the year ended 4 April 2017

The directors have pleasure in presenting their Annual Report and Accounts for the year ended 4 April 2017.

The Annual Report and Accounts have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU. All financial information given in this Directors' report is taken solely from the statutory results prepared on this basis. More information is included in note 1 to the Accounts. Unaudited, underlying results that allow comparison between 2017 and 2016 are given in the Strategic Report.

Business objectives, future developments and key performance indicators

The Group's objectives and future plans are set out in the Strategic Report, together with its principal key performance indicators.

Profits and capital

Profit before tax for the year ended 4 April 2017 was £1,054 million (2016: £1,279 million). The profit after tax transferred to the general reserve was £757 million (2016: £985 million).

Total Group reserves at 4 April 2017 were £9,610 million (2016: £9,407 million). Further details on the movements of reserves are given in the Group statement of movements in members' interests and equity.

Gross capital at 4 April 2017 was £14,314 million (2016: £13,160 million) including £531 million (2016: £531 million) of core capital deferred shares (CCDS), £992 million (2016: £992 million) of other equity instruments, £2,905 million (2016: £1,817 million) of subordinated debt and £276 million (2016: £413 million) of subscribed capital. The ratio of gross capital as a percentage of shares and borrowings at 4 April 2017 was 7.1% (2016: 6.9%) and the free capital ratio was 6.2% (2016: 6.0%). The Annual business statement includes an explanation of these ratios.

Mortgage arrears

The Group's mortgage portfolios at 4 April 2017 included 1,674 mortgage accounts (2016: 1,454), including those in possession, where payments were more than 12 months in arrears. The total principal outstanding in these cases was £195 million (2016: £182 million). The total value of arrears in these cases was £20 million (2016: £18 million) or 0.01% (2016: 0.01%) of total mortgage balances. The methodology for calculating mortgage arrears is based on the Council of Mortgage Lenders' definition of arrears, where months in arrears is determined by dividing the arrears balance outstanding by the latest contractual payment.

Charitable and political donations

Results for the year include charitable donations of £5,539,117 (2016: £3,963,262), including £2,842,500 (2016: £2,523,333) to the Nationwide Foundation. In addition, employees have contributed time for volunteering programmes at a cost of £1,224,713 (2016: £1,547,726), resulting in a total commitment to the community of £6,763,830 (2016: £5,510,988). No donations were made for political purposes. Time allowed to employees to carry out civic duties can amount to a donation; a small number of employees are supported in this way.

Participation in the unclaimed assets scheme

The Society participates in the Government-backed unclaimed assets scheme, whereby savings accounts that have been inactive for 15 years and where the account holder cannot be traced are eligible to be transferred into a central reclaim fund. The central reclaim fund has the responsibility for retaining sufficient monies to meet the costs of future reclaims for any previously transferred dormant account balances, and to transfer any surplus to the Big Lottery Fund for the benefit of good causes which have a social or environmental purpose. On 5 April 2017, the Society transferred £4,996,120 (5 April 2016: £1,185,455) to Reclaim Fund Ltd, the administrators of the unclaimed assets scheme. The total contributions from inception to that date are £57,498,792.

Creditor payment policy

Our policy is to agree the terms of payment with suppliers at the start of trading, ensure that suppliers are aware of the terms of payment, and pay in accordance with all contractual and other legal obligations. It is our policy to settle the supplier's invoice for the complete provision of goods and services (unless there is an express provision for stage payments) within the agreed payment terms, subject to full conformity with the terms and conditions of the purchase. The Society's creditor days were 12 days at 4 April 2017 (2016: 13 days).

Risk management

We seek to manage all the risks that arise from business activities undertaken. There is a formal structure for monitoring and managing risk across Nationwide, comprising a risk appetite agreed by the Board, detailed risk management frameworks, and independent governance and risk oversight. The risk management objectives and risk framework are set out in the Business and Risk Report.

The principal risks, as well as the top and emerging risks that could affect delivery of Nationwide's strategy, are also detailed in the Business and Risk Report.

There are a number of committees, frameworks and policies to manage these risks. These are set out in the Report of the directors on corporate governance and in the Business and Risk Report.

Directors' report *continued*

Disclosure requirements under CRD IV country-by-country reporting

In compliance with the Regulations of Article 89 of the Capital Requirements Directive IV (CRD IV) Country-by-Country Reporting Regulations 2013, additional information will be published, in respect of the year ended 4 April 2017, by 31 December 2017. This information will be available by that date on Nationwide's website: **nationwide.co.uk**

Employees

Through our PRIDE culture and values we are focused on putting members' and customers' interests first, and we believe that being a great employer is fundamental to achieving this.

Developing our people

We have continued to invest in the development of our leaders and will be focusing on a new leadership proposition for 2017 to support our refreshed strategy and values. Our development activity also means that we have been able to provide many career progression opportunities for our internal talent, whilst we continue to attract new talent to the Society from external sources.

Our award-winning Emerging Talent programmes for graduates and apprentices are an important part of our overall talent strategy in regard to early pipeline development. Going forward, the new apprenticeship standards provide an excellent platform to increase our commitment to offering a range of apprenticeship routes to both new and current people here at Nationwide.

This year we have delivered 56,981 training days to equip our branch and contact centre people with the knowledge, skills and behaviours to serve our members well. An increased emphasis on induction and service skills aligned to our refreshed strategy will be our focus for the year ahead.

Employee engagement

We aim to maintain our industry leading levels of employee engagement and enablement, uniquely positioned as a successful mutual financial services organisation. We focus on an inclusive culture, underpinned by PRIDE, in which employees can perform to their full potential. More information about PRIDE and employee engagement can be found in the Strategic Report.

pride

As a national organisation with local representation, we aim to contribute to each of our local communities. Our social investment strategy enables employees to engage locally through our volunteering programme. In 2016/17 we channelled £5 million into charities and communities and 75% of our employees were involved in volunteering and fundraising.

Nationwide continues to consult actively with the Nationwide Group Staff Union. The Employee Involvement Committee, chaired by an executive director, acts as a forum where representatives from the business and the Union consult and share information on a range of business and employment issues for the benefit of our employees and our business.

Equality, diversity and inclusion

Our approach to equality, diversity and inclusion (ED&I) is integral to our people strategy.

We take a fully inclusive approach to recruitment and to developing our employees. We provide equal access to recruitment processes, training, career development and promotion opportunities for all our people regardless of their ethnicity, faith and belief, gender, gender identity, marital status, age or disability. Should employees become disabled, we will work with them to, wherever possible, put in place the adjustments they may need to continue their employment, including appropriate training and/or redeployment where necessary. We are also proud to note that over 80% of women return to Nationwide following maternity leave, often on more flexible working arrangements, and we are working to increase that figure further.

Having a workforce that is representative of UK communities means that we are better able to serve the needs of our members and provide the excellent service that they expect and deserve. We are committed to increasing diversity across the senior leadership population (Board, executive leaders and their direct reports). Our targets by the year 2020 for female and BAME (Black, Asian and Minority Ethnic) representation in this population are set at 33% and 8% to 15% respectively. At 4 April 2017, female representation across the whole Society was 63.1% with representation in our senior population at 29.3% and board representation at 33.3%. BAME representation was at 6% across our senior population, with board representation at 8.3%.

This year we were proud to make a public commitment through signing HM Treasury's Women in Finance Charter, and we will publish our gender pay gap reporting prior to the Government's target date of 4 April 2018.

While we are proud of the progress made to increase the diversity of our workforce and create an inclusive environment, we recognise there is more to do, particularly in respect of ethnicity and disability. We are now focusing on actions that will help to improve these areas. Our BAME mentoring circles have expanded UK-wide with participants benefiting from working with a senior mentor and a group of peers to focus on career development opportunities. A reciprocal mentoring programme is also underway to develop a greater understanding of difference and the experiences of those from minority groups in the workplace. We continue to make improvements to our policies and processes to support disabled employees and are pleased to be trialling work placements in the organisation.

Female and male representation across the Society as at 4 April 2017:

	Board members		Senior managers		Total employees	
	Number	%	Number	%	Number	%
Female	4	33	109	29	11,784	63
Male	8	67	263	71	6,905	37
Total	12	100	372	100	18,689	100

Directors' report *continued*

Environment

Our goal is to be among the best performers for environmental sustainability in the UK financial services sector.

Our business is growing which in turn is creating a need for new buildings and increased use of digital technology and data management facilities. Despite these challenges we have continued to reduce our carbon emissions. We also continue to divert our waste from landfill. We do, however, face new challenges such as increased numbers of people working in our administration centres, which mean that water usage and the amount of waste we produce has increased slightly.

The targets that we set ourselves last year, to achieve by 2020, remain unchanged:

- carbon emissions will not exceed 2015 levels
- we will reduce water use by 5% by 2020
- we will reduce waste by 100 tonnes and increase the amount we recycle to at least 80% by 2020.

As we continue to grow our business successfully we are focused on ways of reducing our environmental impacts, and since July 2016 at least 50% of our electricity has been generated on a solar farm.

We also remain committed to identifying, targeting and addressing inefficiencies in our supply chain. Having been the first high street financial services provider to be certified at level one of the Carbon Trust Supply Chain Standard in 2015, we achieved recertification of this standard during the year.

A summary of our performance is as follows:

	Year to 4 April 2017	Year to 4 April 2016	Baseline year 4 April 2011
Carbon dioxide (CO_2e) in tonnes (notes i and ii)			
Scope 1 emissions			
Energy	**4,498**	3,138	4,890
Travel	**1,887**	2,239	2,448
Scope 2 emissions			
Electricity	**35,840**	44,934	50,802
Total Scope 1 and 2 emissions (note iii)	**42,225**	50,311	58,140
PPA carbon reduction (note iv)	**(12,925)**	-	-
Absolute carbon outturn	**29,300**	50,311	58,140
Total carbon dioxide in tonnes per FTE	**1.69**	2.81	3.46
Water use (cubic metres)	**221,560**	198,450	259,718
Water use (cubic metres) per FTE	**12.83**	11.06	15.45

Notes:

i. CO_2e is an abbreviation of 'carbon dioxide equivalent' and is the internationally recognised measure of greenhouse gas emissions.

ii. When calculating our carbon emissions we have used the DEFRA 2015 conversion factors.

iii. Scope 1 covers direct combustion of fuels and company owned vehicles and Scope 2 covers emissions from electricity.

iv. Represents the contribution of a solar power purchase agreement, producing emissions free energy backed by renewable obligations certificates.

Directors' responsibilities in respect of the preparation of the Annual Report and Accounts

This statement, which should be read in conjunction with the Independent auditor's report, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Report and Accounts, the directors' emoluments disclosures within the Report of the directors on remuneration, the Annual business statement and the Directors' report.

As required by the Building Societies Act 1986 (the Act), the directors have prepared an Annual Report and Accounts which gives a true and fair view of the income and expenditure of the Society and the Group for the financial year and of the state of the affairs of the Society and the Group as at the end of the financial year, and which provides details of directors' emoluments in accordance with Part VIII of the Act and regulations made under it. The Act states that the requirements under international accounting standards achieve a fair presentation. In preparing the Annual Report and Accounts, the directors have:

- selected appropriate accounting policies and applied them consistently
- made judgements and estimates that are reasonable and prudent
- stated whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements
- prepared the financial statements on the going concern basis.

As required by the Disclosure and Transparency Rules of the Financial Conduct Authority, the directors have included a management report containing a fair review of the business and a description of the principal risks and uncertainties facing the Group. This information is contained in the Strategic Report and the Business and Risk Report. In addition to the Annual Report and Accounts, as required by the Act, the directors have prepared an Annual business statement and a Directors'

Directors' report *continued*

report, each containing prescribed information relating to the business of the Society and its connected undertakings.

The British Bankers' Association Code for Financial Reporting Disclosure (the BBA Code), published in September 2010, sets out five disclosure principles together with supporting guidance. The principles are that UK financial institutions will:

- provide high quality, meaningful and decision-useful disclosures
- review and enhance their financial instrument disclosures for key areas of interest
- assess the applicability and relevance of good practice recommendations to their disclosures, acknowledging the importance of such guidance
- seek to enhance the comparability of financial statement disclosures across the UK banking sector
- clearly differentiate in their annual reports between information that is audited and information that is unaudited.

The principles of the BBA Code have been adopted in preparing the Annual Report and Accounts.

We aim to continually enhance our disclosures and their usefulness to the readers of the financial statements in the light of developing market practice and areas of focus. One such example is the revised forbearance disclosures presented in the Business and Risk Report. Following participation in a BBA industry working group, we have aligned our forbearance reporting to the European Banking Authority's financial reporting definitions to provide greater consistency and allow improved comparison across the industry.

A copy of the Annual Report and Accounts can be found on Nationwide Building Society's website at **nationwide.co.uk** (Results and accounts section). The directors are responsible for the maintenance and integrity of statutory and audited information on the website. Information published on the internet is accessible in many countries with different legal requirements. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' statement pursuant to the disclosure and transparency rules

The directors confirm that, to the best of each director's knowledge and belief:

- the financial statements, prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group and Society
- the management report contained in the Strategic Report and the Business and Risk Report includes a fair review of the development and performance of the business and the position of the Group and Society, together with a description of the principal risks and uncertainties that they face.

Directors' responsibilities in respect of accounting records and internal control

The directors are responsible for ensuring that the Society and its connected undertakings:

- keep accounting records which disclose with reasonable accuracy the financial position of the Society and the Group and which enable them to ensure that the Annual Report and Accounts comply with the Building Societies Act
- establish and maintain systems for control of its business, records, inspection and reports.

The directors have general responsibility for safeguarding the assets of the Group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors who held office at the date of approval of this report confirm that, so far as they are each aware, there is no relevant audit information of which the Group's auditors are unaware, and each director has taken all the steps that they ought to have taken as directors to make themselves aware of any relevant audit information and to establish that the Group's auditors are aware of that information.

Going concern and business viability

The directors' responsibilities in respect of going concern are set out below. In addition, compliance with the UK Corporate Governance Code requires the directors to state in a Business Viability Statement whether there is a reasonable expectation the Society and the Group will be able to continue in operation and meet their liabilities as they fall due. The period assessed under the Business Viability Statement is required to be significantly longer than the minimum period of 12 months over which going concern is assessed.

Directors' responsibilities in respect of going concern

In preparing the financial statements the directors have satisfied themselves that it is reasonable for them to conclude that it is appropriate to adopt the going concern basis in accordance with the 'Financial Reporting Council's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' and IAS 1 Presentation of Financial Statements.

The Group meets its day to day liquidity requirements through the management of both its retail and wholesale funding sources and is required to maintain a sufficient buffer over regulatory capital requirements in order to continue to be authorised to carry on its business.

The Group's business activities, along with its financial position, capital structure, risk management approach and factors likely to affect its future performance are described in the Strategic Report and the Business and Risk Report.

The Group's forecasts and projections, taking account of possible changes in trading performance and funding retention, and including stress testing and scenario analysis, show that the Group will be able to operate at adequate levels of both liquidity and capital for the next 12 months. Furthermore the Group's capital ratios and its total capital resources are comfortably in excess of PRA requirements.

After making enquiries the directors are satisfied that the Group has adequate resources to continue in business for the foreseeable future and that, therefore, it is appropriate to adopt the going concern basis in preparing the financial statements.

Business Viability Statement

In addition to the going concern statement, and in accordance with provision C.2.2 of the UK Corporate Governance Code, the directors confirm that they have a reasonable expectation that both the Society and the Group will be able to continue in operation and meet their liabilities as they fall due over the next three years. In making this confirmation the Board has specifically sought input from the Audit Committee.

The assessment covers a period of three years as this is within the period covered by the Group's medium-term plan (the Plan) and

Directors' report *continued*

regulatory and internal stress testing. The time period chosen reflects the consideration that the level of uncertainty relating to the assessment increases the longer the period chosen. The pace of change of the economic, market and regulatory environments in which the Group operates may undermine the reliability of longer forecasts.

The directors have based this statement on a robust assessment of those risks that could threaten the business model, future profitability, solvency, liquidity or capital adequacy of the Group. In making the assessment, the directors considered a range of information concerning each of these risks across a range of scenarios, including but not limited to the Plan and the programme of regulatory and internal stress testing it undertakes. In particular:

- The Plan is reviewed by the directors in detail at least annually. The Plan makes certain assumptions about the performance of the Group and the economic, market and regulatory environments in which it operates.
- The Plan includes consideration of how financial performance would be affected in a downside scenario throughout the assessment period.
- Alternative forecasts are also constructed against a number of stress scenarios, including a robust downside scenario as part of the Board's review of the Internal Capital Adequacy Assessment Process (ICAAP). This is a severe stress of the UK economy, with large increases in unemployment and interest rates negatively impacting consumers and households, resulting in a steep fall in house prices.
- Liquidity stress tests are conducted as part of the Internal Liquidity Adequacy Assessment Process (ILAAP). The ILAAP demonstrates that sufficient liquid assets are held to meet cash outflows during a severe but plausible scenario where there is a combined market-wide and Nationwide-specific stress, resulting in, among other things, in a multi-notch credit rating downgrade. In addition to a high-quality liquidity buffer, Nationwide maintains diverse funding sources and has contingency funding arrangements available for use in a stress.

The review considered all aspects of emerging regulation where there is sufficient clarity over future standards to inform the analysis. For example, our assessment of the Group's capital position reflects our latest understanding of capital buffer and leverage requirements likely to be imposed on the Group.

Information relevant to these assessments can be found in the following sections of the Annual Report and Accounts:

- The Group's principal activities, business model, and strategic direction are described in the 'Strategic Report' (pages 10 to 17);
- A financial summary, including a review of the latest income statement and balance sheet, is provided in the 'Financial Review' section (pages 18 to 26);
- A review of the Group's capital position is included in the 'Solvency risk' section (pages 118 to 121);
- The Group's liquidity position is described in the 'Liquidity and funding risk' section (pages 109 to 117); and
- The Group's top and emerging risks and policies and processes for managing principal risks are described in the 'Business and Risk Report' (pages 80 to 135).

Fair, balanced and understandable

The directors are satisfied that the Annual Report and Accounts, taken as a whole, are fair, balanced and understandable, and provide the information necessary for members and other stakeholders to assess the Group's position and performance, business model and strategy.

Details of the governance procedures that have been embedded to support this can be found in the Audit Committee report.

Directors

The directors of the Society who were in office at any point during the year and up to the date of signing the financial statements were:

David Roberts – Chairman	**Mitchel Lenson**
Joe Garner – Chief Executive Officer	**Kevin Parry** (appointed 23 May 2016)
Tony Prestedge – Chief Relationships and Distribution Officer	**Lynne Peacock**
Mark Rennison – Chief Financial Officer	**Roger Perkin** (retired 21 July 2016)
Chris Rhodes – Chief Products and Propositions Officer	**Baroness Usha Prashar** (appointed 18 January 2017)
Rita Clifton	**Tim Tookey**
Mai Fyfield	

The Board has agreed that in accordance with the UK Corporate Governance Code (see the Report of the directors on corporate governance) that all the directors will stand for election or re-election on an annual basis. In accordance with these requirements, all the directors will stand for re-election at the 2017 AGM apart from Joe Garner, Kevin Parry and Baroness Usha Prashar who are standing for election for the first time.

None of the directors have any beneficial interest in equity shares in, or debentures of, any connected undertaking of the Society. 56% of awards to directors from the 2016/17 Directors' Performance Award will be linked to the value of the Society's core capital deferred shares, details of which have been provided in the Report of the directors on remuneration. 50% of outstanding awards under the 2014/15 and 2015/16 Directors' Performance Awards and the legacy 2013-16 Medium Term Performance Pay Plan are also linked to the value of the Society's core capital deferred shares.

The auditors

A resolution to re-appoint PricewaterhouseCoopers LLP as auditors will be proposed at the Annual General Meeting.

David Roberts
Chairman, 22 May 2017

Report of the directors on corporate governance

For the year ended 4 April 2017

David Roberts

Dear fellow member,

I am pleased to deliver my second Corporate Governance Report as Chairman.

Our founding principles

Nationwide is the world's largest building society. For over 130 years, mutuality has shaped who we are, defined what we do and informed how we do it.

As a building society, we are owned by our members and are answerable to them. Your Board's mandate is for the long term success of the Society, which means we have responsibilities to current and future members. As Chairman, I am responsible for ensuring that your Board operates effectively within a sound governance framework, based on best practice principles suitable for Nationwide's status as a mutual. So, for example, we seek to adhere to the UK Corporate Governance Code.

Ensuring strong oversight

We were founded on the belief that ordinary people can achieve more together than they can on their own. To enable that, a strong governance framework is a necessary, but not in itself sufficient, condition for sustainable success. Many companies with strong frameworks have failed as beyond the rules there are principles that matter deeply, such as transparency, trust, openness and balance.

How our people behave is what determines whether we and our members prosper, so our culture is fundamentally important. We have seen all too many examples of bad things happening when companies do not behave as they say they will. Which is why, as well as determining strategy, overseeing management and taking responsibility for significant risks, the Board sets Nationwide's values and standards.

Your Board's commitment to good governance has served your Society well and we will always aspire to the highest standards in order to safeguard your interests. The Nomination and Governance Committee of the Board plays a major role in ensuring appropriate focus on governance as we adapt to new ways of doing business and the evolving regulatory landscape.

It is important to make sure that our governance arrangements stay fit for purpose and take account of changes in best practice. It is also important that our governance addresses the evolving risks and challenges we face as a modern mutual as our business adapts and grows to meet changing member and societal demands.

I assumed the regulatory responsibility of Whistleblowers' Champion from March 2016. This includes responsibility for ensuring and overseeing the integrity, independence and effectiveness of the firm's policies and procedures on whistleblowing. I also have responsibility for controls to protect whistleblowers from being victimised because they have disclosed their concerns. It is integral to Nationwide's culture that our people feel that they can confidently speak up if they see something that does not feel right. I am actively involved in supporting activities to raise awareness of our whistleblowing arrangements.

Strengthening and diversifying our leadership

Effective leadership is a prerequisite for good governance. A key part of my role is making sure we have the best possible people running and overseeing the Society. I would therefore like to thank my fellow directors for the care and commitment which they offer, the constructive challenge that they bring and their dedication to serving our members.

Following Joe Garner's appointment as Chief Executive Officer, the Board has supported the expansion and development of the Executive Committee, which has resulted in a wider range of skills and backgrounds serving your interests.

I am also responsible for ensuring that your Board collectively has the right mix of skills, diversity and independence to provide appropriate oversight of the business in what we believe will be a more dynamic, competitive and fast-moving retail financial services marketplace.

So I am delighted to report that during the year, we have been able to strengthen the Board with two new independent non executive directors. Further details are set out in the report of the Nomination and Governance Committee.

The appointments of Kevin Parry and Baroness Usha Prashar during the period have enhanced the Board's skills and experience across a range of areas.

Kevin brings deep knowledge of the financial sector as a result of his successful career in both executive and non executive roles in the financial sector and professional practice. Usha brings broad skills from the not-for-profit and public sectors and is one of the UK's most experienced policy advisors.

Since the year end we have announced the appointment of Gunn Waersted, a senior financial services executive with a 35-year career spanning financial services, telecommunications and petrochemicals, to the Society's Board from 1 June 2017.

Report of the directors on corporate governance *continued*

Listening to our members

The Board is determined that members' interests should be at the heart of everything we do. As our owners, our members, along with our employees, are stakeholders with a real say in how the Society is run.

So, as well as the AGM, for many years we have also held regular live TalkBacks around the country. Directors and senior management attend and members can raise any subject. In addition, every week the CEO and the Executive Committee meet a selection of branch and contact centre employees to hear feedback and review products and services with individuals who serve members every day.

We therefore support the government's call for greater representation of employees and customers in company decision making because we see the benefits that it has brought to Nationwide.

Refreshing our strategy

Following Joe Garner's appointment as Chief Executive Officer, he engaged all 18,000 of our people at Nationwide in 'The Big Conversation'. Together with feedback from members, this helped inform our refreshed strategy to make sure we deliver the services and customer experience our members want in 2017 and beyond. As a result, we have created a Colleague Panel to consider the 22,000 pieces of feedback we received.

Our strategy is based on building society, nationwide and we have defined five cornerstones which support our purpose and plan. They are:

- **Built to Last** – Being safe, secure, sustainable and dependable.
- **Building PRIDE** – Shared values, shared culture, doing the right thing.
- **Building Legendary Service** – Providing a service that is genuinely different – heartfelt, easy, lifelong and personal.
- **Building Thriving Membership** – Delivering real value to members.
- **Building a National Treasure** – Leading by example and making a difference.

Our ambition remains unequivocally 'member first'. Sometimes this involves difficult choices. For instance, in the current low interest rate environment, we have made conscious decisions over the year to balance the interests of our savers and borrowers – supporting our members during times of uncertainty.

2016/17 was another successful year for the Society. We now have over 15 million members and we continued to maintain a high standard of service, while managing our profits in the interests of members. Ultimately it is our people who deliver for our members day in and day out. Your directors will continue to set the tone for Nationwide and provide strong leadership for our people. I am confident the Board has the capacity and capabilities to continue to fulfil this responsibility for the benefit of you, our members.

David Roberts
Chairman

Governance at Nationwide

As the world's largest building society, Nationwide is owned by, and run for, its members. We are proud of, and committed to, our mutual status which sets us apart from other types of businesses. We compete with banks in areas such as current accounts, savings, mortgages and personal loans. However, as a mutual, Nationwide is different, we are owned principally by retail members who are also our customers and are therefore able to reinvest our profits into supporting lending to our members as well as improving products and customer service, and rewarding loyalty. During the year we have made conscious decisions, such as pledging to help savers and borrowers, which have contributed to a reduction in profits in the year in line with expectations, demonstrating our commitment to put members' interests first.

As a mutual, our overriding principle is doing the right thing for our members which is at the heart of everything we do. We also balance the interests of a number of stakeholders including employees, customers, suppliers, regulators and communities. Our governance structures are designed to ensure that decisions are underpinned by our PRIDE values which are described in the Strategic Report.

UK Corporate Governance Code principles

The Board adheres to best practice governance principles, in particular, the UK Corporate Governance Code (the Code). Although the Code sets the standards for public listed companies, the Prudential Regulation Authority (PRA) expects building societies to follow the Code where practical to do so. Where possible and appropriate, the Society aims to comply with the Code's principles and provisions to ensure alignment with good practice, transparency and openness. As the Code is not written with mutuals in mind, the Board has regard to the Guidance for Building Societies (June 2016 version) issued by the Building Societies Association (BSA) to assist building societies in applying the Code.

The Board considers that the Society has, throughout the period, complied with the principles and relevant provisions of the Code to the extent applicable to building societies; this report explains how it has done so. The format of this report follows the Code's key themes of leadership, effectiveness, accountability and member engagement.

This report covers the period commencing 5 April 2016 until the date of the report.

Report of the directors on corporate governance *continued*

Leadership and effectiveness

The role of the Board

As a major player in the UK financial services sector, it is imperative that we have in place robust risk management and control frameworks, including in relation to governance. Corporate governance is the set of internal standards and principles established by the Board to ensure sound and prudent control over the business. The Board sets the tone from the top and is responsible for promoting ethical leadership, culture, values, governance, controls and risk management. The Board relies on management, via the Chief Executive Officer, to cascade the agreed standards to the business. The Society's governance arrangements are communicated to the business through the Nationwide Governance Manual (NGM).

Nationwide's governance structure is based on the leadership principles in the Code. The Board is responsible for ensuring the sustainability of the business model in order to deliver long term success for members of the Society. The Board operates under formal terms of reference which include a schedule of matters reserved to the Board for decision, with the day to day running of the business delegated to the Chief Executive Officer. Key activities of the Board and its committees are planned and documented on an annual basis. The Board is also responsible for ensuring that the business is conducted in accordance with applicable laws and regulations including the Society's Memorandum and Rules.

The Board sets the strategy and high level remuneration policy which the Remuneration Committee ensures is implemented. Strategic objectives are documented in the Society's strategy which is reviewed in detail and approved by the Board annually and monitored regularly. This year, the Society's Plan has been reviewed and a revised strategy approved by the Board. Performance against the Plan is monitored on an ongoing basis using key financial and non-financial indicators, along with consideration of the principal risks which are explained in the Business and Risk Report.

In reviewing management's performance, the Board is concerned to ensure that management has the necessary skills and resources to deliver the Plan within a framework of sound systems and controls. The Board sets prudent but stretching targets for achieving the strategy whilst ensuring that key risks are adequately assessed and managed. Whilst adhering to the Plan is important, it is essential that the Society can respond in a timely and considered manner to member needs and the current fast paced and evolving market.

How the Board spent its time

As part of its ongoing responsibility for monitoring performance and holding the Chief Executive Officer and his Executive Committee ('the Executive') to account, the Board receives a number of regular reports and meeting minutes as well as keeping key components of the strategy, business performance and significant risks under review.

The following is a sample of some of the matters that the Board has considered during the year. For details of how the other committees spend their time, please refer to the individual reports:

Board responsibility	Key activity/items discussed
Members and other customers	• Review of analysis of how Nationwide is perceived by members, employees and the public from a reputational perspective • Updates on open banking and how it might improve the customer experience • Considering Nationwide's brand, marketing strategy and advertising campaigns • Feedback from the Member TalkBack programme • Approval of the AGM notice and documentation • Review of the analysis of the 2016 AGM and consideration of how to enhance member engagement
Strategy and performance	• Monthly reports from the Chief Executive Officer on performance and customer service metrics • Strategy refresh and implementation updates as well as updates on the outputs of The Big Conversation with employees • Product updates such as current account, savings and mortgage performance • How to balance the interests of our savers and borrowers • Reviewing the potential impact of the UK leaving the EU
People, culture and remuneration	• The culture within Nationwide and potential areas for development • Review of the remuneration and reward principles • Reviewing Nationwide's social investment strategy and activities

Report of the directors on corporate governance *continued*

Board responsibility	Key activity/items discussed
Finance and internal controls	• Monthly updates from the Chief Financial Officer regarding business performance, including profit, sales and retail performance, capital and liquidity • Review of economic and market assumptions • Review of the Financial Plan and efficiency initiatives • Approval of the interim management statements, interim and full year results • Approving payment of distributions • Stress testing results and analysis
Risk and compliance	• Updates from the Board Risk Committee Chairman as well as the Chief Risk Officer on the risk profile of the business • Regulatory engagement monthly reports, detailing interaction with both the Prudential Regulatory Authority and the Financial Conduct Authority • Updates regarding the Market Abuse Regime (MAR) and associated policies • Annual report of the whistleblowing officer[1] • Conduct risk considerations
Technology and security	• Progress of the Society's IT Security and Cyber Programme • Monitoring IT service and resilience and disaster recovery • Considering future IT innovations and their potential impact including, for example, cloud computing • Industry developments and the Government's updated Cyber Security Strategy • Cyber security updates
Governance	• Annual review of governance arrangements, for example review of the Board Composition and Succession Policy • Appointment of new non executive directors to expand and enhance the skills and experience of the Board and the re-election of the Chairman • Review of the Chairman's performance • Authorisation of the directors' register of interests • Appointment of the Society Secretary

[1] Operational oversight of the Society's whistleblowing arrangements (as per C.3.5 of the UK Corporate Governance Code) is provided by the Whistleblowing Committee.

How the Board committees spent their time

In order to ensure that adequate time is devoted to Board business, the Board operates through a number of formally constituted committees. The terms of reference of the Board and its committees are reviewed at least annually and can be found on the Society's website: **nationwide.co.uk**

The key activities of the Board and its committees are planned on an annual basis but also allow sufficient time for urgent or ad hoc matters to be considered on a timely basis. The Board has access to all committee minutes and receives regular reports from the relevant committee chairs on the business transacted at each committee meeting.

The Board committees are:

Audit Committee – the Audit Committee is chaired by Kevin Parry, an independent non executive director. Kevin, who was appointed to the role in July 2016, is an experienced audit committee chairman and is considered by the Board to have a competency in accounting and auditing as well as recent and relevant financial experience. The Board also considers that the Audit Committee as a whole has relevant sector experience. The work of the Audit Committee is to provide oversight of, amongst other things, financial reporting, internal and external audit, compliance oversight, internal controls and risk management systems. The Committee's work is detailed in the Audit Committee report.

Board Risk Committee – the Board Risk Committee is chaired by Tim Tookey, an independent non executive director with strong experience of major retail financial services organisations. Work of the Board Risk Committee is detailed in the Board Risk Committee report. The purpose of the Board Risk Committee is to provide oversight and advice to the Board in relation to current and potential future risk exposures and future risk strategy, including determination of risk appetite.

Report of the directors on corporate governance *continued*

Nomination and Governance Committee – the Chairman of the Board is also the Chairman of the Nomination and Governance Committee. The purpose of the Committee is to assist the Chairman in keeping the composition of the Board under review, to make recommendations to the Board on executive level appointments and to lead the appointments process for nominations to the Board. The Committee also reviews the Board's governance arrangements and makes recommendations to the Board to ensure that the arrangements are consistent with best practice.

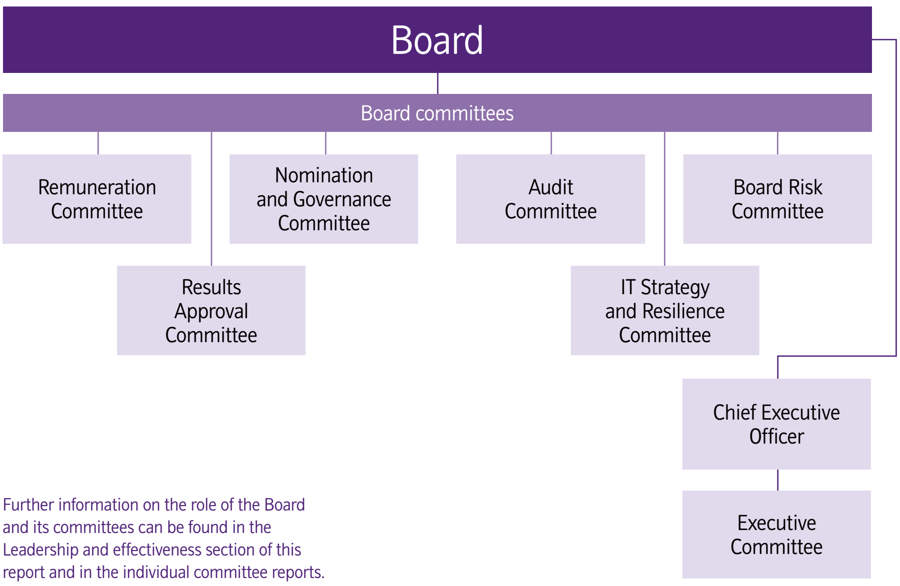
Remuneration Committee – the Remuneration Committee is chaired by Lynne Peacock, an independent non executive director who is also the Society's Senior Independent Director. The Board has delegated to the Committee authority to determine the framework for remuneration of the Chairman, the directors and other senior executives of the Society. A review of activities undertaken during the year is contained in the Report of the directors on remuneration.

Results Approval Committee – the Committee is chaired by the Chairman of the Board. The role of the Committee is to review and execute decisions made by the Board in relation to the Annual Report and Accounts, the Interim Results and the Interim Management Statements.

IT Strategy and Resilience Committee – the Committee is chaired by Mitchel Lenson, an independent non executive director. The purpose of the Committee is to provide oversight and advice to the Board on the IT strategy, architecture, delivery roadmap and architectural governance controls. The Committee also has oversight of the strategic investment portfolio and oversight of all individual programmes with an investment spend of over £50 million or of strategic importance. The work of the Committee is described in the IT Strategy and Resilience Committee report.

Board structure

An overview of the Board structure and its committees as at 4 April 2017 is set out below:



Further information on the role of the Board and its committees can be found in the Leadership and effectiveness section of this report and in the individual committee reports.

Report of the directors on corporate governance *continued*

Roles and responsibilities

The roles and responsibilities of Board members are agreed by the Board and set out in writing in role descriptions and in individual terms of service. These and any relevant statement of responsibilities were reviewed and approved by the Board in January 2016 to reflect the introduction of the Senior Managers Regime in March 2016. Given the influence they exercise over the Society's conduct, the Chairman, principal Committee Chairs and the Senior Independent Director are subject to all aspects of the Senior Managers Regime. In addition, all non executive directors are subject to the Conduct Rules. Whilst all directors must satisfy requirements relating to their fitness and propriety, the appointment of non executive directors who fall outside the Senior Managers Regime are no longer subject to pre-approval by the regulator. The collective and individual responsibilities of Board members are also set out in the Nationwide Governance Manual.

Terms of appointment for non executive directors are available on the Society's website. These and any relevant statements of responsibility can also be obtained from the Chief Legal Officer and Society Secretary on request.

Typically, non executive directors are appointed for an initial period of three years and may be invited to serve a second, or on occasion, a third term. This is subject to the overall Board composition and succession needs and helps ensure that the quality, skillset, knowledge and experience of the Board collectively best reflects the Society's needs from time to time. Where a non executive director serves a third term, the Board will review that director's continued service on an annual basis. All directors are required to stand for annual election by members.

There is a clear division of responsibilities between the Chairman, as leader of the Board, and the Chief Executive Officer who is responsible for the day to day running of the business. Key responsibilities of the Chairman, Senior Independent Director (SID), non executive directors and the Chief Executive Officer are summarised in the table below.

Role	Responsibilities
Chairman	• Provides leadership of the Board and ensures the effectiveness of all aspects of the Board's role. • Fosters a culture of open dialogue and mutual respect between the executive and non executive directors and facilitates an effective contribution from all directors. • Facilitates open and honest debate and constructive challenge of the executive directors. • Together with other Board members, sets the strategic direction and risk appetite of the Society. • Together with the other Board members, promotes the long term success and ensures the accountability of the Society to its members. • Promotes the interests of the Society. • Supervises and supports the Chief Executive Officer.
Chief Executive Officer	• Responsible for the day to day running of the business and accountable to the Board for the financial and operational performance. • Leads the Executive Committee to direct and co-ordinate the management of the business generally. • Implements and monitors systems for the apportionment and oversight of responsibilities, controls and best practices, policies and processes which maintain Nationwide's reputation for operational efficiency and high standards of business conduct. • Establishes and maintains effective working relationships with the Chairman, the Board and all directors and officers and is available to the Chief Internal Auditor, Chief Risk Officer and Chief Compliance Officer. • Establishes and maintains effective working relationships with regulators, the Government, industry sector analysts, trade organisations and the media and strategically influences and lobbies these bodies as and when appropriate in the best interests of Nationwide. • Promotes Nationwide, its good corporate image and social standing in the UK financial services industry.
Senior Independent Director	• Provides a sounding board for the Chairman. • Leads the annual review of the Chairman's performance by the Board. • Is available to directors and members should a situation arise where it is necessary for concerns to be referred to the Board other than through the Chairman or Chief Executive Officer.

Strategic Report
Governance
Business and Risk Report
Financial Statements
Other Information

Report of the directors on corporate governance *continued*

Role	Responsibilities
Non executive directors	• Collectively set the tone from the top, in particular in relation to culture and governance and hold the Executive to account for embedding and maintaining the Society's culture and values. • Contribute to the development of the strategy and risk appetite exercising effective oversight over risk management controls. • Monitor performance against the Plan. • Bring independent judgement, skills and experience to the boardroom and engage in open and honest debate, including constructive challenge and support to the executive directors. • Promote the long term success of the Society for the benefit of members and ensure that the Society meets its regulatory obligations as a regulated firm.
Executive directors	• As members of the Board, collectively with non executive directors, set the strategy, risk appetite, culture and values. • Submit proposals to the Board for decision or approval, ensuring timely and accurate management information to facilitate sound decision making. • Ensure that the Board is kept informed of all significant matters, escalating issues on a timely basis. • Are accountable to the Board for the execution of the strategy and the performance of the business. • Hold specific management responsibilities in the day to day running of the business.

Board composition

Biographies for all directors in place as at the date of this report are set out in the Board of directors section.

The Board is made up of a majority of independent non executive directors. As at the date of this report, the Board comprises the Chairman, seven independent non executive directors and four executive directors who collectively possess an appropriate balance of expertise suitable for Nationwide's business. Each non executive director not only brings a broad range of business knowledge and experience but also provides specific skills in key areas such as retail banking, information technology, strategy, brand, finance, risk and public policy.

Diversity

Improving diversity and inclusion at Nationwide has remained a focus for the Board throughout the financial year. The Board met the 2011 Davies Review target of 25% of women on the Board by July 2015. Following the appointment of Gunn Waersted on 1 June 2017, almost 40% of Nationwide's Board and over half of the non executive directors will be women. In addition, Nationwide has committed to increasing female representation to 33% by 2020 across the senior leadership population (Board, executive leaders and their direct reports) with an objective of building a strong pipeline of senior women. In order to enhance other aspects of diversity, the Board has also set a target for Black, Asian and Minority Ethnic (BAME) of 8% to 15% representation in the same senior leadership population by 2020. Further detail can be found in the report of the Nomination and Governance Committee.

Independence

All non executive directors have been assessed by the Nomination and Governance Committee to be independent as to character and judgement and to be free of relationships and other circumstances that might impact their independence.

David Roberts, Chairman, was deemed to be independent upon his appointment to the role of non executive director and Chairman Elect. As the Chairman commits a substantial proportion of his time to the role and represents Nationwide in a number of capacities, it is acknowledged that his independence will diminish during his tenure.

Board changes

During the year there have been a number of changes to the Board, detailed as follows:

- Joe Garner was appointed as Chief Executive Officer on 5 April 2016.
- Roger Perkin, Senior Independent Director and Chair of the Audit Committee, retired at the 2016 AGM having served on the Board for six years. Lynne Peacock succeeded Roger Perkin as the Senior Independent Director in July 2016.
- Kevin Parry joined the Board on 23 May 2016 and succeeded Roger Perkin as Chair of the Audit Committee in July 2016.
- Baroness Usha Prashar joined the Board on 18 January 2017.

With effect from 1 June 2017 Gunn Waersted will join the Board as an independent non executive director.

Appointments to the Board are generally led by the Nomination and Governance Committee. Further information can be found in the Committee's report.

Member nominations

Members of Nationwide have the right to nominate candidates for election to the Board, subject to the Society's own Rules and compliance with PRA and FCA requirements. No such nominations had been received by 4 April 2017, this being the deadline for election to the Board at the 2017 AGM.

Report of the directors on corporate governance *continued*

Attendance and time commitment

The Board met 12 times during the year, including an annual strategy conference in October 2016. The Board schedule is set in advance to allow adequate notice of meetings. It is recognised that new directors appointed during the year do not receive the same level of notice which might impact attendance during the early part of their tenure.

The attendance record for the Board members during the period is set out below. The table shows the actual number of meetings attended with the number of meetings for which directors were eligible to attend shown in brackets. The table only shows the attendance record for meetings at which directors are members. In addition, the executive directors are present at a number of the Committees as attendees. A list of regular attendees for each Committee is included in the respective Committee reports.

Attendance record for Board members

	Board	Audit Committee	Nomination and Governance Committee	Remuneration Committee	Board Risk Committee	IT Strategy and Resilience Committee	Results Approval Committee
Rita Clifton	12 (12)	7 (8)	-	11 (11)	-	-	-
Mai Fyfield	11 (12)	-	-	-	-	7 (7)	-
Joe Garner*	12 (12)	-	-	-	-	-	3 (3)
Mitchel Lenson	12 (12)	-	-	-	9 (9)	7 (7)	-
Kevin Parry**	9 (10)	7 (7)	3 (3)	-	6 (6)	-	2 (2)
Lynne Peacock	12 (12)	7 (8)	5 (5)	11 (11)	9 (9)	-	2 (2)
Roger Perkin****	4 (4)	2 (2)	2 (2)	-	5 (5)	-	1 (1)
Usha Prashar***	3 (3)	-	-	2 (2)	-	-	-
Tony Prestedge*	12 (12)	-	-	-	-	-	-
Mark Rennison*	12 (12)	-	-	-	-	-	3 (3)
Chris Rhodes*	12 (12)	-	-	-	-	-	-
David Roberts	12 (12)	-	5 (5)	11 (11)	-	7 (7)	3 (3)
Tim Tookey	12 (12)	8 (8)	5 (5)	-	9 (9)	7 (7)	-

Notes:
* Executive Directors
** Joined the Board on 23 May 2016
*** Joined the Board on 18 January 2017
**** Retired from the Board on 21 July 2016

All directors receive papers for Board meetings. These are delivered electronically, allowing directors to access information no matter where they are in the world. Should a director be unable to attend the meeting, the Chairman seeks the director's views in advance of the meeting.

The amount of time that non executive directors are expected to commit in the discharge of their duties is agreed upon an individual basis and depends upon their responsibilities. As part of the appointment process, the individual time commitment for non executive directors is agreed upon appointment and reviewed annually thereafter. For this year, the Chairman has individually confirmed with each non executive that they have been able to allocate sufficient time to fulfilling their duties. When considering the time commitment expected from each individual director, certain factors will be taken into account, for example whether the appointee is the Chair or member of one or more Board Committee, whether the director has any external executive director responsibilities and any relevant regulatory requirements. Typically, this time commitment equates to between 40 and 60 days per annum for a Committee Chair and a minimum of 30 days per annum for a non executive director who does not chair a Committee.

The Chairman will spend a minimum of two and a half days per week on Nationwide business. Details of his other directorships are listed in the Annual business statement.

Conflicts of interest

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

If any potential conflict arises, the Society's own Rules permit the Board to authorise the conflict, subject to such conditions or limitations as the Board may determine. In situations where a potential conflict arises, the director will excuse themselves from any meeting or discussion, and all material in relation to that matter will be restricted, including Board papers and minutes.

Report of the directors on corporate governance *continued*

Board effectiveness

The Board keeps its performance under review and formally evaluates its effectiveness on an annual basis. Following an external review, facilitated by Independent Audit Limited last year, in 2017 the Board has undertaken an internal effectiveness review with support provided by Independent Audit Limited, to ensure thematic continuity and comparability of output. The process was overseen by the Nomination and Governance Committee. Further information can be found in that Committee's report.

Accountability

The Board is accountable to the members of the Society and seeks to balance their interests with the broader range of stakeholders, including other customers, employees, regulators, suppliers and the wider community.

The Board is responsible for ensuring that a sound system of internal control is maintained to support Nationwide's strategy and objectives. The Board approves the risk appetite and metrics and stress testing results, including the Concurrent Stress Test, the Internal Capital Adequacy Assessment Process and the Individual Liquidity Adequacy Assessment Process. It receives regular reports and assessments of risk and control processes, and recommendations from the Board Risk Committee on matters spanning all major risk categories and risk appetite.

The Board is responsible for assessing the principal risks facing Nationwide, including those that could potentially threaten its business model, future performance, solvency or liquidity. These risks are set out in the Business and Risk Report which explains how they are being managed. To manage these risks effectively, the Board monitors the risk management and internal control systems and carries out an annual review of their effectiveness. The Board delegates detailed review of these to the Board Risk Committee and Audit Committee as set out below.

Board Risk Committee – The Board approves risk appetite. It has delegated responsibility for monitoring performance against appetite to the Board Risk Committee along with responsibility for approval of the Enterprise Risk Management Framework (ERMF) and principal risk management strategies. The ERMF is an enterprise-wide risk framework which defines how risk management should operate across the business. Further information about the ERMF is set out in the Business and Risk Report.

Audit Committee – The Board has delegated responsibility for reviewing the adequacy and effectiveness of internal controls to the Audit Committee. The Board has also delegated oversight of the management of the relationship with the external auditors to the Audit Committee, details of which are set out in the Audit Committee report. The Audit Committee receives reports from the external auditors, PricewaterhouseCoopers LLP, and has a discussion with the external auditors at least once a year without management present, to ensure that there are no unresolved issues of concern.

Audit Committee and Board Risk Committee – The Audit Committee and the Board Risk Committee receive regular reports throughout the year, which include information about reviews conducted by the Risk function and Internal Audit. The chairs of the Board Risk Committee and the Audit Committee are accountable to the Board to which both provide regular updates covering the committees' activities, providing an opportunity to highlight any potential areas of concern. During 2016/17 the Audit Committee and Board Risk Committee also held a joint meeting to allow for discussion and challenge of internal control and risk management issues relevant to both committees. Between them, the Audit Committee and the Board Risk Committee have reviewed all components of the ERMF, including the effectiveness of local risk and control management and reporting.

During the year, the risk management and internal control systems have been reviewed and, on the basis of this review, the Board is satisfied that Nationwide has an adequate system of risk management and internal control. The ERMF will continue to be enhanced to ensure it remains appropriate for the size and complexity of the organisation and is responsive to increased business sophistication, emerging developments and regulatory change.

Individual accountability – Individual accountability at Board and senior manager level has been strengthened during the year following the introduction of the Senior Managers Regime in March 2016. This established a revised framework under which senior managers are individually and personally accountable for specific areas of the business. It also introduced a certification regime requiring an assessment of the fitness and propriety of staff in positions where the decisions they make could pose significant harm to the business or customers. In support of this, all directors have access to the services and advice of the Chief Legal Officer and Society Secretary, and are able to obtain independent, professional advice on matters relating to their responsibilities.

Appropriate directors' and officers' insurance cover is maintained in respect of legal and regulatory claims against directors and officers in relation to Nationwide's business.

Under the Society's Memorandum and Rules, and to the extent permitted by law, directors have been granted an indemnity by Nationwide in respect of any third party liabilities which they incur as a result of holding office. This policy was in force during the financial year and at the date of approval of this report.

Further information on risk management and the performance of internal controls is set out in the Audit Committee report, the Board Risk Committee report and the Business and Risk Report.

Report of the directors on corporate governance *continued*

Listening to our members

As a mutual organisation, our members are also the owners of Nationwide and, as such, they need to be able to share their views on the overall direction of the business. We seek to ensure they can do this in a number of ways. Our aims are:

- to make it as easy as possible for members to talk to us in whichever way they prefer
- to listen and respond to their suggestions and comments with products and services built around their needs
- to include members in any activities they would like to be involved in.

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

Member involvement is such an important principle for us as a mutual. We work hard to make it as easy as possible for members to have their say and constantly work to improve our communication. Last year, we used research to make the paper pack more accessible to members, and as a result, saw a small uplift in members returning a paper ballot in the AGM. The online voting hub provided more information than ever before for members to make their decisions about how to cast their vote in the AGM, although the online turnout was down on the previous year. As has been the practice for a number of years, the meeting will be held at venues across the UK, meaning we are truly nationwide and accessible. This year, the AGM will be held at The ICC, Birmingham on Thursday 20 July 2017.

We also work throughout the year to communicate with our members as owners of the business, and to encourage feedback on the way we operate. The main ways in which we have done this during 2016/17 are as follows:

Face to face: Our popular Member TalkBack programme continued into 2016/17 with the delivery of eight events across the UK. Over 600 members took part in these events over the course of the year. These events aim to facilitate dialogue between our members and our Society's board directors and senior management, and 100% of members attending felt 'valued' or 'more valued' as a result of taking part. Of the 106 questions which have been answered, 99% of members thought the questions were answered fairly and honestly.

We also started a series of new branch activities for members, which saw us providing 'sneak peek' events for members before our new branches in Stratford and Belfast opened, as well as a series of engagement events to hear from members and the community in the run up to the Glastonbury branch opening.

Online: 2016 saw the very first Nationwide webinars being delivered for the benefit of members and potential members. Two webinars have been delivered so far, one for first time buyers, another for members wanting to find out more about digital innovation. The webinars proved to be a popular forum, with members rating them 3.8/5 stars and 82% saying that the 30-minute time slot was about right.

In addition, members can use our online Member Suggestion Scheme. We received over 1,000 ideas via this scheme during the year. Here are just a few of the member suggestions we have received over the past 12 months that we are working on:

- contactless credit cards
- showing 'pending transactions' on the mobile banking app
- recognising member loyalty through our proposition.

We review every suggestion we receive. To see past examples of why member engagement is so important to our Society, visit **nationwide.co.uk/about/why-choose-nationwide/all-about-membership**

Social media and e-newsletter: The number of followers on our main social media channels has increased by almost 40% over the last 12 months with content relating to our Voices campaign, social investment and fraud education generating the most engagement.

The research we commission: As well as the research we commission to find out how our members rate our service, we have around 5,000 members signed up to our online customer research panel 'Member Connect', which helps us by providing feedback on a variety of topics. Each week we ask them to take part in a survey. This year the panel gave us their views on topics like lending in retirement, our savings promises and cashless innovations. They can provide feedback on whatever is concerning them. We also ask them to take part in regular online discussions and polls. It's a two-way channel: every quarter we send out a newsletter recognising their contribution and telling them how their feedback has shaped our thinking.

Report of the directors on corporate governance *continued*

Audit Committee report

Committee members	Regular attendees	
Kevin Parry (Chairman – from July 2016)	Chairman of the Board	Chief Relationships and Distribution Officer
Rita Clifton	Chief Executive Officer	Chief Risk Officer
Lynne Peacock	Chief Compliance Officer	Director of Financial Reporting
Tim Tookey	Chief Internal Auditor (incl. interim)	Director of Financial Planning and Stress Testing
	Chief Financial Officer	Representatives from PricewaterhouseCoopers LLP
	Chief Products and Propositions Officer	

Former Committee members

Roger Perkin (Chairman until July 2016)

What does the Committee do?

The Committee provides oversight of, and reports to the Board on:

- Financial reporting covering the appropriateness of accounting policies and their applications including: the going concern presumption and business viability, the key judgements in the annual and interim financial results, the clarity of disclosures relating to accounting judgements and estimates and its recommendation to the Board as to whether the external financial reporting meets the principles of being 'fair, balanced and understandable'.
- Risk management systems and internal controls over financial reporting and procedures to prevent money laundering, financial crime, bribery and corruption.
- Internal Audit – the appointment or dismissal of the Chief Internal Auditor, the approval of the Internal Audit work programme, key audit findings and the quality of Internal Audit work.
- The approved work and key findings of the Compliance Oversight function.
- The relationship with the external auditors and the effectiveness of the external audit process. This includes: the independence of external auditors, reviewing the annual plan, the quality of the audit work and the appropriateness of the skills of the audit team, agreeing audit and non-audit fees and any external audit tender process.
- Oversight of the fulfilment of duties under the Senior Managers Regime of: the Audit Committee Chairman for the Internal Audit function and the Compliance function and the Chief Financial Officer for financial and regulatory reporting.

The Committee's terms of reference are reviewed and approved at least annually by the Board and are available at **nationwide.co.uk**

Committee governance

The Committee was in place throughout the year, held eight meetings and fulfilled its duties in accordance with its terms of reference.

Dear fellow member,

This is my first report to you as Chairman of Nationwide's Audit Committee. I am delighted to have inherited a well-established Committee and should like to thank my predecessor, Roger Perkin, for his hard work and diligence over the last six years, a period of significant change in the UK's financial services sector.

Thanks are also due to Matt Cheetham of Deloitte who was seconded to head the Society's Internal Audit function pending the recruitment of a full time Chief Internal Auditor. Matt did much to modernise the function and I look forward to working with Janet Chapman, who was recently appointed to take Internal Audit to the next stage of its development.

Report of the directors on corporate governance *continued*

Audit Committee report *continued*

In addition to our normal business, in 2016/17 the Audit Committee addressed:

- The development of the Internal Audit function under its new leadership.
- Preparations for the implementation of IFRS 9. The International Accounting Standards Board completed the final element of its comprehensive response to the financial crisis with the publication of IFRS 9 Financial Instruments in July 2014. The package of improvements introduced by IFRS 9 includes a logical model for classification and measurement, a single, forward-looking 'expected loss' impairment model and a substantially-reformed approach to hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018.
- The content of private reporting to the Prudential Regulation Authority (PRA) by the external auditor.
- Third party risk management.
- End to end process management.

We continue to work closely with the Board Risk Committee. We recognise that some matters are relevant to both the Audit and Board Risk Committees and so, in order to undertake our duties effectively, we have initiated an annual joint Audit and Board Risk Committee meeting to consider matters of common interest: the overall assurance plan; the annual compliance plan; the annual prudential risk management plan and the annual Internal Audit plan.

My report to you is structured in four parts:

- Governance
- Report on the year
- Internal Audit
- External audit.

Governance

All members of the Committee are independent non executive directors. Their attendance at Audit Committee meetings during the year is set out in the Report of the directors on corporate governance. After each meeting, I provide a verbal report to the Board on matters discussed by the Committee.

Membership and skills

The Board believes members of the Audit Committee have the financial, risk, control and commercial expertise required to provide effective challenge to management. Tim Tookey and I are considered by the Board to have competency in accounting and auditing as well as recent and relevant financial experience.

Individuals from the above table are regularly invited to meetings, but the Audit Committee typically meets privately for part of its meetings and also has regular private meetings separately with the Chief Risk Officer, Chief Internal Auditor and the external auditors. These meetings address the level of co-operation and information exchange and provide an opportunity for participants to raise any concerns directly with the Committee.

Duties

In carrying out its duties, the Committee is authorised by the Board to obtain any information it needs from any director or employee of the Society. It is also authorised to seek, at the expense of the Society, appropriate professional advice as needed. The Committee did not need to take any independent advice during the year.

Effectiveness

The Committee reviews its effectiveness annually. In 2016, an external review was facilitated by Independent Audit Limited. In 2017, the review was internally-led being designed in conjunction with Independent Audit Limited to ensure thematic continuity and comparability of output. The review confirmed the effectiveness of the Committee and determined that it would on occasion benefit from additional external perspectives.

Additionally, I met individually with each member of the Committee to discuss directly the effectiveness of the Committee. No important matters emerged.

Report on the year

Audit agenda

The Audit Committee has a rolling agenda comprising recurring business, seasonal business (notably financial and regulatory reporting) and other business (such as ad hoc investigations). As recurring business, the Committee reviews and discusses:

- Internal controls and risk management encompassing Internal Audit plans and reports; compliance plans and reports; financial control developments and responses to improvement recommendations
- Financial reporting, including accounting and financial reporting considerations and disclosures
- External audit, including the independence, scope and findings of PwC's audit and non-audit work
- Statutory and similar duties, such as reporting to regulators and providers of capital.

Detail of work

The focus of work in respect of 2016/17 is described below.

Financial reporting

The Committee reviewed the Society's accounting policies and confirmed they were appropriate to be used in the financial statements. There are no important changes this year but the Committee also considered future changes. The implementation of IFRS 9 (particularly in respect of loan loss provisions) is a complicated project and consequently the Committee regularly reviewed its progress so that the Society can comment on the impact of the implementation when reliable estimates are available during 2017/18.

The Committee believes that some non-GAAP (generally accepted accounting principles) measures, known as Alternative Performance Measures, can add insight to IFRS reporting and provide a more useful indication of long term operating performance (see 'fair, balanced and understandable' below). The Committee was content with the measures used, such as underlying profit, and the definitions of their quantification.

Report of the directors on corporate governance *continued*

Audit Committee report *continued*

The Committee reviewed the basis of accounting, including the going concern basis of preparation of financial statements and the business viability statement. We assessed profitability, levels of capital, availability of funding and liquidity, together with output of stress tests and reverse stress tests. We considered the cash flows resulting from its business activities and factors likely to affect its future development, performance and position, together with the assessment of principal risks as set out in more detail in the Business and Risk Report. We concluded that the profitability, balance sheet and capital position are robust, and that it remained appropriate to prepare the accounts on a going concern basis. As last year, we concluded that our work also supported the business viability statement for a three year period, which is within the period covered by the Group's medium term plan, regulatory and internal stress testing and the period over which important financial and regulatory changes typically emerge.

Significant time was spent on our review of the half year and full year financial statements, and also the interim management statements published in August 2016 and February 2017. In considering the financial statements, we discussed and challenged management's analyses, the external auditor's work and conclusions on the main areas of judgement.

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

Accounting estimates and judgements

In compiling a set of financial statements it is necessary to make estimates and judgements about outcomes that are typically dependent on future events. This year the more significant matters related to:

- **Impairment provisions for loan portfolios** – we debated changes to assumptions with management to ensure that they were fully substantiated and satisfied ourselves that the provisions properly reflected loan impairments. In the continuing low interest rate environment, it is particularly difficult to identify events leading to impairments. We concluded that it was appropriate to increase provisions relating to interest only mortgages, as well as making adjustments to the reference periods used to determine losses where arrears have not yet emerged. We were also satisfied that provisions were sufficient to cover cases of forbearance. We continue to scrutinise the adequacy of loan loss provisions in accordance with currently in force accounting standards. We anticipate that provisions will be higher under IFRS 9 as a result of moving from an incurred loss to an expected loss model.
- **Customer redress** – we keep abreast of customer conduct issues, always seeking to ensure that Nationwide behaves to high ethical and regulatory standards. Where mistakes have or might have been made, provisions for redress and related expenses are estimated. The Committee ensures that provisioning is based on realistic outcomes and up to date information such as the FCA's determination of the final period for PPI claims.
- **Defined benefit pension liabilities** – we reviewed key market and accounting assumptions used to calculate the pension deficit, comparing them to market data and assessing the sensitivity of the deficit to changes in those assumptions.
- **Impairments of fixed assets** – we reviewed the output of a review of the carrying value of fixed assets, particularly relating to capitalised hardware and software. We were satisfied with the quantification of impairments.

The Committee also reviewed and was satisfied that no issues arose in respect of management's application of the effective interest rate method, revenue recognition and hedging.

Fair, balanced and understandable

We considered and contributed to the overall presentation of the financial statements, culminating in our assessment of whether the Annual Report and Accounts 2017 are fair, balanced and understandable. We considered whether the overall portrayal of Nationwide is open and honest, whether we set out both our successes and our challenges, and whether we use language that a person with reasonable knowledge of financial sector financial reporting can understand. We considered whether the reporting was contextualised against the backdrop of our clearly defined strategy.

The Committee reviewed and was satisfied that the Alternative Performance Measures which complement the IFRS numbers give a more complete view of the performance of the business. For example, the Committee considered carefully and was satisfied that the gain on the sale of the stake in Visa Europe was properly treated and disclosed within underlying profit. Additionally, the Committee debated the measurement of the financial benefit delivered to members and was satisfied with the explanation of its quantification.

We were provided with a report by management setting out the review processes used to assess the overall presentation of the annual report and financial statements. This included an independent management review which concluded that the reporting was clear, consistent, balanced, open and appropriately focused on material items. After consideration of management's report and our own review, we concluded that we could inform the Board that, in our opinion, the Annual Report and Accounts were fair, balanced and understandable.

Report of the directors on corporate governance *continued*

Audit Committee report *continued*

Effectiveness of internal controls

To inform our consideration of internal controls, we received and discussed reports from a number of business areas, senior management teams and external sources during the year:

- **Compliance Oversight** – Compliance Oversight plays an important role in monitoring the Society's compliance with regulatory requirements and, critically, ensuring that we continue to deliver fair customer outcomes. The Audit Committee approved the compliance oversight plan for the year, and discussed with the Chief Compliance Officer the resources available to complete the planned programme of work. The Committee was satisfied with quarterly reports and an annual report setting out the overall results of their oversight work, the more significant issues and themes arising and the effectiveness of action taken to resolve issues.
- **Risk Oversight** – the Audit Committee discussed the annual Risk Oversight plan (that had been approved by the Board Risk Committee) alongside the Internal Audit and Compliance Oversight plans to ensure sufficiency and efficiency of coverage. Further information is in the report of the Board Risk Committee.
- **Financial Crime** – we received satisfactory reports on the steps taken and management's effectiveness in meeting its commitments to prevent financial crime and to avoid bribery, corruption and money laundering.
- **Financial Controls Framework** – we continued to focus on the Financial Controls Framework, the embedding of which further strengthened the internal control environment. Results of assurance testing were presented to and discussed by the Committee.
- **Reports from management** – during the year we invited members of the senior management team to our meetings to discuss the more significant issues raised by Internal Audit, Risk Oversight, Compliance Oversight and the external auditors. These discussions demonstrated to the Audit Committee that management takes internal control seriously, and that action is taken to resolve any important issues.
- **Internal and external audit reports** – the Audit Committee approved the Internal Audit plan for the year, and discussed detailed quarterly reports from Internal Audit as well as an annual report which gave an overall assessment of the effectiveness of internal control. The Committee received reports from the external auditors throughout the year. Details of both audit functions are set out below.

Internal Audit

Internal Audit plays a key role in providing independent assessment and challenge of governance, risk and control at Nationwide – it operates in line with its charter which is reviewed by the Committee every year. Internal Audit comprises approximately 80 people and is led by the Chief Internal Auditor who reports to the Committee Chairman. In addition, there are co-sourcing arrangements in place with Deloitte LLP and KPMG LLP which are used to support specific technical reviews. During 2016/17 the function completed approximately 110 internal audits. The Committee was particularly interested in the reports on the effectiveness of access management security, data security and management, commercial real estate lending, evidencing decision making, cross-divisional process management and the execution of change projects.

The Committee received regular reports from the Chief Internal Auditor on:

- The implementation of the approved plan and proposed changes to that plan.
- Key findings from completed reviews including the impact on financial reporting processes and related applications.
- The status of management's implementation of agreed improvement actions including the reasons for any rescheduling of committed actions.
- The assessment of the effectiveness of Internal Audit. In particular, the Committee reviewed a follow-up report to the last external assessment undertaken by EY and was satisfied with progress made in the year.

We monitored the adequacy of Internal Audit resources, including the financial budget and the availability of external specialists. We were satisfied that Internal Audit had adequate resources and continued to develop its sophistication, drawing on the findings of the prior year external quality assurance review.

During the year there was a process of succession for the Chief Internal Auditor, overseen by the Committee. This resulted in us approving the appointment of Janet Chapman to the role. Janet is an experienced auditor of banks and we anticipate she will bring her knowledge and experience to bear in developing the Internal Audit function in Nationwide.

I met monthly with the Chief Internal Auditor, and spent time with the Internal Audit team discussing the priorities for their work. The Committee attended a number of workshops with Internal Audit senior management, discussing audit planning and priorities.

Based on its review, the Committee concluded that the function continued to be effective and has determined that there should be an increased focus on customer conduct and service audits in the next financial year.

The external auditors did not place reliance on the work of Internal Audit this year.

External audit

The Audit Committee is responsible for oversight of the relationship with PricewaterhouseCoopers LLP (PwC), the external audit firm, and the effectiveness of the audit process. This includes making recommendations to the Board and subsequently to members on the reappointment of the external auditor, for determining their independence from the Society and agreeing the scope and fee for the audit. Following its review, the Committee recommended the reappointment of PwC prior to seeking the approval of members at the AGM.

The Committee also:

- Reviewed the proposed audit plan in advance of the annual audit.
- Approved the audit engagement letter and proposed audit fee.
- Reviewed and discussed formal reports provided by PwC.
- Reviewed the annual findings of the Audit Quality Review team of the Financial Reporting Council (FRC) in respect of the audit firm.

Report of the directors on corporate governance *continued*

Audit Committee report *continued*

- Reviewed PwC's transparency report for the year ended 30 June 2016.
- Scrutinised the findings of the FRC's Audit Quality Review team in respect of the Nationwide audit for 2015/16, and discussed them with the audit team. The Committee was satisfied with the audit team's plan to address the findings on their audit for 2016/17.
- Discussed the auditors' conclusions in respect of their work on privileged access to systems.

The Audit Committee considered the performance and appropriateness of the external audit firm embracing:

- **Independence** – the Board has an established policy setting out the non-audit services that can be sourced from the external auditor. The aim of the policy, which is reviewed annually, is to safeguard the independence and objectivity of the external auditors and comply with the ethical standards of the FRC. The policy specifies services that are permitted, prohibited or require pre-approval. The Committee monitors the implementation of the policy and considers proposals from management to use the external auditors for non-audit services. We challenged the appropriateness of the recommendations and the independence threats potentially arising. Additionally, PwC has confirmed that it has complied with relevant regulatory and professional requirements and its objectivity is not impaired. The Committee is satisfied that PwC remained independent throughout the year.
- **Audit and non-audit fees** – in addition to the independence policy set out above the individual and overall non-audit fees were reviewed. All fees payable to PwC, unless they are clearly trivial, are pre-approved by the Audit Committee. The fees are set out in the notes to the accounts. The Committee is satisfied that the non-audit fees as to their nature and quantum do not detract from PwC's audit independence and quality.
- **Audit quality and materiality** – the Committee places great importance on the quality and effectiveness of the external audit. The Committee looks to the audit team's continuing professional education, objectivity, professional scepticism, relationship with management, professional standards and performance against regulatory requirements. The Committee approved the audit engagement letter and determined the audit fee to be sufficient to allow PwC to perform its audit. In addition, the Audit Committee Chairman regularly meets the audit partner and interviewed the auditors on the work undertaken to support their opinion on the financial statements. The Committee has discussed the accuracy of financial reporting (known as materiality) with PwC both as regards accounting errors that will be brought to the Committee's attention and as regards amounts that would need to be adjusted so that the financial statements give a true and fair view. Overall audit materiality has been set at £52 million (2016: £50 million). This equates to approximately 5% of pre-tax profit. This is within the range that audit opinions are conventionally thought to be reliable.
- **Audit effectiveness** – a formal assessment was completed on the effectiveness of the external audit firm. A survey was carried out which considered their expertise and independence, including feedback from senior management. This found the external auditors and the audit process to be both robust and effective.
- **Audit firm appointment** – regulatory requirements for audit firm rotation require the Society to change its external audit firm no later than 2020. The Committee discussed the timing of firm rotation and concluded that we will appoint the successor firm in 2019 to carry out the audit of the 2019/20 financial statements. The tender process to select the incoming audit firm will commence in the summer of 2017, with a recommendation to the Board towards the end of the year. We are well advanced in our preparations for the tender which will be robust and thorough. I shall report on the process and its outcome next year.

If any member has feedback on the content of this report, I should be pleased to receive their comments.

Kevin Parry
Chairman – Audit Committee

Report of the directors on corporate governance *continued*

Board Risk Committee report

Committee members	Regular attendees	
Tim Tookey (Committee Chair) Mitchel Lenson Kevin Parry (appointed May 2016) Lynne Peacock	Chairman of the Board Chief Executive Officer Chief Financial Officer Chief Products and Propositions Officer Chief Risk Officer Chief Internal Auditor (incl. interim)	Chief Compliance Officer Chief Credit Officer Chief Relationships and Distribution Officer Director of Enterprise Risk Strategy Representatives from PricewaterhouseCoopers LLP

Former Committee members

Roger Perkin (member until July 2016)

What does the Committee do?

Responsible for:

- advising the Board on current and potential future risk exposures
- overseeing risk management as a whole at Nationwide
- monitoring the Enterprise Risk Management Framework (ERMF) including risk appetite, risk monitoring, and risk adjustments to remuneration.

Committee governance

The Committee was in place throughout the year and held nine meetings.

Further detail about the Enterprise Risk Management Framework (ERMF) including three lines of defence, risk appetite and the risk committee structure can be found in the Business and Risk Report.

Dear fellow member,

Over the past year, we have focused on continuing to build the Society's resilience to key risks in the interests of our customers, against a background of ongoing scrutiny of the banking industry, and the EU referendum increasing economic and political uncertainty in the UK and Eurozone.

My report to you is structured in four parts:

- Governance
- Report on the year
- Risk reporting
- Outlook.

Report of the directors on corporate governance *continued*

Board Risk Committee report *continued*

Governance

All members of the Committee are independent non executive directors and their attendance during the year is set out in the Report of the directors on corporate governance. Following each Committee meeting, verbal updates were provided to the Board, summarising Committee activities undertaken, areas where we have challenged management and key decisions taken by the Committee. This is accompanied by reports from the Chief Risk Officer.

Membership and skills

The Committee's membership is set out above with the Board believing that it contains the necessary breadth and depth of experience to provide effective challenge to management.

Duties

The principal purpose of the Committee is to provide oversight and advice to the Board in relation to risk-related matters. It allows for a subset of non executive directors to provide more focus on risk than would be possible in Board meetings. In addition to the regular attendees from management, we invite subject matter experts to present on a variety of topics to enable robust challenge of key risks facing Nationwide. At each meeting the Committee discusses, and challenges as appropriate, the current and emerging risk exposures of the Society.

The Committee also oversees the Executive Risk Committee, which is the management committee responsible for ensuring a co-ordinated risk management approach across all risks, and provides regular updates to the Board on areas where the Committee has challenged management and key decisions.

Effectiveness

The Committee reviews its effectiveness annually, as part of the annual Board effectiveness review. The 2017 review was internally-led, and took the form of online questionnaires, and interviews with Committee members and members of the management team. The 2017 review concluded that the Committee remains effective. It highlighted a number of areas for ongoing focus, including the need for more formal reporting from certain other committees, and a re-balancing of its agendas to increase the focus on more strategic items.

Report on the year

The Committee has balanced its agenda to ensure standing areas of risk management are addressed whilst maintaining flexibility to consider key risks that are escalated during the course of the year. Each review is accompanied by an independent second line opinion to ensure that the Committee receives an unbiased report. During 2016/17, the Society's risk profile has remained relatively stable. The Society has taken proactive steps to manage risk exposures before they materialise. The results of the latest Bank of England stress testing exercise demonstrate that Nationwide Building Society is resilient to a severe stress, and considerable time was devoted to assessing the lending and financial portfolios to ensure the Society remains strong and resilient. The Committee also has responsibility for overseeing the Enterprise Risk Management Framework (ERMF) and lending, financial, operational and strategic risk oversight teams and their independence and effectiveness, whilst the Audit Committee oversees the Compliance Oversight function.

Specific matters covered by the Committee in the year included:

ERMF

The Committee endorsed the Board's risk appetite for subsequent approval by the Board at the start of the financial year. We also discussed risk adjustments to executive remuneration including a full review of the Society's risk performance and risk events.

Regular governance updates included a review of the segregation of duties between the first and second lines of defence to ensure that both remain independent and effective. The Committee concluded that safeguards in place provided effective compensating controls for potential conflicts in segregation of duties and that management demonstrated good awareness of these issues.

A review of the ERMF's effectiveness was also completed to support the Committee in its responsibilities relating to the UK Corporate Governance Code requirements for risk management. The Committee was satisfied with the report and that Nationwide has an adequate system of risk management and internal control.

Lending risk

The Committee reviewed and approved the prime residential and specialist lending risk strategies and associated metrics to enable effective monitoring of these portfolios in September 2016. In addition, reviews into specific aspects of the secured lending portfolio were presented during the year for debate and challenge, including how Nationwide manages intermediary business and the Society's approach to collections and recoveries. The Committee was satisfied that the lending portfolios are being managed appropriately and specifically requested a review of high loan to value lending and an analysis of extreme, highly improbable scenarios ('tail risks') therein.

The Committee also discussed potential impacts of changes in the economy and the impact on our members whilst household debt levels remain high and pressures are being experienced in real wage growth.

We also debated the recent regulatory changes to the buy to let market and the Society's response to increased tax liabilities for landlords, as well as the risks associated with Nationwide's decision to cease new commercial lending. It was agreed that, with the planned mitigation, all residual risks would be within risk appetite.

Financial risk

The Committee reviewed the draft Internal Capital Adequacy Assessment Process (ICAAP) alongside Risk Oversight and Internal Audit opinions. There have been no significant changes in Nationwide's underlying risk profile and the Committee recommended the results to the Board for approval.

The Committee reviewed the Internal Liquidity Adequacy Assessment Process (ILAAP) in conjunction with the liquidity and funding strategy. After due consideration, the Committee considered that the liquidity and funding strategy remained appropriate and prudent, and recommended the liquidity and funding strategy and ILAAP to the Board for approval.

The Committee debated and approved the underlying economic and business assumptions related to the 2016 Concurrent Stress Testing exercise, including Risk Oversight and Internal Audit opinions. We satisfied ourselves that the assumptions were not over-optimistic and provided challenge and scrutiny of the results at a subsequent meeting.

Report of the directors on corporate governance *continued*

Board Risk Committee report *continued*

The Committee also reviewed the results of the 2016 reverse stress test, which aimed to explore relevant tail risk that would need to exist to get to the point of business non-viability. This stress test had considered ways in which material strategic risks might develop and the Committee discussed the potential liquidity risk associated with this scenario prior to approving it for submission to the Prudential Regulation Authority (PRA).

In June 2016, the Committee reviewed the Society's recovery plan and specifically discussed the scope of management actions and changes to Nationwide's recovery trigger framework before approving the plan for submission to the PRA.

In addition, the Committee reviewed the 2016 triennial funding valuation of the Nationwide Pension Fund and the associated de-risking strategy and approved the 2016 Pillar 3 disclosures for publication, noting that the process for creating the disclosures had been enhanced.

Operational risk

IT resilience continues to be a key area of focus for the Committee and in June 2016, the IT Disaster Recovery Plan was reviewed in detail in conjunction with the IT Disaster Recovery testing schedule. The Committee supported the 2016/17 test schedule and sought assurance that all key systems had been included and tested.

Other IT and resilience related risk strategies, including the risk of cyber attacks, are monitored by the IT Strategy and Resilience Committee on behalf of this Committee, to ensure these critical areas receive sufficiently detailed scrutiny and review.

Conduct and compliance risk

In November 2016, the Committee reviewed and, after due consideration, approved risk strategies associated with product and service design and review, sales, after sales, financial crime and firm and culture. Specific points of discussion included the definition of vulnerable customers and the need to review the Firm and Culture policy following its refresh.

The Committee considered Nationwide's culture, concluding that the Society continued to ensure fair outcomes for its members underpinned by a customer-centric culture. The Committee stressed the importance of Nationwide being clear on what it was trying to aspire to in terms of members, stakeholders and our people and agreed to consider redefining the Firm and Culture risk category to separate governance from culture. This work was conducted in the context of a wider review of culture undertaken by the Board.

The Committee also received regular updates on anti-money laundering sanctions screening capability and action being taken to improve underlying technology. The discussions around this topic demonstrated that management takes this area of risk management very seriously and that action is taken to resolve any important issues.

Strategic risk

In November 2016, the Committee reviewed risks to, and inherent within, Nationwide's strategy, as part of its refresh, in order to suggest a programme of future deep-dives for the Committee. These included, as an example, the consideration of a scenario that combined a steep rise in interest rates due to inflationary pressures with stagnant wage growth.

It also considered risks in the context of the EU referendum and the economic and political uncertainty in the Eurozone. The Society took specific measures to enhance liquidity and protect the financial stability of Nationwide ahead of the vote and Nationwide continues to regularly monitor this risk and ensures that management takes appropriate mitigating actions.

Risk reporting

Risk reporting is comprehensive across all risk categories (see the Business and Risk Report for details). The Committee considers Board risk appetite in detail and makes recommendations to the Board for its adoption. It then monitors performance against Board risk appetite and undertakes appropriate reviews on material risk issues to ensure that the Society remains within appetite. More granular risk appetite metrics are escalated when a trigger or limit has been breached to enable robust challenge of management's response to the issue.

In addition, the Committee considers longer term risks to delivering the Society's strategy and emerging issues that could present risks in the future. These top and emerging risks are presented within the Business and Risk Report.

The Committee also approved the oversight plans for the year (with the exception of compliance oversight, which is overseen by the Audit Committee) and discussed with the Chief Risk Officer the resources available to complete the planned programme of work. The Committee was satisfied with the quarterly reports which set out the overall results of oversight work, the more significant issues and any themes arising from the reviews.

Outlook

Over the next 12 months, the Committee will continue to focus on the top and emerging risks, monitor the macroeconomic environment, and ensure we deliver what is required by our regulators and other authorities. Other areas of focus will include risks associated with the execution of Nationwide's strategy, reviews into specific areas of risk, and the simplification of the ERMF to further improve its effectiveness. The Committee will also oversee the development of more insightful forward-looking management information. Expectations of the safety, security, resilience and ethics of financial institutions remain high and the Committee engages fully with management to oversee the continued strengthening of these within the Society's business operations to ensure that our customers' interests are safeguarded.

Tim Tookey
Chairman – Board Risk Committee

Report of the directors on corporate governance *continued*

IT Strategy and Resilience Committee report

Committee members	Regular attendees	
Mitchel Lenson (Committee Chair) Mai Fyfield (appointed May 2016) David Roberts (Chairman of the Board) Tim Tookey	Chief Executive Officer Chief Financial Officer Chief Compliance Officer Chief Internal Auditor (incl. interim) Chief Information Officer Chief Products and Propositions Officer Chief Relationships and Distribution Officer Chief Risk Officer Chief Transformation Officer Chair of the Audit Committee (optional attendee)	External experts: Usama Fayyad Mark Hartley Conrad Prince James S. Greene Lisa Stanton Further detail on the Committee's external experts can be found at **nationwide.co.uk**

Former Committee members

N/A

What does the Committee do?

The Committee is responsible for oversight of Nationwide's:

- IT strategy, architecture, delivery roadmap and architectural governance controls
- IT-related risk categories and review of the IT risk profile
- IT resilience strategy
- IT service delivery performance
- framework of IT systems, controls and procedures
- strategic investment portfolio.

Committee governance

The Committee was in place throughout the year and held seven meetings, including a deep dive on technology solutions.

Dear fellow member,

Nationwide recognises that online safety and the resilience of its IT systems are of fundamental importance to the day to day running of the business and safeguarding the interests of our members and customers. Over the past year, we have therefore focused on supporting the Society in building its resilience to key cyber risks and overseeing the IT strategy.

My report to you is structured in three parts:

- Governance
- Report on the year
- Outlook.

Report of the directors on corporate governance *continued*

IT Strategy and Resilience Committee report *continued*

Governance

All members of the Committee are independent non executive directors and their attendance during the year is set out in the Report of the directors on corporate governance. Following each Committee meeting, verbal updates were provided to the Board.

Membership and skills

The Committee's membership is set out above. During the year the Committee engaged five external experts to support the Society's continued commitment to digital innovation, the mobile channel, payments, data and security innovation. This engagement of external experts to support a Board sub-committee exclusively dedicated to IT strategy, technology, resilience, innovation and business transformation is believed to be one of the first of its kind in the financial services sector in the UK.

Duties

The Committee oversees IT strategy and governance controls and resilience risk strategies, including in relation to cyber security. The Committee reviews and monitors progress and makes recommendations to the Board Risk Committee. It also oversees the strategic investment portfolio.

Effectiveness

The Committee reviews its effectiveness annually, as part of the annual Board effectiveness review. The 2017 review was internally-led, and took the form of online questionnaires, and interviews with Committee members and members of the management team. The 2017 review concluded that the Committee remains effective, and highlighted a number of areas of focus, including the need to delineate IT strategy from business strategy, and to ensure that reviews of major programmes highlight key learnings.

Report on the year

The Committee has an agenda that is balanced between regular business and other issues that are escalated during the course of the year. Throughout the year the Committee has covered regular business such as: reporting on the level of service performance of the IT platform; reporting on the IT service, cyber and IT risk scorecard; updates on the information management architecture solution strategy; and the transformation portfolio – performance and risk review. Alongside this the Committee also received oversight opinions from both the Society's Compliance and Internal Audit functions to assist it in its challenge function.

Additionally, more specific matters covered by the Committee in the year included:

IT service

The Committee reviews IT service to our members on a regular basis. As our members are changing the ways in which they wish to transact (for example the increasing use of contactless payments and mobile banking), it is our role to challenge management as to how the Society's IT infrastructure and risk framework can support the needs of customers, ensuring a positive experience and providing a secure platform for their transactions.

IT strategy and cyber security

The refresh of the IT strategy, as overseen by the Committee, has led to an increased focus on cyber security, with the creation of a cyber security strategy, the set-up of a dedicated team and a Security Operations Centre (SOC), and a rolling programme of technology investments designed to keep pace with the increased rate, scope and sophistication of cyber threats to our systems and data.

Next generation digital and banking programme

The Committee has overseen the delivery of elements of the next generation digital banking programme, including the Society's updated App which offers greater functionality to customers and an improved experience. Nationwide Building Society's stated ambition is to be market leader in customer service and the Committee has received market insight to support delivery of this ambition which has already seen the Society be amongst the first to offer our customers access to Android Pay.

Open Banking

The Government's aim is that Open Banking will mean reliable, personalised financial advice, precisely tailored to particular individual circumstances delivered securely and confidentially. The Committee recognises that changes in society and technology are accelerating digital trends across all sectors. Alongside this, within the financial services sector there is also a regulatory catalyst for Open Banking to become a reality in the next 1 to 2 years. The Committee has considered what the future of digital banking could be and advised the Board as to Nationwide's progress, informing the strategic debate and helping to ensure that the Society remains well placed for the future and able to best serve its members.

Outlook

Over the next 12 months the Committee will continue to focus on the ongoing level of IT service including the changing cyber threat landscape. It will also focus on the delivery of the Society's strategic IT initiatives whilst also considering emerging technological trends that could potentially impact the ongoing delivery of service to our members. Of particular note will be the way in which we oversee the investment in our branch network whilst concentrating on how the changing use of technology will interact with it to enhance the overall member experience.

Mitchel Lenson
Chairman – IT Strategy and Resilience Committee

Report of the directors on corporate governance *continued*

Nomination and Governance Committee report

Committee members	Regular attendees
David Roberts (Committee Chair) Kevin Parry (appointed July 2016) Lynne Peacock Tim Tookey	Chief Executive Officer Chief People Officer Chief Legal Officer and Society Secretary

Former Committee members

Roger Perkin (member until July 2016)

What does the Committee do?

- Reviews the Board's governance arrangements, and makes recommendations to the Board on governance matters.
- Reviews the structure, size and composition of the Board so that it is effective in serving the interests of members.
- Reviews all director recruitment and on-boarding to ensure that leaders are selected and set up to succeed in fulfilling their responsibilities to members.
- Reviews the performance and development of directors to help them continue to be effective leaders now and in the future.
- Reviews talent and succession plans for director and senior management roles to ensure that there is a pipeline of talent ready to take on future leadership responsibilities.
- Sets the Board governance framework and provides oversight of governance arrangements.

The Committee's Terms of Reference are reviewed and approved at least annually by the Board and are available at **nationwide.co.uk**

Committee governance

The Committee was in place throughout the year and held five meetings for regular business.

Dear fellow member,

The Nomination and Governance Committee has continued to play a key role in ensuring Nationwide's corporate governance remains in line with best practice and that the Society has the right talent in place to support its strategic ambitions. The Committee has overseen the on-boarding of Joe Garner as Chief Executive and the ensuing organisational changes in support of the refreshed strategy. The composition and diversity of the Board has been further enhanced by the recruitment of two new non executive directors, ensuring the Board remains fit for purpose.

My report to you is structured in four parts:

- Governance
- Report on the year
- Organisational change
- Equality, diversity and inclusion.

Report of the directors on corporate governance *continued*

Nomination and Governance Committee report *continued*

Governance

The Committee comprises solely independent non executive directors. Their attendance during the year is set out in the Report of the directors on corporate governance. The Committee Chairman provided a verbal update to the Board following each Committee meeting.

Membership and skills

The Board believes members have the necessary range of skills and expertise required to provide effective challenge to management.

Duties

The Committee is responsible for ensuring that the Board composition is appropriate having regard to the current and future needs of the business, including succession planning for both Board and executive level positions. Along with the Chairman of the Society it is also responsible for ensuring that the Board has the right mix of skills, diversity and independence to provide appropriate oversight of all aspects of the business. The Committee oversees the appointment of non executive directors and is responsible for assessing the independence of non executive directors and for ensuring that they can commit the necessary time to their role. The Committee is also responsible for overseeing governance arrangements on behalf of the Board. In carrying out its duties the Committee is authorised to seek, at the expense of the Society, appropriate professional advice as needed.

Effectiveness

In addition to overseeing the annual Board effectiveness review, the Committee reviews its own effectiveness annually, as part of the Board effectiveness review. The 2017 review was internally-led, and took the form of online questionnaires, and interviews with Committee members and members of the management team. The 2017 review concluded that the Committee remains effective. It highlighted that the expansion of the Committee's role over the year to include governance matters had been successful. The review also underlined the need for the Committee (and the Board as a whole) to continue to monitor the pipeline of management talent.

Report on the year

The focus of the Committee's work in respect of 2016/17 is set out below:

Board composition

Making sure that the Board has the right balance of skills, diversity and independence is an important part of ensuring its effectiveness. The Committee keeps the composition of the Board under review to ensure that it provides effective oversight of all areas of the business, that it is equipped to deal with emerging challenges and that changes to the Board and its committees can be achieved without undue disruption.

The Board Composition and Succession Policy provides guidance on the size, structure and composition of the Board, including succession. A copy of the policy is available on our website: **nationwide.co.uk**

The Committee continues to review the skills and experience required to ensure that the Board is well placed to address the changing needs and challenges of the business. This helps inform decisions about the future composition of the Board and has guided our selection of new non executive directors to the Board this year.

Board recruitment

The recruitment process for non executive directors is overseen by the Committee and is designed to ensure that the Board collectively possesses the right range of skills and expertise to oversee the full range of business activities and brings appropriate objectivity and independent judgement. Accordingly, the recruitment process is rigorous and involves the use of an independent search firm, and a comprehensive selection process. All appointments are subject to extensive external checks.

Using this process, the Committee has presided over the following Board changes during the year:

- The appointment of Kevin Parry as Chairman of the Audit Committee in July 2016, fulfilling succession requirements for this important role. He has a strong background in the financial sector and significant experience of chairing audit committees both in and outside of retail financial services.
- The appointment of Baroness Usha Prashar in January 2017, bringing considerable experience and valuable insights into government and the public policy arena and strengthening the overall composition of the Board.
- The appointment of Gunn Waersted who will join the Board with effect from 1 June 2017, bringing her experience as a highly successful chief executive officer of both public and mutually owned businesses.

The Committee was supported by the JCA Group in relation to the appointment of Kevin Parry and Gunn Waersted. Usha Prashar was introduced by executive search firm, Audeliss.

In addition, the Committee had oversight of the process by which Lynne Peacock succeeded Roger Perkin as Senior Independent Director in July 2016.

Board induction and development

All new directors undergo a comprehensive induction programme, which is designed to help new directors make an early contribution to the Board. The induction programme is tailored to the individual needs of the individual director, as identified during the selection process, and will cover such matters as strategy, risk, culture, financial controls, products, members and people. It also includes meetings across the Society and visits to various branches and office locations.

Training for Board directors addresses a range of Society specific and market or regulatory matters. During the year, topics included conduct risk, core capital deferred shares and external perspectives on Nationwide. Board directors also have regular performance reviews and access to external learning resources to support their ongoing development and contribution.

Board effectiveness

The Board keeps its performance under review and formally evaluates its effectiveness on an annual basis. Following an external review, facilitated by Independent Audit Limited last year, in 2017 the Board has undertaken an internal effectiveness review with support provided by Independent Audit Limited, to ensure thematic continuity and comparability of output. The process was overseen by the Nomination and Governance Committee, and took the form of online questionnaires, and interviews with directors and members of the management team.

The results of the review were considered by the Board at its May 2017 meeting, and it was concluded that the Board remains effective. The output of the effectiveness review will be used as the basis for the Board's 2017/18 effectiveness plan, which will include the following priorities:

- enhancing the Board's understanding of the future needs of the Society's membership base
- enhancing the suite of forward-looking indicators to assess future changes in member behaviour and the broader market
- continuing to monitor and develop the pipeline of management talent
- further developing the role of the IT Strategy and Resilience Committee
- improving further the content and clarity of Board papers.

Report of the directors on corporate governance *continued*

Nomination and Governance Committee report *continued*

Talent, succession and leadership development

We remain committed to growing our own talent with good results as shown in the organisational change activity. During the last 12 months, over half of our senior vacancies were filled internally. We continue to review our succession plans and invest in a pipeline of talent to support this. Specifically, this year the Committee has considered succession plans for roles covered by the new regulatory regime and latterly the impact of the organisational changes on our future talent pipeline.

We are investing in the ongoing development of leadership capability, which focuses on the mindset and skills required to deliver our refreshed strategy and renewed PRIDE values.

Governance

The Committee seeks to ensure that the Society's governance framework facilitates sound decision making. It also ensures that due regard is paid to the interests of key stakeholders including members, customers, employees, regulators, suppliers and communities.

Key governance activities during the year included:

- Overseeing compliance with the Senior Managers Regime.
- Review of the Nationwide Governance Manual (NGM) and overseeing the Society's system of governance.
- Reviewing and making recommendations on the composition of the Board and its committees.
- Overseeing the register of directors' interests.
- Reviewing non executive directors' time commitments.
- Considering the implications of the Business, Innovation and Skills Committee corporate governance inquiry and the Government's Green Paper on Corporate Governance Reform.

Organisational change

Following the succession of Joe Garner to the role of Chief Executive Officer, all employees were engaged in 'The Big Conversation' to help inform the refresh of our strategy. Together with independent research, their feedback helped shape decisions about the future organisation design. In particular, the insights identified the need to create conditions for greater speed, agility and empowerment in respect of decision making through flatter structures. In turn, it is anticipated that this will help deliver the service and outcomes our members want and need and lead to greater efficiency.

This has resulted in the re-structuring of the Society into twelve Communities. Six new members joined the Executive Committee with four of these being progressed from within the organisation. At the next level 73.5% of new leadership roles were filled internally. The Committee provided oversight of these changes and we were pleased with the availability of good internal talent and the quality of external candidates we were able to attract. As a result, the Society has successfully transitioned through this period of change and is well positioned to deliver our refreshed strategy.

Equality, diversity and inclusion

The Society has made good progress with its equality, diversity and inclusion strategy this year. This has been achieved through a continued focus on awareness raising and education, including unconscious bias training for all people managers, new disability awareness online training and the development of an online toolkit for managers. In addition, Diversity Week 2017 featured external keynote speakers and opinion formers at a range of audience events that were open to all employees. Other activity has included a review of governance arrangements to ensure consistent levels of activity and reporting across the business.

We continue to endorse and leverage the power of employee network groups. Sponsored by senior leaders, these are groups of employees who share similar characteristics or life experiences and want to use those similarities to create cross-functional workplace connections, provide professional development, mentoring opportunities and advance business initiatives.

We have committed to increasing female representation to 33% by 2020 across the senior leadership population (Board, executive leaders and their direct reports). I am pleased to report that, due to our focus on strengthening the talent pipeline at executive level, we have achieved 29.3% female representation and we are therefore making excellent progress towards our target. Specifically, as of 4 April 2017, 50% of Nationwide's non executive directors are female. In 2016, we were proud to sign the HM Treasury's Women in Finance Charter. All our gender targets are updated annually in September and are published at: **nationwide.co.uk/about/media-centre-and-specialist-areas/women-in-finance-charter**

Our strategy also includes initiatives aimed at increasing representation in other areas, including ethnicity and disability. We have set an ambitious target of between 8% to 15% for BAME representation across the senior leadership population and, with current representation standing at 6%, we recognise that further attention will be needed to achieve this target. In relation to disability, we are working to develop greater understanding and confidence in this area, and encouragingly the numbers of employees who feel confident to disclose a disability continues to rise.

In closing, I would like to thank Committee members for their commitment throughout an active and productive year. The Committee continues to play an important role in ensuring that the Society has an effective Board and Executive, and it remains well-placed to support the Board in building sustainable success for the benefit of our members.

David Roberts
Chairman – Nomination and Governance Committee

Board composition			
Executive / Non executive membership			
Executive 4		**Non executive** 8	
Gender			
Male 8		**Female** 4	
Age			
45-50 3	**51-55** 4	**56-60** 2	**61+** 3
Tenure			
0-3yrs 6	**4-6yrs** 3	**6+yrs** 3	

Report of the directors on remuneration

For the year ended 4 April 2017

Lynne Peacock

Dear fellow member,

I am pleased to present the Remuneration Committee's report, including details of your directors' pay for the year to 4 April 2017. It is an important subject and I set out below for you how Nationwide seeks to attract and retain your management team.

Our approach

As a mutual, we start from a place where we want to be clear, fair, and reasonable with regards to remuneration. We believe in pay for performance, where that performance is directly linked to member interests. That is why we measure performance using drivers that are key to us, like outstanding service and thriving membership.

Our approach to pay is commensurate with our status as a mutual. For example, unlike many of our competitors, we choose to keep our performance pay capped at the regulatory maximum of 100% of fixed remuneration (base salary, pension and other benefits) rather than seeking members' approval to increase the cap, and we do not pay additional fixed allowances alongside salary.

Of course, we have to recognise that we compete for talent across the financial services sector and the broader market, so we need to strike a balance and be competitive too. We do that by looking for base pay and benefits to reflect market realities, but for performance pay to be lower than at most of our competitors for executive directors.

Our policy

During the year, the Committee undertook a comprehensive review of the remuneration policy of the Society as a whole, with the aim of ensuring that the way we pay our people is consistent with and supports the interests of our members. As a result, we are moving to an approach where all employees, including our executive directors, are assessed on the basis of the same measures and targets. In addition, our most senior team have tailored team and personal performance targets.

We propose that our policy will operate as follows:

- There will continue to be only one overall performance pay opportunity for our executive directors (the Directors' Performance Award or DPA) based on the achievement of challenging Society, team and individual objectives.
- For 2017/18 there will be two elements to the DPA: one in which all employees including executive directors participate on the same basis; and a second for our most senior population (again, including executive directors) and which is subject to long-term deferral. The Society's performance will be assessed by the same measures and targets for both elements of the plan.
- Overall, target and maximum opportunities for management remuneration will fall modestly. For executive directors, we have reduced the 2017/18 performance pay opportunity to a target of 98% of salary and a maximum of 152% of salary for the Chief Executive and a target of 78% of salary and a maximum of 112% of salary for other executive directors. Previous maximums were 160% and 120% of salary respectively.
- Senior awards are also being deferred for longer – extended to seven years. Deferred awards remain subject to adjustment for risk and may be reduced or reclaimed for up to ten years from the award date.

We would like to invite members to vote on our proposed policy, as described further below.

New Chief Executive

Joe Garner joined the Society as our Chief Executive on 5 April 2016 and details of his remuneration package were disclosed in last year's report. On joining Nationwide, Joe Garner forfeited outstanding incentive awards from previous employers and the Committee agreed to provide compensation for an element of these awards, as set out below:

- Cash payments totalling £589,029 payable in four instalments between July 2017 and August 2018; and
- A deferred award with an initial value of £481,723 linked to the value of the Society's core capital deferred shares (CCDS) payable in three instalments between April 2016 and March 2018.

This buy-out compensation is no more generous in terms or amounts than he would have otherwise received from previous employers, and the outstanding amounts remain subject to his continued employment with Nationwide. They may also be subject to repayment if he resigns or is dismissed for gross misconduct within two years of receipt.

Report of the directors on remuneration *continued*

How the directors have performed

Our leadership team has delivered strong performance this year, driven by our consistent focus on putting the needs of our members first. We continue to be ranked number one for customer satisfaction amongst our high street peer group[1]. The number of active members is at a record high and we have grown main product relationships with over 7.8 million customers. Underlying income and profit have increased[2] and we strengthened our capital position. Our cost income ratio is robust and we continue to invest in new products and technologies.

The impact on directors' performance pay

Our strong results have led to payments being awarded under the DPA. Details of how these payments have been calculated are set out in this report. In achieving the stretching targets which they were set, the Committee considers that our directors have delivered real benefits for the Society and all our members.

Member voting on remuneration

There will be two separate member votes on remuneration this year. The first will be on our remuneration policy, as outlined above. Our remuneration policy was last approved by our members three years ago at the 2014 AGM and, in line with best practice, we are therefore submitting our Policy Report to an advisory vote again this year. It is not intended that any other payments to directors be made outside of this policy, other than as a result of regulatory change.

The second vote will be the annual advisory vote on our Annual Report on Remuneration outlining our approach during 2016/17 and how we propose to implement the new policy during 2017/18.

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

Lynne Peacock
Chair of the Remuneration Committee

Policy Report

Remuneration policy for executive directors

Our pay policy and framework for senior executive roles is set at a level which enables us to motivate, reward and retain our leadership team to deliver value for our members. Our intention is to reward our executives at a level which is fair but not excessive. In summary:

- Base salaries are reviewed annually and are set taking into account market levels of pay.
- We believe in pay for performance, and operate a performance pay plan which rewards our executive directors for the achievement of challenging key performance objectives based on the Society's Plan.
- The performance of executive directors is assessed against a balanced scorecard of measures which focus on delivering benefits for our members and reflect our mutual interests. This approach means that executive directors are not encouraged to focus on performance in a single area at the expense of other priorities.
- The Remuneration Committee seeks input from our Audit and Risk Committees when determining incentive payments to ensure the level of reward is appropriately adjusted for risk.
- The award levels as a percentage of base salary under our performance pay plan are below those of our main competitors. This means that the maximum potential total remuneration levels for our executive directors are below the market median.
- Our performance pay plan incorporates features to encourage sound risk management practices. These features include deferral of part of our performance pay and the ability of the Remuneration Committee to reduce or cancel the deferred element if it emerges that the original assessment of performance was misleading or if performance declines substantially over the deferral period.

The policy summarised in the table on the following pages will apply from the 2017 AGM.

[1] © GfK 2017, Financial Research Survey (FRS), 12 months ending 31 March 2017 vs 31 March 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).

[2] Correction: The statement included in the original text above that "Underlying income and profit have increased" is incorrect and was included in error. As noted elsewhere in the Annual Report and Accounts both underlying income and profit were lower in 2017 than in 2016. In the year to 4 April 2017 underlying income was £3,285 million and underlying profit was £1,030 million whereas in the year to 4 April 2016 they were £3,333 million and £1,337 million respectively.

Report of the directors on remuneration *continued*

Summary of remuneration policy for executive directors – Fixed pay

	Purpose	Operation	Opportunity	Performance metrics
Base salary	Provides base salary that is market competitive and reflects the size and complexity of the role.	Base salary is normally reviewed on an annual basis. Any changes are normally effective from 1 April.	Whilst there is no maximum, base salaries are set taking into account market data for similar roles in the financial services sector. Other factors considered include the individual's skills, experience and performance and the approach being taken on salaries in the wider organisation.	Not applicable.
Benefits	Provides a market competitive package as part of fixed remuneration.	Benefits may include a car allowance, access to shared drivers when required, healthcare and insurance benefits. Other benefits may be provided to enable recruitment/retention or relocation.	Whilst there is no maximum value to the benefits provided, benefits are reviewed regularly to ensure they remain appropriate. The value of benefits may vary depending on service providers, cost and market conditions. Additional benefits may be provided if considered necessary to secure/retain an individual.	Not applicable.
Pension	Provides post-retirement benefits for participants in a cost efficient manner.	Executive directors receive a cash allowance in lieu of pension. M M Rennison is a deferred member of the Group's defined benefit plan.	Cash allowances are set as a percentage of base salary in accordance with pre-existing terms of employment. The maximum pension allowance payable is 40% of base salary. The defined benefit plans are no longer open to new joiners and would only be used for an executive director where an individual is promoted to the Board with an existing entitlement. The maximum accrual rate that would apply under existing defined benefit schemes is 1/60th of their pensionable salary for each year of service.	Not applicable.

Report of the directors on remuneration *continued*

Summary of remuneration policy for executive directors – Variable pay				
	Purpose	**Operation**	**Opportunity**	**Performance metrics**
Our performance pay plan, the **Directors' Performance Award** (DPA), comprises two elements: (i) an all-employee element. (ii) an element in which the most senior team participate subject to deferral provisions.	Rewards achievement of stretching Society, team and individual targets for a single financial year, with payment spread over the longer-term.	*All-employee element* Awards are normally paid in cash following the end of the financial year based on performance achieved in the year. Operates on the same basis for all employees. *Senior team element* At the end of the one year performance period an award is made to reflect achievement against performance metrics. The award is paid in cash across six payment dates. Not more than 40% of the total performance pay award is paid after the end of the performance period and at least 60% is deferred for between three and seven years in line with regulatory requirements. A minimum of 50% of both the upfront and deferred elements is linked to the value of the Society's core capital deferred shares (CCDS) and subject to a twelve month retention period. The Remuneration Committee may reduce or cancel payments under the DPA if it believes that the plan outcomes are not representative of the overall performance of the Society. (note i)	The targets set in the Society's Plan need to be achieved to generate a 'target' award, and considerably exceeded to generate the maximum award. Under the all-employee element, all employees, including our directors, receive the same percentage of salary award. The overall maximum opportunity varies by role (see below) but will not exceed the limit laid down by regulatory standards. (note ii) Maximum DPA award levels (i.e. under both elements combined) by role are: • 152% of base salary for the Chief Executive • 112% of base salary for other executive directors.	Detailed performance measures are approved by the Remuneration Committee to reflect the priorities of the Society. (note iii) Performance may be assessed against a broad range of financial, strategic, team and individual measures, with performance being assessed over one year. The weighting of performance measures will be reviewed annually, with the Committee having the ability to adjust the weighting from year to year to recognise particular financial and strategic priorities. However, not less than 60% of the senior team element will be based on Society performance measures. The Remuneration Committee has discretion to make adjustments to performance targets to reflect significant one-off items which occur during the performance period.
Summary of remuneration policy for executive directors – Other				
Regulation	Provision to ensure regulatory compliance.	In the event that regulatory standards change, the Remuneration Committee has discretion to make any changes to ensure regulatory compliance, even if a revised policy has not been put to members for an advisory vote. Any such changes would be included in the policy report at the next AGM.		

Notes:

i. In determining out-turns under any performance pay plan, the Committee takes into account performance against targets and considers performance on a risk-adjusted basis, evaluating progress against defined measures of risk within the context of our Group Risk Appetite. This is a formalised process, which also includes input and feedback from the Audit and Risk Committees. In this manner, the Committee has discretion to reduce an employee's performance pay in relation to risk-related matters.

In addition, the Committee regularly reviews whether prior year payments remain supported by the overall performance of the Society. In certain circumstances the Committee has discretion under malus and clawback provisions to reduce or cancel all or part of these payments. Such circumstances may include but are not limited to material misstatement, or under-performance which may be directly attributed to management decisions. The period during which awards are subject to clawback may be extended to up to ten years in some circumstances.

ii. Regulations currently require that the maximum level of variable pay (performance pay under the DPA) cannot exceed 100% of total fixed remuneration (base salary, pension payments and other benefits). For the purpose of calculating the value of variable pay for this ratio, a discount can be applied to up to 25% of the variable pay element to take account of the payment timescale (time value of money), provided it is paid in instruments that are deferred for at least five years. Details of how the discount factor may be calculated can be found at www.eba.europa.eu.

iii. Performance measures are selected by the Committee each year to reflect the priorities of the Society. The Committee sets targets based on those measures at a level which it considers appropriately stretching in relation to the Society's Plan and overall risk appetite.

Report of the directors on remuneration *continued*

Remuneration arrangements throughout the Society

The remuneration policy for our executive directors is designed in line with the remuneration philosophy and principles that underpin remuneration for the wider Society. Within this framework, whilst there are differences in reward opportunity across seniority levels, individuals are incentivised towards consistent business goals and objectives. Indeed, the all-employee element of the DPA operates with the same performance measures and same opportunity levels (as a percentage of salary) for all employees, including executive directors.

Prior contractual commitments and awards under legacy incentive plans

Any contractual commitments or performance pay awards entered into in accordance with the previous policy, before the current disclosure regulations came into force or before a person became a director will be honoured.

There are outstanding awards which apply to directors made under arrangements which are not part of the forward looking policy effective from the AGM. Payments will be made under these legacy plans following the AGM (in satisfaction of these historic awards), and therefore they form part of this policy.

In particular, individuals may hold outstanding awards under our previously operated performance pay plans, including the Directors' Performance Pay Plan (DPPP), the Directors' Performance Award (DPA) and the Medium Term Performance Pay Plan (MTPPP). Outstanding awards under previously operated performance pay plans will continue to be paid out, subject to performance and other conditions where relevant, in line with their original payment schedules.

Remuneration Committee discretion

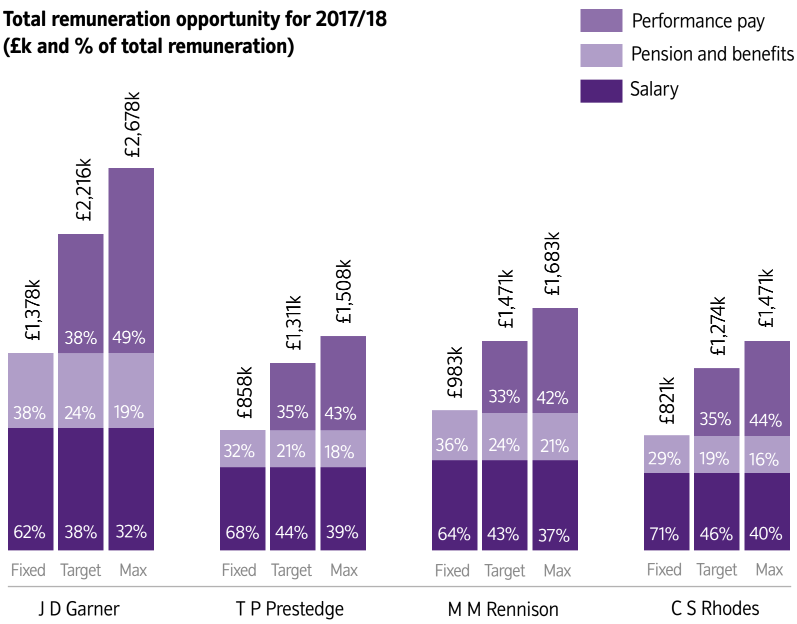
The Remuneration Committee reserves the right to reduce (including to zero) or defer any payments made and has discretion to reduce the size of payments made to take into account risk or other factors.

What our executive directors could earn in 2017/18 based on performance

The chart below illustrates the amounts that executive directors would be paid under three different performance scenarios:

- **Fixed remuneration** – this shows the fixed elements of pay (base salary, pensions and benefits).
- **Target** – assuming we deliver target levels of performance against the measures set out in our performance pay plan.
- **Maximum** – assuming performance pay arrangements pay out in full. This would only occur where performance has been truly exceptional across all of the measures set.

Total remuneration opportunity for 2017/18 (£k and % of total remuneration)



Breakdown of fixed remuneration for 2017/18 (£'000)	J D Garner	T P Prestedge	M M Rennison	C S Rhodes
Salary	855	580	625	580
Pension	342	191	206	191
Benefits (2016/17 actual)	181	87	152	50
Total fixed remuneration	**1,378**	**858**	**983**	**821**

Report of the directors on remuneration *continued*

Recruitment policy

If a new executive director is recruited, the Remuneration Committee will as far as possible determine their ongoing remuneration package as set out in the policy table.

On the appointment of a new executive director, the Remuneration Committee would consider whether it was necessary to offer a higher maximum award level under our performance pay plan in order to secure the desired candidate. Any such increase would remain within the overall limit laid down by regulatory standards and would only be applicable for the period of twelve months following appointment.

The Remuneration Committee may also consider whether it is necessary to offer any one-off arrangements on the recruitment of a new executive director to buy-out performance pay and any other remuneration arrangements from current or previous employers. In making any such offer, the Committee will seek to ensure that the buy-out is on materially similar terms to the arrangements being forfeited in terms of their value and vesting dates, and take into account the extent to which performance conditions applied to the original awards. Where possible, any buy-out will be structured within the parameters of our existing performance pay plan. If there is not sufficient scope to compensate the individual through our existing performance plan, an individual tailored plan would be put in place. In line with regulatory requirements, buy-out awards may continue to be subject to malus and clawback provisions at the discretion of the individual's previous employer.

Although our intention would be to offer any new director benefits in line with the policy set out in the policy table, if individual circumstances required this, the Remuneration Committee would consider offering a new recruit such additional benefits as might be required to secure their services.

Service contracts and policy on payments to departing directors

Executive director	J D Garner	T P Prestedge	M M Rennison	C S Rhodes
Service contract effective from	5 April 2016	28 August 2007	1 February 2007	20 April 2009
Date first appointed to the Board	5 April 2016	28 August 2007	1 February 2007	20 April 2009

Executive directors' terms and conditions of employment are detailed in their individual contracts which include a notice period of 12 months from the Society to the individual and a notice period of six months from the individual to the Society. The notice period offered to any new recruit would be in line with this approach. Each contract includes a provision for a termination payment in lieu of notice up to a maximum of 12 months' base salary and benefits, with the exception of C S Rhodes and J D Garner whose contracts provide for payment in lieu of notice up to a maximum of 12 months' base salary only. The settlement offered to an executive director on termination will depend on the circumstances of their departure.

Leaver provisions

If an individual leaves in good leaver circumstances (defined as redundancy, retirement, ill health, death or by mutual consent, e.g. for redundancy/succession planning purposes), they would, subject to approval by the Committee on an individual basis, normally be offered a payment in lieu of notice covering 12 months' base salary, contractual benefits, pension accrual (or cash alternative, on a cost neutral basis for the Society) and pension allowance, subject to mitigation (as described below).

In respect of the DPA from 2017/18:

- Where an individual leaves during the performance year in good leaver circumstances they may, at the Committee's discretion, receive a pro-rata award for the period of time served, the deferred portion of which will lapse and not be paid.
- Eligibility for deferred payments is normally subject to continued employment during the first four years of the plan cycle, including the initial performance period.
- Where an individual leaves in good leaver circumstances following the end of the relevant performance year they will normally receive 25% of the deferred award for each full year served under the plan, including the current performance year.
- The Remuneration Committee retains the discretion to adjust the proportion of the deferred payments that are retained by a leaver based on the facts and circumstances of the departure. Furthermore, following departure, the Remuneration Committee may still also reduce or cancel payments if it believes that the plan outcomes are not representative of the overall performance of the Society.
- Retained awards and deferred plan payments are paid at the usual payment date although the Remuneration Committee will have discretion to accelerate any payments to the leaving date in exceptional circumstances.

In respect of performance pay plans in operation for financial years prior to 2016/17, some awards are retained or deferred. For these plans, the following would be offered:

- Awards which are subject only to the retention period would be paid in full on the normal dates for the plan, subject to continued performance adjustment requirements.
- Any outstanding deferred payments under the DPA would be paid on the normal payment dates, subject to continued performance adjustment requirements. Awards would normally be pro-rated for time served over the initial three year deferral period although the Committee may increase the proportion of the deferred payments that are retained by a leaver based on the facts and circumstances of the departure.

Depending on the individual circumstances, the Remuneration Committee retains discretion to allow a departing director to continue to participate in other outstanding cycles of any performance pay plans, to waive the application of the Early Retirement Factor under the Pension Scheme, or to make any other compensatory award that might be deemed appropriate.

Individuals who leave in other circumstances (e.g. resignation) would receive only contractual payments to which they are entitled and would not receive any payment in respect of performance pay plans, unless the Remuneration Committee determines there is a due case for discretion.

Mitigation

The Remuneration Committee's policy is that payments in lieu of notice should be made in monthly instalments and subject to mitigation (where contractually enforceable), although the Committee has discretion to waive this if this is considered appropriate in individual circumstances. All of the current executive director contracts allow for mitigation. This means that after leaving Nationwide, should they start employment elsewhere, any outstanding payments in lieu of notice due from Nationwide will lapse and not be paid.

Report of the directors on remuneration *continued*

Remuneration policy for non executive directors

Summary of remuneration policy for non executive directors	Purpose	Operation	Opportunity
Chairman and non executive director fees	Provide a market competitive fee level for the role at Nationwide.	The Chairman's fee is normally reviewed and approved by the Remuneration Committee on an annual basis. Non executive director fees are normally reviewed and approved by the executive directors and the Chairman on an annual basis. Non executive directors are paid a basic fee, with an additional supplement paid for serving on or chairing a Board Committee. The Chairman and non executive directors do not take part in any performance pay plans or in any pension arrangements. Benefits may be provided if considered appropriate. Any changes are typically effective from 1 April.	Whilst there is no maximum level, fees are set taking into account practice at other organisations as well as the time commitment for the role at Nationwide.

Consideration of employment conditions elsewhere in the Society

The pay and conditions of the broader employee population are taken into account when determining executive remuneration. The Remuneration Committee reviews base salary levels, other elements of fixed remuneration and details of performance pay plans offered to all employees each year, and is always mindful of ensuring that the pay policy for senior roles is consistent with the culture and values of the Society as a whole.

Our policy is to offer packages which are competitive with the financial services market in which we operate and where individuals are rewarded for delivering value to members.

The individual elements of remuneration offered vary between the different roles. For example, benefits provision is tailored to reflect typical market practice for different roles.

A copy of the policy was shared with the Nationwide Group Staff Union in advance of publication. However, there was no formal consultation. Those employees who are also members of the Society will be able to vote on the Policy Report and the Annual Report on Remuneration.

Consideration of member views

At recent AGMs we have received a significant majority vote in favour of our remuneration reports. We are also mindful of views expressed by individual members regarding specific aspects of the policy. When taking decisions on remuneration policy, the Remuneration Committee is always conscious of the need to ensure executives are motivated and rewarded to deliver value for our members.

Annual Report on Remuneration

Base salary

The table below sets out the base salary levels for executive directors which were in effect during the year and their revised salaries as at 1 April 2017. An overall aggregate increase of 2.2% applies across the executive directors, which is in line with the pay review for the wider employee population. Note that the increase of 3.6% for Mr Prestedge is to recognise he is now undertaking a broader role.

Base salary	2017/18	2016/17	% increase
J D Garner (note i)	**£855,000**	£840,000	1.8%
T P Prestedge	**£580,000**	£560,000	3.6%
M M Rennison	**£625,000**	£614,000	1.8%
C S Rhodes	**£580,000**	£568,000	2.1%

Note:

i. J D Garner became Chief Executive on 5 April 2016

Report of the directors on remuneration *continued*

Current variable remuneration – Directors' Performance Award (DPA)

The DPA was the only performance pay plan in which executive directors participated in 2016/17.

The maximum award level for 2016/17 was 160% of salary for the Chief Executive and 120% of salary for other executive directors. For 2017/18, overall opportunity levels for performance pay have been reduced slightly to 152% and 112%.

The DPA element rewards individual performance and the attainment of challenging strategic and financial metrics. The measures fall within the following broad areas and ensure focus on delivering benefits for our members:

Member measures (75% of award)
Customer satisfaction (25%)
Growing customer relationships (25%)
Financial efficiency (25%)

+

Individual performance (25% of award)
Individual performance objectives reflecting each individual's contribution towards the delivery of the Society's Plan

Payments are made at the discretion of the Remuneration Committee who may reduce or cancel payments if it believes that the plan outcomes are not representative of the overall performance of the Society.

The Society also has the ability to claw back performance pay awards for up to ten years after they were awarded in some circumstances.

Outcomes for DPA 2016/17

A risk gateway must be passed before any payment is made under the plan, based on measures of statutory profit and CET1 capital ratio, and this gateway was achieved in 2016/17.

In reviewing performance under the DPA during 2016/17, the Committee then assessed the Society's performance against three equally weighted measures:

Measure	**Performance target range: threshold – maximum**	**Performance relative to targets**	**Outcome**	**Performance pay achieved (% of salary)**	
				Chief Executive	**Executive directors**
Customer satisfaction rating (based on average for the financial year)	1st – 1st with an 8% lead	Above target	1st in our high street peer group with a 6.7% lead[1]	30.2%	23.5%
Growing customer relationships	7.33 million – 7.90 million	Above target, approaching maximum	Main product relationships with 7.81 million customers	35.7%	27.1%
Financial efficiency (cost income ratio, CIR)	62.5% – 54.0%	Marginally above target	CIR of 60.2%	26.5%	21.0%
Total performance pay achieved based on Society performance (prior to Remuneration Committee adjustment)				**92.4%**	**71.6%**
The Remuneration Committee concluded that the CIR outcome of 60.2% did not appropriately reflect the underlying performance of the Society principally with respect to financial efficiency, particularly during a time of focus on improving performance in this area. As a result, the Committee decided to apply a downward adjustment which effectively reduced CIR performance from 60.2% to 62.3%.				(12.4%)	(9.7%)
Total performance pay achieved based on Society performance (after Remuneration Committee adjustment)				**80.0%**	**61.9%**

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

Report of the directors on remuneration *continued*

For the element based on individual performance, performance has been assessed as follows:

Executive director	Performance pay achieved (% of salary) / maximum available	Comments
J D Garner	35% / 40%	Above target for strong individual performance, reflecting his overall leadership of the Society.
T P Prestedge	26.7% / 30%	Above target for strong individual performance, reflecting the achievement of objectives around a refreshed strategy and innovation.
M M Rennison	23.3% / 30%	Above target for individual performance, reflecting his leadership of the Society's strong financial performance for the year.
C S Rhodes	23.3% / 30%	Above target for individual performance, reflecting the trading and financial performance of the division under his leadership.

For 2016/17, 40% of each individual's award vests in June 2017 and the remaining 60% is deferred, payable in five equal amounts between years three and seven following the date of award. 50% of the upfront portion and 60% of the deferred portion is linked to the performance of the Society's core capital deferred shares (CCDS). These elements are subject to a six month retention period and so will be paid to participants, in cash, in the following December.

Chief Executive remuneration for the past eight years

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

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

Notes:

i. Joe Garner commenced his role as Chief Executive on 5 April 2016. In all previous financial years, Graham Beale was the Chief Executive.

ii. This includes the value of buy-out awards (£1,071k), which are detailed in the single figure table and accompanying notes. These awards do not form part of ongoing remuneration. If this amount is excluded, the figure would be £2,315k.

iii. The Chief Executive's total remuneration for 2014/15 and 2015/16 includes awards under the DPA as well as legacy payouts under the directors' previous medium-term plan as a result of the transition period between plans.

Change in remuneration of Chief Executive

The change in remuneration (base salary, benefits (including pension) and annual performance pay only) for the Chief Executive from 2015/16 to 2016/17 compared to the average for all other employees is as follows:

	Salary	Benefits	Annual performance pay
Chief Executive (note i)	-5.94%	-9.46%	-11.54%
Average employee	-2.36% (note ii)	+8.85%	+9.37%

Notes:

i. Change in incumbent from G J Beale to J D Garner.

ii. This reflects a change in the year-on-year mix of employees with fewer senior and more junior roles, and their corresponding salaries, rather than a reduction in salaries for individuals employed across both years.

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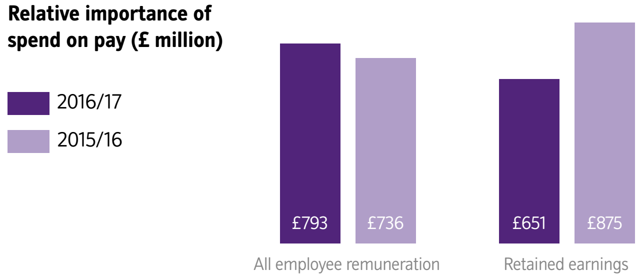
Report of the directors on remuneration *continued*

Relative importance of spend on pay

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

Payroll costs represent 39.2% of total administrative expenses. Nationwide's profit after tax for the year was £757 million, of which £106 million was paid as distributions and the remaining £651 million is held as retained earnings.

Relative importance of spend on pay (£ million)



Executive directors' remuneration

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

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

The table below shows the total remuneration for each executive director for the years ended 4 April 2017 and 4 April 2016.

The performance pay plan awards shown are the total award under each plan, rather than the amount that is paid upfront. For DPA awards, only 40% of the award for 2016/17 is payable in 2017 and the remainder is deferred for up to seven years.

Single total figure of remuneration for each executive director (£'000)

2017	**Fixed remuneration**			**Variable remuneration**			
Executive directors *(Audited)*	**Salary**	**Benefits (note i)**	**Pension allowance**	**Variable remuneration (note ii)**	***Buyout award (note iii)***	***Total pay package including buyout award (note iv)***	**Total pay package excluding buyout award**
J D Garner	**840**	**181**	**336**	**958**	***1,071***	***3,386***	**2,315**
T P Prestedge	**560**	**87**	**185**	**496**	**-**	***1,328***	**1,328**
M M Rennison	**614**	**152**	**203**	**523**	**-**	***1,492***	**1,492**
C S Rhodes	**568**	**50**	**187**	**484**	**-**	***1,289***	**1,289**
Total	**2,582**	**470**	**911**	**2,461**	***1,071***	***7,495***	**6,424**

Single total figure of remuneration for each executive director (£'000)

2016 Executive directors *(Audited)*	Salary	Benefits (note i)	Pension allowance	Variable remuneration (note ii)	*Legacy variable remuneration (note v)*	*Total pay package including legacy*	Total pay package excluding legacy
J D Garner	-	-	-	-	-	-	-
T P Prestedge	536	83	177	481	*355*	*1,632*	1,277
M M Rennison	602	90	199	520	*399*	*1,810*	1,411
C S Rhodes	557	60	184	463	*369*	*1,633*	1,264
G J Beale (note vi)	893	214	357	1,083	*866*	*3,413*	2,547
Total	2,588	447	917	2,547	*1,989*	*8,488*	6,499

Notes:

i. Taxable benefits include private medical cover, car allowance and the use of a company vehicle and driver when required for business purposes.

ii. Variable remuneration consists of the awards under the DPA. Details of this plan and associated performance measures are set out earlier in this 2017 Annual Report on Remuneration. Note that DPA amounts are determined based on salary for the 12-month period ending 31 March.

iii. This buy-out figure represents two elements: i) the initial total value of a deferred award linked to the value of the Society's core capital deferred shares (CCDS), 74% of which was paid in the year with the remaining 26% due to be paid in March 2018; and ii) cash payments totalling £589,029 which are due to be paid in four instalments between July 2017 and August 2018.

iv. This total value (£1,071k) of the buy-out awards does not form part of ongoing remuneration. If this amount is excluded, the total single figure would be £2,315k.

v. Legacy variable remuneration consists of awards under the MTPPP. Although the plan was discontinued for years starting after 2014, the nature of the plan which measured business performance over a three year period means there were awards in 2016 in respect of the MTPPP initiated in 2013.

vi. G J Beale stepped down from the board as Chief Executive on 4 April 2016. Details of his payments for loss of office are set out in the 2016 Annual Report on Remuneration (within the Annual Report and Accounts 2016).

Report of the directors on remuneration *continued*

Executive directors' pensions

M M Rennison has ceased ongoing participation of the Society's defined benefit pension plans and has become a deferred member. No executive director accrued any additional pension entitlement during the year. The change in accrued pensions shown in the table below is as a result of inflationary increases that are required by legislation. The increase in transfer values over the year reflect changes in the assumptions used to calculate pension transfer values for individual pension fund members. The normal retirement age for the Society's pension plans ranges from 60 to 65.

Table of the value of pension benefits for executive directors (£'000)

Executive directors *(Audited)*	**Accrued pension at 4 April 2017** (a)	Accrued pension at 4 April 2016 (b)	**Transfer value at 4 April 2017** (c)	Transfer value at 4 April 2016 (d)	**Change in transfer value** (c)-(d)	**Additional pensions earned in year** (e)	**Transfer value of the increase**	**Directors' contributions in year**
M M Rennison	**59**	58	**1,583**	1,341	**242**	**-**	**-**	**-**

Notes:

1. The transfer value basis is set by the Nationwide Pension Fund Trustee and is based on financial market conditions at the calculation date. The increase in transfer value over the year reflects these financial market changes (which have increased the transfer value for all members of the Fund including executive directors) in addition to the fact that the executive director is one year older and thus one year closer to normal retirement age.
2. M M Rennison accrued no additional deferred pension during the year other than inflationary increases required by legislation.

Explanations:

(a) and (b) show deferred pension entitlement at 4 April 2017 and 2016 respectively.
(c) is the transfer value of the deferred pension in (a) calculated at 4 April 2017.
(d) is the transfer value of the deferred pension in (b) calculated at 4 April 2016.
(e) is the increase in pension built up during the year. A zero figure means that, after allowing for inflation, no additional pension was built up.

Other directorships

Executive directors and members of senior management may be invited to become non executive directors of other companies, subject to the agreement of the Society. These appointments provide an opportunity to gain broader experience outside Nationwide and therefore benefit the Society. Providing that appointments are not likely to lead to a conflict of interest, executive directors may accept non executive appointments and retain the fees received. With effect from 1 July 2014, the number of external appointments that executive and non executive directors can hold is limited as required under CRD IV.

Payments for loss of office

No payments for loss of office were made during the year.

Payments to past directors

No payments were made to past directors during the year.

Report of the directors on remuneration *continued*

Remuneration of eight highest paid senior executive officers – excluding main Board

The pay details of the eight highest paid senior executive officers who are not main Board directors are set out below. This is part of our ongoing commitment to transparency and meeting sector best practice on remuneration disclosure.

Remuneration of eight highest paid senior executive officers (excluding main Board directors)

2017	1 £'000	2 £'000	3 £'000	4 £'000	5 £'000	6 £'000	7 £'000	8 £'000
Fixed (note i)	463	391	365	322	213	318	238	293
Variable								
Cash bonus	165	131	114	106	92	124	99	130
Deferred cash bonus	247	196	171	159	62	113	66	87
Total variable	412	327	285	265	154	237	165	217
Contractual severance	-	-	-	-	204	-	111	-
Total remuneration	875	718	650	587	571	555	514	510

Note:

i. Fixed remuneration includes base salary and car allowance.

Chairman and non executive directors

The fee policy was last reviewed in March 2017. Inflationary increases of around 1.5% have been made to both the Chairman fee and the basic fee for non executive directors. There have been no increases to other elements of the fee policy.

Fee Policy

	Fees for 2017/18	Fees for 2016/17
Chairman	£389,000	£383,000
Basic fee	£66,000	£65,000
Senior Independent Director (note i)	£40,000	£40,000
Chairman of the Audit Committee or Board Risk Committee	£35,000	£35,000
Member of the Audit Committee or Board Risk Committee	£15,000	£15,000
Remuneration Committee Chairman	£35,000	£35,000
Remuneration Committee member	£15,000	£15,000
Nomination and Governance Committee member	£5,000	£5,000
IT Strategy and Resilience Committee Chairman	£25,000	£25,000
IT Strategy and Resilience Committee member	£10,000	£10,000

Note:

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

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

Report of the directors on remuneration *continued*

Single total figure of remuneration for non executive directors

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

Single total figure of remuneration for each non executive director

(Audited)	**2017 Society & Group fees £'000**	2016 Society & Group fees £'000
G M T Howe (Chairman) (note i)	**-**	98
D L Roberts (Chairman) (note i)	**383**	306
R Clifton	**95**	92
M Fyfield (note ii)	**74**	51
M K Jary (note iii)	**-**	26
M A Lenson	**105**	97
K A H Parry (note iv)	**99**	-
L M Peacock (Senior Independent Director) (note v)	**138**	125
R K Perkin (Senior Independent Director) (note v)	**43**	127
U K Prashar (note vi)	**16**	-
T Tookey (note ii)	**130**	96
Total	**1,083**	1,018
Pension payments to past non executive directors (note vii)	**252**	268

Notes:

i. D L Roberts succeeded G M T Howe as Chairman on 23 July 2015.
ii. M Fyfield and T Tookey joined the Board on 2 June 2015.
iii. M K Jary retired from the Board on 23 July 2015.
iv. K A H Parry joined the Board on 23 May 2016.
v. L M Peacock succeeded R K Perkin as Senior Independent Director on 21 July 2016.
vi. U K Prashar joined the Board on 18 January 2017.
vii. The Society stopped granting pension rights to non executive directors who joined the Board after January 1990.

Report of the directors on remuneration *continued*

Remuneration Committee

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

The Committee also oversees the remuneration policy throughout the Society, with a specific focus on the risks posed by remuneration policies and practices.

The Committee's terms of reference were last reviewed and updated in April 2017. The full terms of reference are available on the Society's website.

The members of the Remuneration Committee are all independent non executive directors of the Society and include a member of the Board Risk Committee. During the year the Committee members were: Lynne Peacock (Chairman of the Committee), David Roberts, Rita Clifton and Usha Prashar (from January 2017).

The Committee met eleven times during the year. This includes three remuneration strategy review meetings which were outside of meetings scheduled as part of the usual annual cycle.

Activities of the Committee during the year included:

- a comprehensive strategic review of our approach to remuneration
- agreeing the performance targets for awards to be made under the DPA, taking into account the Society's Plan
- reviewing the outcome of the performance pay plan awards which were paid in respect of the year
- ongoing work in relation to the PRA / FCA Remuneration Codes and how they apply to Nationwide as a mutual
- agreeing the approach for executive director base salary increases for 2017/18.

During the year the Committee was supported by the Chief People Officer, the Divisional Director, Human Resources and where appropriate the Chief Executive, who is invited to attend Committee meetings to provide further background information and context to assist the Committee in its duties. The Remuneration Committee is supported by the Board Risk Committee on risk related matters including performance pay plan design, the assessment of specific performance measures, and wider issues relating to risk and business protection. The Remuneration Committee is also supported by and receives input from the Board Audit Committee. In no case is any person present when their own remuneration is discussed.

All non executive directors were invited to attend one Committee meeting during the year to discuss the remuneration strategy for the Society.

In performing its duties, the Remuneration Committee draws on the advice of independent external consultants. During the year the Committee received advice on regulatory developments, best practice and remuneration trends from Deloitte LLP, who were appointed by the Committee following a tender process.

Deloitte is a member of the Remuneration Consultants Group and as such, voluntarily operates under the code of conduct in relation to executive remuneration consulting in the UK.

As well as advising the Remuneration Committee, Deloitte also provided tax, financial advisory, risk, internal audit and consulting services to the Society during the year. The Committee is satisfied that the advice received is objective and independent, and reviews annually all other services provided by Deloitte to ensure this continues to be the case. Deloitte's fees are charged on a time and expenses basis. Their fees for advice provided to the Committee during 2016/17 were £252,275.

Voting at AGM

A resolution to approve the 2015/16 'Report of the directors on remuneration' was passed at the 2016 AGM. The Remuneration Policy was last approved by members at the 2014 AGM. In each case votes were cast as follows:

	Report of the directors on remuneration	Remuneration Policy
Votes in favour	592,100 (93.53%)	738,438 (91.4%)
Votes against	40,987 (6.47%)	69,518 (8.6%)
Votes withheld	10,211	13,341

Lynne Peacock
Chair of the Remuneration Committee
22 May 2017

Business and Risk Report

Business and Risk Report

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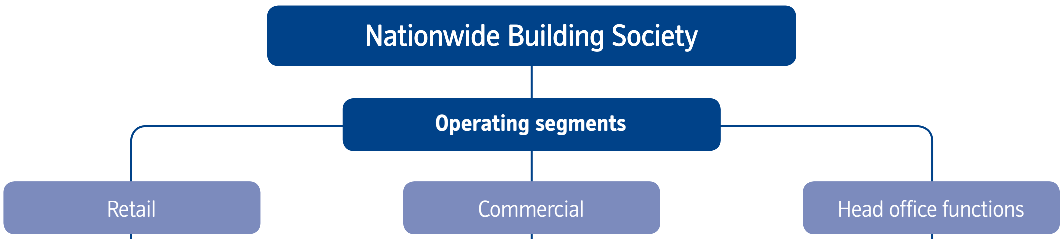
Business and Risk Report *continued*

Introduction

Keeping members' money safe by being secure and dependable is fundamental to the way Nationwide operates. This is encapsulated within the strategic principle of being Built to Last which focuses on a prudent approach to risk management. This Business and Risk Report explains the Group's business, the risks it is exposed to and how it manages those risks.

Nationwide is organised into three business operating segments: Retail, Commercial and Head office functions. The Group is predominantly a retail focused operation which trades almost exclusively within the UK. Wholesale funding is accessed from both UK and overseas markets. As the risks of the organisation are managed on a Group basis, and given the dominant position of the Society within the Group structure, the disclosures in the Business and Risk Report are on a consolidated basis covering the activities of both the Group and the Society.

The chart below shows Nationwide's business operating segments and how these activities are reflected in its risk measures. The regulatory risk weighted assets (RWAs) below indicate the relative risks each area carries as at 4 April 2017. Further details regarding Nationwide's RWAs and capital position are included in the 'Solvency risk' section of this report.



Business activities					
• Prime residential lending • Specialist residential lending • Consumer banking • Savings products • Investments		• Social housing lending • Project finance lending • Commercial real estate lending		• Treasury including funding, liquidity and market risk management • Central support functions	
Regulatory risk weighted assets as at 4 April 2017					
	£m		**£m**		**£m**
Credit risk	19,504	Credit risk	5,636	Credit risk	3,636
Operational risk	4,734	Operational risk	100	Operational risk	31

Note:

No amounts are shown for market risk RWAs as the Group has elected to set these to zero, as permitted by the Capital Requirements Regulation (CRR) where the exposure is below the threshold of 2% of own funds.

Business and Risk Report *continued*

Principal risks

Whilst it is accepted that all business activities involve some degree of risk, Nationwide seeks to protect its members by appropriately managing the risks that arise from its activities. The principal types of risk inherent within the business, and the attitude to managing them, are set out below.

Risk category	Definition	Attitude
Lending	The risk that a borrower or counterparty fails to pay the interest or to repay the principal on a loan or other financial instrument (such as a bond) on time.	• Nationwide primarily lends on prime residential mortgages and sets prudent limits to control the exposure to other portfolios, such as buy to let and unsecured lending. • The commercial portfolios are being actively managed to maturity, as commercial lending is now closed to new business. Risk management of these portfolios focuses on refinance, extension and concentration risks. • Treasury credit risk is accepted only to support the liquidity strategy; for derivative activities necessary to support the member proposition; and to manage legacy positions.
Financial	The risk of Nationwide having inadequate earnings, cash flow or capital to meet current or future requirements and expectations.	• Financial risks are tightly managed, whilst allowing Nationwide to meet members' needs when designing products and services. • Where residual financial risks exist, sufficient amounts of capital or liquidity are held to mitigate their impact.
Operational	The risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.	• Nationwide operates its business to ensure a minimum level of serious disruption to members, brand and reputation, with systems and services designed to achieve defined levels of availability and performance.
Conduct and compliance	The risk that Nationwide exercises inappropriate judgement or makes errors in the execution of its business activities, leading to: • non-compliance with regulation or legislation • market integrity being undermined, or • an unfair outcome being created for customers.	• Products and services should meet customer needs and expectations and perform as represented. • Sustainable partnerships are built with members and customers by providing the right information at the right time, and value for money products and services. • Customer detriment and/or dissatisfaction is addressed in a timely and fair manner. • Nationwide safeguards personal data, does not exploit asymmetries and does not disadvantage customers or customer segments or take advantage of customer vulnerability. • Nationwide does not conduct or facilitate market abuse or financial crime and does not distort competition.
Strategic	The risk of significant loss or damage arising from business decisions that impact the long term interests of the membership, or from an inability to adapt to external developments.	• Nationwide does not overcommit by targeting too many strategic priorities at any one time, ensuring the most effective and efficient use of its resources. It is committed to a mutual business model that is focused on the provision of retail financial services, almost exclusively in the UK.

The frameworks for managing the above risks, including associated risk appetite, limits and supporting policies, are reviewed at least annually, and are subject to continuous monitoring by the relevant governance committees.

Top and emerging risks

In addition to the above principal risks that are inherent in Nationwide's business, the top and emerging risks that could affect delivery of the strategy are identified and monitored as an integral element of risk management. It is accepted that all business activities involve some degree of risk. Steps are therefore taken to protect members by ensuring that these activities are managed appropriately. Nationwide's 'built to last' strategic cornerstone focuses on being safe, secure, sustainable and dependable for members.

Top and emerging risks are identified through the process outlined in the 'Managing risk' section of this report and are closely tracked throughout the governance structure. These risks are kept under close observation through risk reporting.

Following the result of the EU referendum, the impact of the UK's impending exit from the EU is one of the top risks. This is due to the widespread political and economic uncertainty it has caused, which spans all risk categories. In addition to this, risk management activity over the past year has focused on strengthening business resilience and managing the pace of change in the digital and regulatory environments. Nationwide's top and emerging risks fall within the following categories:

Business and Risk Report *continued*

Top and emerging risks *continued*

Macroeconomic environment

Nationwide monitors global and domestic macroeconomic factors to ensure preparedness for their potential impacts. Domestically, the effects of Brexit, the upcoming UK general election and the potential for a second Scottish referendum are focus areas. The impact of the continued low interest rate environment and the risks to the business model are closely monitored. The Board also discusses the potential risks to economic growth and stability within financial markets that would be posed by a Eurozone financial crisis, geopolitical instability or a downturn in China or emerging markets.

The result of the Brexit vote has caused political and economic uncertainty. Reassuringly, UK growth projections have recovered since their initial post-referendum fall and the UK regulators have made no immediate changes to their objectives or policies. Nevertheless, a number of key initiatives from the European Commission are in flight and it is expected that these will transpose into UK law despite a vote to leave. Nationwide is well placed to respond to and implement the requirements resulting from these initiatives, and will continue to monitor this position and any associated impacts.

Cyber security, data protection and operational resilience

With increasingly sophisticated cyber security compromises being reported within both financial and non-financial sectors, Nationwide is very alert to the risks posed by breaches of its cyber defences. Cyber security remains a high priority and Nationwide will continue to focus on improving the awareness of its customers and employees, as well as continuing to build its understanding of the developing threats, its defences and its resilience to cyber attacks.

Members' data is safeguarded by investing heavily to maintain and protect systems. To date, Nationwide has successfully defended against data breaches, and continues to ensure that developments are up to date so that members continue to receive the protection that they expect.

In an increasingly digital world, there is pressure to manage considerably larger volumes of data securely and effectively. Nationwide operates a dedicated Operational Resilience function to ensure it meets member expectations for secure, highly reliable and widely available services.

The pace of change in the digital and regulatory environments

Over recent years there has been a dramatic increase in the demand for digital products and services due to the convenience that they can bring. This has seen an influx of innovative new offerings in the market place and the number of challenger banks and Fintech disruptors has increased. Collectively the changes may pose a challenge to Nationwide's core markets and product pricing. The Board continues to monitor the possible impact on Nationwide's business model, and continues to invest heavily in its digital channels and new payment technologies.

Changes in regulation and the resulting impact on the competitive environment from, amongst other things, Open Banking and ring fencing of the major UK banks, continue to be considered by the Board. Nationwide is well placed to respond to these complex regulatory changes, and to provide a variety of products and services which are designed to meet customers' needs. The Board will continue to review Nationwide's ability to respond in an efficient and agile manner.

Lending risk

Lending risk is the risk that a borrower or counterparty fails to pay interest or to repay the principal on a loan or other financial instrument (such as a bond) on time. Lending risk also encompasses extension risk and concentration risk.

This section provides information on Nationwide's exposure to lending risk arising from loans and advances, together with details of the level of collateral held and impairment charges recognised during the period. It also provides information about the key risk measures for each of the loan portfolios.

Nationwide manages lending risk for each of the following portfolios:

Portfolio	Definition
Residential mortgages	Loans secured on residential property; Nationwide manages prime and specialist lending separately
Consumer banking	Unsecured lending including current account overdrafts, personal loans and credit cards
Commercial lending	Loans to registered social landlords, loans made under the Private Finance Initiative and commercial real estate lending
Treasury	Treasury liquidity, derivatives and discretionary portfolios

In addition, a small other lending portfolio is held of £17 million (2016: £20 million) which primarily includes £8 million of deferred consideration relating to an investment in Visa Inc and £5 million of collateral to support repurchase transactions. There is no significant exposure to lending risk on this portfolio.

Maximum exposure to lending risk

Lending risk largely arises from exposure to loans and advances to customers, which account for 85.9% (2016: 87.3%) of Nationwide's total lending risk exposure. Within this, exposure relates primarily to residential mortgages, which account for 91.4% (2016: 90.7%) of total loans and advances to customers and which comprise high quality assets with low occurrences of arrears and possessions. The increase in the proportion of residential mortgages is primarily driven by Nationwide's continued support for first time buyers which has contributed to the £8 billion growth in prime lending in the year.

In addition to loans and advances to customers, Nationwide is exposed to lending risk on all other financial assets. For financial assets recognised on the balance sheet, the maximum exposure to lending risk represents the balance sheet carrying value after allowance for impairment. For off-balance sheet guarantees, the maximum exposure is the maximum amount that Nationwide would have to pay if the guarantees were to be called upon. For loan commitments and other credit related commitments that are irrevocable over the life of the respective facilities, the maximum exposure is the full amount of the committed facilities.

Nationwide's maximum exposure to lending risk has risen from £220 billion to £234 billion, reflecting the growth in residential mortgage loans.

Business and Risk Report *continued*

Lending risk *continued*

Maximum exposure to lending risk

2017	Gross balances	Less: impairment provisions	Carrying value	Commitments (note i)	Maximum lending risk exposure	% of total lending risk exposure
(Audited)	£m	£m	£m	£m	£m	%
Cash	13,017	-	13,017	-	13,017	6
Loans and advances to banks	2,587	-	2,587	115	2,702	1
Investment securities – AFS	9,764	-	9,764	-	9,764	4
Investment securities – HTM (note ii)	-	-	-	1,774	1,774	1
Derivative financial instruments	5,043	-	5,043	-	5,043	2
Fair value adjustment for portfolio hedged risk (note iii)	746	-	746	-	746	-
Investments in equity shares	67	-	67	-	67	-
	31,224	-	31,224	1,889	33,113	14
Loans and advances to customers:						
Residential mortgages	171,263	(144)	171,119	12,589	183,708	78
Consumer banking	3,949	(269)	3,680	26	3,706	2
Commercial lending (note iii)	12,580	(25)	12,555	851	13,406	6
Other lending (note iv)	17	-	17	75	92	-
	187,809	(438)	187,371	13,541	200,912	86
Total	219,033	(438)	218,595	15,430	234,025	100

Maximum exposure to lending risk

2016	Gross balances	Less: impairment provisions	Carrying value	Commitments (note i)	Maximum lending risk exposure	% of total lending risk exposure
(Audited)	£m	£m	£m	£m	£m	%
Cash	8,797	-	8,797	-	8,797	4
Loans and advances to banks	3,591	-	3,591	115	3,706	2
Investment securities – AFS	10,612	-	10,612	-	10,612	5
Derivative financial instruments	3,898	-	3,898	-	3,898	2
Fair value adjustment for portfolio hedged risk (note iii)	756	-	756	-	756	-
Investments in equity shares	126	-	126	-	126	-
	27,780	-	27,780	115	27,895	13
Loans and advances to customers:						
Residential mortgages	162,164	(102)	162,062	12,336	174,398	79
Consumer banking	3,869	(281)	3,588	39	3,627	2
Commercial lending (note iii)	13,197	(59)	13,138	1,065	14,203	6
Other lending (note iv)	20	(1)	19	75	94	-
	179,250	(443)	178,807	13,515	192,322	87
Total	207,030	(443)	206,587	13,630	220,217	100

Notes:

i. In addition to the amounts shown above, the Group has, as part of its retail operations, revocable commitments of £9,202 million (2016: £8,513 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 the Group, subject to notice requirements, and given their nature are not expected to be drawn down to the full level of exposure.

ii. At the balance sheet date, Nationwide had entered a commitment to subscribe to up to a maximum of £1.8 billion of residential mortgage backed securities (RMBS) under a programme to securitise Bradford & Bingley residential mortgage assets. This commitment was wholly fulfilled by Nationwide purchasing £1.2 billion RMBS following the issue on 25 April 2017. These have been classified as held to maturity (HTM) investment securities.

iii. The fair value adjustment for portfolio hedged risk and the fair value adjustment for micro hedged risk (included within the carrying value of the commercial lending portfolio) represent hedge accounting adjustments. They are indirectly exposed to lending risk through the relationship with the underlying loans covered by Nationwide's hedging programmes.

iv. The other lending portfolio includes deferred consideration relating to an investment in Visa Inc and collateral balances to support repo transactions.

Business and Risk Report *continued*

Lending risk *continued*

Movements in impaired loans by lending risk segment

The table below shows the movements throughout the year of all loans classified as impaired. The balance shown represents the entire financial asset rather than just the amount that is overdue.

Movements in impaired loan balances

2017	Prime mortgages	Specialist mortgages	Consumer banking	Commercial lending	Other lending	Total
(Audited)	£m	£m	£m	£m	£m	£m
At 5 April 2016	366	412	260	171	5	1,214
Classified as impaired during the year	323	358	110	6	-	797
Transferred from impaired to unimpaired	(298)	(333)	(44)	(26)	(3)	(704)
Amounts written off	(14)	(37)	(92)	(105)	-	(248)
Disposals	-	-	-	-	-	-
Repayments and other movements	(5)	1	(1)	(1)	(2)	(8)
At 4 April 2017	372	401	233	45	-	1,051

Movements in impaired loan balances

2016	Prime mortgages	Specialist mortgages	Consumer banking	Commercial lending	Other lending	Total
(Audited)	£m	£m	£m	£m	£m	£m
At 5 April 2015	396	499	225	608	10	1,738
Classified as impaired during the year	343	391	113	38	-	885
Transferred from impaired to unimpaired	(344)	(410)	(27)	(70)	-	(851)
Amounts written off	(23)	(66)	(41)	(283)	(5)	(418)
Disposals	-	-	-	-	-	-
Repayments and other movements	(6)	(2)	(10)	(122)	-	(140)
At 4 April 2016	366	412	260	171	5	1,214

Note:
Loans that were classified as impaired and loans that have transferred into or out of the impaired classification are based on the relevant status at each month end, when compared to the previous month end.

Forbearance

Nationwide is committed to supporting customers facing financial difficulty by working with them to find a solution through proactive arrears management and forbearance. This is the case for residential mortgages, consumer banking and commercial lending.

Forbearance occurs when concessions are made to the contractual terms of a loan, when the customer is facing or about to face difficulties in meeting their financial commitments. A concession is where the customer receives assistance, which could be a modification to the previous terms and conditions of a facility or a total or partial refinancing of debt, either mid-term or at maturity. Requests for concessions are principally attributable to:

- temporary cash flow problems;
- breaches of financial covenants; or
- an inability to repay at contractual maturity.

During the year, Nationwide participated in a British Bankers Association working group, which was established to ensure a consistent approach to the reporting of forbearance across the industry. The working group agreed to use forbearance definitions based upon the European Banking Authority financial reporting definitions as the basis for consistent reporting. Nationwide's reporting has been updated to reflect the agreed approach. There has been no change to how customers in financial difficulties are treated.

The concession events and exit criteria which are used to classify balances subject to forbearance for residential mortgages, consumer banking and commercial lending are described in the relevant sections of this report.

Business and Risk Report *continued*

Lending risk – Residential mortgages

Summary

Nationwide's residential mortgages include both prime and specialist loans. Prime residential mortgages are mainly Nationwide branded advances made through the branch network and intermediary channels. Specialist lending consists of buy to let mortgages originated under The Mortgage Works (UK) plc (TMW) brand.

Strong levels of new lending in the prime portfolio has seen the residential mortgage exposure grow from £162 billion to £171 billion over the year. In part this has been driven by continued support for first time buyers and reflects a commitment given to the UK government to make available £10 billion a year to this segment of the market subject to meeting our lending criteria. In the period Nationwide widened its support for borrowers in the later stages of life with the introduction of a Borrowing in Retirement proposition for those in receipt of a regular pension income. Operating within risk appetite these commitments reflect Nationwide's intention to stand by its members and support the UK economy.

Nationwide controls its lending risk through the application of credit criteria designed to restrict the maximum loan size at higher loan to value (LTV), robust affordability calculations and a credit scoring framework that regulates higher LTV exposures. Portfolio performance is closely measured and monitored against approved risk appetite limits.

Over the period the geographical distribution across the UK has remained stable and the average LTV, weighted by value, has remained at 55%. Support for first time buyers has seen the proportion of new lending made to this segment increase to 36% (2016: 28%). This has contributed to a rise in the average LTV of new lending to 71% (2016: 69%) and growth in the proportion of the portfolio with an LTV above 80%, rising to 9.6% (2016: 8.5%). It is also one of the factors that led to an increase in the proportion of new lending being written at income multiples of 4.5 or greater which during the year has risen to 10.6% (2016: 7.0%).

In contrast the proportion of lending made to the buy to let segment has reduced this year to 14% (2016: 22%) following a decision taken in May 2016 to increase the minimum interest cover ratio (ICR) requirement from 125% to 145% and reduce the maximum LTV from 80% to 75%. These steps were taken in response to forthcoming changes to the income tax relief available for buy to let borrowers which will materially affect the cash flow and affordability for some landlords. The lending policy changes are designed to ensure buy to let borrowing remains sustainable and affordable for our borrowers. In May 2017 we reintroduced 125% ICR lending for basic rate taxpayers to recognise the lower impact of the forthcoming tax changes on these borrowers.

Arrears levels remain low across prime and specialist lending, reflecting the favourable economic conditions and low interest rate environment and supported by robust credit assessment and affordability controls at the point of lending. The proportion of loans more than three months in arrears remained at 0.45% and significantly below the Council of Mortgage Lenders (CML) average of 0.91%. With the immediate outlook for the UK less certain and the buy to let market facing increased costs and potentially less investor demand, the expectation is for a very gradual rise in arrears from these low levels.

The proportion of non-performing loans reduced to 1.6% (2016: 2.0%) while provisions for impairment increased as a result of enhancements to the provision methodology and assumptions to ensure they continue to reflect appropriately the incurred losses within each portfolio. These enhancements, which resulted in an additional £45 million of impairment charge, reflect the extended period for arrears to arise from a loss event and the risks associated with the ability of borrowers to repay capital balances at the maturity of interest only loans.

Lending and new business

The table below summarises the residential mortgages portfolios:

Residential mortgage lending				
	2017		2016	
(Audited)	**£m**	**%**	£m	%
Prime	138,004	81	129,973	80
Specialist:				
Buy to let	30,087	18	28,646	18
Self-certified	2,071	1	2,338	1
Near prime	784	-	859	1
Sub prime	317	-	348	-
	33,259	19	32,191	20
Total residential mortgages	171,263	100	162,164	100

Note: Self-certified, near prime and sub prime lending were discontinued in 2009.

Business and Risk Report *continued*

Lending risk – Residential mortgages *continued*

Distribution of new business by borrower type (by value)	2017	2016
	%	%
Prime:		
Home movers	30	31
First time buyers	36	28
Remortgagers	19	18
Other	1	1
Total prime	86	78
Specialist:		
Buy to let new purchases	3	8
Buy to let remortgagers	11	14
Total specialist	14	22
Total new business	100	100

Note: All new business measures exclude existing customers who are only switching products and/or taking further advances.

In October 2014, the Financial Policy Committee (FPC) introduced a 15% limit on the proportion of new lending that may be written at income multiples of 4.5 and above. This limit applies to residential mortgages, excluding buy to let. The proportion of new lending at income multiples of 4.5 or higher has averaged 10.6% (2016: 7.0%). The increase partly reflects the higher proportion of lending to first time buyers as Nationwide continues to support this segment of the market. The proportion of new lending at income multiples of 4.5 or higher is closely monitored and controlled to remain within risk appetite.

The proportion of lending to buy to let investors reduced during the year as a consequence of Nationwide taking a lead in the market and increasing the minimum interest cover ratio requirement in anticipation of the effect forthcoming tax rises will have on affordability for some property investors.

Lending risk

Residential mortgage lending continues to have a low risk profile as demonstrated by a low level of arrears compared to the industry average. The residential mortgages portfolio comprises many relatively small loans which are broadly homogenous, have low volatility of credit risk outcomes and are diversified in terms of the UK market and geographic segments.

LTV and lending risk concentration

LTV is calculated by weighting the borrower level LTV by the individual loan balance to arrive at an average LTV. This approach is considered to most appropriately reflect the exposure at risk.

Average LTV of loan stock	2017	2016
	%	%
Prime	54	54
Specialist	59	61
Group	55	55

Average LTV of new business	2017	2016
	%	%
Prime	72	71
Specialist (buy to let)	62	65
Group	71	69

Note: The LTV of new business excludes further advances and product switchers.

The average LTV of buy to let new lending reduced by 3 percentage points. This is due in part to the introduction of a reduced maximum LTV of 75% in May 2016 (previously 80%).

LTV distribution of new business	2017	2016
	%	%
0% to 60%	26	26
60% to 75%	31	40
75% to 80%	9	9
80% to 85%	14	12
85% to 90%	17	11
90% to 95%	3	2
Over 95%	-	-
Total	100	100

Business and Risk Report *continued*

Lending risk – Residential mortgages *continued*

The maximum LTV for new prime residential customers is 95%. The proportion of new lending greater than 80% LTV has increased to 34% (2016: 25%) in part as a result of the strategy to support the first time buyer market.

Geographical concentration

Residential mortgage balances by LTV and region

2017	Greater London	Central England	Northern England	South East England	South West England	Scotland	Wales	Northern Ireland	Total	
(Audited)	£m	£m	£m	£m	£m	£m	£m	£m	£m	%
Performing loans										
Fully collateralised LTV ratio:										
Up to 50%	28,493	9,737	6,361	8,783	5,630	2,915	1,208	833	63,960	
50% to 60%	11,822	5,612	3,748	4,637	3,141	1,649	681	357	31,647	
60% to 70%	8,659	6,888	5,737	3,852	3,426	2,366	972	395	32,295	
70% to 80%	5,169	4,905	5,897	2,216	2,198	2,619	1,296	352	24,652	
80% to 90%	3,084	2,483	3,304	1,314	1,207	1,285	707	324	13,708	
90% to 100%	288	237	699	132	102	157	233	140	1,988	
	57,515	29,862	25,746	20,934	15,704	10,991	5,097	2,401	168,250	98.2
Not fully collateralised:										
Over 100% LTV (A)	5	6	40	2	3	16	8	239	319	0.2
Collateral value on A	*4*	*5*	*35*	*1*	*2*	*15*	*8*	*199*	*269*	
Negative equity on A	*1*	*1*	*5*	*1*	*1*	*1*	*-*	*40*	*50*	
Total performing loans	57,520	29,868	25,786	20,936	15,707	11,007	5,105	2,640	168,569	98.4
Non-performing loans										
Fully collateralised LTV ratio:										
Up to 50%	504	153	100	120	66	40	20	25	1,028	
50% to 60%	192	98	69	69	41	28	12	11	520	
60% to 70%	69	105	107	58	49	42	17	12	459	
70% to 80%	17	94	105	21	32	36	24	10	339	
80% to 90%	8	42	86	6	6	18	15	11	192	
90% to 100%	1	7	53	-	1	7	14	7	90	
	791	499	520	274	195	171	102	76	2,628	1.6
Not fully collateralised:										
Over 100% LTV (B)	-	1	12	-	-	2	3	48	66	-
Collateral value on B	*-*	*1*	*11*	*-*	*-*	*2*	*3*	*38*	*55*	
Negative equity on B	*-*	*-*	*1*	*-*	*-*	*-*	*-*	*10*	*11*	
Total non-performing loans	791	500	532	274	195	173	105	124	2,694	1.6
Total residential mortgages	58,311	30,368	26,318	21,210	15,902	11,180	5,210	2,764	171,263	100.0
Geographical concentrations	34%	18%	15%	12%	9%	7%	3%	2%	100%	

Business and Risk Report *continued*

Lending risk – Residential mortgages *continued*

Residential mortgage balances by LTV and region

2016	Greater London	Central England	Northern England	South East England	South West England	Scotland	Wales	Northern Ireland	Total	
(Audited)	£m	£m	£m	£m	£m	£m	£m	£m	£m	%
Performing loans										
Fully collateralised LTV ratio:										
Up to 50%	26,991	8,795	5,866	7,855	5,051	2,711	1,178	785	59,232	
50% to 60%	12,350	4,971	3,402	4,262	2,733	1,547	637	346	30,248	
60% to 70%	8,465	6,636	5,052	4,363	3,460	2,095	903	390	31,364	
70% to 80%	4,062	5,454	6,282	2,211	2,359	2,776	1,273	371	24,788	
80% to 90%	1,559	2,210	3,135	894	918	1,380	657	271	11,024	
90% to 100%	85	177	901	66	60	232	212	151	1,884	
	53,512	28,243	24,638	19,651	14,581	10,741	4,860	2,314	158,540	97.7
Not fully collateralised:										
Over 100% LTV (A)	7	8	80	1	4	31	13	301	445	0.3
Collateral value on A	*6*	*7*	*73*	*1*	*3*	*29*	*13*	*248*	*380*	
Negative equity on A	*1*	*1*	*7*	-	*1*	*2*	-	*53*	*65*	
Total performing loans	53,519	28,251	24,718	19,652	14,585	10,772	4,873	2,615	158,985	98.0
Non-performing loans										
Fully collateralised LTV ratio:										
Up to 50%	522	161	107	127	73	43	27	26	1,086	
50% to 60%	245	100	68	74	52	28	13	12	592	
60% to 70%	110	131	108	76	60	42	20	12	559	
70% to 80%	29	114	139	42	48	46	24	12	454	
80% to 90%	7	74	98	7	17	28	19	12	262	
90% to 100%	1	14	73	1	2	13	16	7	127	
	914	594	593	327	252	200	119	81	3,080	1.9
Not fully collateralised:										
Over 100% LTV (B)	-	3	25	2	1	3	5	60	99	0.1
Collateral value on B	-	*3*	*22*	*1*	*1*	*3*	*5*	*46*	*81*	
Negative equity on B	-	-	*3*	*1*	-	-	-	*14*	*18*	
Total non-performing loans	914	597	618	329	253	203	124	141	3,179	2.0
Total residential mortgages	54,433	28,848	25,336	19,981	14,838	10,975	4,997	2,756	162,164	100.0
Geographical concentrations	33%	18%	16%	12%	9%	7%	3%	2%	100%	

The value of partially collateralised non-performing loans has reduced to £66 million (2016: £99 million), primarily reflecting the growth in house prices.

During the period the proportion of loan balances with an LTV greater than 80% has increased to 9.6% (2016: 8.5%) reflecting the new lending and support for first time buyers. In comparison, the proportion of lending greater than 80% LTV in Greater London is 5.8% (2016: 3.0%).

Business and Risk Report *continued*

Lending risk – Residential mortgages *continued*

Arrears

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

	2017	2016
	%	%
Prime	0.36	0.35
Specialist	0.89	0.90
Group	0.45	0.45
CML industry average	0.91	1.04

Favourable economic conditions and a continued low interest environment have resulted in the arrears performance of both the prime and specialist mortgage portfolios reaching a level where any future changes are more likely to be gradual upward movements rather than further falls. The combined arrears rate of 0.45% was approximately half of the Council of Mortgage Lenders' (CML) industry average rate of 0.91%.

Impaired loans

Impaired and non-performing loans are identified primarily by arrears status. Impaired accounts are defined as those greater than three months in arrears and include accounts subject to possession. Non-performing accounts include:

- all impaired loans
- loans which are past due but not impaired, including any loan where a payment due is received late or missed
- past term interest only loans which have gone into litigation.

The non-performing loan amount represents the entire loan balance rather than just the payment overdue.

Loans on interest only or payment holiday concessions are initially categorised according to their payment status as at the date of concession, with subsequent revisions to this category assessed against the terms of the concession.

Impairment provisions are held in relation to both the performing and non-performing segments of the residential mortgage portfolio. Provisions reflect losses which have been incurred at the balance sheet date, based on objective evidence. Individual impairment provisions are assigned to accounts in possession and a collective provision is assigned to all other accounts. For currently performing loans, the provision reflects losses arising from impairment events that have occurred within the portfolio but are not identifiable at the reporting date.

Residential mortgages by payment status

2017	Prime	Specialist	Total	
(Audited)	£m	£m	£m	%
Performing:				
Neither past due nor impaired	136,374	32,195	168,569	98.4
Non-performing:				
Past due up to 3 months	1,258	663	1,921	1.1
Impaired:				
Past due 3 to 6 months	156	173	329	0.2
Past due 6 to 12 months	117	118	235	0.2
Past due over 12 months	91	91	182	0.1
Litigations (past term interest only)	-	1	1	-
Possessions	8	18	26	-
Total non-performing loans	1,630	1,064	2,694	1.6
Total residential mortgages	138,004	33,259	171,263	100.0
Non-performing loans as a % of total residential mortgages	1.2%	3.2%	1.6%	
Impairment provisions (£m)	34	110	144	
Impairment provisions as a % of non-performing balances	2.1%	10.3%	5.3%	
Impairment provisions as a % of total residential mortgages	0.02%	0.33%	0.08%	

Business and Risk Report *continued*

Lending risk – Residential mortgages *continued*

Residential mortgages by payment status

2016	Prime	Specialist	Total	
(Audited)	£m	£m	£m	%
Performing:				
Neither past due nor impaired	127,986	30,999	158,985	98.0
Non-performing:				
Past due up to 3 months	1,621	780	2,401	1.5
Impaired:				
Past due 3 to 6 months	170	188	358	0.2
Past due 6 to 12 months	115	115	230	0.2
Past due over 12 months	75	91	166	0.1
Litigations (past term interest only)	-	-	-	-
Possessions	6	18	24	-
Total non-performing loans	1,987	1,192	3,179	2.0
Total residential mortgages	129,973	32,191	162,164	100.0
Non-performing loans as a % of total residential mortgages	1.5%	3.7%	2.0%	
Impairment provisions (£m)	25	77	102	
Impairment provisions as a % of non-performing balances	1.3%	6.5%	3.2%	
Impairment provisions as a % of total residential mortgages	0.02%	0.24%	0.06%	

The proportion of non-performing loans has reduced to 1.6% (2016: 2.0%) as a consequence of the portfolio growth and continued low levels of early arrears.

The provision balance has increased to £144 million (2016: £102 million). The provisioning methodology and assumptions have been reviewed and updated to ensure they appropriately reflect incurred losses within the portfolio, resulting in a £45 million increase in provisions. Specific areas of focus included maturing interest only loans and the period for losses to emerge on up to date loans.

Impairment losses for the year

	2017	2016
(Audited)	**£m**	£m
Prime	**11**	8
Specialist	**47**	10
Total	**58**	18

Possessions

Number of properties in possession as % of total book

	2017		2016	
	Number of properties	**%**	Number of properties	%
Prime	**89**	**0.01**	57	0.01
Specialist	**136**	**0.05**	117	0.04
Group	**225**	**0.01**	174	0.01
CML industry average		**0.03**		0.03

Repossession numbers have increased in the year following revisions to the repossession process.

Business and Risk Report *continued*

Lending risk – Residential mortgages *continued*

Interest only mortgages

Nationwide does not offer any new advances for prime residential mortgages on an interest only basis. However, there are historical balances which were originally advanced as interest only mortgages or where a change in terms to an interest only basis was agreed (this option was withdrawn in 2012). Maturities on interest only mortgages are managed closely, engaging regularly with customers to ensure the loan is redeemed or to agree a strategy for repayment.

The majority of the specialist portfolio comprises buy to let loans, of which approximately 85% are advanced on an interest only basis.

Interest only mortgages

2017	Term expired (still open)	Due within one year	Due after one year and before two years	Due after two years and before five years	Due after more than five years	Total	% of total book
	£m	£m	£m	£m	£m	£m	%
Prime	64	337	444	1,636	13,604	16,085	11.7
Specialist	104	202	216	1,173	28,037	29,732	89.4
Total	168	539	660	2,809	41,641	45,817	26.8

Interest only mortgages

2016	Term expired (still open)	Due within one year	Due after one year and before two years	Due after two years and before five years	Due after more than five years	Total	% of total book
	£m	£m	£m	£m	£m	£m	%
Prime	58	396	475	1,731	16,178	18,838	14.5
Specialist	98	174	254	1,002	27,084	28,612	88.9
Total	156	570	729	2,733	43,262	47,450	29.3

Interest only loans that are ‘term expired (still open)’ are, to the extent that they are not otherwise in arrears, considered performing for six months, pending renegotiation of the facility. After six months, the loans are, if not in litigation, classified as forborne.

Negative equity on non-performing loans

Negative equity of non-performing residential mortgages

	2017		2016	
	Prime	Specialist	Prime	Specialist
	£m	£m	£m	£m
Past due but not impaired	1	3	2	4
Impaired	1	5	1	10
Possessions	-	1	-	1
Total	2	9	3	15

Note:
Collateral is capped at the amount outstanding on an individual loan basis.

The stable arrears position and growth in house prices have combined to reduce the value of non-performing loans in negative equity to £11 million (2016: £18 million).

Forbearance

The following concession events are included within the forbearance reporting for residential mortgages:

Past term interest only concession

Nationwide works with customers who are unable to repay the capital at term expiry of their interest only mortgage. Where a customer is unable to renegotiate the facility within six months of maturity but no legal enforcement is pursued, the account is considered forborne. Should another concession event such as a term extension occur within the six month period, this will also be classed as forbearance. Additional provisions are held against these mortgages to account for the increased risk of a customer being unable to repay.

Interest only concessions

Where a temporary interest only concession is granted the loans do not accrue arrears for the period of the concession and are not categorised as impaired, unless already impaired, provided the revised interest only repayment amount is maintained. Provisions are held as if the arrears were accumulating in line with any shortfall against the full contractual payment.

Business and Risk Report *continued*

Lending risk – Residential mortgages *continued*

Capitalisation

When a customer emerges from financial difficulty, and provided they have made at least six full monthly instalments, they are offered the ability to capitalise standing arrears. This results in the account being repaired and the loans are categorised as not impaired provided contractual repayments are maintained. Additional provisions are held for these loans, reflecting the heightened probability of future default for these customers.

Term extensions (within term)

Customers in financial difficulty may be allowed to extend the term of their mortgage. On a capital repayment mortgage this will reduce their monthly commitment; interest only customers will benefit by having a longer period to repay the capital at maturity. Additional provisions are held for these loans, reflecting the heightened probability of future default for these customers.

Permanent interest only conversions

In the past, some customers in financial difficulty were granted a permanent interest only conversion, normally reducing their monthly commitment. This facility was withdrawn in March 2012. Additional provisions are held for these loans, reflecting the heightened probability of future default for these customers.

The table below provides details of residential mortgages subject to forbearance.

Balances subject to forbearance			
2017	**Prime**	**Specialist**	**Total**
	£m	**£m**	**£m**
Past term interest only concessions	**154**	**141**	**295**
Interest only concessions	**501**	**70**	**571**
Capitalisation	**59**	**72**	**131**
Term extensions (within term)	**42**	**16**	**58**
Permanent interest only conversions	**6**	**33**	**39**
Total forbearance	**762**	**332**	**1,094**
Impairment provision on forborne loans	**7**	**11**	**18**

Balances subject to forbearance			
2016	Prime	Specialist	Total
	£m	£m	£m
Past term interest only concessions	129	116	245
Interest only concessions	541	86	627
Capitalisation	76	85	161
Term extensions (within term)	54	18	72
Permanent interest only conversions	10	36	46
Total forbearance	810	341	1,151
Impairment provision on forborne loans	8	11	19

Note:
Loans where more than one concession event has occurred are reported under the latest event.

Alignment with the European Banking Authority financial reporting definitions, has resulted in two key changes to reporting for Nationwide as follows:

1. Certain concessions previously reported as re-negotiated loans are not included in the agreed definition of forbearance. This includes:
   - agreements for customers to pay less than the contractual amount, but where arrears still accumulate
   - payment holidays taken by eligible customers not in financial difficulty
   - interest only mortgages for which the principal remains outstanding for up to six months after maturity
   - changes in loan term or repayment type that do not relate to financial difficulty.
2. Exit criteria have been introduced, whereby loans exit forbearance if they meet certain payment and arrears conditions, including a two year probation period post the forbearance event. The previous reporting of re-negotiated loans included all balances that had ever been forborne since 2008.

Business and Risk Report *continued*

Lending risk – Residential mortgages *continued*

Balances previously reported as re-negotiated at 4 April 2016 were £13,041 million. Using the current definition of forbearance, this year's report includes £1,151 million of balances that were forborne at that date. The changes are summarised below:

Reconciliation of balances at 4 April 2016	Prime	Specialist	Total
	£m	£m	£m
Re-negotiated loans as previously reported	11,098	1,943	13,041
Changes in reporting definition (note i)	(9,192)	(1,295)	(10,487)
Exit criteria for forborne loans	(1,096)	(307)	(1,403)
Forborne loans	810	341	1,151

Note:

i. The changes in reporting definition have led to the removal of concessions that do not relate to financial difficulty, primarily £6,193 million of loans where there have been changes in loan term and £2,378 million of loans where payment holidays have been taken by an eligible customer. The amounts removed include all loans that have been subject to these concessions since 2008.

Lending risk – Consumer banking

Summary

The consumer banking portfolio comprises balances on unsecured retail banking products, specifically overdrawn current accounts, personal loans and credit cards. Despite continued intense competition, total balances across these portfolios have grown by 2% to £3,949 million during the period (2016: £3,869 million), with an increasing proportion of products held by existing Nationwide members. This has been achieved by maintaining focus on meeting more member needs, with the successful launch of a student account and continued enhancement of digital services.

Asset quality on the unsecured portfolios has remained strong, benefiting from proactive risk management practices and continued low interest rates. Non-performing balances (excluding charged off accounts) have remained stable, whilst charged off balances have reduced by 12% to £174 million (2016: £197 million) and forbearance levels have also reduced by 10% to £76 million (2016: £84 million).

Impairment provisions are held against both performing and non-performing segments of the consumer banking portfolio. The provision methodology has been updated, and provisions increased to recognise the impact of prolonged low interest rates and the favourable economic environment potentially dampening the emergence of arrears. Across the consumer banking portfolios this has increased provision coverage on impaired balances by 5%.

Consumer banking balances	2017		2016	
(Audited)	£m	%	£m	%
Overdrawn current accounts	261	7	247	6
Personal loans	1,957	49	1,901	49
Credit cards	1,731	44	1,721	45
Total consumer banking	3,949	100	3,869	100

Lending risk

Impaired loans

Lending risk on the consumer banking portfolios is primarily monitored and reported based on delinquency status, since no security is held against the loans. Impaired accounts are defined as those greater than three months in arrears. Non-performing accounts include all impaired loans and loans which are past due but not impaired, including any loan where a payment due is received late or missed. The non-performing loan amount represents the entire loan rather than just the payment overdue.

The performance of the portfolios is closely monitored, with corrective action taken when appropriate to ensure adherence with risk appetite.

Impairment provisions are held for both the performing and non-performing segments of the consumer banking portfolio and provisions reflect losses which have been incurred at the balance sheet date, based on objective evidence. For performing loans, the impairment provision reflects the assessment of losses arising from events that have occurred but which have not been specifically identified at the reporting date.

Business and Risk Report *continued*

Lending risk – Consumer banking *continued*

Consumer banking by payment due status

2017	Overdrawn current accounts	Personal loans	Credit cards	Total	
(Audited)	£m	£m	£m	£m	%
Performing:					
Neither past due nor impaired	225	1,822	1,591	3,638	92
Non-performing:					
Past due up to 3 months	12	38	28	78	
Impaired:					
Past due 3 to 6 months	4	10	12	26	
Past due 6 to 12 months	3	11	2	16	
Past due over 12 months	3	14	-	17	
	22	73	42	137	4
Charged off (note i)	14	62	98	174	4
Total non-performing	36	135	140	311	
Total consumer banking lending	261	1,957	1,731	3,949	100
Non-performing loans as % of total (excluding charged off balances)	9%	4%	3%	4%	
Impairment provisions excluding charged off balances	15	48	42	105	
Impairment provisions on charged off balances	13	60	91	164	
Total impairment provisions	28	108	133	269	
Impairment provisions as a % of non-performing loans (including charged off balances)	78%	80%	95%	86%	
Impairment provisions as % of total balances	11%	6%	8%	7%	

Business and Risk Report *continued*

Lending risk – Consumer banking *continued*

Consumer banking by payment due status

2016	Overdrawn current accounts	Personal loans	Credit cards	Total	
(Audited)	£m	£m	£m	£m	%
Performing:					
Neither past due nor impaired	206	1,742	1,576	3,524	91
Non-performing:					
Past due up to 3 months	16	42	27	85	
Impaired:					
Past due 3 to 6 months	4	11	11	26	
Past due 6 to 12 months	3	11	3	17	
Past due over 12 months	4	16	-	20	
	27	80	41	148	4
Charged off (note i)	14	79	104	197	5
Total non-performing	41	159	145	345	
Total consumer banking lending	247	1,901	1,721	3,869	100
Non-performing loans as % of total (excluding charged off balances)	11%	4%	2%	4%	
Impairment provisions excluding charged off balances	13	46	38	97	
Impairment provisions on charged off balances	12	75	97	184	
Total impairment provisions	25	121	135	281	
Impairment provisions as a % of non-performing loans (including charged off balances)	61%	76%	93%	81%	
Impairment provisions as % of total balances	10%	6%	8%	7%	

Note:

i. Charged off balances relate to accounts which are closed to future transactions and are held on the balance sheet for an extended period (up to 36 months, depending on the product) whilst recovery procedures take place.

Strong asset quality in the unsecured portfolio has been maintained, with total non-performing balances (excluding charged off accounts) reducing by 7% to £137 million (2016: £148 million).

Impairment losses for the year

	Overdrawn current accounts	**Personal loans**	**Credit cards**	**Total**
(Audited)	**£m**	**£m**	**£m**	**£m**
Year to 4 April 2017	**12**	**28**	**38**	**78**
Year to 4 April 2016	14	38	44	96

Impairment losses have reduced by £18 million. The charge for the year includes £7 million (2016: £29 million) in relation to assumption updates made to ensure that the provisions in the up to date book remain appropriate in the prolonged low interest rate environment.

Business and Risk Report *continued*

Lending risk – Consumer banking *continued*

Forbearance

The following concession events are included within the forbearance reporting for consumer banking:

Payment concession

This concession consists of reduced monthly payments over an agreed period and may be offered to customers with an overdraft or credit card. For credit cards subject to such a concession, arrears do not increase provided the payments are made.

Interest suppressed payment arrangement

This temporary interest payment concession results in reduced monthly payments and may be offered to customers with an overdraft, credit card or personal loan. Interest payments and fees are suppressed during the period of the concession and arrears do not increase.

Balances re-aged/re-written

As customers repay their debt in line with the terms of their arrangement and begin to emerge from financial difficulty we will repair their accounts, bringing them into an up-to-date and performing position. For personal loans we will re-write their account over a longer term, to maintain a reduced monthly payment. For credit cards we re-age the account and set the payment status to 'up-to-date', at which point the customer is treated in the same way as any other performing account.

Impairment provisions on forborne accounts are calculated to ensure that they appropriately capture any heightened likelihood for these accounts to default.

The table below provides details of the consumer banking exposures which are subject to forbearance.

Balances subject to forbearance				
2017	**Overdrawn current accounts**	**Personal loans**	**Credit cards**	**Total**
	£m	**£m**	**£m**	**£m**
Payment concession	17	-	2	19
Interest suppressed payment concession	5	29	18	52
Balances re-aged/re-written	-	-	5	5
Total forbearance	22	29	25	76
Impairment provision on forborne loans	3	24	16	43

Balances subject to forbearance				
2016	Overdrawn current accounts	Personal loans	Credit cards	Total
	£m	£m	£m	£m
Payment concession	19	-	3	22
Interest suppressed payment concessions	4	30	21	55
Balances re-aged/re-written	-	-	7	7
Total forbearance	23	30	31	84
Impairment provision on forborne loans	2	25	19	46

Note:
Where more than one concession event has occurred, exposures are reported under the latest event.

Alignment with the European Banking Authority financial reporting definitions has resulted in two key changes:

1. Certain concessions previously reported as re-negotiated balances are not included in the agreed definition of forbearance:
   - Personal loans with a repayment plan are only reported as forbearance where interest is suppressed. Previously all repayment plans were reported as renegotiated balances.
   - Current accounts previously considered as a repair, where the overdrawn balance on a plan had been repaid in full, are not included in the current definition of forbearance.
2. Exit criteria have been introduced, whereby loans exit forbearance if they meet certain payment and arrears conditions, including a two year probation period post the forbearance event. The previous reporting of re-negotiated loans included all balances that had ever been forborne since 2010.

Business and Risk Report *continued*

Lending risk – Consumer banking *continued*

Balances previously reported as re-negotiated at 4 April 2016 were £214 million. Using the current definition, this year's report includes £84 million of balances that were forborne at that date. The changes are summarised below:

Reconciliation of balances at 4 April 2016	Overdrawn current accounts	Personal loans	Credit cards	Total
	£m	£m	£m	£m
Re-negotiated balances as previously reported	34	138	42	214
Changes in reporting definition (note i)	(1)	(107)	-	(108)
Exit criteria for forborne balances	(10)	(1)	(11)	(22)
Forborne balances	23	30	31	84

Note:

i. The amounts removed include all balances that have been subject to these concessions since 2010.

Lending risk – Commercial lending

Summary

The commercial loan portfolio comprises the following:

Commercial lending balances	2017		2016	
(Audited)	**£m**	**%**	£m	%
Commercial real estate (CRE)	2,568	23	3,009	25
Registered social landlords (note i)	7,546	67	7,625	65
Project finance (note ii)	1,096	10	1,197	10
Total commercial lending	11,210	100	11,831	100
Fair value adjustment for micro hedged risk (note iii)	1,370		1,366	
Total	12,580		13,197	

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.

Following a strategic review of the commercial lending business, it was concluded that it is no longer a good fit with the core purpose of Nationwide. The strategy for the commercial lending portfolio is to hold and actively manage to maturity in line with contractual terms.

The registered social landlord and project finance portfolios now amount to 77% (2016: 75%) of the commercial lending portfolio, reflecting the managed exit of CRE, together with scheduled repayments and redemptions.

Notwithstanding the reduction in CRE lending, the exposure remains well spread across sectors and geographic regions.

The registered social landlord and project finance assets are fully performing and remain stable, reflecting their long term, lower risk nature.

Lending risk

Lending risk in the commercial loan portfolio is linked to delinquency and the availability of collateral to cover any loan balances. Nationwide adopts robust credit management policies and processes designed to recognise and manage the risks arising, or likely to arise, from the portfolio.

The lending risk in the CRE portfolio continues to reduce as the portfolio of loans contracts, the volume of non-performing loans reduces and real estate market conditions continue to be favourable.

The registered social landlord portfolio is risk rated using internal rating models with the major drivers being financial strength, independent viability assessment ratings provided by the Homes and Communities Agency and the type and size of the registered social landlord. The distribution of exposures is weighted more towards the stronger risk ratings and, against a backdrop of a long history of zero defaults, the risk profile of the portfolio remains low.

The project finance portfolio is secured against contractual cash flows from projects procured under the Private Finance Initiative rather than physical assets. The majority of loans are secured on projects which are now operational and benefiting from secure long term cash flows, with only one case, with a balance of £24 million, remaining in the construction phase.

Business and Risk Report *continued*

Lending risk – Commercial lending *continued*

Loan to value

The following table shows the CRE portfolio by LTV and region:

CRE lending balances by LTV and region					
2017	**London**	**South East**	**Rest of UK (note i)**	**Total**	
(Audited)	**£m**	**£m**	**£m**	**£m**	**%**
Performing loans					
Fully collateralised					
LTV ratio (note ii):					
Less than 25%	217	19	38	274	
25% to 50%	702	178	359	1,239	
51% to 75%	466	66	361	893	
76% to 90%	8	4	59	71	
91% to 100%	1	8	1	10	
	1,394	275	818	2,487	97
Not fully collateralised:					
Over 100% LTV (A)	2	-	5	7	-
Collateral value on A	*-*	*-*	*4*	*4*	
Negative equity on A	*2*	*-*	*1*	*3*	
Total performing loans	1,396	275	823	2,494	97
Non-performing loans (note iii)					
Fully collateralised					
LTV ratio:					
Less than 25%	1	-	-	1	
25% to 50%	9	3	2	14	
51% to 75%	8	1	4	13	
76% to 90%	-	-	3	3	
91% to 100%	3	4	3	10	
	21	8	12	41	2
Not fully collateralised:					
Over 100% LTV (B)	1	3	29	33	1
Collateral value on B	*-*	*-*	*20*	*20*	
Negative equity on B (note iv)	*1*	*3*	*9*	*13*	
Total non-performing loans	22	11	41	74	3
Total CRE loans	1,418	286	864	2,568	100
Geographical concentration	55%	11%	34%	100%	

Business and Risk Report *continued*

Lending risk – Commercial lending *continued*

CRE lending balances by LTV and region

2016	London	South East	Rest of UK (note i)	Total	
(Audited)	£m	£m	£m	£m	%
Performing loans					
Fully collateralised					
LTV ratio (note ii):					
Less than 25%	136	24	60	220	
25% to 50%	1,021	219	419	1,659	
51% to 75%	329	111	390	830	
76% to 90%	3	13	46	62	
91% to 100%	1	-	5	6	
	1,490	367	920	2,777	92
Not fully collateralised:					
Over 100% LTV (A)	-	3	3	6	-
Collateral value on A	*-*	*2*	*2*	*4*	
Negative equity on A	*-*	*1*	*1*	*2*	
Total performing loans	1,490	370	923	2,783	92
Non-performing loans (note iii)					
Fully collateralised					
LTV ratio:					
Less than 25%	17	-	2	19	
25% to 50%	10	9	5	24	
51% to 75%	8	5	17	30	
76% to 90%	3	-	18	21	
91% to 100%	-	-	6	6	
	38	14	48	100	4
Not fully collateralised:					
Over 100% LTV (B)	7	52	67	126	4
Collateral value on B	*5*	*36*	*47*	*88*	
Negative equity on B (note iv)	*2*	*16*	*20*	*38*	
Total non-performing loans	45	66	115	226	8
Total CRE loans	1,535	436	1,038	3,009	100
Geographical concentration	51%	14%	35%	100%	

Notes:

i. Includes lending to borrowers based in the Channel Islands.

ii. The LTV ratio is calculated using the on-balance sheet carrying amount of the loan divided by the indexed value of the most recent independent external collateral valuation. The Investment Property Databank (IPD) monthly index is used.

iii. Non-performing loans include impaired loans and loans with arrears of less than three months which are not impaired.

iv. All non-performing loans with negative equity are impaired.

Non-performing loans have reduced and now represent 3% of CRE balances (2016: 8%). Both the proportion of partially collateralised non-performing loans and the shortfall on collateral for non-performing loans have also reduced. These changes reflect improving book performance and managed exit activity to reduce exposure to assets outside of risk appetite or which do not align to lending strategy.

Business and Risk Report *continued*

Lending risk – Commercial lending *continued*

Credit risk concentrations

The CRE exposure remains well spread across sectors, and geographic regions as shown below:

CRE lending balances and impairment provisions by type and region

2017	London	South East	Rest of UK (note i)	Total
	£m	£m	£m	£m
Retail	433	170	209	812
Office	222	28	222	472
Residential	686	37	263	986
Industrial and warehouse	29	29	99	157
Leisure and hotel	48	22	57	127
Other	-	-	14	14
Total CRE lending	1,418	286	864	2,568
Impairment provision:				
Retail	1	4	2	7
Office	1	-	2	3
Residential	1	-	5	6
Industrial and warehouse	-	-	1	1
Leisure and hotel	-	-	6	6
Other	-	-	2	2
Total impairment provisions	3	4	18	25

CRE lending balances and impairment provisions by type and region

2016	London	South East	Rest of UK (note i)	Total
	£m	£m	£m	£m
Retail	459	235	317	1,011
Office	201	69	208	478
Residential	666	71	256	993
Industrial and warehouse	29	36	158	223
Leisure and hotel	88	25	87	200
Other	92	-	12	104
Total CRE lending	1,535	436	1,038	3,009
Impairment provision:				
Retail	2	12	8	22
Office	4	1	3	8
Residential	1	-	5	6
Industrial and warehouse	-	-	12	12
Leisure and hotel	1	-	7	8
Other	-	-	3	3
Total impairment provisions	8	13	38	59

Note:

i. Includes lending to borrowers based in the Channel Islands.

Business and Risk Report *continued*

Lending risk – Commercial lending *continued*

Arrears and impairment

Impairment provisions are held in relation to both the performing and non-performing segments of the commercial lending portfolio. Provisions reflect losses which have been incurred at the balance sheet date, based on objective evidence. Individual impairment provisions are assigned to facilities exhibiting signs of financial difficulty and a collective provision is assigned to all other accounts. For currently performing loans, the collective provision reflects losses arising from impairment events that have occurred within the portfolio but are not identifiable at the reporting date.

No losses have been experienced on the registered social landlord or project finance portfolios and there is no non-performance within these portfolios. As a result, impairment provisions are only required against the CRE portfolio.

The table below sets out the payment due status and impairment provisions for the CRE portfolio:

CRE lending balances by payment due status

	2017		2016	
(Audited)	**£m**	**%**	£m	%
Performing:				
Neither past due nor impaired	2,494	97	2,783	92
Non-performing:				
Past due up to 3 months but not impaired (note i)	29	1	55	2
Impaired (note ii):				
Past due up to 3 months	24	1	115	4
Past due 3 to 6 months	1	-	21	1
Past due 6 to 12 months	3	-	4	-
Past due over 12 months	17	1	28	1
Possessions (note iii)	-	-	3	-
Total non-performing balances	74	3	226	8
Total	2,568	100	3,009	100
Impairment provisions				
Individual	20	80	54	92
Collective	5	20	5	8
Total impairment provisions	25	100	59	100
Provision coverage ratios				
Individual provisions as % of impaired balances		44		32
Total provisions as % of non-performing balances		34		26
Total provisions as % of total balances		1		2
Estimated collateral:				
Against loans past due but not impaired	29	100	55	100
Against impaired loans	32	71	133	78
Total collateral against non-performing balances	61	82	188	83

Notes:

i. The status 'past due up to 3 months but not impaired' includes any asset where a payment due under strict contractual terms is received late or missed. The amount included is the entire financial asset rather than just the payment overdue.

ii. Impaired loans include those balances which are more than three months in arrears, or against which an individual provision is held.

iii. Possession balances represent loans for which Nationwide has taken ownership of security pending sale. Assets in possession are realised to derive the maximum benefit for all interested parties. Nationwide does not occupy or otherwise use for any purposes the repossessed assets.

Total non-performing loans, before provisions, have reduced by £152 million to £74 million, and there has been a reduction of £34 million in total impairment provisions, reflecting the managed exit activity, improving book performance and an improvement in market conditions.

Impairment loss/(reversal) for the year

	2017	2016
(Audited)	**£m**	£m
Total	(5)	(34)

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Business and Risk Report *continued*

Lending risk – Commercial lending *continued*

The improved CRE market conditions, including increased liquidity and capital values, have resulted in a net impairment reversal of £5 million. The higher reversal in the previous year reflects higher levels of total impaired balances impacted by improving market conditions, and increased levels of recoveries.

Forbearance

Forbearance is recorded and reported at borrower level and applies to all commercial lending including impaired exposures and customers subject to enforcement and recovery action. Impairment provisions on forborne loans are calculated on an individual borrower basis.

For commercial customers in financial difficulty, the following concession events are included within forbearance reporting:

Refinance

Debt restructuring, either mid-term or at maturity, will be considered where asset sales or external refinance cannot be secured to repay facilities in full and where a restructure is considered to provide the best debt recovery outcome for both the customer and Nationwide.

Interest concession

The temporary postponement of interest or a reduction to the interest rate charged, during which period the loans do not accrue arrears, may be considered where the customer is experiencing payment difficulties.

Capital concession

Capital concessions consist of temporary suspensions to capital repayments to allow the customer time to overcome payment difficulties, the full or partial consolidation of previous payment arrears or the partial write-off of debt.

Security amendment

Where a customer seeks the release of assets charged to Nationwide as security for their commercial loan, this will be treated as forbearance where Nationwide's position is weakened in terms of either the loan to value of the remaining exposure or the level of interest cover available.

Extension at maturity

Customers who are unable to repay the loan at term expiry may be given short term maturity extensions to allow them time to negotiate the repayment of facilities in full either via asset sales or external refinance.

Breach of covenant

Where a customer is unable to comply with either financial or non-financial covenants, as specified in their loan agreement, a temporary waiver or amendment to the covenants will be considered, as appropriate.

The table below provides details of the commercial loans which are subject to forbearance.

Lending subject to forbearance

	2017	2016
	£m	£m
Refinance	34	40
Modifications:		
Interest concession	1	2
Capital concession	50	64
Security amendment	56	139
Extension at maturity	126	150
Breach of covenant	80	142
Total	347	537
Impairment provision on forborne loans	17	41

Note:
Loans where more than one concession event has occurred are reported under the latest event.

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

Overall, the CRE exposures currently subject to forbearance have reduced to £347 million, principally as a result of the controlled exit from non-core, higher risk loans, and now represent 14% of CRE loan balances (2016: 18%).

There are no instances of forbearance in either the registered social landlord or project finance portfolios.

CRE balances previously reported as subject to forbearance at 4 April 2016 were £588 million. Updating the prior year figures to fully align to the EBA definitions results in a minor revision to balances reported as forborne at 4 April 2016 to £537 million.

Business and Risk Report *continued*

Lending risk – Treasury assets

Summary

The Treasury portfolio is held primarily for liquidity management and, in the case of derivatives, for market risk management. As at 4 April 2017 treasury assets represent 13.7% (2016: 12.9%) of total assets.

The net increase in the portfolio compared to the previous year is predominantly due to an increase in cash balances. This follows the replacement during the year of the Bank of England's Funding for Lending Scheme (FLS), under which Nationwide received treasury bills that were held off-balance sheet, with the Term Funding Scheme (TFS), under which cash is received.

Treasury asset balances

	2017	2016
(Audited)	£m	£m
Cash	13,017	8,797
Loans and advances to banks	2,587	3,591
Investment securities	9,831	10,738
Treasury liquidity and investment portfolio	25,435	23,126
Derivative assets	5,043	3,898
Total Treasury portfolio	**30,478**	27,024

Note:

Derivatives are classified as assets where their fair value is positive and liabilities where their fair value is negative. At 4 April 2017, derivative liabilities were £3,182 million (2016: £3,463 million).

In line with the Board's liquidity risk appetite, investment activity is restricted to high quality liquid securities comprising central bank reserves and highly rated debt securities issued by a limited range of governments, multilateral development banks ('supranationals') and government guaranteed agencies. In addition, cash is invested in highly rated liquid assets that are eligible for accessing central bank funding operations.

The total balance of out of policy legacy assets (investment securities acquired prior to the financial crisis and no longer within approved risk appetite) has reduced from £423 million to £172 million during the year, primarily through ongoing sales. A £9 million impairment charge (2016: £8 million reversal) was recognised during the year. Opportunities to exit positions continue to be assessed against prevailing market conditions and financial implications.

Derivatives are used to reduce exposure to market risks but are not used for trading or speculative purposes. There are no exposures to emerging markets, hedge funds or credit default swaps.

Managing treasury credit risks

Credit risk within the Treasury portfolio arises primarily from the instruments held by Treasury for operational, liquidity and investment purposes. The Treasury Credit Risk function manages all aspects of credit risk in accordance with the risk governance framework, under the supervision of the Credit Committee.

An established governance structure exists to identify and review under-performing assets and assess the likelihood of future losses. A monthly review is undertaken of the current and expected future performance of all Treasury assets. Collateral held as security for Treasury assets is determined by the nature of the instrument. Treasury's liquidity portfolio assets are generally unsecured; however, reverse repos, asset-backed securities and similar instruments are secured by pools of financial assets.

Assets are impaired where there is objective evidence that current events and/or performance will result in a loss. Impairment assessments evaluate, among other factors, volatility in valuation, evidence of deterioration in the financial health of the obligor, industry and sectoral performance, and underlying cash flows.

In addition, counterparty credit risk arises from the use of derivatives; these are only traded with highly-rated organisations and are collateralised under market standard documentation.

Business and Risk Report *continued*

Lending risk – Treasury assets *continued*

Liquidity and investment portfolios

The liquidity and investment portfolio of £25,435 million (2016: £23,126 million) comprises liquid assets and other securities. The size of the portfolio reflects fluctuations in market prices, Nationwide's operational and strategic liquidity requirements and legacy asset disposals. An analysis of the 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)

2017		**AAA**	**AA**	**A**	**Other**	**UK**	**US**	**Europe**	**Other**
(Audited)	**£m**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Liquid assets:									
Cash and reserves at central banks (note ii)	13,017	-	90	-	10	90	-	10	-
Government bonds (note ii)	6,438	10	90	-	-	78	9	13	-
Supranational bonds	459	88	12	-	-	-	-	-	100
Covered bonds	931	100	-	-	-	51	-	33	16
Residential mortgage backed securities (RMBS)	922	100	-	-	-	61	-	39	-
Asset-backed securities (other)	285	100	-	-	-	83	-	17	-
Liquid assets total	22,052	14	80	-	6	81	3	13	3
Other securities:									
RMBS (note iii)	288	27	3	70	-	98	-	2	-
Commercial mortgage backed securities (CMBS)	11	-	38	24	38	38	62	-	-
Collateralised loan obligations	226	86	14	-	-	88	12	-	-
Student loans (note iii)	120	48	52	-	-	-	100	-	-
Other investments	151	-	32	28	40	44	24	32	-
Other securities total	796	42	19	31	8	69	24	7	-
Loans and advances to banks (note iv)	2,587	-	47	51	2	70	18	10	2
Total	25,435	14	74	6	6	80	5	12	3

Liquidity and investment portfolio by credit rating (note i)

2016		AAA	AA	A	Other	UK	US	Europe	Other
(Audited)	£m	%	%	%	%	%	%	%	%
Liquid assets:									
Cash and reserves at central banks	8,797	99	-	1	-	90	-	10	-
Government bonds	6,321	82	18	-	-	75	14	11	-
Supranational bonds	522	90	10	-	-	-	-	-	100
Covered bonds	980	100	-	-	-	52	-	36	12
Residential mortgage backed securities (RMBS)	1,068	100	-	-	-	65	-	35	-
Asset-backed securities (other)	318	100	-	-	-	62	-	38	-
Liquid assets total	18,006	92	7	1	-	78	5	13	4
Other securities:									
RMBS (note iii)	563	20	15	54	11	72	-	25	3
Commercial mortgage backed securities (CMBS)	40	-	16	67	17	16	84	-	-
Collateralised loan obligations	528	84	13	3	-	78	22	-	-
Covered bonds	31	-	-	100	-	-	-	100	-
Student loans (note iii)	145	22	50	26	2	6	94	-	-
Other investments	222	-	28	50	22	28	50	22	-
Other securities total	1,529	39	19	34	8	58	26	15	1
Loans and advances to banks (note iv)	3,591	25	19	31	25	68	9	11	12
Total	23,126	79	10	7	4	75	7	13	5

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. The UK's credit rating was downgraded from AAA to AA by S&P in June 2016, impacting the ratings for cash and government bonds.

iii. Comparatives have been restated for the reclassification of certain amounts based on underlying assets.

iv. Loans and advances to banks includes derivative collateral and reverse repo balances.

Business and Risk Report *continued*

Lending risk – Treasury assets *continued*

The analysis on the previous page does not include off-balance sheet funding, including £4.8 billion (2016: £8.5 billion) of primary liquidity representing short dated UK Treasury bills held as a result of FLS. These are included in the analysis of funding in the 'Liquidity and funding risk' section of this report.

Available for sale reserve

Of the total £25,435 million (2016: £23,126 million) liquidity and investment portfolio, £9,831 million (2016: £10,738 million) is held as available for sale (AFS). These assets are marked to market, with fair value movements recognised in reserves.

Of these assets, £66 million (2016: £125 million) are classified as Level 3 (valuation not based on observable market data) for the purposes of IFRS 13. The decrease from the prior year is primarily due to the disposal of Nationwide's investment in Visa Europe Limited, valued at £81 million, partly offset by the acquisition of preference shares in Visa Inc. Further details can be found in note 15 to the accounts. Details of fair value movements can be found in notes 24 and 25 to the accounts.

The table below shows the fair value carrying amount and associated AFS reserve for the liquidity and investment assets.

Fair value of treasury assets and AFS reserve

	2017		2016	
	Fair value on balance sheet	Cumulative AFS reserve	Fair value on balance sheet	Cumulative AFS reserve
(Audited)	£m	£m	£m	£m
Liquid assets:				
Cash and reserves at central banks	13,017	(note i)	8,797	(note i)
Government bonds	6,438	(383)	6,321	(422)
Supranational bonds	459	(4)	522	(3)
Covered bonds	931	(17)	980	(12)
Residential mortgage backed securities (RMBS)	922	2	1,068	8
Asset-backed securities (other)	285	-	318	1
Liquid assets total	22,052	(402)	18,006	(428)
Other securities:				
RMBS (note ii)	288	4	563	23
Commercial mortgage backed securities (CMBS)	11	-	40	6
Collateralised loan obligations (CLO)	226	-	528	5
Covered bonds	-	-	31	(3)
Student loans (note ii)	120	6	145	13
Other investments	151	(31)	222	(97)
Other securities total	796	(21)	1,529	(53)
Loans and advances to banks	2,587	(note i)	3,591	(note i)
Total	25,435	(423)	23,126	(481)
AFS reserve before hedge accounting and taxation		(423)		(481)
Hedge accounting adjustment for interest rate risk		370		498
Taxation		9		(9)
AFS reserve (net)		(44)		8

Notes:

i. Not applicable for 'Cash' and 'Loans and advances to banks'.

ii. Comparatives have been restated for the reclassification of certain amounts based on underlying assets.

As at 4 April 2017, the balance on the AFS reserve had moved to a £44 million gain, net of tax (2016: £8 million loss). The movements in the AFS reserve reflect general market movements and the disposal of legacy assets. The fair value movement of AFS assets that are not impaired has no effect on profit.

Business and Risk Report *continued*

Lending risk – Treasury assets *continued*

Country exposures

The following table summarises the exposure to institutions outside the UK. The exposures are shown at their balance sheet carrying values.

Country exposures

2017	**Cash**	**Government bonds**	**Mortgage backed securities**	**Covered bonds**	**Supra-national bonds**	**Loans to banks**	**Other corporate (note i)**	**Other assets**	**Total**
(Audited)	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Finland	-	218	-	24	-	-	-	-	242
France	-	-	-	31	-	-	1	54	86
Germany	-	484	-	-	-	44	-	43	571
Ireland	1,258	-	-	-	-	27	-	-	1,285
Italy	-	-	-	-	-	-	3	-	3
Netherlands	-	153	366	-	-	-	-	-	519
Portugal	-	-	-	-	-	-	-	-	-
Spain	-	-	-	-	-	-	-	-	-
Total Eurozone	1,258	855	366	55	-	71	4	97	2,706
USA	16	600	7	-	-	474	-	182	1,279
Rest of world (note ii)	-	-	-	400	459	232	-	-	1,091
Total	1,274	1,455	373	455	459	777	4	279	5,076

Country exposures

2016	Cash	Government bonds	Mortgage backed securities	Covered bonds	Supra-national bonds	Loans to banks	Other corporate (note i)	Other assets	Total
(Audited)	£m	£m	£m	£m	£m	£m	£m	£m	£m
Finland	-	242	-	23	-	-	-	-	265
France	-	-	-	52	-	60	4	66	182
Germany	-	365	-	-	-	107	3	102	577
Ireland	871	-	-	-	-	18	-	-	889
Italy	-	-	21	-	-	-	3	-	24
Netherlands	-	82	385	-	-	-	-	-	467
Portugal	-	-	22	-	-	-	-	-	22
Spain	-	-	85	31	-	-	-	-	116
Total Eurozone	871	689	513	106	-	185	10	168	2,542
USA	8	902	35	-	-	350	-	365	1,660
Rest of world (note ii)	-	-	17	383	522	627	-	-	1,549
Total	879	1,591	565	489	522	1,162	10	533	5,751

Notes:

i. Other corporate exposures are held via a European commercial loan facility reported as part of loans and advances to customers.

ii. Rest of world exposure is to Australia, Canada, Denmark, Norway, Sweden and Switzerland.

Exposure to Eurozone countries continues to be actively managed. During the year, Nationwide disposed of its Portuguese and Spanish mortgage backed assets. Cash held in the Republic of Ireland is with the Central Bank of Ireland.

None of the exposures detailed in the table above were in default at 4 April 2017 (2016: £3 million), and no impairment was incurred on these assets in the period (2016: £nil).

Business and Risk Report *continued*

Lending risk – Treasury assets *continued*

Derivative financial instruments

Derivatives are used to reduce exposure to market risks, although the application of accounting rules can create volatility in the income statement in a financial year. The fair value of derivative assets at 4 April 2017 was £5.0 billion (2016: £3.9 billion) and the fair value of derivative liabilities was £3.2 billion (2016: £3.5 billion).

The International Swaps and Derivatives Association (ISDA) Master Agreement is Nationwide's preferred agreement for documenting derivative transactions. A Credit Support Annex (CSA) is always executed in conjunction with the ISDA Master Agreement. Under the terms of a CSA, collateral is passed between parties to mitigate the market-contingent counterparty risk inherent in the outstanding positions. CSAs are two way agreements where both parties post collateral dependent on the exposure of the derivative. Collateral is paid or received on a regular basis (typically daily) to mitigate the mark to market exposures on derivatives.

Nationwide's CSA legal documentation for derivatives grants legal rights of set off for transactions with the same overall counterparty. Accordingly, the credit risk associated with such positions is reduced to the extent that negative mark to market values offset positive mark to market values in the calculation of credit risk within each netting agreement.

Under the terms of CSA netting arrangements, outstanding transactions with the same counterparty can be offset and settled net following a default, or another predetermined event. Under CSA arrangements, netting benefits of £2.2 billion (2016: £2.0 billion) were available and £2.8 billion of collateral (2016: £1.8 billion) was held. Only cash is held as collateral.

To comply with EU regulatory requirements, Nationwide has indirect clearing arrangements with a central counterparty (CCP) which it uses to clear standardised derivatives.

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

Derivative credit exposure

	2017				2016			
Counterparty credit quality	**AA**	**A**	**BBB**	**Total**	AA	A	BBB	Total
(Audited)	**£m**	**£m**	**£m**	**£m**	£m	£m	£m	£m
Gross positive fair value of contracts	2,077	2,576	390	5,043	1,128	2,770	-	3,898
Netting benefits	(797)	(1,030)	(389)	(2,216)	(532)	(1,488)	-	(2,020)
Net current credit exposure	1,280	1,546	1	2,827	596	1,282	-	1,878
Collateral	(1,261)	(1,537)	(1)	(2,799)	(580)	(1,224)	-	(1,804)
Net derivative credit exposure	19	9	-	28	16	58	-	74

Financial risk

Nationwide is exposed to financial risks as follows:

Risk category	Definition
Liquidity and funding	Liquidity risk is the risk that Nationwide is unable to meet its liabilities as they fall due and maintain member and stakeholder confidence. Funding risk is the risk that Nationwide is unable to maintain diverse funding sources in wholesale and retail markets and manage retail funding risk that can arise from excessive concentrations of higher risk deposits.
Solvency	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.
Market	The risk that the net value of, or net income arising from, assets and liabilities is impacted as a result of market price or rate changes.
Pension	The risk that the value of the Fund's assets will be insufficient to meet the estimated liabilities of the Fund. Pension risk can adversely impact Nationwide's capital position and/or result in increased cash funding obligations to the Fund.
Earnings	The risk that a source of income or value is unable to continue to add the expected value, due to changes in market, regulatory or other environmental factors.

Financial risk is managed within a framework of approved assets, currencies and capital instruments supported by detailed limits set by either the Board or the Assets and Liabilities Committee (ALCO) under its delegated mandate. The Board retains responsibility for approval of derivative classes that may be used for market risk management purposes, restrictions over the use of such derivative classes (within the limitations imposed under the Building Societies Act, Section 9A) and for asset classes that may be classified as liquidity.

Business and Risk Report *continued*

Financial risk – Liquidity and funding risk

Summary

Nationwide manages liquidity and funding risks within a comprehensive risk framework which includes its policy, strategy, limit setting and monitoring, stress testing and robust governance controls.

This framework ensures that Nationwide maintains a stable and diverse funding base and sufficient holdings of high-quality liquid assets, so that there is no significant risk that liabilities cannot be met as they fall due.

Liquidity and funding levels continued to be within Board risk appetite and regulatory requirements at all times during the year.

Nationwide monitors its position relative to internal risk appetite and the regulatory short term liquidity stress metric, the Liquidity Coverage Ratio (LCR), which ensures that sufficient high quality liquid assets are held to survive a short term severe but plausible liquidity stress.

The Group's LCR at 4 April 2017 was 124.0% (2016: 142.6%), which reflects its strategy of maintaining a LCR above 100%. The decrease in the LCR reflects the inclusion of additional outflows in the LCR following the finalisation of new Pillar 1 requirements and the impact of a one-off item in respect of Nationwide's commitment to acquire financial assets. On a like-for-like basis, the LCR remains broadly consistent with last year's.

Nationwide also monitors its position against the future longer-term regulatory funding metric, the Net Stable Funding Ratio (NSFR). Based on current interpretations of regulatory requirements and guidance, the NSFR at 4 April 2017 was 132.6% (2016: 127.9%) which exceeds the expected 100% minimum future requirement.

Funding risk

Funding strategy

Nationwide's funding strategy is to remain predominantly retail funded; retail customer loans and advances are therefore largely funded by customer deposits. Non-retail lending, including treasury assets and commercial customer loans, are largely funded by wholesale debt, as set out below.

Funding profile

	2017	2016		**2017**	2016
Assets	**£bn**	£bn	**Liabilities**	**£bn**	£bn
Retail mortgages	**171.1**	162.1	Retail funding	**146.9**	144.9
Treasury assets (including liquidity portfolio)	**25.4**	23.1	Wholesale funding	**55.5**	45.8
Other retail lending	**3.7**	3.6	Capital and reserves	**14.3**	13.2
Commercial/Other lending	**12.6**	13.1	Other liabilities	**5.0**	5.0
Other assets	**8.9**	7.0			
	221.7	208.9		**221.7**	208.9

Nationwide's loan to deposit ratio[1] at 4 April 2017 was 122.6% (2016: 117.2%).

[1] The loan to deposit ratio represents loans and advances to customers divided by shares + other deposits + amounts due to customers (excluding repurchase agreements and collateral received).

Business and Risk Report *continued*

Financial risk – 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. Nationwide's wholesale funding strategy is to remain active in core markets and currencies.

On-balance sheet wholesale funding has increased by £9.7 billion to £55.5 billion. This is due to increased collateral inflows following the depreciation of sterling against other major currencies and replacement of Funding for Lending Scheme (FLS) maturities with on-balance sheet funding, including £6 billion of drawings from the Bank of England's Term Funding Scheme (TFS). This is reflected in Nationwide's wholesale funding ratio (on-balance sheet wholesale funding as a proportion of total funding liabilities) which was 27.1% at 4 April 2017 (2016: 24.8%).

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

Wholesale funding currency

	2017						2016					
	GBP £bn	EUR £bn	USD £bn	Other £bn	Total £bn	% of total	GBP £bn	EUR £bn	USD £bn	Other £bn	Total £bn	% of total
Deposits (note i)	7.7	1.4	0.1	-	9.2	16	9.0	0.5	0.2	-	9.7	21
Certificates of deposit	5.3	-	-	-	5.3	10	4.7	-	0.4	-	5.1	11
Commercial paper	-	-	1.8	-	1.8	3	0.2	-	1.1	-	1.3	3
Covered bonds	3.3	11.4	-	0.2	14.9	27	2.5	11.1	-	0.2	13.8	30
Medium term notes	3.1	6.2	3.6	0.8	13.7	25	2.3	4.8	2.2	0.6	9.9	22
Securitisations	0.9	1.2	1.4	-	3.5	6	1.9	1.2	1.6	-	4.7	10
TFS	6.0	-	-	-	6.0	11	-	-	-	-	-	-
Other	0.3	0.8	-	-	1.1	2	0.2	1.0	0.1	-	1.3	3
Total	26.6	21.0	6.9	1.0	55.5	100	20.8	18.6	5.6	0.8	45.8	100

Note:

i. Includes protected equity bond (PEB) balances of £0.8 billion (2016: £1.9 billion).

To mitigate cross-currency refinancing risk, Nationwide ensures it holds liquidity in each currency to cover at least the next ten business days of wholesale funding maturities.

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

Wholesale funding – residual maturity

2017	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
Deposits (note i)	5.3	1.3	2.0	0.6	9.2	-	-	9.2
Certificates of deposit	0.4	1.7	2.4	0.8	5.3	-	-	5.3
Commercial paper	0.5	0.6	0.6	0.1	1.8	-	-	1.8
Covered bonds	-	-	0.8	-	0.8	0.8	13.3	14.9
Medium term notes	-	-	0.1	1.2	1.3	1.8	10.6	13.7
Securitisations	0.3	-	0.3	0.1	0.7	0.6	2.2	3.5
TFS	-	-	-	-	-	-	6.0	6.0
Other	-	-	-	-	-	-	1.1	1.1
Total	6.5	3.6	6.2	2.8	19.1	3.2	33.2	55.5
Of which secured	0.3	-	1.1	0.1	1.5	1.4	22.4	25.3
Of which unsecured	6.2	3.6	5.1	2.7	17.6	1.8	10.8	30.2
% of total	11.7	6.5	11.2	5.0	34.4	5.8	59.8	100.0

Business and Risk Report *continued*

Financial risk – Liquidity and funding risk *continued*

Wholesale funding – residual maturity

2016	Not more than one month	Over one month but not more than three months	Over three months but not more than six months	Over six months but not more than one year	Subtotal less than one year	Over one year but not more than two years	Over two years	Total
	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Deposits (note i)	4.1	1.2	1.6	1.9	8.8	0.9	-	9.7
Certificates of deposit	1.3	1.6	1.7	0.5	5.1	-	-	5.1
Commercial paper	0.3	0.9	0.1	-	1.3	-	-	1.3
Covered bonds	0.1	-	-	1.2	1.3	0.8	11.7	13.8
Medium term notes	-	-	-	0.9	0.9	0.6	8.4	9.9
Securitisations	-	-	-	1.4	1.4	0.7	2.6	4.7
Other	-	-	-	-	-	-	1.3	1.3
Total	5.8	3.7	3.4	5.9	18.8	3.0	24.0	45.8
Of which secured	0.1	-	-	2.6	2.7	1.5	15.3	19.5
Of which unsecured	5.7	3.7	3.4	3.3	16.1	1.5	8.7	26.3
% of total	12.6	8.1	7.4	12.9	41.0	6.6	52.4	100.0

Note:

i. Includes protected equity bond (PEB) balances of £0.8 billion (2016: £1.9 billion).

At 4 April 2017, cash, government bonds and supranational bonds included in the liquid asset buffer, including FLS treasury bills, represented 129% (2016: 128%) of wholesale funding maturing in less than one year, assuming no rollovers.

Liquidity risk

Total liquidity

Nationwide ensures it has sufficient liquid assets, in terms of both amount and quality, to meet daily cash flow needs as well as stressed requirements driven by internal and regulatory liquidity assessments. The composition of the liquid asset buffer is subject to limits, set by the Board and Assets and Liabilities Committee (ALCO), in relation to issuer, currency and asset type.

The table below sets out the sterling equivalent fair value of the liquidity portfolio, categorised by issuing currency. It includes off-balance sheet liquidity (FLS treasury bills) and excludes encumbered assets.

Liquid assets

	2017				2016			
	GBP	**EUR**	**USD**	**Total**	GBP	EUR	USD	Total
	£bn	**£bn**	**£bn**	**£bn**	£bn	£bn	£bn	£bn
Cash and reserves at central banks	11.8	1.2	-	13.0	7.9	0.9	-	8.8
Government bonds	10.0	0.5	0.7	11.2	13.4	0.5	0.9	14.8
Supranational bonds	0.2	-	0.3	0.5	0.4	-	0.1	0.5
Covered bonds	0.4	0.5	-	0.9	0.5	0.6	-	1.1
RMBS	0.5	0.4	-	0.9	0.7	0.3	0.1	1.1
Asset-backed securities	0.3	-	-	0.3	0.2	0.1	-	0.3
Other securities	0.3	0.2	0.2	0.7	0.4	0.6	0.3	1.3
Total	23.5	2.8	1.2	27.5	23.5	3.0	1.4	27.9

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.

Government bonds in the table above include £4.8 billion of off-balance sheet FLS treasury bills. The average combined month end balance of cash and reserves at central banks, government and supranational bonds during the year was £29.5 billion (2016: £22.8 billion). This increase is largely due to the replacement during the year of FLS, under which Nationwide received off-balance sheet treasury bills, with TFS, under which cash is received.

Business and Risk Report *continued*

Financial risk – Liquidity and funding risk *continued*

Nationwide also holds a portfolio of high quality, central bank eligible covered bonds, RMBS and asset-backed securities. Other securities are held that are not eligible for central bank operations but can be monetised through repurchase agreements with third parties or through sale.

Nationwide undertakes securities financing transactions in the form of repurchase (repo) agreements. This demonstrates the liquid nature of the assets held in its liquid asset buffer and also satisfies regulatory requirements. Cash is borrowed in return for pledging assets as collateral and because settlement is on a simultaneous 'delivery versus payment' basis, the main credit risk arises from intra-day changes in the value of the collateral. This is largely mitigated by Nationwide's collateral management processes.

Repo market capacity is assessed and tested regularly to ensure there is sufficient capacity to rapidly monetise the liquid asset buffer in a stress.

For contingent purposes, Nationwide pre-positions unencumbered mortgage assets at the Bank of England which can be used in the Bank of England's liquidity operations if market liquidity is severely disrupted.

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)									
2017	**Due less than one month (note ii)**	**Due between one and three months**	**Due between three and six months**	**Due between six and nine months**	**Due between nine and twelve months**	**Due between one and two years**	**Due between two and five years**	**Due after more than five years**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Financial assets									
Cash	13,017	-	-	-	-	-	-	-	13,017
Loans and advances to banks	2,226	-	-	-	-	-	-	361	2,587
Available for sale investment securities	40	13	116	66	57	216	2,002	7,254	9,764
Loans and advances to customers	2,890	1,309	1,937	1,877	1,910	7,259	22,057	148,132	187,371
Derivative financial instruments	11	94	130	30	121	324	2,317	2,016	5,043
Other financial assets (note iii)	36	22	15	28	10	60	265	384	820
Total financial assets	18,220	1,438	2,198	2,001	2,098	7,859	26,641	158,147	218,602
Financial liabilities									
Shares	112,403	1,666	6,169	4,905	4,513	9,842	3,870	1,174	144,542
Deposits from banks	2,499	123	20	48	16	28	6,000	-	8,734
Of which repo	-	-	-	-	-	-	-	-	-
Of which TFS	-	-	-	-	-	-	*6,000*	-	*6,000*
Other deposits	2,882	1,075	1,885	336	255	15	11	-	6,459
Due to customers	1,818	130	305	45	67	11	-	-	2,376
Secured funding – ABS and covered bonds	341	20	1,086	128	90	1,394	10,137	6,280	19,476
Senior unsecured funding	894	2,339	3,126	657	1,431	1,765	5,022	5,629	20,863
Derivative financial instruments	37	11	35	41	57	135	505	2,361	3,182
Other financial liabilities (note iii)	-	-	(2)	-	1	8	1	-	8
Subordinated liabilities	-	-	-	-	103	-	700	2,102	2,905
Subscribed capital (note iv)	-	-	-	-	-	-	-	276	276
Total financial liabilities	120,874	5,364	12,624	6,160	6,533	13,198	26,246	17,822	208,821
Off-balance sheet commitments (note v)	15,784	-	-	-	-	-	-	-	15,784
Net liquidity difference	(118,438)	(3,926)	(10,426)	(4,159)	(4,435)	(5,339)	395	140,325	(6,003)
Cumulative liquidity difference	(118,438)	(122,364)	(132,790)	(136,949)	(141,384)	(146,723)	(146,328)	(6,003)	-

Business and Risk Report *continued*

Financial risk – Liquidity and funding risk *continued*

Residual maturity (note i) 2016	Due less than one month (note ii)	Due between one and three months	Due between three and six months	Due between six and nine months	Due between nine and twelve months	Due between one and two years	Due between two and five years	Due after more than five years	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Financial assets									
Cash	8,797	-	-	-	-	-	-	-	8,797
Loans and advances to banks	3,179	87	-	-	-	-	-	325	3,591
Available for sale investment securities	6	15	14	1	178	352	3,680	6,366	10,612
Loans and advances to customers	2,825	1,256	1,929	1,810	1,823	7,124	20,237	141,803	178,807
Derivative financial instruments	25	151	128	102	30	227	994	2,241	3,898
Other financial assets (note iii)	5	15	107	17	65	142	234	299	884
Total financial assets	14,837	1,524	2,178	1,930	2,096	7,845	25,145	151,034	206,589
Financial liabilities									
Shares	103,296	1,632	5,875	4,608	5,122	10,731	6,251	1,200	138,715
Deposits from banks	1,658	184	168	41	19	-	25	-	2,095
Of which repo	*122*	-	*5*	-	-	-	-	-	*127*
Other deposits	2,549	1,392	1,843	716	391	737	7	-	7,635
Due to customers	3,563	543	1,347	345	215	126	62	-	6,201
Secured funding – ABS and covered bonds	65	19	43	2,238	323	1,524	7,002	8,263	19,477
Senior unsecured funding	1,637	2,478	1,810	315	1,040	632	3,878	4,818	16,608
Derivative financial instruments	31	9	23	33	84	338	647	2,298	3,463
Other financial liabilities (note iii)	2	2	1	1	(1)	-	8	-	13
Subordinated liabilities	-	-	-	-	-	114	669	1,034	1,817
Subscribed capital (note iv)	-	-	-	-	-	-	-	413	413
Total financial liabilities	112,801	6,259	11,110	8,297	7,193	14,202	18,549	18,026	196,437
Off-balance sheet commitments (note v)	13,630	-	-	-	-	-	-	-	13,630
Net liquidity difference	(111,594)	(4,735)	(8,932)	(6,367)	(5,097)	(6,357)	6,596	133,008	(3,478)
Cumulative liquidity difference	(111,594)	(116,329)	(125,261)	(131,628)	(136,725)	(143,082)	(136,486)	(3,478)	-

Notes:

i. The analysis excludes certain non-financial assets (including property, plant and equipment, intangible assets, investment property, other assets, deferred tax assets and accrued income and expenses prepaid) and non-financial liabilities (including provisions for liabilities and charges, accruals and deferred income, current tax liabilities, other liabilities and retirement benefit obligations).

ii. Due less than one month includes amounts repayable on demand.

iii. Other financial assets and liabilities include the fair value adjustments for portfolio hedged risk and investments in equity shares.

iv. The principal amount for undated subscribed capital is included within the due more than five years column.

v. 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 ALCO. Nationwide uses judgement and past behavioural performance of each asset and liability class to forecast likely cash flow requirements.

Business and Risk Report *continued*

Financial risk – Liquidity and funding risk *continued*

Financial liabilities – gross undiscounted contractual cash flows

The tables below provide an analysis of gross contractual cash flows. The totals differ from the analysis of residual maturity as they include interest, accrued at current rates for the average period until maturity, on the balances outstanding at the balance sheet date.

Amounts are allocated to the relevant maturity band based on the timing of individual contractual cash flows.

Gross contractual cash flows

2017	Due less than one month (note i)	Due between one and three months	Due between three and six months	Due between six and nine months	Due between nine and twelve months	Due between one and two years	Due between two and five years	Due after more than five years	Total
(Audited)	£m	£m	£m	£m	£m	£m	£m	£m	£m
Shares	112,403	1,733	6,228	4,954	4,552	9,943	4,020	1,320	145,153
Deposits from banks	2,499	127	25	51	20	43	6,022	-	8,787
Other deposits	2,882	1,079	1,887	337	255	15	11	-	6,466
Due to customers	1,818	131	306	45	67	11	-	-	2,378
Secured funding – ABS and covered bonds	346	25	1,159	108	280	1,720	10,505	6,686	20,829
Senior unsecured funding	896	2,457	3,199	668	1,557	2,051	5,516	5,980	22,324
Subordinated liabilities	-	-	64	-	201	130	987	2,330	3,712
Subscribed capital (note ii)	1	1	4	3	4	14	42	223	292
Total non-derivative financial liabilities	120,845	5,553	12,872	6,166	6,936	13,927	27,103	16,539	209,941
Derivative financial liabilities:									
Gross settled derivative outflows	*2*	*140*	*400*	*106*	*1,097*	*56*	*862*	*272*	*2,935*
Gross settled derivative inflows	*(2)*	*(135)*	*(396)*	*(100)*	*(1,082)*	*(43)*	*(817)*	*(261)*	*(2,836)*
Gross settled derivatives – net flows	*-*	*5*	*4*	*6*	*15*	*13*	*45*	*11*	*99*
Net settled derivative liabilities	*60*	*129*	*142*	*171*	*122*	*422*	*759*	*1,454*	*3,259*
Total derivative financial liabilities	60	134	146	177	137	435	804	1,465	3,358
Total financial liabilities	120,905	5,687	13,018	6,343	7,073	14,362	27,907	18,004	213,299
Off-balance sheet commitments (note iii)	15,784	-	-	-	-	-	-	-	15,784
Total financial liabilities including off-balance sheet commitments	136,689	5,687	13,018	6,343	7,073	14,362	27,907	18,004	229,083

Business and Risk Report *continued*

Financial risk – Liquidity and funding risk *continued*

Gross contractual cash flows

2016	Due less than one month (note i)	Due between one and three months	Due between three and six months	Due between six and nine months	Due between nine and twelve months	Due between one and two years	Due between two and five years	Due after more than five years	Total
(Audited)	£m	£m	£m	£m	£m	£m	£m	£m	£m
Shares	103,296	1,723	5,956	4,675	5,177	10,866	6,387	1,369	139,449
Deposits from banks	1,657	184	169	41	19	-	25	-	2,095
Other deposits	2,550	1,398	1,846	717	391	737	7	-	7,646
Due to customers	3,563	549	1,351	347	216	127	63	-	6,216
Secured funding – ABS and covered bonds	70	23	68	2,282	503	1,832	7,683	8,444	20,905
Senior unsecured funding	1,638	2,583	1,769	332	1,152	854	4,292	5,336	17,956
Subordinated liabilities	-	-	38	-	49	212	233	1,704	2,236
Subscribed capital (note ii)	1	5	4	7	4	22	67	362	472
Total non-derivative financial liabilities	112,775	6,465	11,201	8,401	7,511	14,650	18,757	17,215	196,975
Derivative financial liabilities:									
Gross settled derivative outflows	*26*	*244*	*101*	*27*	*889*	*1,221*	*2,079*	*1,015*	*5,602*
Gross settled derivative inflows	*(25)*	*(234)*	*(88)*	*(14)*	*(830)*	*(1,088)*	*(1,858)*	*(897)*	*(5,034)*
Gross settled derivatives – net flows	*1*	*10*	*13*	*13*	*59*	*133*	*221*	*118*	*568*
Net settled derivative liabilities	*56*	*119*	*188*	*163*	*170*	*489*	*840*	*1,257*	*3,282*
Total derivative financial liabilities	57	129	201	176	229	622	1,061	1,375	3,850
Total financial liabilities	112,832	6,594	11,402	8,577	7,740	15,272	19,818	18,590	200,825
Off-balance sheet commitments (note iii)	13,630	-	-	-	-	-	-	-	13,630
Total financial liabilities including off-balance sheet commitments	126,462	6,594	11,402	8,577	7,740	15,272	19,818	18,590	214,455

Notes:

i. Due less than one month includes amounts repayable on demand.

ii. The principal amount for undated subscribed capital is included within the due more than five years column.

iii. Off-balance sheet commitments include amounts payable on demand for unrecognised loan commitments, customer overpayments on residential mortgages where the borrower is able to draw down the amount overpaid and commitments to acquire financial assets.

Asset encumbrance

Encumbrance arises where assets are pledged as collateral against secured funding and other collateralised obligations and therefore cannot be used for other purposes. The majority of asset encumbrance arises from the use of prime mortgage pools to collateralise the Covered Bond and Silverstone secured funding programmes (see note 16) and from participation in the FLS and 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 liquidity buffer. Other unencumbered assets, such as non-prime mortgages, are capable of being encumbered with a degree of further management action. Assets which do not fall into either of these categories are classified as not being capable of being encumbered.

An analysis of Nationwide's encumbered and unencumbered on-balance sheet assets is set out on the next page. The table excludes off-balance sheet assets, such as FLS treasury bills which Nationwide is permitted to re-use. This disclosure is not intended to identify assets that would be available in the event of a resolution or bankruptcy.

Business and Risk Report *continued*

Financial risk – Liquidity and funding risk *continued*

Asset encumbrance

2017	Assets encumbered as a result of transactions with counterparties other than central banks				Other assets (comprising assets encumbered at the central bank and unencumbered assets)					Total
						Assets not positioned at the central bank				
	As a result of covered bonds	As a result of securitisations	Other	Total	Assets positioned at the central bank (i.e. prepositioned plus encumbered)	Readily available for encumbrance	Other assets that are capable of being encumbered	Cannot be encumbered	Total	
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Cash	1,538	567	-	2,105	-	10,697	-	215	10,912	13,017
Loans and advances to banks	-	-	1,393	1,393	927	-	-	267	1,194	2,587
Available for sale investment securities	-	-	-	-	32	9,732	-	-	9,764	9,764
Loans and advances to customers	19,322	10,412	-	29,734	33,376	75,032	49,229	-	157,637	187,371
Derivative financial instruments	-	-	-	-	-	-	-	5,043	5,043	5,043
Other financial assets	-	-	-	-	-	-	-	820	820	820
Non-financial assets	-	-	-	-	-	-	-	3,068	3,068	3,068
Total	**20,860**	**10,979**	**1,393**	**33,232**	**34,335**	**95,461**	**49,229**	**9,413**	**188,438**	**221,670**

Asset encumbrance

2016	Assets encumbered as a result of transactions with counterparties other than central banks				Other assets (comprising assets encumbered at the central bank and unencumbered assets)					Total
						Assets not positioned at the central bank				
	As a result of covered bonds	As a result of securitisations	Other	Total	Assets positioned at the central bank (i.e. prepositioned plus encumbered)	Readily available for encumbrance	Other assets that are capable of being encumbered	Cannot be encumbered	Total	
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Cash	1,328	397	-	1,725	-	6,851	-	221	7,072	8,797
Loans and advances to banks	-	-	1,511	1,511	765	-	-	1,315	2,080	3,591
Available for sale investment securities	-	-	128	128	42	10,442	-	-	10,484	10,612
Loans and advances to customers	18,996	12,368	-	31,364	28,387	70,312	48,744	-	147,443	178,807
Derivative financial instruments	-	-	-	-	-	-	-	3,898	3,898	3,898
Other financial assets	-	-	-	-	-	-	-	884	884	884
Non-financial assets	-	-	-	-	-	-	-	2,350	2,350	2,350
Total	20,324	12,765	1,639	34,728	29,194	87,605	48,744	8,668	174,211	208,939

Managing liquidity and funding risk

Nationwide's management of liquidity and funding risks aims to ensure that at all times there are sufficient liquid assets, both as to amount and quality, to:

- cover cash flow mismatches and fluctuations in funding
- retain public confidence
- meet financial obligations as they fall due, even during episodes of stress.

Business and Risk Report *continued*

Financial risk – Liquidity and funding risk *continued*

This is achieved through the management and stress testing of business cash flows, and through the translation of Board risk appetite into appropriate risk limits. This ensures a prudent funding mix and maturity profile, sufficient levels of high quality liquid assets and appropriate encumbrance levels are maintained.

The Liquidity and Funding risk framework is reviewed by the Board as part of the annual Internal Liquidity Adequacy Assessment Process (ILAAP). ALCO is responsible for managing the balance sheet structure, including the Funding Plan, and its risks. This includes setting and monitoring more granular limits within Board limits. A consolidated cash flow forecast is maintained and reviewed weekly to support ALCO in monitoring key risk metrics.

A Liquidity Contingency Plan (LCP) is maintained which describes early warning triggers for indicating an emerging liquidity or funding stress as well as escalation procedures and a range of actions that could be taken in response to ensure sufficient liquidity is maintained. The LCP is tested annually to ensure it remains robust. Nationwide also has a Recovery Plan which describes potential actions that could be utilised in a more extreme stress.

Liquidity stress testing

To mitigate liquidity and funding risks generated by its business activities, Nationwide aims to maintain a liquid asset buffer of at least 100% of the anticipated outflows seen under internal stress test scenarios and the regulatory-prescribed LCR.

Potential contractual and behavioural stress outflows are assessed across a range of liquidity risk drivers over 30 business days, with the key assumptions shown below. A three month assessment is also performed against which LCP capacity is assessed. Internal stress assumptions are reviewed regularly with changes approved by ALCO, and approved annually by the Board as part of the ILAAP.

Liquidity risk driver	Modelling assumptions used
Retail funding	Significant unexpected outflows are experienced with no new deposits received.
Wholesale funding	Zero rollover of maturing long term wholesale funding and only partial rollover of certain short term funding following credit rating downgrades. No new wholesale funding is received.
Off-balance sheet	Contractual outflows occur in relation to secured funding programmes due to credit rating downgrades. Lending commitments continue to be met. Collateral outflows arise due to adverse movements in market rates. Inflows from mortgages or retail and commercial loans are assessed on a behavioural basis.
Intra-day	Liquidity is needed to pre-fund outgoing payments.
Liquid assets	Asset values are reduced in recognition of the stressed conditions assumed.

At 4 April 2017, potential stressed net outflows under the most severe 30 business day stress test (a combined market-wide and Nationwide-specific stress scenario) were modelled at £22.1 billion (2016: £22.6 billion). The liquid asset buffer as a percentage of stressed net outflows equated to 118% (2016: 114%).

External credit ratings

During the year all of the major rating agencies reviewed the Society's credit ratings. The Society's short and long term credit ratings at 22 May 2017 are as follows:

Credit ratings	Long term	Short term	Tier 2	Date of last rating action / confirmation	Outlook
Standard & Poor's	A	A-1	BBB	January 2017	Negative
Moody's	Aa3	P-1	Baa1	January 2017	Negative
Fitch	A+	F1	A-	February 2017	Stable

In January 2017, both Standard & Poor's and Moody's affirmed their long term and short term ratings and left their negative outlook on Nationwide's long term rating unchanged. This negative outlook is part of a sector-wide action involving all UK banks and building societies.

In February 2017, Fitch upgraded Nationwide's long term deposits and senior unsecured debt to A+ from A. The one notch upgrade was made to reflect Fitch's view that Nationwide's qualifying junior debt buffer is now sufficiently large to provide protection for senior unsecured creditors in case of the Society's failure.

The table below sets out the amount of additional collateral Nationwide would need to provide in the event of a one and two notch downgrade by external credit rating agencies.

	Cumulative adjustment for a one notch downgrade	Cumulative adjustment for a two notch downgrade
	£bn	£bn
2017	3.3	3.7
2016	4.1	4.5

The contractually required cash outflow would not necessarily match the actual cash outflow as a result of management actions that could be taken to reduce the impact of the downgrades.

Business and Risk Report *continued*

Financial risk – Solvency risk

Summary

Solvency risk is the risk that Nationwide fails to maintain sufficient capital to absorb losses throughout a full economic cycle and sufficient to maintain the confidence of current and prospective investors, members, the Board and regulators. Capital is held to protect members, cover inherent risks, provide a buffer for stress events and support the business strategy. In assessing the adequacy of capital resources, risk appetite is considered in the context of the material risks to which Nationwide is exposed and the appropriate strategies required to manage those risks.

Managing solvency risk

A number of tools are employed to support the management of solvency risk. The Board is responsible for setting risk appetite with respect to solvency risk, which is articulated through its risk appetite statements, and it defines minimum levels of capital, including leverage, that it is willing to operate with. These are translated into specific risk metrics, which are monitored by the Board Risk Committee, Assets and Liabilities Committee (ALCO) and other internal management committees.

The capital structure is managed to ensure that Nationwide continues to meet minimum regulatory requirements, as well as meeting the expectations of other key stakeholders. As part of the risk appetite framework, strong capital ratios are targeted relative to both regulatory requirements and major banking peers. Any planned changes to the balance sheet, potential regulatory developments and other factors (such as trading outlook, movements in the available for sale reserve and defined benefit pension deficit) are all considered.

The capital strategy is to manage capital ratios through retained earnings, supplemented by external capital where appropriate. With general reserves forming the majority of capital resources, profitability is an important factor when considering the ability to meet capital requirements. A return on capital framework is in place, based upon an allocation of overall capital requirements, which is part of the performance monitoring activity for individual product segments. In recent years, Nationwide's ability to supplement retained earnings through the issuance of Common Equity Tier 1 (CET1), Additional Tier 1 and Tier 2 capital instruments has been demonstrated, and its non-core portfolios have been significantly deleveraged.

Capital is held to meet Pillar 1 requirements for credit, operational and market risks. In addition, the PRA requires firms to hold capital to meet Pillar 2A requirements, which are set out in the Individual Capital Guidance (ICG). This is a point in time estimate, set by the PRA on an annual basis, of the amount of capital required to be held to meet risks partly covered by Pillar 1 such as credit concentration and operational risk, and risks not covered by Pillar 1 such as pension and interest rate risk.

In order to protect against the risk of consuming Pillar 1 or Pillar 2A requirements (thereby breaching ICG), firms are subject to regulatory capital buffers which are set out in CRD IV. In addition, the PRA may set a firm-specific buffer based upon supervisory judgement informed by the impact of stress scenarios on a firm's capital requirements and resources, and taking into account other factors including leverage, systemic importance and any weaknesses in firms' risk management and governance procedures.

A regular Internal Capital Adequacy Assessment Process (ICAAP) is also undertaken. This considers the minimum amount of capital to be held in order to cover all risks including credit risks, operational risks, interest rate risks in the banking book and pension risks. It also considers an additional buffer to ensure that the impact of a severe but plausible stress can be absorbed. As a result of this internal assessment, the PRA sets Nationwide's Pillar 2 capital requirements.

Regular stress tests are undertaken, covering Nationwide and its subsidiaries, to enhance the understanding of potential vulnerabilities and how management actions might be deployed in the event of stressed conditions developing. These stress tests project capital resources and requirements over a five-year period, during severe but plausible scenarios that cover a range of macro-economic or market-wide scenarios, and idiosyncratic scenarios that test particular risks to the business model. Stress test results are reported to the Board Risk Committee.

Nationwide aims to be in a position where it would maintain strong capital and leverage ratios in the event of a severe but plausible economic or idiosyncratic stress. Embedded in the risk appetite framework is an expectation to maintain the CET1 and leverage ratios in excess of regulatory minima, including buffers where appropriate.

A set of management actions is maintained that would be available in the event of a breach of one or more of the risk metrics, to support the capital position. In a more severe stress, Nationwide would consider the implementation of its Recovery Plan, maintained under UK regulatory rules implementing the European Bank Recovery and Resolution Directive (BRRD), which documents a broad range of management actions. In addition, reverse stress testing is carried out using extreme, highly improbable scenarios to further test the viability of Nationwide's business model.

During 2016, the major UK banks and building societies, including Nationwide, took part in the PRA's annual Concurrent Stress Test (CST), which assessed firms' resilience to a severe global downturn. The specified stress scenario was a combination of the more severe elements of CST 2014 and CST 2015, incorporating a sharp increase in the cost of credit for households and businesses accompanied by a 0% base rate, a near doubling of the unemployment rate to a peak of 9.5% and a 31% fall in UK house prices.

Despite the severity of this scenario the results illustrate the strength and resilience of Nationwide with low point stressed ratios for CET1 and leverage of 15.6% and 4.2% respectively after the effect of management actions.

Nationwide, along with the major UK banks, is currently taking part in the 2017 CST. As part of this, the Annual Cyclical Scenario (ACS) features a global and domestic economic downturn, with a sharp rise in interest rates in the UK. In addition to the ACS, this is the first year that participating firms are required to complete the Biennial Exploratory Scenario. This scenario features persistently low interest rates combined with compressed margins because of an assumed increase in competition, driven by advances in financial technology and new entrants to the market.

Business and Risk Report *continued*

Financial risk – Solvency risk *continued*

Capital position

The capital disclosures included in this report are reported on a CRD IV end point basis. This assumes that all CRD IV requirements are in force during the period, with no transitional provisions permitted. In addition, the disclosures are on a Group (consolidated) basis, including all subsidiary entities, unless otherwise stated.

Key capital ratios	2017	2016
Solvency (note i)	%	%
Common Equity Tier 1 (CET1) ratio	25.4	23.2
Total Tier 1 ratio	28.4	26.1
Total regulatory capital ratio	36.1	30.9
Leverage	£m	£m
UK leverage exposure (note ii)	215,894	204,346
CRR leverage exposure (note iii)	228,428	213,181
Tier 1 capital	9,547	9,005
UK leverage ratio	4.4%	4.4%
CRR leverage ratio	4.2%	4.2%

Notes:

i. The solvency ratios have been calculated under CRD IV on an end point basis. Transitional ratios can be found in the Pillar 3 Disclosure 2017 at **nationwide.co.uk**

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 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.

Capital and leverage ratios have remained well in excess of regulatory requirements with a Common Equity Tier 1 (CET1) ratio of 25.4% (2016: 23.2%) and a UK leverage ratio of 4.4% (2016: 4.4%).

The CET1 ratio has increased, reflecting profit after tax for the period of £757 million, offset by an increase in the defined benefit pension deficit which reduced the general reserve by £255 million. The total capital ratio increased to 36.1% (2016: 30.9%) due to the increase in profits and the issuance of $1.25 billion of qualifying Tier 2 subordinated debt.

The CET1 ratio on an Individual (solo) consolidated basis at 4 April 2017 was 25.6% (2016: 23.3%), marginally greater than the Group's CET1 ratio due to higher general reserves as a result of cash flow hedge accounting. Further detail on the capital position measured on an Individual consolidated basis can be found within the annual Pillar 3 Disclosure 2017 at **nationwide.co.uk**

CRD IV requires firms to calculate a non-risk-based leverage ratio, to supplement risk-based capital requirements. The current regulatory threshold is set at 3%. The risk of excessive leverage is managed through regular monitoring and reporting of the leverage ratio, which forms part of risk appetite.

Nationwide has been granted permission to report a UK leverage ratio on the basis of measurement announced by the PRA in August 2016. Minimum leverage requirements are monitored by the PRA on this basis. It is calculated using the Capital Requirements Regulation (CRR) definition of Tier 1 for the capital amount and the Delegated Act definition of the exposure measure, excluding eligible central bank reserves.

The UK leverage ratio is 4.4% at 4 April 2017 (2016: 4.4%). The ratio has remained stable as profits have broadly offset increases in both the defined benefit pension deficit and the increase in UK leverage exposure, which was mainly driven by higher mortgage balances.

The CRR leverage ratio is calculated using the same definition of Tier 1 for the capital amount and the Delegated Act definition of the exposure measure. The CRR leverage ratio remained at 4.2% (2016: 4.2%) as profits have broadly offset the increase in the pension deficit and the higher CRR leverage exposure, which was driven by increased mortgage balances and liquid assets (further details on liquid assets are contained in the 'Liquidity and funding risk' section of this report).

Further details on leverage can be found in the Pillar 3 Disclosure 2017 at **nationwide.co.uk**

Business and Risk Report *continued*

Financial risk – Solvency risk *continued*

Nationwide's latest Pillar 2A Individual Capital Guidance (ICG) was received in August 2016 following an ICAAP. It equates to circa £2.2 billion, of which at least circa £1.2 billion must be met by CET1 capital, and was broadly unchanged from the previous ICG. This amount is equivalent to 6.6% of RWAs as at 4 April 2017 (2016: 6.4%), reflecting the low average risk weight, given that approximately 75% (2016: 76%) of total assets are in the form of secured residential mortgages, of which 81% (2016: 80%) are prime.

The table below reconciles the general reserves to total regulatory capital. Both 2017 and 2016 have been presented on an end point basis and so do not include non-qualifying instruments.

Total regulatory capital	2017 £m	2016 £m
General reserve	9,316	8,921
Core capital deferred shares (CCDS)	531	531
Revaluation reserve	67	64
Available for sale reserve	44	(8)
Regulatory adjustments and deductions:		
Foreseeable distributions (note i)	(43)	(42)
Prudent valuation adjustment (note ii)	(23)	(55)
Own credit and debit valuation adjustments (note iii)	-	(2)
Intangible assets (note iv)	(1,174)	(1,120)
Goodwill (note iv)	(12)	(12)
Excess of regulatory expected losses over impairment provisions (note v)	(151)	(264)
Total regulatory adjustments and deductions	(1,403)	(1,495)
Common Equity Tier 1 capital	8,555	8,013
Additional Tier 1 capital securities (AT1)	992	992
Total Tier 1 capital	9,547	9,005
Dated subordinated debt (note vi)	2,555	1,628
Collectively assessed impairment allowances	27	21
Tier 2 capital	2,582	1,649
Total regulatory capital	12,129	10,654

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.

vi. 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.

CET1 capital resources have increased by £542 million. This is primarily the result of profit for the year, partly offset by a reduction in reserves due to an increase in the defined benefit pension deficit. The excess of expected losses over provisions is also lower due to reduced regulatory expected losses, mainly a result of the continued run-off of the commercial book.

Tier 2 capital has increased, in line with plans to meet pending Minimum Requirement for Own Funds and Eligible Liabilities (MREL) requirements, following the issuance of $1.25 billion of qualifying Tier 2 subordinated debt.

Business and Risk Report *continued*

Financial risk – Solvency risk *continued*

Risk weighted assets

The table below shows the breakdown of our risk weighted assets (RWAs) by risk type:

Risk weighted assets	2017 £m	2016 £m
Credit risk:		
Retail mortgages	13,863	14,086
Retail unsecured lending	5,641	5,621
Commercial loans	5,636	6,194
Treasury	849	1,039
Counterparty credit risk (note i)	1,221	1,296
Other (note ii)	1,566	1,635
Total credit risk	28,776	29,871
Operational risk	4,865	4,604
Market risk (note iii)	-	-
Total risk weighted assets	33,641	34,475

Notes:

i. Relates to derivative financial instruments and repurchase agreements.

ii. Relates to fixed and other assets, including investments in equity shares.

iii. Nationwide has elected to set this to zero, as permitted by the CRR, as exposure is below the threshold of 2% of own funds.

RWAs have reduced by £834 million since 4 April 2016, to £33,641 million. Commercial RWAs have continued to decrease, driven by continued run-off of the commercial book and improvements in the credit quality of the remaining exposures. Residential mortgage RWAs are lower as the impact of rising house prices has outweighed the increasing mortgage balances. Treasury RWAs have decreased due to a reduction in exposures to banks. Operational risk RWAs, calculated on the Standardised Approach, have increased due to higher income.

Details on how RWAs are calculated can be found in the Pillar 3 Disclosure 2017 at **nationwide.co.uk**

Regulatory developments

Whilst there are a number of areas where potential requirements are yet to be finalised, regulatory announcements during the financial year mean that there is better visibility of the expected impact. However, Nationwide will remain engaged in the development of the regulatory approach to ensure it is prepared for any change.

Nationwide is currently required to maintain a minimum leverage ratio of 3%, with a supplementary leverage ratio buffer of 0.35% to be implemented in 2019. The Financial Policy Committee has the ability to set a countercyclical leverage buffer; this is currently 0%, but could be set up to a maximum of 0.9%. The PRA has introduced a modification to the UK leverage ratio framework, with the introduction of a UK leverage ratio measure which excludes qualifying central bank reserves from the leverage exposure measure. This follows recommendations made by the Financial Policy Committee in 2016. The Financial Policy Committee is due to undertake a review of the UK leverage ratio framework during 2017.

The Basel Committee continues to reaffirm its commitment to finalising reforms to the Basel III framework, including the risk weighted assets framework, the leverage ratio framework and the introduction of an output floor (which will prevent IRB risk weights falling below a certain level). It is not clear at this stage when these will be finalised and are likely to become effective. The PRA has also consulted on revised expectations for IRB models for residential mortgages, which are likely to be effective in 2019. Whilst these amendments are expected to result in an increase in RWAs and therefore a reduction in the CET1 ratio, they are not expected to result in a material increase in Nationwide's overall capital requirements.

As part of the BRRD, the Bank of England, in its capacity as the UK resolution authority, has published its policy for setting the MREL and provided firms with indicative MREL. It is anticipated that Nationwide will be subject to a requirement to hold twice the minimum capital requirements (i.e. 6% of UK leverage exposure), plus the applicable buffers, from January 2020. Current total MREL resources are equal to circa 5.9% of UK leverage ratio exposure. While this results in a small shortfall to be met over the period to January 2020, Nationwide has a strong foundation from which to meet MREL requirements through issuance of Tier 2 capital, or, if it becomes available through legislative changes, a senior non-preferred debt instrument.

Business and Risk Report *continued*

Financial risk – Market risk

Overview

Market risk is the risk that the net value of, or net income arising from, assets and liabilities is impacted because of market price or rate changes, specifically interest rates, currency rates or equity prices. Aligned to Nationwide's 'built to last' strategic cornerstone, market risks are not taken unless they are essential to core business activities, or they are designed to provide stability of earnings. Nationwide does not have a trading book.

The principal market risks, linked to Nationwide's balance sheet assets and liabilities, are listed in the table below, irrespective of materiality.

Market risk linkage to the balance sheet

	2017 £bn	Market risk				
		Interest rate risk	Basis risk	Swap spread risk	Currency risk	Product option risk
Assets						
Cash	13.0	•			•	
Loans and advances to banks	2.6	•	•		•	
Available for sale investment securities	9.8	•	•	•	•	
Derivative financial instruments	5.0	•	•	•	•	•
Loans and advances to customers	187.4	•	•		•	•
Other assets	3.9	•	•		•	
Total assets	**221.7**					
Liabilities						
Shares (customer deposits)	144.5	•	•			•
Deposits from banks	8.7	•	•		•	
Other deposits (including PEB deposits)	6.5	•	•		•	•
Due to customers (including offshore deposits)	2.4	•	•		•	•
Debt securities in issue	40.3	•	•		•	
Derivative financial instruments	3.2	•	•	•	•	•
Subordinated liabilities	2.9	•	•		•	
Other liabilities (note i)	2.0	•	•		•	
Total liabilities	**210.5**					

Notes:

i. Other liabilities include the defined benefit pension scheme. The scheme is exposed to equity risk (the risk of movements in share prices), interest rate risk and credit spread risk. Pension risk is managed separately from Nationwide's core business operations. For further details, see the 'Pension risk' section of this report.

• Represents assets or liabilities exposed to market risk, irrespective of materiality.

Summary

UK interest rate movements in the first half of the year were primarily driven by the EU referendum, with significant volatility seen prior to the vote, and a sharp fall immediately following the result. A package of measures, including a rate cut announced by the Bank of England in August, helped to stabilise the market and interest rates rose in response before stabilising in the second half of the year.

Sterling also weakened sharply after the referendum and remains volatile, with future movements likely to be dependent upon the path taken to achieve Brexit. Nationwide has limited exposure to currency risk.

The broader economic landscape also remains uncertain with concerns around the strength of the global economy. Despite an increase in the level of interest rates from the US Federal Reserve for a third time, globally, interest rates remain low and are likely to stay low in many parts of the developed world for some time.

A Value at Risk (VaR) model is used to monitor market interest rate risk. The market uncertainty around the timing and direction of base rate changes contributes to volatility. This could increase the likelihood of results outside of those predicted by the VaR model. Earnings are also subject to fluctuations due to volatility in interest rates.

Internal risk limits remain low to restrict the potential exposure to market risk arising from the daily management of residual positions, with relevant market risk metrics reported to the Assets and Liabilities Committee (ALCO).

The Basel Committee on Banking Supervision published the Standards for Interest Rate Risk in the Banking Book (IRRBB) in April 2016. Nationwide expects to be fully compliant with these enhanced disclosure requirements, which are expected to be applicable from 2018.

The European Commission (EC) proposed a set of reforms to capital requirements for market risk in November 2016. Included within this proposed set of reforms are elements of the Basel Disclosure Standards for IRRBB and more granular instructions for calculation of own funds requirements for market risk in the non-trading book. Nationwide will assess the new guidelines over the coming months and ensure readiness in anticipation of adoption of the proposal. The EC expects the proposed regulation to be effective from 2019.

Business and Risk Report *continued*

Financial risk – Market risk *continued*

Market risk management

Market risk only arises in the banking book and Nationwide does not have a trading book. Most of the exposure to market risk arises from fixed rate mortgages or savings and changes in the market value of the liquidity portfolio. There is a limited amount of currency risk on non-sterling financial assets and liabilities held.

The principal market risks that affect Nationwide are listed below together with the types of risk reporting measures used:

Market risk exposure	Reporting measure
Interest rate risk	Value sensitivity / Value at Risk
Basis risk	Earnings sensitivity
Swap spread risk	Value sensitivity / Value at Risk
Currency risk	Value at Risk
Product option risk	Value at Risk

In addition, stress analysis is used to evaluate the impact of more extreme, but plausible events. These techniques are described below with a review of the exposures during the year.

Sensitivity analysis

Sensitivity analysis is used to assess the change in value of, for example, the net exposure to a one basis point (0.01%) parallel shift in interest rates (PV01). This analysis is performed daily by currency. Sensitivity analysis is also used to evaluate swap spread risk.

Earnings sensitivity

Income sensitivity metrics are used to measure and quantify exposure to interest rate risks. These techniques apply rate shocks to the rates paid on liabilities and to the rates earned on assets and the impact on earnings is calculated. Both risks are described below in more detail.

Value at Risk (VaR)

VaR is a technique that estimates the potential losses that could occur on risk positions because of future movements in market rates and prices, over a specified time horizon, to a given level of statistical confidence. VaR is based on historic market behaviour and uses a series of recorded market rates and prices to derive plausible future scenarios. This considers inter-relationships between different markets and rates. There are separate models for interest rates and currencies.

The VaR model used incorporates risk factors based on interest rate and currency volatilities and correlations. A 10-day horizon and a 99% confidence level is typically used in day to day VaR monitoring. VaR is used to monitor interest rate, swap spread and currency risks and is not used to model income. Exposures against limits are reviewed daily by management. Actual outcomes are monitored on an ongoing basis by management to test the validity of the assumptions and factors used in the VaR calculation. Values reported below are on the same basis as those used internally.

Although VaR is a valuable guide to risk, it needs to be viewed in the context of the following limitations which may mean that exposures could be higher than modelled:

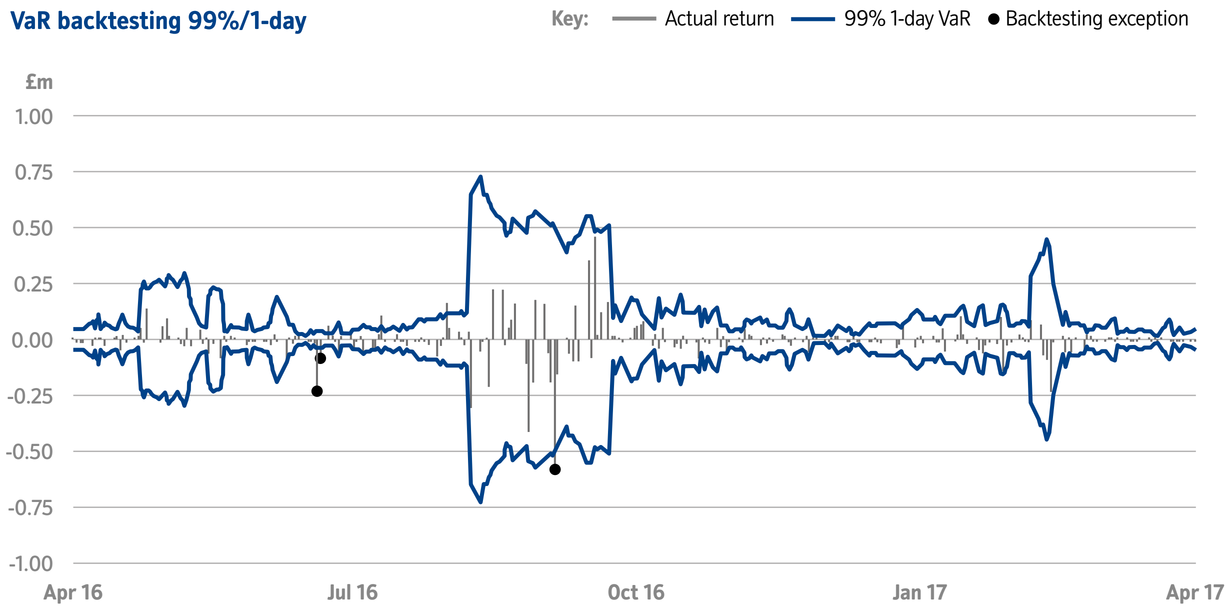
- The use of a 99% confidence level, by definition, does not take account of changes in value that might occur beyond this level of confidence.
- VaR models often under-predict the likelihood of extreme events and over-predict the benefits of offsetting positions in those extreme events.
- The VaR model uses historical data to predict future events. Extreme market moves beyond those used to calibrate the model will deliver exceptions. For example, in periods of heightened volatility the model is likely to under-predict market risks and in periods of low volatility it is likely to over-predict market risks.
- Historical data may not adequately predict circumstances arising from government interventions and stimulus packages, which increase the difficulty of evaluating risks.

Business and Risk Report *continued*

Financial risk – Market risk *continued*

To seek to mitigate these limitations, backtesting of the VaR model is undertaken on a regular basis to ensure that the model is appropriate. This process compares actual performance against the estimated VaR numbers. An exception is created when a loss is greater than the daily VaR on any given day. In 2016/17, the backtesting did not highlight any model deficiencies. The chart below shows the results of this backtesting. The three loss exceptions were due to significant movements in market rates on each of those days, two of which immediately followed the EU referendum. The result remains within acceptable tolerance for regulatory purposes of four or fewer exceptions over the period.

VaR backtesting 99%/1-day



The model is subject to an annual review process to ensure it continues to be appropriate for risk reporting. The types of risks not captured in VaR include:

- Product option risk for which Pillar 2 capital is held.
- Market liquidity risk – this has a limited impact because, whilst Nationwide requires an appropriate level of market liquidity to manage market risk, it does not have a high ongoing dependency on it given that it does not operate a trading book.
- Fair value Level 3 asset management – only a very small portfolio of these assets is held and, whilst historic data is not a reliable predictor of the future, the impact is limited (capital is held for these assets as a Prudent Valuation Adjustment).
- Interest rate movements that can impact credit/debit valuation adjustments (CVA/DVA). These are not captured in the VaR or sensitivity analysis but are negligible.

Stress analysis

To evaluate the potential impact of more extreme but plausible events or movements in a set of financial variables the standard VaR metric is supported with sensitivity and stress analysis.

For example, for interest rate risk exposures, the standard PV01 sensitivity analysis is supplemented by the production of stressed sensitivity measures. A more severe 200 basis point (2.0%) parallel shift in interest rates is calculated in a similar manner to PV01; this sensitivity analysis is known as PV200. PV200 numbers are generated and monitored daily.

In addition, stressed VaR is used to estimate the potential loss arising from unfavourable market movements in a stressed environment. It is calculated in the same way as standard VaR, calibrated over a two year period and on a 99% 10-day basis but uses volatilities and correlations from a period of significant financial stress.

Each quarter, the residual interest rate risk and currency positions are also subjected to a range of stressed scenarios designed to highlight potential losses in extreme market conditions. The results of these scenarios are reviewed by management to provide insight into the circumstances in which losses may occur.

A range of metrics are also regularly produced focusing on the crystallisation of product option risks under stressed events.

Interest rate risk

The main market risk faced is interest rate risk. Market movements in interest rates affect the interest rate margin realised from lending and borrowing activities.

To reduce the impact of such movements, hedging activities are undertaken by Nationwide's Treasury function. For example, interest rate risks generated by lending to and receiving deposits from customers are offset against each other internally. The remaining net exposure is managed using derivatives, within parameters set by ALCO.

The income contribution from the reserves and non-interest bearing current accounts are subject to the volatility of short term interest rates. This is smoothed using structural hedging to reduce the volatility of earnings.

Business and Risk Report *continued*

Financial risk – Market risk *continued*

The table below highlights the limited amount to which Nationwide is exposed to interest rate risk. The risk is calculated each day and summarised over the financial year:

Interest rate risk	2017			2016		
	Average	**High**	**Low**	Average	High	Low
	£m	**£m**	**£m**	£m	£m	£m
VaR (99%/10-day) *(audited)*	**0.5**	**2.4**	**0.1**	0.3	0.8	0.1
Sensitivity analysis (PV01) *(audited)*	**0.0**	**0.1**	**(0.0)**	0.0	0.1	(0.1)
Stress testing (PV200: all currencies)	**4.0**	**19.3**	**(9.3)**	6.9	19.3	(10.8)

Basis risk

Basis risk arises where variable rate assets and liabilities re-price with reference to differing short term interest rate benchmarks. The primary interest rates that Nationwide is exposed to are the Bank of England base rate and three month Libor. Changes in the difference between base rate and three month Libor over time will impact earnings.

Assets and liabilities are offset by a reference rate, or 'basis' type. Exposure to the net mismatch is mitigated, where necessary, by transacting basis swaps to ensure Nationwide remains within internally agreed risk limits.

Earnings sensitivity

Earnings sensitivity measures the risk that income is adversely affected by changes in interest rates. The sensitivity of earnings to changes in interest rates is measured monthly using a forecasting model and potential interest rate scenarios.

The table below sets out the sensitivity of future earnings to rises and falls in interest rates over a one year period:

Potential favourable/(adverse) impact on annual earnings	2017	2016
(Audited)	**£m**	£m
+200 basis points shift	**250**	230
+100 basis points shift	**117**	108
-25 basis points shift, floored at 1 basis point	**(68)**	(25)

The following should be noted in relation to the above:

- impacts are calculated for a forward period of one year
- the interest rate sensitivities set out above are illustrative only and are based on a static balance sheet; all assets and liabilities maturing within the year are assumed to reinvest in like for like products
- the negative shift scenarios are floored at one basis point to prevent rates from turning negative
- the reported sensitivities will vary over time due to several factors, such as the timing of maturing assets and liabilities, market conditions, customer behaviour and strategic changes to the balance sheet mix, and should not therefore be considered predictive of future performance
- the sensitivity analysis includes all financial assets and liabilities held
- the model does not take any management actions into account.

The absolute levels of interest rates can influence the flexibility to manage earnings. If interest rates fall further or become negative, margins may be constrained because it is unlikely that the benefit to borrowers can be fully offset through current account or savings product rate changes.

Swap spread risk

A liquidity portfolio is held to manage liquidity risk. These assets are predominantly fixed rate sovereign debt securities and interest rate swaps are used to hedge the interest rate risk on these assets. However, there remains a residual risk associated with the possible movement in the spread between sovereign debt yields and swap rates. This 'swap spread risk' reflects the fact that the market value of the liquidity portfolio can change due to movements in bond and swap rates. In economic terms, this risk is only realised if a bond is sold and the swap is cancelled ahead of maturity.

This market risk is monitored using stressed VaR metrics and the risk is controlled via internal limits linked to capital requirements. Exposures are monitored daily and are reported monthly to ALCO.

Business and Risk Report *continued*

Financial risk – Market risk *continued*

Currency risk

Currency exposure is managed through natural offset on the balance sheet or using derivatives to reduce exposures to acceptable levels. ALCO sets and monitors limits on the net currency exposure. The table below sets out the limited extent of the residual exposure to currency risk:

Currency risk

	2017			2016		
	Average	**High**	**Low**	Average	High	Low
(Audited)	**£m**	**£m**	**£m**	£m	£m	£m
VaR (99%/10-day)	0.1	0.2	0.0	0.1	0.3	0.0

Product option risk

Market risk also arises because of customers exercising options contained within fixed rate products which can require changes to hedging. The key product risks are prepayment risk (early redemption or overpayment of fixed rate mortgages), access risk (early withdrawal of fixed rate savings), and take-up risk (higher or lower completions of fixed rate mortgages). These risk exposures are quantified under a range of stress scenarios using models that predict customer behaviour in response to changes in interest rates. The potential impacts are then closely monitored. These stressed risk measures are subject to a set of limits and are reported to ALCO, along with proposed management actions where necessary to bring the exposures within limits. This approach is also used to assess internal capital requirements for product option risks.

Model risk

Managing market risk effectively is highly dependent on effective models. The models are designed as representations of business systems to help describe the impact of various scenarios and to optimise decisions taken as a result.

The risk associated with market risk models is controlled and managed through the Model Validation Policy. This requires all significant models be validated by an independent oversight team prior to use. The validation process identifies model strengths and weaknesses, assesses the potential impact of these and suggests appropriate mitigating actions. After implementation, model performance is assessed regularly via back testing and sensitivity analysis. All models are also subject to a more thorough periodic review, at least annually, to ensure they remain fit for purpose. The results of the model performance assessment are used to inform future model development.

Calculations to determine the capital requirements for interest rate risk are made using the same models as those used for monitoring day to day interest rate risk.

Financial risk – Pension risk

Overview

Nationwide has funding obligations to several defined benefit pension schemes. Pension risk is defined as the risk that the value of the pension schemes' assets will be insufficient to meet the estimated liabilities. Pension risk can adversely impact Nationwide's capital position and may result in increased cash funding obligations to the pension schemes.

The most significant pension scheme is the Nationwide Pension Fund (the Fund), which is closed to new employees, although some employees continue to accrue benefits. In accordance with UK legislation, the assets of the Fund are held in a legally separate trust from the Group's assets and are administered by a board of trustees (the Trustee) who have fiduciary responsibilities to the beneficiaries of the Fund.

Risk factors

Volatility in investment returns from the assets and the value of the liabilities cause volatility in the Fund's deficit. The key risk factors impacting the deficit are set out below; these factors can have a positive or negative impact on the deficit.

Long term interest rates and credit spreads

Decreases in long term interest rates and/or credit spreads will increase the value placed on the Fund's liabilities. The increase in liabilities will be partially offset by an increase in the value of the Fund's bonds and credit investments.

Inflation

The majority of the pension benefits are linked to inflation. Higher inflation will lead to higher liabilities (although, for most benefits, caps on the level of inflationary increases protect the Fund against extreme inflation). Where asset values are correlated with inflation (for example, index linked gilts and inflation swaps), the increase in the liabilities will be partially offset by asset increases.

Asset performance

Liabilities are calculated using a discount rate set with reference to bond yields. If the assets underperform the bond yields, this will cause the net position of the Fund to deteriorate.

The Fund also holds a significant proportion of return-seeking assets such as equities and credit investments. Whilst return seeking assets are expected to outperform the liabilities in the long term, they create risk and volatility in the short to medium term. The investment in return seeking assets, such as equities, is monitored by both the Trustee and Nationwide to ensure it remains appropriate given the Fund's long term objectives. Further details on the movement of assets are set out in note 33 to the accounts.

Business and Risk Report *continued*

Financial risk – Pension risk *continued*

Longevity (life expectancy)

The majority of pension benefits received by members of the Fund are paid for life. Therefore, Nationwide is exposed to the risk of Fund members living longer than expected, as this would lead to pension benefits being paid for longer. Nationwide periodically updates its estimates of future longevity of members of the Fund, having regard to the most up to date mortality data and projections of mortality rates produced by the Continuous Mortality Investigation.

Regulation

Nationwide is exposed to potential changes in the regulatory environment and pension legislation, which could increase the pension liabilities and/or impact Nationwide's capital position.

In addition, a change in the methodology used to derive key actuarial assumptions (for example, the discount rate, or longevity assumptions) can result in a change in the assessment of the liabilities and therefore the deficit. However, the ultimate cost of providing benefits will depend on actual future events, rather than assumptions made.

Summary

During the year £149 million of employer deficit contributions were paid. These deficit contributions are included in employer contributions in the table below (together with employer contributions in respect of benefit accrual during the period), with further annual deficit contributions of £49 million payable over each of the next four years in line with the current deficit recovery plan.

The latest triennial valuation of the Fund, which has an effective date of 31 March 2016, is currently underway. Employer contributions in future years, including a new deficit recovery plan, are expected to be agreed with the Trustee during 2017/18.

The retirement benefit obligation that appears within liabilities on the balance sheet has increased from £213 million to £423 million, as set out below:

Changes in the present value of net defined benefit liability		
	2017	2016
	£m	£m
At 5 April	(213)	(286)
Pension charge	**(64)**	(69)
Net interest cost	**(5)**	(7)
Actuarial remeasurement	**(347)**	42
Employer contributions (including deficit contributions)	**206**	107
At 4 April	**(423)**	(213)

The actuarial remeasurement quantifies the impact on the deficit from the updating of economic and demographic assumptions. Positive movements in the Fund's assets in excess of the discount rate, of £951 million, were driven by strong equity price returns and increased bond valuations. However, the change in actuarial assumptions over the year (driven by market conditions, partially offset by updating the longevity assumptions) has resulted in liabilities increasing by £1,298 million, which was more than the positive movements in the Fund's assets and resulted in an increase in the Fund's deficit.

During the year £712 million of equities were sold and reinvested into credit and liability matching assets to reduce risk and increase investment diversification of the Fund's assets. The Fund entered into £246 million of long-dated inflation swaps to reduce its exposure to inflation risk. These activities have partially offset the impact of changes in market conditions.

Outlook

Regular production of analysis, insight and monitoring supports pension risk management and helps Nationwide to anticipate any management actions that may be required. This includes risk appetite articulation and regular reporting to governance committees, including the Executive Committee and Board Risk Committee. In addition, pension risk is embedded into Nationwide's Enterprise Risk Management Framework and stress testing processes.

Over the long term, the Trustee intends to significantly reduce the Fund's risk, and Nationwide actively engages with the Trustee to ensure broad alignment on investment objectives and implementation. This is supported by permanent representation by Nationwide at the Trustee's Investment and Funding Committee and investment working groups, sharing management information between Nationwide and the Trustee to consider specific risk management initiatives.

Potential initiatives to reduce pension risk include, but are not limited to, adjusting the asset allocation (for example further reducing the allocation to equities and increasing the allocation to bonds), adjusting contribution levels and adjusting the level of benefits that members of the Fund accrue in the future.

Business and Risk Report *continued*

Financial risk – Earnings risk

Overview

Nationwide ensures that it can generate sustainable profits by focusing on recurrent sources of income that generate value commensurate with the risks taken. Earnings risk is defined as the risk that sources of income or value are unable to continue to add the expected value due to changes in market, regulatory or other environmental factors. The Society manages and monitors this risk as part of ongoing business performance reporting to senior management and the Board.

Strategy

Ensuring that Nationwide continues to remain profitable is key to the longevity and self-sufficiency of the business model. The aim of earnings risk strategy is to maintain sufficient earnings, and a minimum level of profit, capable of withstanding plausible trading risks and delivering member value. The earnings risk strategy identifies and quantifies plausible trading risks within the context of Nationwide's financial forecast, taking into account the potential impact of economic and market uncertainties. These risks are assessed against management and Board risk appetite, aligned to the Financial Performance Framework which ensures achievement of the right balance between distributing value to members, investing in the business and maintaining financial strength.

Earnings risk is managed and mitigated through a range of measures such as:

- **Financial forecasting**
  As part of the financial planning process Nationwide forecasts performance over a five year period with an updated earnings forecast reviewed by management monthly, taking into consideration the key risks and sensitivities.
- **Monitoring of financial performance**
  The various components of earnings are monitored monthly against internal forecasts, limits and triggers across a variety of committees and forums, which consider potential earnings risks and possible mitigating actions.
- **Stress testing and sensitivity analysis**
  Earnings are regularly stress tested as part of internal management reporting such as the financial plan downside and upside scenarios, Internal Capital Adequacy Assessment Process and reverse stress test. In addition, earnings are tested externally under the PRA's Concurrent Stress Test scenarios. As a result, sensitivity analysis of expected earnings is conducted against a range of possible stress testing and sensitivity scenarios.

Outlook

Given the ongoing European and global economic environment there is an increased risk of uncertainty in the economic markets in which Nationwide operates. In addition, there is a risk of increased competition in the mortgage market, driving mortgage margins lower. This economic and competitive market context is expected to maintain pressure on Nationwide's net interest margin. Furthermore, should economic conditions deteriorate there is a risk of increased credit impairments adversely impacting earnings. Nationwide will continue to monitor the external economic environment to identify and mitigate any threats to achieving forecast earnings.

Business and Risk Report *continued*

Operational risk

Operational risk profile

Nationwide defines operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. Nationwide manages operational risk across a number of sub-categories, the most significant of which cover cyber, IT resilience and security, business continuity, payments and fraud.

Nationwide's operational risk profile is informed by risk assessments from across the business, and by review and challenge by both management and the Risk Oversight function. Risk Oversight supports the business in managing the risks it faces in its normal day-to-day activities and when implementing change programmes. Nationwide continues to strengthen and embed the operational risk framework, expanding the use of techniques such as scenario analysis and 'war-gaming' to support the understanding of current and future risks and to optimise risk-based decision making across the business.

Risk Oversight also monitors and reports on the operational risk events that have occurred, to better understand those exposures that require management attention. For the purposes of this report, operational risk events include only those where a financial loss arises from an operational risk incident. Nationwide records operational risk events against causal categories, as well as reporting them against the operational risk categories defined by the Basel Committee on Banking Supervision in Basel II. This allows comparison of operational risk experience with its peer group.

Operational risk experience

A significant majority of Nationwide's operational risk events have been recorded against three of the Basel categories: 'Clients, Products & Business Practices', 'External Fraud' and 'Execution, Delivery and Process Management'. These categories account for 99.1% by value, and 95.3% by number, of Nationwide's operational risk events (2016: 98.4% by value and 93.1% by number).

Whilst the highest losses are against the Clients, Products and Business Practice category, Nationwide typically experiences a relatively low volume of these events. This contrasts with the External Fraud event category, where a higher volume of events is observed, though with lower individual losses. In line with continuing trends in the financial services sector, Nationwide has seen a continued increase in the number of low value fraud events, primarily through 'card not present' fraud.

Operational risk events by Basel risk category (note i) % of total events by value	2017	2016 (note ii)
	%	%
Clients, products and business practices (note iii)	79.5	77.7
External fraud	9.8	11.6
Execution, delivery and process management	9.8	9.1
Internal fraud	0.0	0.5
Business disruption and system failure	0.3	0.1
Damage to physical assets	0.4	0.6
Employment practices and workplace safety	0.2	0.4
Total	100.0	100.0

Operational risk events by Basel risk category (note i) % of total events by number	2017	2016 (note ii)
	%	%
Clients, products and business practices	11.8	14.5
External fraud	77.4	71.7
Execution, delivery and process management	6.1	6.9
Internal fraud	0.3	1.0
Business disruption and system failure	0.5	0.5
Damage to physical assets	3.4	3.8
Employment practices and workplace safety	0.5	1.6
Total	100.0	100.0

Notes:

i. Risk events with losses over £5,000; multiple losses relating to the same event are only counted once.

ii. Comparatives have been restated to include additional historic data and to align to the current classification methodology.

iii. Includes the costs of customer redress in relation to ongoing payment protection insurance claims.

Business and Risk Report *continued*

Operational risk *continued*

Current environment

Over the course of the year, the overall portfolio of operational risks has remained relatively stable. The continued increase in customers' expectations towards the management of key inherent risks such as cyber-security and IT resilience, coupled with the high pace of change and focus on delivering a refreshed strategy, have been matched by increased control and monitoring. Nationwide's focus is on being safe, secure and dependable in order to ensure service availability and customer data are protected.

The main drivers of operational risk are as follows:

Cyber security and data protection

The maturity and sophistication of organised cyber-crime continue to increase and have been highlighted by a number of recent attacks in the financial and non-financial sectors, including payment services. Such attacks have also increased the public awareness of cyber-threats. As a result of the continued increasing threat from cyber-crime, security controls have needed to keep pace to prevent, detect and respond to any threats or attacks. The constant threat posed by a cyber attack directly impacts the existing risks associated with external fraud, data loss, data integrity and availability. Nationwide recognises the impact a successful cyber attack could have on the business and its customers.

Significant effort continues to be focused on discharging Nationwide's cyber risk management responsibilities effectively, with ongoing investment in appropriate technology and processes. This ensures that operations and, more importantly, customers are safeguarded. The cyber security control framework includes systems, processes, policies and controls to ensure cyber risk is managed effectively and is designed to ensure that effective approaches are in place to respond to any attacks, whether aimed directly at Nationwide or at other parties, where there may be an indirect impact on its customers. Cyber security remains a high priority and Nationwide will continue to focus on improving the awareness of its customers and employees, as well as continuing to build its understanding of the developing threats, its defences and its resilience to cyber attacks.

IT and operational resilience

Nationwide's implementation of new systems, infrastructures and processes, alongside the maintenance of legacy systems, introduces a level of operational complexity. In an increasingly digital world, customer expectations are rising, with a significantly lower tolerance of service disruption. Ensuring a highly reliable and widely available service requires resilient IT, business systems and processes. Meanwhile the exponential rise in data used in digital services increases the complexity and cost of managing data securely and effectively. In response, Nationwide operates a dedicated Operational Resilience Function to ensure it meets customer expectations for service levels associated with both internal and externally sourced IT and operations.

People risk

Nationwide relies on talented and dedicated people to deliver its strategy and provide first class service, and to operate a strong risk and control framework. Nationwide continues to monitor and closely manage the impact on its people as it structures itself to deliver the refreshed strategy and the products, services and experience that customers want, to ensure that the required levels of skill, knowledge and engagement are maintained.

Pace of change in a digital environment

Whilst the member-focused nature of Nationwide's business model puts it in a good position to respond to the varied and evolving needs of customers, Nationwide is committed to making it easier to transact through a range of channels. The scale and pace of change can create delivery challenges. Such challenges have the potential to disrupt Nationwide's operating environment and negatively impact the service experienced by customers. These operational risks are managed through a strong focus on service management, transformation governance and programme management disciplines.

Nationwide invests significantly in its digital channels, regularly updating the mobile and internet banking services and enabling new payment technologies. The experience for customers and staff in branches continues to improve with the roll out of the next generation of the Mobile Banking application and the strategic commitment to transform branches. Nationwide had one significant operational incident during the year, which resulted in restricted access to the previous version of the Mobile Banking application over three days. Actions have been taken to prevent reoccurrence.

Outlook

The operational risk outlook focuses on the environment in which Nationwide operates and on its strategy. The drivers of operational risk are expected to remain broadly consistent, with four main themes:

- Adherence to changing legislation, specifically in relation to data in the form of General Data Protection Regulations (GDPR), and payments in the form of Payment Services Directive 2.
- The scale and pace of change, particularly in a digital environment and with the enablement of Open Banking.
- IT resilience and the increasingly sophisticated cyber security threats.
- The continued reliance on strategic third party partners. Nationwide continues to invest in this area to maintain and develop appropriate controls to ensure that residual risk exposures are managed within appetite.

Strategic Report
Governance
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Other Information

Business and Risk Report *continued*

Conduct and compliance risk

Conduct and compliance risk profile

Conduct and compliance risk is the risk that Nationwide exercises inappropriate judgement or makes errors in the execution of its business activities, leading to non-compliance with regulation or legislation, market integrity being undermined, or an unfair outcome being created for members and customers. A programme of activity is underway to continually assess and mature the approach to the management of conduct and compliance risk across Nationwide.

Current environment

The regulatory environment remains challenging, with a variety of complex regulatory changes and new regimes being embedded, as regulators continue to drive an agenda committed to rebuilding trust and confidence in the UK financial services markets. Nationwide is supportive of these developments.

The embedding of conduct risk management across Nationwide continues to be an area of focus. The activity is underpinned by a set of internal principles, known as the Conduct Outcomes Statements, designed to support fair customer outcomes and protect markets. This supports the strengthening of a 'risk aware culture', which enables effective risk management and meets the expectations of customers and regulators.

Great importance is attached to the culture within Nationwide, ensuring that values and behaviours clearly align to its strategy. At the same time, continual assessment of new and existing risks in the conduct and compliance environment ensures that risk exposure is appropriately managed. These risks include but are not limited to: uses of new technology, cyber crime, product and service changes and regulatory change.

There is currently a significant volume of regulatory change impacting the industry; some of the key items relevant to Nationwide are listed below:

- In March 2016, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) introduced the Senior Managers Regime, Certification Regime and Conduct Rules, to strengthen individual accountability and hold individuals accountable for their actions in relation to regulated activities. On 7 March 2017, the Conduct Rules came into force. These rules capture all employees except for ancillary roles. Nationwide has successfully implemented these changes.
- The European Union's Fourth Anti-Money Laundering Directive, which comes into force in June 2017, aims to enhance processes to counter money laundering and terrorist financing. Nationwide is committed to operating a business that prevents, deters and detects money laundering and terrorist financing, and will introduce any changes required in line with the new directive and industry guidance.
- MIFID II (the Markets in Financial Instruments Directive and Regulation) comes into force on 3 January 2018. It sets out the rules for the provision of investment services and activities in complex financial instruments, increased customer and client protection standards, rules for trading venues and new standards for transaction reporting. Two projects are currently underway to make the changes necessary to meet the requirements. The approaches have been independently validated, and Nationwide is expected to be fully compliant by the implementation deadline.
- Payment Services Directive 2 (PSD2) will be transposed into UK law in January 2018 and will bring new payment service providers into the scope of regulation, open up access to payment accounts through authorised third parties, and require enhanced security and authentication measures. It will require substantial changes in processes and IT infrastructure. The Society is currently making the necessary changes to meet the requirements.
- The General Data Protection Regulation (GDPR) comes into force in May 2018 and applies to personal data. Its definition is more detailed than the Data Protection Act (DPA) and makes it clear that information such as an online identifier, e.g. an IP address, can be personal data. It applies to both automated personal data and to manual filing systems where personal data is accessible according to specific criteria. This is wider than the DPA's definition and could include chronologically ordered sets of manual records containing personal data. A significant programme of work is in place to make the changes necessary to meet the requirements.
- On 2 March 2017, the FCA finalised plans to place a deadline of 29 August 2019 on Payment Protection Insurance (PPI) complaints. The FCA also detailed the actions it expects firms to take in response to the Supreme Court ruling on 'Plevin v Paragon Personal Finance Ltd' which may impact some PPI cases. Nationwide has a redress programme of activity in place that will manage and oversee the impacts of the Supreme Court ruling. Further information on provisions for PPI and other customer redress is provided in note 30 to the accounts.

Outlook

In an ever demanding regulatory and digital environment, where the pace of innovation can increase conduct and compliance risk exposure, Nationwide remains committed to delivering products and services aligned to the needs of members and customers. This will be done in a prudent way that supports Nationwide's values and manages those opportunities, risks and threats in accordance with its strategy and core purpose.

The FCA's market study on competition in the Mortgage sector was launched in December 2016, with the final report expected in 2018. As the UK's second largest mortgage provider, this will be of significant interest. Ongoing communications on this subject will be monitored and enhancements to the current proposition will be implemented where appropriate.

Nationwide is well placed to continue to respond to these complex regulatory changes and will continue to provide a secure and dependable variety of products and services which are designed to meet the needs of members and customers.

Business and Risk Report *continued*

Strategic risk

Nationwide defines strategic risk as the risk of significant loss or damage arising from business decisions that impact the long term interests of the membership, or from an inability to adapt to external developments. It encompasses risks that could become a material issue for Nationwide's business model or arise from strategic initiatives. Whilst all business areas are responsible for managing their own risks, management of strategic risk is primarily the responsibility of the Executive Committee.

Nationwide assesses the external environment to consider risks that may materially affect the delivery of its strategy and aims to address these risks in developing its plans. Key activities to support the management of strategic risk include stress testing processes and the regular review of business performance and risk reporting data by the Board and Executive Committee. Some of the top and emerging risks have the potential to affect more than one risk category, and could have a significant impact on the business model if these were to crystallise within the same timeframe, and are therefore monitored under strategic risk.

In managing strategic risk, strategic investments are evaluated with regard to the potential benefit for both current and future members. Nationwide's activities are centred around mainstream UK retail personal financial services, with participation in other non-member business activities only where these activities fit with core capabilities, diversify risks, and earn a premium return for its members.

The strategy is designed to respond to strategic risks to the business model. The key risks that could require the strategy to be adapted are changes in customer behaviour, the competitive environment in which Nationwide operates and the continuing low interest rate environment. These are all noted in the PRA's latest Biennial Exploratory Scenario, which forms part of the 2017 Concurrent Stress Test (CST) activity, and will provide Nationwide with the opportunity to stress the impact to margins.

Customers are expected to make greater use of digital channels and their expectations for service availability and quality will continue to increase. However, there is a risk that new technology is adopted more quickly than anticipated, or that new propositions offered by competitors alter customer expectations. Both would require a change to current plans.

It is expected that the core markets in which Nationwide operates will remain highly competitive due to existing and new competitors. The implementation of Open Banking could result in the emergence of new competitors, potentially with substantially different business models that materially alter this environment. Nationwide is investing in developing Open Banking solutions to support members' needs and to mitigate this risk.

The impact of the continued low interest rate environment, particularly on margins, is monitored closely. Although not expected, a move to zero or negative rates could result in changing customer attitudes to savings, potentially impacting Nationwide's business model. This risk is managed through appropriate pricing of product propositions, as well as prioritising investment activities, to ensure that Nationwide delivers the service that members and customers expect and maintains a sustainable business model.

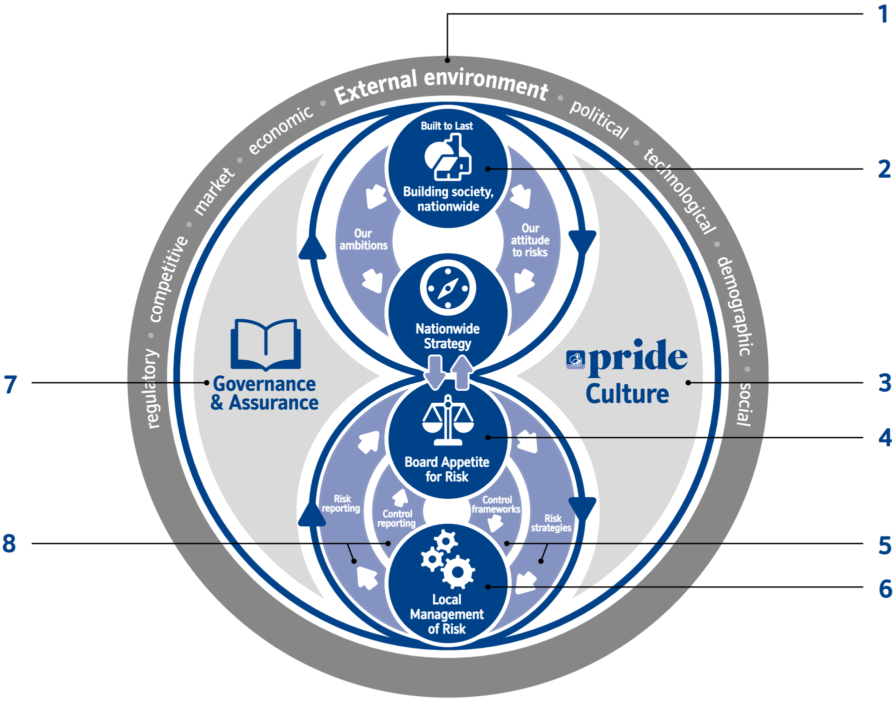
Business and Risk Report *continued*

Managing risk

Effective risk management is at the heart of the business, supporting the delivery of Nationwide's strategy by ensuring it continues to be safe and sustainable and ultimately protecting members' interests. The Society adopts an enterprise-wide risk management framework underpinned by the three lines of defence model to manage risks effectively.

Enterprise risk management framework (ERMF)

The ERMF sets out the high-level policy, standards and requirements for the management of all risks, as shown below and in the table below.



1	**External environment**	Nationwide's risk management agenda is shaped by external environmental factors including but not limited to those listed in the diagram.
2	**Building society, nationwide**	Nationwide's core purpose sets its ambitions and informs its strategy and attitude to risks.
3	**Culture**	Having the right culture supports risk management activity across the business. Nationwide's culture and PRIDE values ensure that members' interests, safety and security are put at the heart of its approach to risk management.
4	**Board appetite for risk**	Board appetite for risk defines how much risk the Board is prepared to take in pursuit of the Society's goals, and establishes a framework for decision making. It is supported by metrics and limits which enable performance against appetite to be effectively reported. Board appetite for risk is informed by, and informs, Nationwide's strategy.
5	**Risk strategies and control frameworks**	The Board approves the risk management strategies and control frameworks that management use to ensure that major risks remain within Board appetite for risk.
6	**Local management of risk**	Local management of risk is the process of identifying, assessing, managing, monitoring and reporting risks. Risk management activity is carried out by all employees to ensure that risks which are part of their day-to-day jobs are properly identified and controlled. As part of this, the Society undertakes stress testing and scenario analysis to ensure that it understands and remains resilient to the impact of remote, but potentially severe, risks. Further details of stress testing can be found in the 'Liquidity and funding risk' and the 'Solvency risk' sections of this report.
7	**Governance and assurance**	Governance and assurance describes the risk committee structures and mandates, and ensures that roles and responsibilities are clear and operate within the Society's three lines of defence model. Further information is included on the following pages.
8	**Risk and control reporting**	Risk and control reporting enables the Board to ensure that risk management and internal control systems are operating adequately and that risks are being managed within risk appetite.

Business and Risk Report *continued*

Managing risk *continued*

Nationwide's three lines of defence model

Nationwide operates a three lines of defence model, ensuring clear separation between risk and control ownership (first line), oversight, support and challenge (second line), and audit assurance (third line). Accountabilities within the three lines of defence model are outlined below:

First line – Risk and Control Ownership	Second line – Oversight, Support and Challenge	Third line – Assurance
Specific accountabilities include:	**Specific accountabilities include:**	**Specific accountabilities include:**
• Setting business objectives	• Providing expert advice on business initiatives	• Performing independent audits of the effectiveness of first line risk and control and second line risk oversight, support and challenge • Taking a risk-based approach to the programme of audit work • Preparing an annual opinion on the risk management and controls framework to present to the Audit Committee
• Defining management risk appetite	• Advising the Board on setting risk appetite	
• Identifying, owning and managing risks	• Reporting aggregate enterprise level risks to the Board	
• Defining, operating and testing controls	• Conducting independent and risk-based assurance	
• Implementing and maintaining regulatory compliance	• Interpreting material regulatory change	
• Adhering to the minimum standards set out in the risk management framework and associated policies	• Setting the risk management framework and associated policies	
• Identifying future threats and risks	• Identifying future threats and risks	

Business and Risk Report *continued*

Managing risk *continued*

Risk committee structure

The Board Risk Committee and Audit Committee continue to provide oversight and advice to the Board. The Executive Risk Committee ensures a co-ordinated management approach across all risk categories. The risk committee structure is represented in the following diagram.

Board

Chair: David Roberts

- Ensure maintenance of sound system of internal control and risk management.
- Review the effectiveness of the risk and control processes to support its strategy and objectives.
- Approve the risk appetite, ERMF and key regulatory documents (such as Internal Capital Adequacy Assessment Process and Individual Liquidity Adequacy Assessment).

Board committees

IT Strategy and Resilience Committee

Chair: Mitchel Lenson

- Oversight of the IT strategy, architecture, delivery roadmap and architectural governance controls.
- Oversight of IT resilience strategy and framework of IT systems and controls.
- Oversight of the strategic investments portfolio and material transformation programmes.

Board Risk Committee

Chair: Tim Tookey

- Provide oversight and advice to the Board on current and emerging risk exposures.
- Review the risk appetite and supporting metrics.
- Review the effectiveness of the ERMF to manage and mitigate risk.

Audit Committee

Chair: Kevin Parry

- Monitor the integrity of the financial statements.
- Review the adequacy and effectiveness of internal controls and risk management systems.
- Monitor the effectiveness of the Compliance Oversight function.
- Review the adequacy of fraud and bribery prevention procedures.
- Monitor the effectiveness of the Internal Audit function.

Executive committees

Executive Risk Committee

Chair: Julia Dunn

- Determine the attitude to risk.
- Exercise responsibility for controlling risk across Nationwide.
- Monitor and review risk exposures.

Conduct and Compliance Committee

Chair: Tom Anderson, Chief Compliance Officer

- Determine the attitude to conduct and compliance risk.
- Manage Nationwide's conduct and compliance risk profile.

Operational Risk Committee

Chair: Debra Bailey

- Determine the attitude to operational risk.
- Manage Nationwide's operational risk profile.

Assets and Liabilities Committee

Chair: Mark Rennison

- Determine the attitude to financial risk.
- Manage Nationwide's financial risk profile.

Credit Committee

Chair: James Tebboth Chief Credit Officer

- Determine the attitude to lending risk.
- Manage Nationwide's lending risk profile.

First line – risk and control ownership

Additional specialist risk sub-committees and forums beneath provide specialist advice

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Independent auditors' report

to the members of Nationwide Building Society

Report on the financial statements

Our opinion

In our opinion, Nationwide Building Society's Group financial statements and Society financial statements (the "financial statements"):

- give a true and fair view of the state of the Group's and of the Society's affairs as at 4 April 2017 and of the Group's and the Society's profit and cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

The purpose and scope of the audit

What we have audited

The financial statements, included within the Annual Report and Accounts (the "Annual Report"), comprise:

- the Group and Society balance sheets as at 4 April 2017;
- the Group and Society income statements and the statements of comprehensive income for the year then ended;
- the Group and Society cash flow statements for the year then ended;
- the Group and Society statements of movements in members' interests and equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

Certain required disclosures have been presented elsewhere in the Annual Report, rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

The financial reporting framework that has been applied in the preparation of the financial statements is IFRSs as adopted by the European Union, and applicable law.

What an audit of financial statements involves

An audit has an important role in providing confidence in the financial statements that are provided by organisations to their members. The audit opinion does not provide assurance over any particular number or disclosure, but over the financial statements taken as a whole. It is the directors' responsibility to prepare the financial statements and to be satisfied that they give a true and fair view.

The scope of an audit is sometimes not fully understood. I believe that it is important that you understand the scope in order to understand the assurance that my opinion provides. My responsibility is to undertake my work and express my opinion in accordance with applicable law and the International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)") as issued by the Financial Reporting Council of the United Kingdom. These standards also require me to comply with the Auditing Practices Board's Ethical Standards for Auditors. A description of the scope of an audit is provided on the Financial Reporting Council's website at www.frc.org.uk; I recommend that you read this description carefully. It is also important that you understand the inherent limitations of the audit which are disclosed in this description, for example the possibility that an approach based upon sampling and other audit techniques may not identify all issues.

My audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Group's and the Society's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

I primarily focused my work in these areas by assessing the directors' judgements against available evidence, forming my own judgements and evaluating the disclosures in the financial statements.

My team and I tested and examined information using sampling and other auditing techniques, to the extent I considered necessary to provide a reasonable basis for me to form my own judgements. We obtained audit evidence by testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, I read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. I obtained this knowledge by attending all Audit Committee meetings and also meeting with senior management. I also met privately with the non executive directors and other key stakeholders, including the regulators of the Group.

Independent auditors' report *continued*

Report on the financial statements *continued*

Factors my team and I considered in setting the audit strategy

On commencement of the audit, my team and I considered both internal and external factors which could influence how we audit the Group. There have been a number of matters we considered when determining the audit strategy this year.

Change in Nationwide strategy

The Group announced a new strategy during the year which is set out in the Annual Report. We tailored our audit approach to be responsive to changes in the Group where they impacted financial reporting and we also considered the risk of change in the continuity of control.

External factors

We also considered the current macroeconomic environment and regulatory developments during the year. We assessed these changes and considered them specifically when auditing the Group's impairment of retail loans and advances to customers and provisions for customer redress. Further detail is set out in the areas of focus section below.

Materiality

We designed the audit by determining materiality based on quantitative thresholds. This together with qualitative considerations helped us to determine the scope of the audit and audit procedures, and to evaluate the effect of misstatements, both individually and on the financial statements as a whole.

We determined materiality for the financial statements as a whole as follows:

Overall Group materiality	£52 million (2016: £50 million).
How we determined it	5% of profit before tax.
Rationale for benchmark applied	Profit before tax is one of the principal considerations when assessing the Group's performance, and is a generally accepted auditing benchmark.

I agreed with the Audit Committee that we would report to them misstatements identified during our audit above £2.6 million (2016: £2.5 million) as well as any misstatements below that amount which, in my view, warranted reporting for qualitative reasons.

Audit scope

We tailored the scope of the audit to ensure that enough work was performed to be able to give an opinion on the financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates. The Group is structured into three segments: Retail, Commercial and Head Office functions. Each of the segments comprises a number of product offerings or service functions. We defined the audit scope at a product and service function level. The consolidated financial statements are a consolidation of the different products and service functions within each segment.

For products that we considered individually financially significant in the context of the Group's consolidated financial statements, we audited their financial information. We then considered the individual financial significance of other products in relation to primary statement account balances and the presence of any significant audit risks and other qualitative factors (including history of misstatements through fraud or error). These products were subject to specific audit procedures over those account balances or to address the significant audit risks or qualitative factors. Inconsequential components (defined as products that, in our view, did not represent a risk of material misstatement either individually or in aggregate) were eliminated from further consideration for specific audit procedures although they were subject to analytical review procedures.

Areas of focus

Based on our understanding of the business, changes in the economic environment and our discussions with the Audit Committee, we performed a risk assessment to determine the higher risk areas. I presented those identified higher audit risk areas during the Audit Committee meeting in October 2016. Throughout the year, our plan was refreshed and revised to address changes in the external and internal environment. The areas of highest audit risk, where we focused most effort and resources, were:

- Impairment of retail loans and advances to customers;
- Provisions for customer redress; and
- Hedge accounting.

Other areas which we considered areas of focus due to changes in environment, business or other findings were:

- Retirement benefit obligations;
- Impairment of computer software; and
- Privileged access management.

This is not a complete list of all risks identified, but these are the areas where we performed the most testing over the year. Some of them are common to major UK financial institutions, some are specific to the Group. In the table below, I have included an explanation of each area of focus, how the audit approach was tailored to address the risk and what I have discussed with the Audit Committee.

Independent auditors' report *continued*

Report on the financial statements *continued*

Impairment of retail loans and advances to customers

Nature of area of focus	Matters discussed with Audit Committee
Impairment of retail loans and advances to customers is an area where a high level of judgement is applied in determining the necessity for and then estimating the size of any impairment. Retail impairment is calculated on a modelled basis for each portfolio of loans. Inputs to the models are primarily based on historical data. In the current year, management again adjusted a number of modelled assumptions to take into account a prolonged period of low interest rates and the risks associated with maturing interest only mortgages. We therefore focused our work on testing the model adjustments and updates to assumptions.	We discussed the appropriateness of the provisioning methodology, the adjustments made to models during the year and the appropriateness of the provision in the current economic environment. In particular, we discussed the appropriateness of management's assumptions of the ability of customers to repay interest only mortgages at the end of their term and the adequacy of retail loan provisioning in the current low interest rate environment.

Procedures performed to support our discussions and conclusions

- We identified and tested the design and operating effectiveness of key controls over the impairment models. We determined that these controls were effective and could be relied upon for the purpose of our audit.
- We tested the key assumptions in the impairment calculation and also agreed them to historical data where appropriate. Where changes had been made in model assumptions, or new overlays to models had been made, we understood the reasons why changes had taken place and used our industry knowledge and experience to evaluate the appropriateness of such changes. We considered the changes and explanations given to be reasonable.
- We tested the operation of models used to calculate the impairment, including using our specialists to rebuild a sample of models using management's assumptions. We found no material differences in these tests.
- We tested the accuracy and completeness of underlying data used in the impairment models. We found no material differences in these tests.
- We tested all significant model overlays, including considering the basis for the adjustment, the logic applied, the source data used and the key assumptions adopted. We found these overlays to be reasonable and supportable.
- We also considered the completeness of overlays identified for latent risks given our own assessment of the industry and economic environment. We did not identify any additional material latent risks not considered by management.

Based on the evidence we obtained, we determined that the impairment model assumptions, data used within the models and refinements to assumptions were reasonable and the resulting estimate is in accordance with accounting standards.

Relevant reference in the Annual Report and Accounts 2017

See note 10 to the financial statements on pages 168 to 170.

Independent auditors' report *continued*

Report on the financial statements *continued*

Provisions for customer redress

Nature of area of focus	Matters discussed with Audit Committee
There is inherent uncertainty in assessing and measuring the potential obligations resulting from ongoing regulatory matters and past sales practices, including mis-selling of Payment Protection Insurance ("PPI") and non-compliance with consumer credit regulations, specifically in respect of the timing and volume of future complaints volumes. A key factor impacting estimation uncertainty related to the Financial Conduct Authority's ("FCA") policy statement 17/3 issued during the year. The policy statement set a time-bar for consumer PPI complaints to be finalised by August 2019, which is later than originally anticipated, and confirmed the inclusion of profit share for Plevin cases. Management had to make updates to their PPI provisioning methodology to reflect the impact of this.	We discussed the risk associated with the accuracy and completeness of customer redress provisions. The discussion focused primarily on revisions to future complaint assumptions required due to the finalisation of the FCA's policy statement on PPI.

Procedures performed to support our discussions and conclusions

- For significant customer redress provisions, we tested the accuracy and completeness of the data used and re-performed the calculations. We found no material differences in these tests.
- We assessed the assumptions used in the estimated provisions for reasonableness based on our broader industry knowledge and traced the actual claims experience and costs to date to historical data without exception.
- We tested a sample of customer complaints by reading related correspondence with the customers to understand whether there were indicators of issues being present that were inconsistent with the outcome recorded. This testing did not identify any exceptions.
- Specifically, for PPI provisioning, we tested how management updated their provisioning models and assumptions to address actual complaints flow and the new FCA policy statement requirements.

Based on the evidence we obtained, we determined that the provisions have been reasonably calculated and are within an acceptable range of expected outcomes.

Given the inherent uncertainty in the calculation of customer redress provisions and their judgemental nature, we considered whether the disclosures of the application of judgement in estimating the provisions adequately reflected the uncertainties associated with customer redress and determined that they did.

No additional material customer redress issues that would require either provision or disclosure in the financial statements were identified as a result of the audit work performed.

Relevant reference in the Annual Report and Accounts 2017

See note 30 to the financial statements on pages 196 to 197.

Independent auditors' report *continued*

Report on the financial statements *continued*

Hedge accounting

Nature of area of focus	Matters discussed with Audit Committee
The Group applies fair value and cash flow hedge accounting under IAS 39 "Financial Instruments: Recognition and Measurement" to manage accounting volatility mainly arising due to interest rate and foreign exchange risks. To qualify for hedge accounting under IAS 39, certain criteria must be met, including documenting the nature and purpose of the hedge, performing testing over its effectiveness and appropriately accounting for the hedging results. Hedge accounting is inherently complex and involves manual processes which present a heightened risk of error.	We discussed the risks associated with hedge accounting due to the complexity involved and continued reliance on manual processes whilst a new treasury system is being implemented to automate the hedge accounting processes.

Procedures performed to support our discussions and conclusions

- We understood and tested the design and operating effectiveness of key controls over the designation and monitoring of hedge relationships, hedge effectiveness testing and the resulting hedge adjustments, as well as the controls over amortisation of balances resulting from de-designated hedge relationships. We determined that we could place reliance on these controls for the purposes of our audit.
- For a sample of hedges, we examined hedge documentation to assess whether it complied with the requirements of IAS 39, including management's assessment of hedge effectiveness at the time of designation. For a sample of fair value and cash flow hedge relationships, we re-performed the hedge effectiveness testing by agreeing inputs, including historical data, to the underlying systems and the modelled calculations. We found no material differences in these tests.
- We recalculated a sample of automated and manual calculations used to generate the hedge accounting adjustments and found that the adjustments were materially accurate. We tested key year-end reconciliations between the underlying source systems and spreadsheets used to evaluate results of hedge effectiveness testing, and recording of hedge adjustments in the income statement and balance sheet for fair value hedge relationships. For cash flow hedge relationships, we tested a sample of manual adjustments posted to the cash flow hedge reserve relating to hedge effectiveness.

Our testing did not identify any material discrepancies in the hedge documentation or material errors in the accounting.

Relevant reference in the Annual Report and Accounts 2017

See note 7 to the financial statements on page 165.

Independent auditors' report *continued*

Report on the financial statements *continued*

Retirement benefit obligations

Nature of area of focus

The Group has a number of defined benefit pension schemes. Our testing focused on the Nationwide Pension Fund scheme which has the most significant funding obligation and is where the majority of the Group's funding deficit lies.

The overall deficit of £423 million at 4 April 2017 had increased significantly during the year. There is inherent judgement in selecting appropriate actuarial assumptions when measuring the pension scheme liabilities. We therefore focused our testing on these assumptions which include the discount rate, rate of inflation and mortality rates. Due to the size of the scheme, small changes in these assumptions can have a significant impact on the financial statements.

Matters discussed with Audit Committee

We discussed the appropriateness of the key actuarial assumptions used in arriving at the pension deficit. The discussion was assisted by our benchmarking of the key actuarial assumptions to those we commonly observe in the market.

Procedures performed to support our discussions and conclusions

- We involved our actuarial experts and met with management to understand the judgements made in determining key economic assumptions used in the calculation of the liability. We assessed the reasonableness of those assumptions by comparing to our own independently determined benchmarks and agreed that the assumptions used by management were reasonable.
- We agreed management's inputs to third party actuarial reports and performed testing of management's review process over the appropriateness of assumptions. We also assessed the Group's actuarial experts and found they were competent and objective.
- We understood and tested the design and operating effectiveness of key controls over pension assets. We determined that we could place reliance on these controls for the purposes of our audit. We confirmed assets with third parties and independently performed a revaluation for a sample of assets.
- We tested the employee data used in calculating the obligation. Where material, we also considered the treatment of curtailments, settlements, past service costs and measurements, and any other amendments made to obligations during the year. No exceptions were noted from these tests.

Based on the evidence obtained, we found that the assumptions used by management in the actuarial valuations for retirement benefit obligations are within a range we consider to be reasonable.

We also read and assessed the disclosures made in the financial statements, including disclosures of the assumptions, and found them to be adequate.

Relevant reference in the Annual Report and Accounts 2017

See note 33 to the financial statements on pages 199 to 202.

Impairment of computer software

Nature of area of focus

The Group has spent a considerable amount on computer software, to meet regulatory requirements, to automate internal processes and to develop digital capability for customer product offerings.

As a result of regulatory and industry developments, certain elements of computer software have become obsolete, have not yielded the result initially aimed for, or have not had the customer uptake rate originally planned for. These impairment indicators have led management to carry out impairment assessments in accordance with IAS 36 "Impairment of Assets" and to recognise an impairment.

Matters discussed with Audit Committee

We discussed whether the impairment is reasonable and complete based on the evidence available for the impaired computer software.

We also discussed our testing for indicators of impairment on the non-impaired computer software.

Procedures performed to support our discussions and conclusions

- For the impaired computer software identified by management, we tested whether the level of recognised impairment is sufficient.
- We tested a sample of non-impaired computer software for indicators of impairment. We considered whether these assets had become idle or were no longer being used for the purpose intended. We also considered risk factors such as digital change in the industry and the ongoing IT infrastructure replacement program.
- We tested the design and operating effectiveness of the control that management has in place to identify indicators of impairment. We determined that the control was designed and operated effectively, and therefore we could place reliance on it for the purposes of our audit.

As a result of our work, we consider the recorded impairment to be reasonable. For those assets where management determined that no impairment was required, we found that the assessments made by management were based upon reasonable assumptions.

Relevant reference in the Annual Report and Accounts 2017

See note 28 to the financial statements on page 194.

Independent auditors' report *continued*

Report on the financial statements *continued*

Privileged access management	
Nature of area of focus The Group is highly dependent on technology due to the significant number of transactions that are processed daily. As a result, the audit approach relies on automated controls and therefore we test access controls over IT systems. Controls over privileged access rights are important as they ensure that changes to applications and data are authorised and made in an appropriate manner. Ensuring that staff only have appropriate access, and that the access is monitored, is key to mitigate the potential for misuse or error as a result of a change to an application or underlying data. Improvements are required to privileged access controls. We focused our testing to satisfy ourselves of there being no material misstatement arising from inappropriate access to technology.	**Matters discussed with Audit Committee** We discussed the risks associated with privileged access due to the complexity of the IT systems that support key applications. We also highlighted to the Audit Committee where we needed to amend our audit approach as a result of the improvements required to the privileged access controls.

Procedures performed to support our discussions and conclusions

We tested access rights over the various aspects of technology relied upon for financial reporting. Specifically, we tested that:

- New access requests for joiners were properly reviewed and authorised;
- Application user access rights were removed on a timely basis when an individual left or moved role;
- Access rights to applications were periodically monitored for appropriateness; and
- Highly privileged access was restricted to appropriate personnel.

Other areas that we independently assessed included password policies, security configurations, controls over changes to applications and databases and controls to ensure that business users, developers and production support did not have access to change applications, the operating system or databases in the production environment.

We identified areas where privileged access controls need to be improved and performed additional procedures:

- Where inappropriate access was identified, we understood the nature of the access, and, where possible, obtained additional evidence on the appropriateness of the activities by testing additional logging and monitoring controls on the systems impacted.
- We performed additional substantive testing to confirm that system accounts were not logged into by staff during the audit period.
- We performed additional testing on other business compensating controls such as payments reconciliations and ledger reconciliations, as well as substantive testing of key reports and balances within impacted systems.

Our additional substantive testing and testing of compensating controls were concluded satisfactorily and enabled us to rely on system generated information for the purpose of our audit.

Relevant reference in the Annual Report and Accounts 2017

This risk relates to IT controls testing which has an indirect impact on the financial statements.

Independent auditors' report *continued*

Other reporting

The Annual Report also contains a considerable amount of other information that is required by various regulators, standard setters or legislation. In respect of this information, our responsibility and reporting are set out in the table below.

Area of Annual Report	Responsibility	Reporting
Other required reporting		
Consistency of other information and compliance with applicable requirements: Opinions on other matters prescribed by the Buildings Societies Act 1986	We are required to report: • Whether the Annual Business Statement and the Directors' Report have been prepared in accordance with the requirements of the Building Societies Act 1986; • Whether the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the accounting records and the financial statements; and • Whether the information given in the Annual Business Statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given.	In our opinion, the Annual Business Statement gives true representation of the matters, information in the Director's Report is consistent with accounting records and financial statements; and both have been prepared in accordance with the Building Societies Act 1986.
Consistency of other information and compliance with applicable requirements: ISAs (UK & Ireland) reporting	We are required to report to you if, in our opinion, information in the Annual Report is: • materially inconsistent with the information in the audited financial statements; • apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group and Society acquired in the course of performing our audit; or • otherwise misleading. As a result of the directors' voluntary reporting on how they have applied the UK Corporate Governance Code (the "Code"), under ISAs (UK & Ireland) we are required to report to you if, in our opinion: • the statement given by the directors on page 42 in accordance with provision C.1.1 of the Code, that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's and Society's position and performance, business model and strategy, is materially inconsistent with our knowledge of the Group and Society acquired in the course of performing our audit. • the section of the Annual Report on pages 53 to 57, as required by provision C.3.8 of the Code, describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.	We have no exceptions to report.
The directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group	As a result of the directors' voluntary reporting on how they have applied the Code, under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to: • the directors' confirmation on pages 41 to 42 of the Annual Report, in accordance with provision C.2.1 of the Code, that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity. • the disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated. • the directors' explanation on pages 41 to 42 of the Annual Report, in accordance with provision C.2.2 of the Code, as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.	We have nothing material to add or to draw attention to.
Propriety of accounting records and information and explanations received	Under the Building Societies Act 1986 we are required to report to you if, in our opinion: • proper accounting records have not been kept by the Society; or • the Society financial statements are not in agreement with the accounting records; or • we have not received all the information and explanations and access to documents we require for our audit.	We have no exceptions to report arising from this responsibility.

Independent auditors' report *continued*

Other reporting *continued*

Area of Annual Report	Responsibility	Reporting
Other voluntary reporting – Opinion on additional disclosures		
Report of the directors on remuneration (pages 66 to 79)	The Society voluntarily prepares a Report of the directors on remuneration in accordance with the provisions of the Companies Act 2006. The directors have requested that we audit the part of the Report of the directors on remuneration specified by the Companies Act 2006 to be audited as if the Society were a quoted company.	In our opinion, the part of the Report of the directors' on remuneration to be audited has been properly prepared in accordance with the requirements of the Companies Act 2006.
Corporate Governance Statement (pages 43 to 65)	The Society prepares a Corporate Governance Statement in accordance with the Disclosure Guidance and Transparency Rules of the Financial Conduct Authority ("FCA") and has chosen voluntarily to comply with the Code. The directors have requested that we review the parts of the Corporate Governance Statement relating to the Society's compliance with the ten provisions of the Code specified for auditor review by the Listing Rules of the Financial Conduct Authority as if the Society were a premium listed company.	We have nothing to report having performed our review.
Going concern	The directors have voluntarily complied with Listing Rule 9.8.6(R)(3)(a) of the FCA and provided a statement in relation to going concern, set out on page 41, required for companies with a premium listing on the London Stock Exchange. The directors have requested that we review the statement on going concern as if the Society were a premium listed company.	We have nothing to report having performed our review.
	The directors have chosen to voluntarily report how they have applied the Code as if the Society were a premium listed company. Under ISAs (UK & Ireland) we are required to report to you if we have anything material to add or to draw attention to in relation to the directors' statement about whether they considered it appropriate to adopt the going concern basis in preparing the financial statements.	We have nothing material to add or to draw attention to.
	As noted in the Directors' report the directors have concluded that it is appropriate to adopt the going concern basis in preparing the financial statements. The going concern basis presumes that the Group and Society have adequate resources to remain in operation, and that the directors intend them to do so, for at least one year from the date the financial statements were signed.	As part of our audit we have concluded that the directors' use of the going concern basis is appropriate. However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Group's and Society's ability to continue as a going concern.

Use of this report

This report, including the opinions, has been prepared for and only for the Society's members as a body in accordance with Section 78 of the Building Societies Act 1986 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Hemione Hudson (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
22 May 2017

Income statements

For the year ended 4 April 2017		Group		Society	
		2017	2016	2017	2016
	Notes	£m	£m	£m	£m
Interest receivable and similar income	3	5,050	5,294	4,724	4,943
Interest expense and similar charges	4	(2,090)	(2,208)	(2,244)	(2,367)
Net interest income		2,960	3,086	2,480	2,576
Fee and commission income	5	446	428	442	421
Fee and commission expense	5	(221)	(192)	(221)	(189)
Income from investments		-	3	-	13
Other operating income	6	100	8	100	8
Gains from derivatives and hedge accounting	7	66	39	69	129
Total income		3,351	3,372	2,870	2,958
Administrative expenses	8	(2,021)	(1,847)	(1,988)	(1,819)
Impairment losses on loans and advances to customers	10	(131)	(81)	(66)	(55)
Impairment (losses)/recoveries on investment securities	14	(9)	8	(9)	8
Provisions for liabilities and charges	30	(136)	(173)	(136)	(173)
Profit before tax		1,054	1,279	671	919
Taxation	11	(297)	(294)	(206)	(228)
Profit after tax		757	985	465	691

The notes on pages 152 to 209 form part of these Accounts.

Statements of comprehensive income

For the year ended 4 April 2017	Notes	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Profit after tax		757	985	465	691
Other comprehensive (expense)/income:					
Items that will not be reclassified to the income statement					
Remeasurements of retirement benefit obligations:					
Retirement benefit remeasurements before tax	33	(347)	42	(345)	42
Taxation	11	92	9	92	9
		(255)	51	(253)	51
Revaluation of property:					
Revaluation before tax	29	1	4	1	4
Taxation	11	2	(7)	2	(7)
		3	(3)	3	(3)
Other items recognised through the general reserve, including effect of corporation tax rate change	11	(1)	(1)	-	-
		(253)	47	(250)	48
Items that may subsequently be reclassified to the income statement					
Cash flow hedge reserve:					
Fair value movements taken to members' interests and equity		1,671	2,099	71	(5)
Amount transferred to income statement		(2,019)	(1,666)	(143)	10
Taxation	11	101	(132)	18	(1)
		(247)	301	(54)	4
Available for sale reserve:					
Fair value movements taken to members' interests and equity		176	(60)	176	(60)
Amount transferred to income statement		(106)	19	(104)	19
Taxation	11	(18)	7	(16)	7
		52	(34)	56	(34)
Other comprehensive (expense)/income		(448)	314	(248)	18
Total comprehensive income		309	1,299	217	709

The notes on pages 152 to 209 form part of these Accounts.

Balance sheets

At 4 April 2017

		Group		Society	
		2017	2016	**2017**	2016
	Notes	**£m**	£m	**£m**	£m
Assets					
Cash		**13,017**	8,797	**13,017**	8,797
Loans and advances to banks		**2,587**	3,591	**2,567**	3,542
Available for sale investment securities	14	**9,764**	10,612	**9,764**	10,612
Derivative financial instruments	17	**5,043**	3,898	**4,022**	3,515
Fair value adjustment for portfolio hedged risk		**746**	756	**746**	756
Loans and advances to customers	16	**187,371**	178,807	**153,900**	146,289
Investments in equity shares	15	**67**	126	**67**	126
Investments in Group undertakings	36	**-**	-	**31,757**	31,402
Intangible assets	28	**1,230**	1,191	**1,218**	1,179
Property, plant and equipment	29	**851**	823	**849**	821
Investment properties		**8**	8	**8**	8
Accrued income and expenses prepaid		**191**	166	**1,311**	421
Deferred tax	11	**103**	35	**98**	27
Other assets	21	**692**	129	**689**	127
Total assets		**221,670**	208,939	**220,013**	207,622
Liabilities					
Shares		**144,542**	138,715	**144,542**	138,715
Deposits from banks	18	**8,734**	2,095	**7,563**	1,373
Other deposits	19	**6,459**	7,635	**8,028**	8,797
Due to customers		**2,376**	6,201	**2,376**	6,201
Fair value adjustment for portfolio hedged risk		**8**	13	**8**	13
Debt securities in issue	21	**40,339**	36,085	**35,872**	30,521
Derivative financial instruments	17	**3,182**	3,463	**4,802**	4,910
Other liabilities		**391**	414	**3,186**	4,760
Provisions for liabilities and charges	30	**387**	343	**386**	340
Accruals and deferred income		**333**	288	**332**	287
Subordinated liabilities	22	**2,905**	1,817	**2,910**	1,823
Subscribed capital	23	**276**	413	**276**	413
Deferred tax	11	**100**	186	**26**	43
Current tax liabilities		**82**	128	**44**	83
Retirement benefit obligations	33	**423**	213	**419**	211
Total liabilities		**210,537**	198,009	**210,770**	198,490
Members' interests and equity					
Core capital deferred shares	34	**531**	531	**531**	531
Other equity instruments	35	**992**	992	**992**	992
General reserve		**9,316**	8,921	**7,660**	7,554
Revaluation reserve		**67**	64	**67**	64
Cash flow hedge reserve		**183**	430	**(56)**	(2)
Available for sale reserve		**44**	(8)	**49**	(7)
Total members' interests and equity		**11,133**	10,930	**9,243**	9,132
Total members' interests, equity and liabilities		**221,670**	208,939	**220,013**	207,622

The notes on pages 152 to 209 form part of these Accounts.

Approved by the board of directors on 22 May 2017.
D L Roberts Chairman, **J D Garner** Chief Executive Officer, **M M Rennison** Chief Financial Officer

Group statement of movements in members' interests and equity

For the year ended 4 April 2017	Core capital deferred shares	Other equity instruments	General reserve	Revaluation reserve	Cash flow hedge reserve	Available for sale reserve	Total
	£m	£m	£m	£m	£m	£m	£m
At 5 April 2016	531	992	8,921	64	430	(8)	10,930
Profit for the year	-	-	757	-	-	-	757
Net remeasurements of retirement benefit obligations	-	-	(255)	-	-	-	(255)
Net revaluation of property	-	-	-	3	-	-	3
Effect of tax rate change on other items through the general reserve	-	-	(1)	-	-	-	(1)
Net movement in cash flow hedge reserve	-	-	-	-	(247)	-	(247)
Net movement in available for sale reserve	-	-	-	-	-	52	52
Total comprehensive income	-	-	501	3	(247)	52	309
Distribution to the holders of core capital deferred shares	-	-	(56)	-	-	-	(56)
Distribution to the holders of Additional Tier 1 capital (note i)	-	-	(50)	-	-	-	(50)
At 4 April 2017	531	992	9,316	67	183	44	11,133

For the year ended 4 April 2016	Core capital deferred shares	Other equity instruments	General reserve	Revaluation reserve	Cash flow hedge reserve	Available for sale reserve	Total
	£m	£m	£m	£m	£m	£m	£m
At 5 April 2015	531	992	7,995	68	129	26	9,741
Profit for the year	-	-	985	-	-	-	985
Net remeasurements of retirement benefit obligations	-	-	51	-	-	-	51
Net revaluation of property	-	-	-	(3)	-	-	(3)
Reserve transfer	-	-	1	(1)	-	-	-
Effect of tax rate change on other items through the general reserve	-	-	(1)	-	-	-	(1)
Net movement in cash flow hedge reserve	-	-	-	-	301	-	301
Net movement in available for sale reserve	-	-	-	-	-	(34)	(34)
Total comprehensive income	-	-	1,036	(4)	301	(34)	1,299
Distribution to the holders of core capital deferred shares	-	-	(56)	-	-	-	(56)
Distribution to the holders of Additional Tier 1 capital (note i)	-	-	(54)	-	-	-	(54)
At 4 April 2016	531	992	8,921	64	430	(8)	10,930

Note:

i. The distribution to the holders of Additional Tier 1 capital is shown net of an associated tax credit of £18 million (2016: £14 million).

The notes on pages 152 to 209 form part of these Accounts.

Society statement of movements in members' interests and equity

For the year ended 4 April 2017

	Core capital deferred shares	Other equity instruments	General reserve	Revaluation reserve	Cash flow hedge reserve	Available for sale reserve	Total
	£m	£m	£m	£m	£m	£m	£m
At 5 April 2016	531	992	7,554	64	(2)	(7)	9,132
Profit for the year	-	-	465	-	-	-	465
Net remeasurements of retirement benefit obligations	-	-	(253)	-	-	-	(253)
Net revaluation of property	-	-	-	3	-	-	3
Net movement in cash flow hedge reserve	-	-	-	-	(54)	-	(54)
Net movement in available for sale reserve	-	-	-	-	-	56	56
Total comprehensive income	-	-	212	3	(54)	56	217
Distribution to the holders of core capital deferred shares	-	-	(56)	-	-	-	(56)
Distribution to the holders of Additional Tier 1 capital (note i)	-	-	(50)	-	-	-	(50)
At 4 April 2017	531	992	7,660	67	(56)	49	9,243

For the year ended 4 April 2016

	Core capital deferred shares	Other equity instruments	General reserve	Revaluation reserve	Cash flow hedge reserve	Available for sale reserve	Total
	£m	£m	£m	£m	£m	£m	£m
At 5 April 2015	531	992	6,921	68	(6)	27	8,533
Profit for the year	-	-	691	-	-	-	691
Net remeasurements of retirement benefit obligations	-	-	51	-	-	-	51
Net revaluation of property	-	-	-	(3)	-	-	(3)
Reserve transfer	-	-	1	(1)	-	-	-
Net movement in cash flow hedge reserve	-	-	-	-	4	-	4
Net movement in available for sale reserve	-	-	-	-	-	(34)	(34)
Total comprehensive income	-	-	743	(4)	4	(34)	709
Distribution to the holders of core capital deferred shares	-	-	(56)	-	-	-	(56)
Distribution to the holders of Additional Tier 1 capital (note i)	-	-	(54)	-	-	-	(54)
At 4 April 2016	531	992	7,554	64	(2)	(7)	9,132

Note:

i. The distribution to the holders of Additional Tier 1 capital is shown net of an associated tax credit of £18 million (2016: £14 million).

The notes on pages 152 to 209 form part of these Accounts.

Cash flow statements

For the year ended 4 April 2017

		Group		Society	
		2017	2016	**2017**	2016
	Notes	**£m**	£m	**£m**	£m
Cash flows generated from/(used in) operating activities					
Profit before tax		1,504	1,279	671	919
Adjustments for:					
Non-cash items included in profit before tax	39	537	240	504	161
Changes in operating assets and liabilities	39	(1,327)	(2,413)	(2,377)	(2,298)
Interest paid on subordinated liabilities		(117)	(102)	(117)	(102)
Interest paid on subscribed capital		(22)	(26)	(22)	(26)
Taxation		(297)	(254)	(212)	(178)
Net cash flows used in operating activities		(172)	(1,276)	(1,553)	(1,524)
Cash flows (used in)/generated from investing activities					
Purchase of investment securities		(5,282)	(4,202)	(5,282)	(4,202)
Sale and maturity of investment securities		6,668	4,905	6,668	4,905
Purchase of property, plant and equipment		(198)	(134)	(198)	(134)
Sale of property, plant and equipment		10	14	10	14
Purchase of intangible assets		(276)	(334)	(276)	(334)
Dividends received from non-Group entities		-	3	-	3
Net cash flows generated from investing activities		922	252	922	252
Cash flows (used in)/generated from financing activities					
Distributions paid to the holders of core capital deferred shares		(56)	(56)	(56)	(56)
Distributions paid to the holders of Additional Tier 1 capital		(68)	(68)	(68)	(68)
Issue of debt securities		28,437	35,350	28,437	34,367
Redemption of debt securities in issue		(26,692)	(28,983)	(25,282)	(27,766)
Issue of subordinated liabilities		949	-	949	-
Redemption of subordinated liabilities		–	(406)	–	(406)
Redemption of subscribed capital		(140)	-	(140)	-
Net cash flows generated from financing activities		2,430	5,837	3,840	6,071
Net increase in cash and cash equivalents		3,180	4,813	3,209	4,799
Cash and cash equivalents at start of year		12,063	7,250	12,014	7,215
Cash and cash equivalents at end of year	39	15,243	12,063	15,223	12,014

The notes on pages 152 to 209 form part of these Accounts.

Notes to the accounts

1. Statement of accounting policies

Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations (IFRICs) issued by the Interpretations Committee, as published by the International Accounting Standards Board (IASB), and adopted by the European Union, and with those parts of the Building Societies (Accounts and Related Provisions) Regulations 1998 (as amended) applicable to organisations reporting under IFRS.

The financial statements have been prepared under the historical cost convention as modified by the revaluation of investment properties, branches and non-specialised buildings, available for sale assets, derivatives, certain mortgage commitments for which a fair value election is made, certain investments in equity shares and certain other deposits. As stated in the Directors' report, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the accounts.

A summary of the Group's accounting policies is set out below. The accounting policies have been consistently applied. As stated in the Group's Interim Results for the period ended 30 September 2016, the derivatives and hedge accounting policy includes additional wording in respect of the classification of cash collateral. The policy now clarifies the treatment of situations where collateral is received from, or given to, counterparties other than banks. There is no impact on prior year comparatives as a result of this change.

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates. Further details on critical accounting estimates are given in note 2.

Adoption of new and revised IFRSs

Minor amendments to IAS 16 Property, Plant and Equipment, IAS 38 Intangible Assets and IAS 1 Presentation of Financial Statements were adopted with effect from 5 April 2016, together with the annual improvements to the IFRSs 2012-2014 cycle. The adoption of these amendments and improvements had no significant impact for the Group.

Future accounting developments

The following pronouncements, relevant to the Group, have been adopted by the EU but are not effective at 4 April 2017 and have therefore not been applied in preparing these financial statements:

Pronouncement	Nature of change	Effective date
IFRS 15 Revenue from Contracts with Customers	IFRS 15 was endorsed by the EU in September 2016. The standard applies to all contracts with customers but does not apply to financial instruments, lease contracts, insurance contracts and certain non-monetary exchanges. IFRS 15 provides a principles-based approach for revenue recognition, and introduces the concept of recognising revenue for obligations as they are satisfied. The standard requires retrospective application, with certain practical expedients available. The Group is currently assessing the impact of this standard; it is expected that it will result in the earlier recognition of certain types of fee and commission income.	Accounting periods beginning on or after 1 January 2018
IFRS 9 Financial Instruments	IFRS 9 was endorsed by the EU in November 2016. The standard will lead to substantial changes in the accounting for financial instruments. Further details are provided below.	Accounting periods beginning on or after 1 January 2018

IFRS 9 Financial Instruments

IFRS 9 will be implemented in the financial statements for the year ending 4 April 2019 and will replace IAS 39 Financial Instruments: Recognition and Measurement. It includes requirements for the classification and measurement of financial instruments, impairment of financial assets and hedge accounting.

Notes to the accounts *continued*

1. Statement of accounting policies *continued*

The principal requirements of IFRS 9 are as follows:

Classification and measurement

The classification of financial assets will be based on the objectives of the Group's business model and the contractual cash flow characteristics of the instruments. Financial assets will then be classified as held at amortised cost, at fair value through other comprehensive income (FVOCI), or at fair value through profit or loss (FVTPL). The changes from the accounting treatment under IAS 39 are not expected to be significant for the Group. There are a limited number of financial assets with contractual cash flow characteristics that will result in a reclassification from amortised cost to FVTPL. The only changes to the classification and measurement of financial liabilities are for liabilities elected to be measured at fair value, where changes in valuation relating to changes in the entity's own credit risk will be presented separately in other comprehensive income rather than in the income statement.

Impairment of financial assets

IFRS 9 changes the basis of recognition of impairment on financial assets from an incurred loss to an expected credit loss (ECL) approach for amortised cost and FVOCI financial assets. This introduces a number of new concepts and changes to the approach to provisioning compared with the current methodology under IAS 39:

- Expected credit losses are based on an assessment of the probability of default, loss given default and exposure at default, discounted to give a net present value. The estimation of ECL should be unbiased and probability weighted, taking into account all reasonable and supportable information, including forward looking economic assumptions and a range of possible outcomes. IFRS 9 has the effect of bringing forward recognition of impairment losses relative to IAS 39 which requires provisions to be recognised only when there is objective evidence of credit impairment.
- On initial recognition, and for financial assets where there has not been a significant increase in credit risk since the date of advance, IFRS 9 provisions will be made for expected credit default events within the next 12 months.
- A key feature of IFRS 9 compared with existing approaches under IAS 39 is that where a loan has experienced a significant increase in credit risk since initial recognition, even though this may not lead to a conclusion that the loan is credit impaired, provisions will be made based on the expected credit losses over the full life of the loan. This change to lifetime loss provisions for significantly credit deteriorated assets is expected to lead to increases in impairment provisions, and to increased volatility in provisions, although the size of the change will depend on a number of factors, including the composition of asset portfolios and the view of the economic outlook at the date of implementation.
- For assets where there is evidence of credit impairment, provisions will be made under IFRS 9 on the basis of lifetime expected credit losses, taking account of forward looking economic assumptions and a range of possible outcomes. Under IAS 39 provisions are based on the asset's carrying value and the present value of the estimated future cash flows. IAS 39 does not explicitly take account of a range of possible economic outcomes including forecasts of any downturn of the economic cycle.

Hedge accounting

The hedge accounting requirements of IFRS 9 are designed to create a stronger link with financial risk management. A separate financial reporting standard will be developed on accounting for dynamic risk management (macro hedge accounting) and IFRS 9 allows the option to continue to apply the existing hedge accounting requirements of IAS 39 until this is implemented. Therefore, no changes are currently being implemented to hedge accounting policies and methodologies.

Implementation strategy

The Group's implementation strategy for IFRS 9 is based on an integrated solution using common systems, tools and data to assess credit risk and account for ECLs. This is consistent with guidance issued by the Basel Committee on Banking Supervision (BCBS) which sets an expectation of a high quality strategic implementation, and will entail changes to the governance, controls, models and business processes relating to credit loss provisioning. An extensive period of dual running of internal management information and processes is taking place during the 2017/18 financial year. The design and build phases of the programme have been completed and test activities are progressing in line with implementation plans.

Responsibilities and accountabilities

The Group has an established IFRS 9 implementation programme with formal governance reporting to the Chief Financial Officer and Chief Risk Officer. Progress is reported regularly to the Audit Committee. This includes oversight of the new IFRS 9 ECL calculations ahead of the application of the new accounting policy from 5 April 2018.

Impact of IFRS 9

The financial reporting impact of IFRS 9 will be quantified once models and systems allow the Group to provide reliable estimates; at this stage our expectation is that IFRS 9 will lead to an increase in provisions held against loans and advances to customers, in so far as it:

- estimates credit losses on certain assets over their full life on an expected credit loss basis, rather than the current incurred loss basis, and
- takes account of forward-looking economic scenarios and will capture potential downside economic risks that are not explicitly included in the current methodology.

The Group does not expect to restate comparatives on the initial adoption of IFRS 9 but will provide detailed transitional disclosures. The Group is monitoring the current BCBS consultation discussions on the regulatory treatment of accounting provisions for capital purposes, including the transitional arrangements for phasing in of additional IFRS 9 provisions. Assessment of the capital planning impact of IFRS 9 will require a deeper understanding of the effect of stressed conditions on ECL projections and consideration of this against these new requirements, when published, and any additional specific UK implementation guidance. However, for IRB portfolios the impact of any increases in accounting provisions under IFRS 9 will be mitigated by the current deductions for excess regulatory expected losses (EL) within the CET1 calculation.

Notes to the accounts *continued*

1. Statement of accounting policies *continued*

Other pronouncements

There are a number of pronouncements relevant to the Group that are neither adopted by the EU nor effective at 4 April 2017 and have therefore not been applied in preparing these financial statements. Details of these pronouncements and their impact are provided in the table below.

Pronouncement	Nature of change	Effective date
Disclosure Initiative (Amendments to IAS 7)	The initiative amends IAS 7 Statement of Cash Flows to clarify that entities shall provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities. The Group has assessed the impact of this amendment and expects to comply with the amended requirements.	Accounting periods beginning on or after 1 January 2017
Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12)	In January 2016, the IASB amended IAS 12 Income Taxes to clarify the recognition of deferred tax assets in respect of unrealised losses. The amendment is not expected to have a significant impact for the Group.	Accounting periods beginning on or after 1 January 2017
Annual Improvements to IFRS Standards 2014 – 2016 Cycle	Amendments have been made to three standards: - IFRS 1 First-time Adoption of International Financial Reporting Standards - IFRS 12 Disclosure of Interests in Other Entities - IAS 28 Investments in Associates and Joint Ventures. These amendments are not expected to have a significant impact for the Group.	Accounting periods beginning on or after 1 January 2017
Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2)	IFRS 2 Share-based Payment was amended in June 2016 to clarify the accounting for cash-settled share-based payment transactions that include a performance condition, the classification of share-based payment transactions with net settlement features, and the accounting for modifications of share-based payment transactions from cash-settled to equity-settled. The Group is currently assessing the impact of this amendment.	Accounting periods beginning on or after 1 January 2018
IFRIC 22 Foreign Currency Transactions and Advance Consideration	This interpretation sets out requirements regarding which exchange rate to use in reporting foreign currency transactions (such as revenue transactions) when payment is made or received in advance. The Group is currently assessing the impact of this interpretation.	Accounting periods beginning on or after 1 January 2018
Transfers of Investment Property (Amendments to IAS 40)	IAS 40 was amended in December 2016 to clarify that an entity shall transfer a property to, or from, investment property when, and only when, there is evidence of a change in use. A change of use occurs if property meets, or ceases to meet, the definition of investment property. The amendment is not expected to have a significant impact for the Group.	Accounting periods beginning on or after 1 January 2018
IFRS 16 Leases	In January 2016, the IASB issued IFRS 16 to replace IAS 17 Leases. Under IFRS 16, accounting for finance leases will remain substantially the same. Operating leases will be brought on-balance sheet through the recognition of assets representing the contractual rights of use and liabilities will be recognised for the contractual payments. This may impact the timing of the recognition of expenses on leased assets. Lessees will recognise interest expense on the lease liability and a depreciation charge on the right-of-use asset. The Group is currently assessing the impact of this standard.	Accounting periods beginning on or after 1 January 2019

Notes to the accounts *continued*

1. Statement of accounting policies *continued*

Basis of consolidation

The assets, liabilities and results of the Society and its undertakings, which include subsidiaries and structured entities, are included in the financial statements on the basis of accounts made up to the reporting date.

The Group consolidates an entity from the date on which the Group: (i) has power over the entity; (ii) is exposed to, or has rights to variable returns from its involvement with the entity; and (iii) has the ability to affect those returns through the exercise of its power. The assessment of control is based on all facts and circumstances. The Group reassesses whether it controls an entity if facts and circumstances indicate that there are changes to one or more of the three elements of control. The Group deconsolidates subsidiaries from the date that control ceases.

A structured entity is an entity in which voting or similar rights are not the dominant factor in deciding control. Structured entities are consolidated when the substance of the relationship indicates control. The Group considers factors such as the purpose and design of the entity, size and exposure to variability of returns and nature of the relationship.

Upon consolidation, intra-Group transactions, balances and unrealised gains are eliminated.

Investments in subsidiary undertakings are stated in the Society accounts at cost less provisions for any impairment in value. The directors consider it appropriate for administrative and commercial reasons that subsidiary undertakings have financial years ending on 31 March. Certain structured entities have year ends other than 31 March and are therefore consolidated using internal management accounts prepared to that date. Adjustment is made for individually significant transactions arising between 31 March and the Society's year end.

Securitisation transactions

The Group has securitised certain mortgage loans by the transfer of the loans to structured entities controlled by the Group. The securitisation enables a subsequent issuance of debt, either by the Society or the structured entities, to investors who gain the security of the underlying assets as collateral. Those structured entities are fully consolidated into the Group accounts.

The transfers of the mortgage loans to the structured entities are not treated as sales by the Society. The Society continues to recognise the mortgage loans on its own balance sheet after the transfer because it retains their risks and rewards through the receipt of substantially all of the profits or losses of the structured entities. In the accounts of the Society, the proceeds received from the transfer are accounted for as a deemed loan repayable to the structured entities.

As explained in note 16, the Group has also entered into self issuances of debt to be used as collateral for repurchase ('repo') and similar transactions. Investments in self issued debt and the equivalent deemed loan, together with the related income, expenditure and cash flows, are not recognised in the Society's or Group's financial statements. This avoids the 'grossing-up' of the financial statements that would otherwise arise.

To manage interest rate risk, the Society enters into derivative transactions with the structured entities, receiving a rate of interest based on the securitised mortgages and paying a rate inherent in the debt issuances. In accordance with IAS 39, these internal derivatives are treated as part of the deemed loan and not separately fair valued because the relevant mortgage loans are not derecognised. All other derivatives relating to securitisations are treated as explained in the derivatives and hedge accounting policy below.

Interest receivable and interest expense

For instruments measured at amortised cost the effective interest rate method is used to measure the carrying value of a financial asset or liability and to allocate associated interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

In calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument (for example, early redemption penalty charges) and anticipated customer behaviour but does not consider future credit losses. The calculation includes all fees received and paid and costs borne that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts above or below market rates.

Interest income on available for sale assets, derivatives and other financial assets at fair value through the income statement is included in interest receivable and similar income. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Fees and commissions

Fees and commissions not directly attributable to generating a financial instrument are recognised on the accruals basis as services are provided, or on the performance of a significant act.

Segmental reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the Executive Committee. The Executive Committee, which is responsible for allocating resources and assessing performance of operating segments, has been identified as the chief operating decision maker. Further information is included in note 12.

No segmental analysis is presented on geographical lines as substantially all of the Group's activities are in the United Kingdom, with limited deposit taking operations in the Isle of Man and the Republic of Ireland.

Notes to the accounts *continued*

1. Statement of accounting policies *continued*

Intangible assets

Intangible assets held by the Group consist primarily of externally acquired and internally developed computer software which is held at cost less accumulated amortisation and impairment. In accordance with IAS 38 Intangible Assets, software development costs are capitalised if it is probable that the asset created will generate future economic benefits. Costs incurred to establish technological feasibility or to maintain existing levels of performance are recognised as an expense.

Web development costs are capitalised where the expenditure is incurred on developing an income generating website.

Where applicable, directly attributable borrowing costs incurred in the construction of qualifying assets are capitalised.

Computer software intangible assets are amortised using the straight line method over their estimated useful lives of between 3 and 10 years. Amortisation commences when the assets are ready for their intended use. Estimated useful lives are reviewed annually and adjusted, if appropriate, in the light of technological developments, usage and other relevant factors.

Computer software is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Where the carrying amount is not recoverable the asset is written down immediately to the estimated recoverable amount, based on value in use calculations.

Leases

The Group has entered into operating leases for land and buildings. Operating leases are leases that do not transfer substantially all the risks and rewards incidental to ownership to the lessee. Operating lease payments and receipts are charged or credited to the income statement on a straight line basis over the life of the lease.

Taxation including deferred tax

Current tax payable on profits, based on the applicable tax law in each jurisdiction, is recognised as an expense in the period in which profits arise. The tax effects of tax losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is determined using tax rates and laws that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets are recognised where it is probable that future taxable profits will be available against which the temporary differences can be utilised. Deferred tax is provided on temporary differences arising from investments in subsidiaries, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future.

Deferred tax assets and liabilities are offset where there is a legally enforceable right to offset current tax assets against current tax liabilities and where the deferred tax assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle on a net basis.

Tax related to the fair value remeasurement of available for sale assets, which is charged or credited to other comprehensive income, is also credited or charged to other comprehensive income and is subsequently reclassified from other comprehensive income to the income statement together with the deferred loss or gain.

Tax related to movements in the fair value of derivatives that are subject to cash flow hedge accounting, which are charged or credited to other comprehensive income and accumulated in the cash flow hedge reserve, is also credited or charged to other comprehensive income and is subsequently reclassified from other comprehensive income to the income statement together with the associated deferred loss or gain from cash flow hedge accounting.

Tax related to movements in the valuation of property, which are charged or credited to other comprehensive income and accumulated in the revaluation reserve, is also credited or charged to other comprehensive income and accumulated in the revaluation reserve.

Tax related to remeasurements of retirement benefit obligations, which are charged or credited to other comprehensive income, is also credited or charged to other comprehensive income.

Property, plant and equipment

Freehold and long leasehold properties comprise mainly branches and office buildings.

Branches and non-specialised buildings are stated at revalued amounts, being the fair value, determined by market based evidence at the date of the valuation, less any subsequent accumulated depreciation and subsequent impairment. Valuations are completed annually, as at 4 April, by external, independent and qualified surveyors who have recent experience in the location and type of properties. Valuations are performed in accordance with the Royal Institution of Chartered Surveyors Appraisal and Valuation Standards and are performed on a vacant possession basis, using a comparative method of valuation with reference to sales prices and observable market rents for similar properties in similar locations.

Increases in the valuations of branches and non-specialised buildings are credited to other comprehensive income except where they reverse decreases for the same asset previously recognised in the income statement, in which case the increase in the valuation is recognised in the income statement. Decreases in valuations are recognised in the income statement except where they reverse amounts previously credited to other comprehensive income for the same asset, in which case the decrease in valuation is recognised in other comprehensive income.

Other property, plant and equipment, including specialised administration buildings and short leasehold buildings, are included at historical cost less accumulated depreciation and impairment. Historical cost includes expenditure that is directly attributable to the acquisition of the items, major alterations and refurbishments.

Notes to the accounts *continued*

1. Statement of accounting policies *continued*

Where applicable, directly attributable borrowing costs incurred in the construction of qualifying assets are capitalised.

Land is not depreciated. The depreciation of other assets commences when the assets are ready for their intended use and is calculated using the straight line method to allocate their cost or valuation over the following estimated useful lives:

- Branches and non-specialised buildings — 60 years
- Specialised administration buildings — up to 60 years
- Short leasehold buildings — the period of the lease
- Plant and machinery — 5 to 15 years
- Equipment, fixtures, fittings and vehicles — 3 to 10 years

Estimated useful lives and residual values are reviewed annually and adjusted, if appropriate, in the light of technological developments, usage and other relevant factors.

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Where the carrying amount is not recoverable the asset is written down immediately to the estimated recoverable amount.

Gains and losses on disposals are included in other operating income in the income statement.

Investment properties

Investment properties, which comprise properties held for rental, are stated at fair value, determined by market based evidence at the date of the valuation. Valuations are completed annually, as at 4 April, by independent surveyors. Changes in fair value are included in the income statement. Depreciation is not charged on investment properties.

Employee benefits

(a) Pensions

The Group operates a number of defined benefit and defined contribution pension arrangements. A defined benefit plan is one that defines the benefit an employee will receive on retirement, depending on such factors as age, length of service and salary.

The liability recognised on the balance sheet in respect of the defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets. The defined benefit obligation is calculated by independent actuaries using the projected unit credit method and assumptions agreed with the Group. The present value of the defined benefit obligation is determined by discounting the estimated future cash flows using interest rates of high quality corporate bonds that have terms to maturity approximating to the terms of the related pension liability.

Actuarial remeasurements arise from experience adjustments (the effects of differences between previous actuarial assumptions and what has actually occurred) and changes in forward looking actuarial assumptions. Actuarial remeasurements are recognised in full, in the year they occur, in other comprehensive income.

The Group also operates defined contribution arrangements. A defined contribution arrangement is one into which the Group and the employee pay fixed contributions, without any further obligation to pay additional contributions. Payments to defined contribution schemes are charged to the income statement as they fall due.

Past service costs are recognised immediately in the income statement.

(b) Other post retirement obligations

The Group provides post retirement healthcare to a small number of former employees. The Group recognises this obligation and the actuarial remeasurement in a similar manner to the defined benefit pension plans.

(c) Other long term employee benefits

The cost of bonuses payable 12 months or more after the end of the year in which they are earned is recognised in the year in which the employees render the related service and when there is an obligation to pay a bonus under the terms of the scheme.

(d) Short term employee benefits

The cost of short term employee benefits, including wages and salaries, social security costs and healthcare for current employees, is recognised in the year of service.

Provisions

A provision is recognised where there is a present obligation as a result of a past event, it is probable that the obligation will be settled and it can be reliably estimated. This includes management's best estimate of amounts payable for customer redress.

The Group has an obligation to contribute to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet compensation claims from, in particular, retail depositors of failed banks. A provision is recognised, to the extent that it can be reliably estimated, when the Group has an obligation in accordance with IAS 37 and the levy is legally enforceable, in line with IFRIC 21 Levies. The amount provided is based on information received from the FSCS, forecast future interest rates and the Group's historic share of industry protected deposits.

Notes to the accounts *continued*

1. Statement of accounting policies *continued*

Financial assets

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

The impact of hedging on the measurement of financial assets is detailed in the derivatives and hedge accounting policy below.

The Group classifies its financial assets at inception into the following four categories:

(a) Financial assets at fair value through the income statement

This category consists of derivative financial assets used for risk management purposes and other financial assets that are designated at fair value through the income statement by the Group.

Assets in this category are carried at fair value. The fair values of derivative instruments are calculated by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from third parties. Gains and losses arising from the changes in the fair values are recognised in the income statement.

The Group recognises the fair value of certain mortgage commitments on the balance sheet to alleviate an accounting mismatch which would otherwise arise from recognising only the movements in the fair value of associated derivatives. The fair value of mortgage commitments is included within other assets or other liabilities. Movements in the fair value are included within gains/losses from derivatives and hedge accounting in the income statement, to offset the fair value movements of the derivatives.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Group's residential and commercial mortgage loans, unsecured lending, loans and advances to banks and cash are classified as loans and receivables.

Loans are recognised when the funds are advanced to customers. Loans and receivables are carried at amortised cost using the effective interest rate method less provisions for impairment.

Loans and receivables acquired through a business combination or portfolio acquisition are recognised at fair value at the acquisition date. The fair value at acquisition becomes the new amortised cost for acquired loans and receivables. Fair value adjustments are made to reflect both credit and interest rate risk associated with the acquired loan assets.

(c) Available for sale assets

Available for sale assets are non-derivative financial assets that are not classified into either of the two categories above. The majority of available for sale assets are measured at fair value using, in the majority of cases, market prices or, where markets have become inactive, prices obtained from market participants. In sourcing valuations, the Group makes use of a consensus pricing service, in line with standard industry practice. In cases where market prices or prices obtained from market participants are not available, discounted cash flow models are used. Further information is provided in notes 24 and 25. Investments in equities that do not have a quoted market price in an active market and whose value cannot be reliably measured are recognised at cost.

Interest on available for sale assets is recognised using the effective interest rate method.

Unrealised gains and losses arising from changes in values are recognised in other comprehensive income, except for amounts relating to impairment losses and foreign exchange gains and losses, which are recognised in the income statement. Gains and losses arising on the sale of available for sale assets are recognised in the income statement, including any cumulative gains or losses previously recognised in other comprehensive income, which are reclassified to the income statement.

(d) Held to maturity

Held to maturity assets are non-derivative financial assets with fixed or determinable payments and fixed maturity dates that the Group has the positive intention and ability to hold to maturity.

Held to maturity assets are initially recognised at fair value including directly related transaction costs. They are measured subsequently at amortised cost using the effective interest rate method, less provisions for impairment.

For the financial years ended 4 April 2017 and 4 April 2016, the Group has not classified any financial assets into the held to maturity category and has not reclassified any financial assets between categories.

Impairment of financial assets

(a) Assets carried at amortised cost

The Group assesses at each balance sheet date whether, as a result of one or more events that occurred after initial recognition, there is objective evidence that a financial asset or group of financial assets is impaired. Evidence of impairment may include:

i) indications that the borrower or group of borrowers is experiencing significant financial difficulty

ii) default or delinquency in interest or principal payments

iii) debt being restructured to reduce the burden on the borrower.

The Group first assesses whether objective evidence of impairment exists either individually for assets that are separately significant or individually or collectively for assets that are not separately significant. If there is no objective evidence of impairment for an individually assessed asset it is included in a group of assets with similar credit risk characteristics and collectively assessed for impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. For loans in a hedge relationship, the effective interest rate used for discounting is calculated using the carrying value of the loan including the hedge adjustment. The resultant provisions are deducted from the appropriate asset values on the balance sheet.

Notes to the accounts *continued*

1. Statement of accounting policies *continued*

The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience. If, in a subsequent period, the amount of impairment loss changes, the provision is adjusted and the amount of additional provision or reversal is recognised in the income statement.

Loans remain on the balance sheet net of associated provisions until they are deemed no longer recoverable. Where a loan is not recoverable, it is written off against the related provision for loan impairment once all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the income statement.

Retail loans

For retail loans cash flows are estimated based on past experience combined with the Group's view of the future considering the following factors:

i) exposure to the customer
ii) based on the number of days in arrears at the balance sheet date, the likelihood that a loan will progress through the various stages of delinquency and ultimately be written off
iii) the amount and timing of expected receipts and recoveries
iv) the realisable value of any security at the estimated date of sale
v) the likely deduction of any costs involved in the recovery of amounts outstanding.

The Group's provision methodology recognises previous arrears as a driver of future possible default and therefore accounts which have either capitalised arrears or have been in arrears in the last 12 months typically attract a higher provision level.

Commercial loans

In assessing objective evidence of a loss event for commercial loans, the following key indicators are considered:

i) contractually due payments exceeding 30 days in arrears
ii) high loan to value or low interest cover ratio
iii) other covenant breaches
iv) loss of significant tenants or other decreases in tenant quality
v) the probability of the borrower entering bankruptcy
vi) restructuring of the debt relating to the borrower's financial difficulties ('forbearance')
vii) local economic conditions (for example, where this impacts on the value of underlying collateral).

Where there is objective evidence of impairment, cash flows are assessed on a case by case basis considering the following factors:

i) aggregate exposure to the customer
ii) the viability of the customer's business model and their capacity to trade successfully out of financial difficulties and generate sufficient cash flows to service debt obligations
iii) the amount and timing of expected receipts and recoveries of collateral
iv) the likely dividend available on liquidation or bankruptcy
v) the extent of other creditors' claims ranking ahead of the Group's, and the likelihood of other creditors continuing to support the borrower
vi) the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident
vii) the realisable value of security at the expected date of sale
viii) the likely deduction of any costs involved in recovery of amounts outstanding
ix) when available, the secondary market price of the debt.

Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired or are considered to be past due.

Where a loan is renegotiated on different terms such that it is substantially a different loan, the loan is derecognised and a new loan is recognised at its fair value.

For those loans, for which no individual impairment is recognised, a collective impairment assessment is made, taking account of the following factors:

i) size of the loan
ii) arrears status
iii) historical loss experience (adjusted for current market conditions)
iv) the estimated period between impairment occurring and the loss being identified ('emergence period').

(b) Available for sale assets

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. If any such evidence exists for available for sale assets, the cumulative loss, measured as the difference between the current amortised cost and the current fair value, less any impairment loss on that asset previously recognised, is recognised in impairment losses/recoveries on investment securities in the income statement.

Notes to the accounts *continued*

1. Statement of accounting policies *continued*

A subsequent decline in the fair value of an available for sale asset is recognised in the income statement when there is further objective evidence of impairment as a result of further decreases in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, the decline in the fair value of the financial asset is recognised in other comprehensive income.

If the fair value of an available for sale asset increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement to the extent it reverses the previously recognised impairment. Any gain in fair value in excess of the original impairment is recognised in other comprehensive income. On disposal, where sales proceeds exceed the carrying amount of an impaired asset, the proportion of the gain which offsets the previously recognised impairment loss is recognised as a credit in impairment losses/recoveries on investment securities in the income statement.

Impairment losses recognised in the income statement on available for sale equity shares are not reversed through the income statement.

Financial liabilities

Borrowings, including shares, deposits, debt securities in issue and subordinated liabilities are recognised initially at fair value, being the issue proceeds net of premiums, discounts and transaction costs incurred.

With the exception of deposits relating to the sale of protected equity bonds (PEBs), which are measured at fair value, all borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is adjusted for the amortisation of any premiums, discounts and transaction costs. The amortisation is recognised in interest expense and similar charges using the effective interest rate method.

Derivative financial liabilities are classified as fair value through the income statement.

Permanent interest bearing shares (subscribed capital) are classified as financial liabilities.

Financial liabilities are derecognised when the obligation is discharged, cancelled or has expired.

Borrowings that are designated as hedged items are subject to measurement under the hedge accounting requirements described in the derivatives and hedge accounting policy below.

The financial liabilities of dormant shares and deposit accounts are extinguished when balances have been transferred to the Government backed unclaimed asset scheme under the terms of the Dormant Accounts and Building Society Accounts Act 2008 with no impact on the income statement.

Fair value of assets and liabilities

IFRS 13 requires an entity to classify assets and liabilities held at fair value and those not measured at fair value but for which the fair value is disclosed according to a hierarchy that reflects the significance of observable market inputs in calculating those fair values. The three levels of the fair value hierarchy are defined below:

Level 1 – Valuation using quoted market prices

Assets and liabilities are classified as Level 1 if their value is observable in an active market. Such instruments are valued by reference to unadjusted quoted prices for identical assets or liabilities in active markets where the quoted price is readily available, and the price reflects actual and regularly occurring market transactions on an arm's length basis. An active market is one in which transactions occur with sufficient volume and frequency to provide pricing information on an ongoing basis.

Level 2 – Valuation technique using observable inputs

Assets and liabilities classified as Level 2 have been valued using models whose inputs are observable in an active market. Valuations based on observable inputs include derivative financial instruments such as swaps and forward rate agreements which are valued using market standard pricing techniques, and options that are commonly traded in markets where all the inputs to the market standard pricing models are observable. They also include investment securities valued using consensus pricing or other observable market prices.

Level 3 – Valuation technique using significant unobservable inputs

Assets and liabilities are classified as Level 3 if their valuation incorporates significant inputs that are not based on observable market data ('unobservable inputs'). A valuation input is considered observable if it can be directly observed from transactions in an active market, or if there is compelling external evidence demonstrating an executable exit price. An input is deemed significant if it is shown to contribute more than 10% to the valuation of a financial instrument. Unobservable input levels are generally determined based on observable inputs of a similar nature, historical observations or other analytical techniques.

Protected equity bonds (PEBs)

Certain non-derivative financial liabilities relating to the sale of PEBs by the Group on behalf of Legal & General, included within other deposits, have been designated at fair value upon initial recognition. Changes in fair value are recognised through the income statement in gains/losses from derivatives and hedge accounting. The changes in the fair value of the PEBs are economically matched using equity-linked derivatives, which do not meet the requirements for hedge accounting. Recording changes in fair value of both the derivatives and the related liabilities through the income statement most closely reflects the economic reality of the transactions. In so doing, this accounting treatment eliminates a measurement inconsistency that would otherwise arise from valuing the PEBs at amortised cost and the derivatives at fair value.

In measuring fair value, separate debit valuation adjustments are made for own credit risk to the extent not already included in the PEBs valuation.

Income received from Legal & General upon inception of a PEB transaction is deferred and recognised in interest expense and similar charges in the income statement on an effective interest basis over the term of the product where it partially offsets interest incurred on the equity-linked derivatives.

Notes to the accounts *continued*

1. Statement of accounting policies *continued*

Derivatives and hedge accounting

Derivatives are entered into to reduce exposures to fluctuations in interest rates, exchange rates, market indices and credit risk, and are not used for speculative purposes.

(a) Derivative financial instruments

Derivatives are carried at fair value with movements in fair values recorded in the income statement. Derivative financial instruments are principally valued by discounted cash flow models using yield curves that are based on observable market data or are based on valuations obtained from third parties. For collateralised positions the Group uses discount curves based on overnight indexed swap rates, and for non-collateralised positions the Group uses discount curves based on term Libor rates.

In the first instance fair values are calculated using mid prices. With the exception of derivatives hedging liabilities relating to the sale of PEBs, an adjustment is then made to derivative assets and liabilities to value them on a bid and offer basis respectively. The bid-offer adjustment is calculated on a portfolio basis and reflects the costs that would be incurred if substantially all residual net portfolio market risks were closed out using available hedging instruments or by disposing of or unwinding actual positions. The methodology for determining the bid-offer adjustments involves netting between long and short positions and the grouping of risk by type, in accordance with hedging strategy. Bid-offer spreads are derived from market sources such as broker data and are reviewed periodically. The derivatives hedging PEBs are not traded in an active market and are therefore valued at mid price.

In measuring fair value, separate credit valuation and debit valuation adjustments are made for counterparty or own credit risk to the extent not already included in the valuation.

All derivatives are classified as assets where their fair value is positive and liabilities where their fair value is negative. Where there is the legal right and intention to settle net, then the derivative is classified as a net asset or liability, as appropriate.

Where cash collateral is received, to mitigate the risk inherent in amounts due to the Group, it is included as a liability within either deposits from banks or other deposits, depending on the counterparty. Similarly, where cash collateral is given, to mitigate the risk inherent in amounts due from the Group, it is included as an asset in either loans and advances to banks or loans and advances to customers. Where securities collateral is received the securities are not recognised in the accounts as the Group does not obtain the risks and rewards of the securities. Where securities collateral is given, the securities have not been derecognised as the Group has retained substantially all the risks and rewards of ownership.

(b) Embedded derivatives

A number of complex contracts contain both a derivative and a non-derivative component, in which case the derivative is termed an embedded derivative. If the economic characteristics and risks of embedded derivatives are not closely related to those of the host contract, and the overall contract itself is not carried at fair value, the embedded derivative is accounted for separately and reported at fair value with gains and losses being recognised in the income statement.

(c) Hedge accounting

When transactions meet the criteria specified in IAS 39, the Group can apply two types of hedge accounting: either hedges of the changes in fair value of the financial asset or liability or hedges of the variability in cash flows of the financial asset or liability:

Fair value hedge accounting

In a micro hedge relationship, the carrying value of the underlying asset or liability ('the hedged item') is adjusted to reflect changes in fair value attributable to the risk being hedged. This creates an offset to the fair value movement of the derivative ('the hedging instrument'). In the case of a portfolio hedge, this fair value adjustment is recorded at a portfolio level in the fair value adjustment for portfolio hedged risk category on the balance sheet. Changes in the fair value of hedged items and hedging instruments are recorded in the income statement.

Cash flow hedge accounting

In a cash flow hedge accounting relationship, the portion of the derivative's fair value movement that is deemed to be an effective hedge is deferred to the cash flow hedge reserve, instead of being immediately recognised in the income statement. The ineffective portion of the derivative fair value movement is recognised immediately in the income statement. Amounts deferred to the cash flow hedge reserve are subsequently recycled to the income statement. This recycling occurs when the underlying asset or liability being hedged impacts the income statement, for example when interest payments are recognised.

To qualify for hedge accounting the hedge relationship must be clearly documented at inception and the derivative must be expected to be highly effective in offsetting the hedged risk. Prospective and retrospective effectiveness must be tested throughout the life of the hedge relationship.

Termination of hedge accounting

The Group discontinues hedge accounting when:

i) it is evident from testing that a derivative is not, or has ceased to be, highly effective as a hedge

ii) the derivative expires, or is sold, terminated or exercised

iii) the underlying item matures or is sold or repaid

iv) the forecast transactions are no longer deemed to be highly probable.

The Group may also decide to cease hedge accounting even though the hedge relationship continues to be highly effective by ceasing to designate the financial instrument as a hedge.

Notes to the accounts *continued*

1. Statement of accounting policies *continued*

In fair value hedge accounting relationships, if the derivative no longer meets the criteria for hedge accounting, the cumulative fair value hedge adjustment is amortised over the period to maturity of the previously designated hedge relationship. If the underlying item is sold or repaid, the unamortised fair value adjustment is immediately recognised in the income statement.

In cash flow hedge accounting relationships, if the derivative no longer meets the criteria for hedge accounting, the cumulative gain or loss from the effective portion of the movement in the fair value of the derivative remains in other comprehensive income until the cash flows from the underlying hedged item are recognised in the income statement. If the underlying item is sold or repaid, the cumulative gain or loss in other comprehensive income is immediately recognised in the income statement.

Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported on the balance sheet if, and only if, there is a currently enforceable legal right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise an asset and settle the liability simultaneously.

Sale and repurchase agreements (including securities borrowing and lending) and collateralised total return swaps

Investment and other securities may be lent or sold subject to a commitment to repurchase them at a pre-determined price (a repo) or a right to continue to receive all future cash flows and changes in capital value on collateral pledged (a total return swap). Such securities are retained on the balance sheet when substantially all the risks and rewards of ownership (typically, the interest rate risk and credit risk on the asset) remain within the Group, and the counterparty liability is included separately on the balance sheet as appropriate.

Similarly, where the Group borrows or purchases securities subject to a commitment to resell them (a reverse repo) or settle all future cash flows and changes in capital value to a third party on collateral held (a reverse total return swap) but does not acquire the risks and rewards of ownership, the transactions are treated as collateralised loans, and the securities are not included on the balance sheet.

The difference between sale and repurchase price is accrued over the life of the agreements using the effective interest rate method.

Equity instruments

Issued financial instruments are classified as equity instruments where the contractual arrangement with the holder does not result in the Group having a present obligation to deliver cash, another financial asset or a variable number of equity instruments. Where the Group does have a present obligation, the instrument is classified as a financial liability.

The proceeds of the issuance of equity instruments are included in equity. Costs incurred that are incremental and directly attributable to the issuance are deducted from the proceeds (net of applicable tax).

Distributions to holders of equity instruments are recognised when they become irrevocable and are deducted, net of tax where applicable, from the general reserve.

Foreign currency translation

The consolidated financial statements are presented in sterling, which is the functional currency of the Society. Items included in the financial statements of each of the Group's entities are measured using their functional currency. Foreign currency transactions are translated into sterling using the exchange rates prevailing at the dates of the transactions.

Monetary items denominated in foreign currencies are retranslated at the rate prevailing at the balance sheet date. Foreign exchange gains and losses resulting from the retranslation and settlement of these items are recognised in the income statement as disclosed in note 7.

Cash flow hedge accounting is applied to derivatives which are economically hedging foreign currency items.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months maturity from the date of acquisition, included within cash and loans and advances to banks on the balance sheet.

Contingent liabilities

Contingent liabilities are possible obligations whose existence is dependent on the outcome of uncertain future events, or those where the outflow of resources is uncertain or cannot be measured reliably.

During the ordinary course of business the Group is subject to threatened or actual legal proceedings. All such material cases are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of incurring a liability. The Group does not disclose amounts in relation to contingent liabilities associated with such claims where the likelihood of any payment is remote or where such disclosure could be seriously prejudicial to the conduct of the claims.

IFRS disclosures

The audited sections in the Business and Risk Report for Lending risk and Financial risk and the Report of the directors on remuneration form an integral part of these financial statements. These disclosures (where marked as 'audited') are covered by the Independent auditors' report for this Annual Report and Accounts.

Notes to the accounts *continued*

2. Judgements in applying accounting policies and critical accounting estimates

The Group has to make judgements in applying its accounting policies which affect the amounts recognised in the accounts. In addition, estimates and assumptions are made that could affect the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, actual results reported in future periods may be based upon amounts which differ from those estimates. The most significant areas where judgements and estimates are made are disclosed in the following notes:

Area of significant judgement and estimate	Note
Impairment provisions on loans and advances	10
Provisions for customer redress	30
Retirement benefit obligations (pensions)	33

3. Interest receivable and similar income

	Group		Society	
	2017	2016	2017	2016
	£m	£m	£m	£m
On residential mortgages	4,843	5,009	3,639	3,818
On other loans:				
Connected undertakings	-	-	901	855
Other	774	835	753	820
On investment securities	372	403	370	403
On other liquid assets	59	33	59	33
Net expense on financial instruments hedging assets	(998)	(986)	(998)	(986)
Total	5,050	5,294	4,724	4,943

Included within interest receivable and similar income is interest income on impaired financial assets of £33 million in the Group and £16 million in the Society (2016: Group £41 million, Society £23 million).

4. Interest expense and similar charges

	Group		Society	
	2017	2016	2017	2016
	£m	£m	£m	£m
On shares held by individuals	1,390	1,577	1,390	1,577
On subscribed capital	34	26	34	26
On deposits and other borrowings:				
Subordinated liabilities	128	99	128	99
Connected undertakings	-	-	74	98
Other	450	577	454	576
On debt securities in issue	767	690	686	592
Net income on financial instruments hedging liabilities	(684)	(768)	(527)	(608)
Interest on net defined benefit pension liability (note 33)	5	7	5	7
Total	2,090	2,208	2,244	2,367

Interest on deposits and other borrowings includes an expense of £327 million (2016: £439 million) in relation to the redemption and maturity of Protected Equity Bond (PEB) deposits which have returns linked to the performance of specified stock market indices. The PEBs are economically hedged using equity-linked derivatives. Net income on financial instruments hedging liabilities includes income of £308 million (2016: £398 million) in relation to the associated derivatives. Further details are included in note 25.

Notes to the accounts *continued*

5. Fee and commission income and expense

Group	2017 Income £m	2017 Expense £m	2017 Net £m	2016 Income £m	2016 Expense £m	2016 Net £m
Current account and savings	229	(156)	73	199	(126)	73
General insurance	81	-	81	78	-	78
Protection and investments	78	-	78	73	-	73
Mortgage	10	-	10	20	(3)	17
Credit card	37	(42)	(5)	46	(36)	10
Other fees and commissions	11	(23)	(12)	12	(27)	(15)
Fee and commission	446	(221)	225	428	(192)	236

Society	2017 Income £m	2017 Expense £m	2017 Net £m	2016 Income £m	2016 Expense £m	2016 Net £m
Current account and savings	229	(156)	73	199	(126)	73
General insurance	81	-	81	78	-	78
Protection and investments	78	-	78	73	-	73
Mortgage	6	-	6	13	-	13
Credit card	37	(42)	(5)	46	(36)	10
Other fees and commissions	11	(23)	(12)	12	(27)	(15)
Fee and commission	442	(221)	221	421	(189)	232

6. Other operating income

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Gain on disposal of investment in Visa Europe Limited	100	-	100	-
Other income	-	8	-	8
Total	100	8	100	8

On 21 June 2016, the Group disposed of its share in Visa Europe Limited, resulting in a gain on disposal of £100 million. Further information is included in note 15.

Other income includes the net amount of rental income, profits or losses on the sale of property, plant and equipment and increases or decreases in the valuations of branches and non-specialised buildings which are not recognised in other comprehensive income.

Notes to the accounts *continued*

7. Gains from derivatives and hedge accounting

	Group		Society	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Derivatives designated as fair value hedges	**161**	(38)	**179**	141
Fair value movement attributable to hedged risk	**(100)**	123	**(129)**	(64)
Gains from fair value hedge accounting (note i)	**61**	85	**50**	77
Derivatives designated as cash flow hedges	**(352)**	434	**(101)**	5
Deferral to cash flow hedge reserve	**348**	(433)	**72**	(5)
Ineffectiveness from cash flow hedge accounting (note ii)	**(4)**	1	**(29)**	-
Derivatives economically hedging mortgage commitments	**(25)**	(61)	**(25)**	(61)
Fair value movement attributable to mortgage commitments	**33**	15	**33**	15
Net gain/(loss) from mortgage pipeline (note iii)	**8**	(46)	**8**	(46)
Fair value (losses)/gains from other derivatives (note iv)	**(19)**	(37)	**(43)**	27
Foreign exchange differences	**20**	36	**83**	71
Total	**66**	39	**69**	129

Notes:

i. Gains or losses from fair value hedges can arise where there is an IFRS hedge accounting relationship in place and either:
- the relationship passed all the monthly effectiveness tests but the fair value movement of the derivative was not exactly offset by the change in fair value of the asset or liability being hedged (sometimes referred to as hedge ineffectiveness); or
- the relationship failed a monthly effectiveness test which, for that month, disallows recognition of the change in fair value of the underlying asset or liability being hedged and in following months leads to the amortisation of existing balance sheet positions.

ii. In cash flow hedge accounting the effective portion of the fair value movement of designated derivatives is deferred to the cash flow hedge reserve. The fair value movement is subsequently recycled to the income statement when amounts relating to the underlying hedged asset or liability are recognised in the income statement. The ineffective portion of the fair value movement is recognised immediately in the income statement.

iii. The Group elects to fair value certain mortgage commitments in order to reduce the accounting mismatch caused when derivatives are used to hedge these commitments.

iv. Other derivatives are those used for economic hedging but which are not in an IAS 39 hedge accounting relationship because hedge accounting is not currently in place.

Although the Group only uses derivatives for the hedging of 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 does not reflect the economic reality of the Group's hedging strategy.

Included within the gain of £66 million (2016: £39 million) was the impact of the following:

- Gains of £61 million (2016: £85 million) from fair value hedge accounting. This includes gains of £47 million (2016: £66 million) from macro hedges, due to hedge ineffectiveness and the amortisation of existing balance sheet amounts. In addition, further gains of £14 million relate to micro hedges (2016: £19 million) due to a combination of hedge ineffectiveness, maturities and disposals.
- Gains of £8 million (2016: losses of £46 million) relating to the mortgage pipeline. The income statement includes the full fair value movement of forward starting interest rate swaps economically hedging the pipeline; however the Group only elects to fair value certain underlying mortgage business within the pipeline.
- Losses of £19 million (2016: £37 million) from valuation adjustments and volatility on other derivatives which are not currently in an IAS 39 hedge accounting relationship.
- Gains of £20 million (2016: £36 million) from the retranslation of foreign currency monetary items not subject to effective hedge accounting, against a backdrop of significant sterling depreciation.

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.

Notes to the accounts *continued*

8. Administrative expenses

	Group		Society	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Employee costs:				
Wages and salaries	**517**	486	**511**	479
Bonuses	**75**	76	**75**	76
Social security costs	**64**	55	**64**	55
Pension costs (note 33)	**137**	119	**136**	118
	793	736	**786**	728
Other administrative expenses	**790**	745	**764**	725
Bank levy (note 30)	**42**	41	**42**	41
	1,625	1,522	**1,592**	1,494
Depreciation, amortisation and impairment	**396**	325	**396**	325
Total	**2,021**	1,847	**1,988**	1,819
Other administrative expenses include:				
Property operating lease rental	**39**	33	**39**	33
Other property costs	**78**	76	**78**	76
Postage and communications	**83**	68	**83**	68
Computer costs	**177**	174	**177**	174
Marketing and advertising	**43**	35	**43**	35
Money transmission and other bank costs	**40**	44	**40**	43
Legal, professional and consultancy	**59**	53	**59**	52
Training, education and other staff related costs	**126**	131	**125**	129
Other	**145**	131	**120**	115
Total	**790**	745	**764**	725

The bonus expense within employee costs in the above table includes elements of long term bonuses which will be paid more than one year from the balance sheet date of £5 million (2016: £8 million). In accordance with accounting standards, some elements of deferred bonuses will be recognised in future periods.

Executive directors and certain senior executives are entitled to bonus payments under two schemes, the Directors' Performance Award and the Medium Term Performance Pay Plan (MTPPP).

Notes to the accounts *continued*

8. Administrative expenses *continued*

The Directors' Performance Award (previously Directors' Performance Pay Plan) for executive directors and certain senior executives, which combines the annual and long term elements under a single scheme, was introduced in the year ended 4 April 2015. Under this scheme, awards are based on current year results but are paid over a period of up to seven years, with part of the awards linked to the value of Nationwide's core capital deferred shares (CCDS). The payment of deferred elements remains subject to further discretion by the Remuneration Committee. These bonuses are recognised in the income statement over the period from the start of the performance year until all relevant criteria have been met.

Up until the year ended 4 April 2014, executive directors and certain senior executives were entitled to MTPPP bonuses based on results over the preceding three year performance cycle. MTPPP bonuses were recognised in the income statement in the final year of the three year performance cycle. The payment of deferred elements of MTPPP remains subject to further discretion by the Remuneration Committee. MTPPP deferred bonuses are awarded in cash.

The MTPPP scheme has now been discontinued and the final bonus expense under the MTPPP was recognised in the income statement in the year ended 4 April 2016. However, elements of historic MTPPP awards under the 2013-2016 award cycle remain due for payment until June 2017.

The table below shows actual and expected charges to the income statement in respect of all Directors' Performance Award bonuses in respect of the 2014/15, 2015/16 and 2016/17 scheme years, and MTPPP bonuses for the final 2013-2016 cycle:

Income statement charge for long term bonuses

	Group and Society								
	Actual 2015/16 (note ii)	**Actual 2016/17 (note ii)**	Expected 2017/18	Expected 2018/19	Expected 2019/20	Expected 2020/21	Expected 2021/22	Expected 2022/23	Expected 2023/24
	£m	**£m**	£m	£m	£m	£m	£m	£m	£m
Medium Term Performance Pay Plan:									
2013-2016	9.7	-	-	-	-	-	-	-	-
Directors' Performance Award: (note i)									
2014/15	4.1	1.7	1.0	0.4	0.2	0.2	-	-	-
2015/16	9.1	3.7	1.5	1.1	0.5	0.3	0.2	-	-
2016/17	-	8.8	3.5	1.4	1.0	0.6	0.4	0.2	0.1
Income statement charge for long term bonuses	22.9	14.2	6.0	2.9	1.7	1.1	0.6	0.2	0.1

Notes:

i. The amount expected is an estimate based on past performance together with current assumptions of future leaver rates and future CCDS performance. From 2016/17 the period over which bonuses are recognised in the income statement was extended based on a change to the bonus deferral period from five to seven years.

ii. In the year ended 4 April 2017, £5 million (2016: £4 million) was recognised in the income statement in relation to awards linked to share based payments. This payment is deferred and therefore included in accruals and deferred income on the balance sheet.

Directors' emoluments, including details of the bonus scheme, are shown as part of the Report of the directors on remuneration in accordance with Schedule 10A, paragraphs 1 to 9 of the Building Societies Act 1986.

The remuneration of the external auditors, PricewaterhouseCoopers LLP, is set out below:

External auditors' remuneration

	Group		Society	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Audit fees for the Group and Society statutory audit	2.2	2.3	2.2	2.3
Fees payable for other services:				
Audit of Group subsidiaries	0.3	0.3	-	-
Audit-related assurance services	1.3	0.7	1.3	0.7
Total audit and audit-related assurance services	3.8	3.3	3.5	3.0
Other non-audit services	0.5	1.1	0.5	1.1
Total	4.3	4.4	4.0	4.1

Notes to the accounts *continued*

8. Administrative expenses *continued*

Audit-related assurance services for the Group and Society include £0.7 million (2016: £nil) in respect of preliminary work performed in relation to the implementation of IFRS 9 Financial Instruments in the year ending 4 April 2019.

The Group's policy in relation to the use of its auditors on non-audit engagements sets out the types of services they are generally precluded from performing. All non-audit services, where the fee is expected to exceed a de minimis limit, are subject to pre-approval by the Audit Committee.

Fees in relation to 'other non-audit services' above relate primarily to work undertaken in relation to the Group's IT operational resilience and regulatory projects.

9. Employees

	Group		Society	
	2017	2016	**2017**	2016
The average number of persons employed during the year was:				
Full time	**14,746**	14,190	**14,671**	14,116
Part time	**4,015**	3,919	**4,002**	3,905
Total	**18,761**	18,109	**18,673**	18,021
Society:				
Central administration	**11,154**	10,392	**11,154**	10,392
Branches	**7,519**	7,629	**7,519**	7,629
Subsidiaries	**88**	88	**-**	-
Total	**18,761**	18,109	**18,673**	18,021

Central administration employee numbers include employees engaged in direct customer facing operations in administrative centres.

10. Impairment provisions on loans and advances to customers

The following provisions have been deducted from the appropriate asset values in the Group balance sheet:

2017	**Prime residential**	**Specialist residential**	**Consumer banking**	**Commercial lending**	**Other lending**	**Total**
Group	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
At 5 April 2016	25	77	281	59	1	443
Charge for the year	**11**	**47**	**78**	**(5)**	**-**	**131**
Amounts written off during the year	**(2)**	**(15)**	**(101)**	**(31)**	**(1)**	**(150)**
Amounts recovered during the year	**1**	**1**	**15**	**3**	**-**	**20**
Unwind of discount	**(1)**	**-**	**(4)**	**(1)**	**-**	**(6)**
At 4 April 2017	**34**	**110**	**269**	**25**	**-**	**438**

2016	Prime residential	Specialist residential	Consumer banking	Commercial lending	Other lending	Total
Group	£m	£m	£m	£m	£m	£m
At 5 April 2015	22	88	216	322	4	652
Charge for the year	8	10	96	(34)	1	81
Amounts written off during the year	(6)	(23)	(44)	(242)	(4)	(319)
Amounts recovered during the year	1	3	18	20	-	42
Unwind of discount	-	(1)	(5)	(7)	-	(13)
At 4 April 2016	25	77	281	59	1	443

Notes to the accounts *continued*

10. Impairment provisions on loans and advances to customers *continued*

The Group impairment provision of £438 million at 4 April 2017 (2016: £443 million) comprises individual provisions of £45 million (2016: £75 million) and collective provisions of £393 million (2016: £368 million).

The impairment provision charges for prime and specialist residential loans include £45 million (2016: £27 million) in relation to enhancements to provisioning methodology and assumptions to ensure that provisions continue to reflect appropriately the incurred losses within the portfolio.

Consumer banking provision assumptions in relation to up to date accounts have also been reviewed and updated, resulting in additional provisions of £7 million (2016: £29 million).

The decrease in impairment provisions held against commercial lending is primarily driven by the continued reduction of the commercial real estate portfolio. The Society's impairment provisions on loans and advances to customers are shown in the table below:

2017	**Prime residential**	**Consumer banking**	**Commercial lending**	**Other lending**	**Total**
Society	**£m**	**£m**	**£m**	**£m**	**£m**
At 5 April 2016	25	281	59	-	365
Charge for the year	11	78	(5)	-	84
Amounts written off during the year	(2)	(101)	(31)	-	(134)
Amounts recovered during the year	1	15	3	-	19
Unwind of discount	(1)	(4)	(1)	-	(6)
At 4 April 2017	34	269	25	-	328

2016	Prime residential	Consumer banking	Commercial lending	Other lending	Total
Society	£m	£m	£m	£m	£m
At 5 April 2015	22	216	322	3	563
Charge for the year	8	96	(34)	1	71
Amounts written off during the year	(6)	(44)	(242)	(4)	(296)
Amounts recovered during the year	1	18	20	-	39
Unwind of discount	-	(5)	(7)	-	(12)
At 4 April 2016	25	281	59	-	365

The Society impairment provision of £328 million at 4 April 2017 (2016: £365 million) comprises individual provisions of £28 million (2016: £58 million) and collective provisions of £300 million (2016: £307 million).

In addition to the Society's impairment loss on loans and advances to customers shown above, the Society's income statement charge includes an £18 million (2016: £16 million) provision release in relation to a loan to a subsidiary undertaking. Further details are included in note 36.

Notes to the accounts *continued*

10. Impairment provisions on loans and advances to customers *continued*

Critical accounting estimates and judgements

Impairment provisions on loans and advances

Impairment is measured as the difference between an asset's carrying amount and the present value of management's estimate of future cash flows. In determining the required level of impairment provisions, the Group uses outputs from statistical models combined with management judgement.

Key assumptions included in the measurement of impairment include the probability of default and the amount of eventual loss given default. Assumptions are based on observed historical data and updated as management considers appropriate to reflect current conditions. The accuracy of the impairment provision will therefore be affected by unexpected changes in these assumptions.

For prime and specialist residential mortgages, the estimate of future house price index (HPI) movements is a key assumption in estimating the eventual loss. The Group does not take account of projected future HPI increases in establishing provisions, other than in relation to the future maturity of interest only mortgages. If no HPI growth is assumed for interest only mortgages provisions would increase by £6 million. If a 10% HPI decrease is assumed for all residential mortgages, including interest only mortgages, provisions would further increase by an estimated £20 million.

Provisions are held in relation to up to date accounts where a loss event has occurred but is not yet identified through evidence of arrears, based on an emergence period. The emergence period represents the estimated period of time between a loss event occurring and an account entering arrears. If this period is increased by one month the provision would increase by an estimated £1 million for prime and specialist residential mortgages, and an estimated £6 million for consumer banking.

For consumer banking, the estimate of future recoveries is a key assumption in estimating the eventual loss. The Group uses a combination of both historical data and management judgement in estimating the level and timing of future recoveries. A 10% change in expected future recoveries would result in an estimated £15 million change in the provision.

In calculating the provisions for commercial loans, estimates of discounted cash flows are made on the basis of the planned strategy for each loan. These estimates include assumptions regarding future expected cash flows in respect of property collateral held. If the property values decreased by 10% the provision would increase by an estimated £3 million.

11. Taxation

Tax charge in the income statement

	Group		Society	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Current tax:				
UK corporation tax	**300**	330	**223**	236
Corporation tax – adjustment in respect of prior years	**(3)**	(8)	**(2)**	(7)
Total current tax	**297**	322	**221**	229
Deferred tax:				
Current year credit	**(1)**	(35)	**(11)**	(12)
Adjustment in respect of prior years	**3**	5	**3**	3
Effect of corporation tax rate change	**(2)**	-	**(2)**	-
Effect of banking surcharge on deferred tax balances	**-**	2	**(5)**	8
Total deferred taxation	**-**	(28)	**(15)**	(1)
Tax charge	**297**	294	**206**	228

Notes to the accounts *continued*

11. Taxation *continued*

The actual tax charge differs from the theoretical amount that would arise using the standard rate of corporation tax in the UK as follows:

Reconciliation of tax charge

	Group		Society	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Profit before tax	**1,054**	1,279	**671**	919
Tax calculated at a tax rate of 20%	**211**	256	**134**	184
Adjustments in respect of prior years	**-**	(3)	**1**	(4)
Banking surcharge	**62**	22	**62**	22
Expenses not deductible for tax purposes/(income not taxable):				
Depreciation on non-qualifying assets	**-**	1	**-**	1
Non-taxable dividends received	**-**	-	**-**	(2)
Bank levy	**8**	8	**8**	8
Effect of results of LLP structured entity (note i)	**-**	-	**(12)**	4
Customer redress	**19**	7	**19**	7
Other	**(1)**	1	**1**	-
Effect of corporation tax rate change	**(2)**	-	**(2)**	-
Effect of banking surcharge on deferred tax balances	**-**	2	**(5)**	8
Tax charge	**297**	294	**206**	228

Note:

i. The Society is liable for tax on the results of Nationwide Covered Bonds LLP, the profit or loss of which is reported within that entity.

The tax on items through other comprehensive income is as follows:

Tax charge/(credit) on items through other comprehensive income

	Group		Society	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Available for sale investment securities	**18**	(7)	**16**	(7)
Cash flow hedges	**(101)**	132	**(18)**	1
Property revaluation	**(2)**	7	**(2)**	7
Retirement benefit obligations	**(92)**	(9)	**(92)**	(9)
Other items through the general reserve, including effect of corporation tax rate change	**1**	1	**-**	-
Total	**(176)**	124	**(96)**	(8)

The Group tax charge through the available for sale reserve of £18 million (2016: £7 million credit) is made up of a charge of £14 million (2016: credit of £35 million) through current tax and a charge of £4 million (2016: £28 million) through deferred tax.

Deferred taxation

Deferred tax is determined using tax rates and laws that are expected to apply in the period when the deferred tax asset is realised or deferred tax liability is settled based on rates enacted or substantively enacted at the balance sheet date, including the banking surcharge where applicable.

The Finance (No. 2) Act 2015 introduced a surcharge of 8% on banking profits from 1 January 2016 and reduced the corporation tax rate from 20% to 19% with effect from 1 April 2017. The Finance Act 2016 was enacted on 15 September 2016 and reduces the corporation tax rate from 19% to 17% from 1 April 2020.

Notes to the accounts *continued*

11. Taxation *continued*

The movements on the deferred tax account are as follows:

Movements in deferred taxation

	Group		Society	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
At 5 April	**(151)**	(15)	**(16)**	15
Income statement (charge)/credit	**(2)**	30	**8**	9
Income statement effect of corporation tax rate change	**2**	-	**2**	-
Income statement effect of banking surcharge	**-**	(2)	**5**	(8)
Taxation on items through the income statement	**-**	28	**15**	1
Available for sale investment securities	**(19)**	(20)	**(19)**	(20)
Cash flow hedges	**70**	(86)	**14**	(1)
Property revaluation	**-**	(1)	**-**	(1)
Other provisions	**14**	-	**14**	-
Retirement benefit obligations	**42**	(14)	**42**	(14)
Effect of corporation tax rate change in other comprehensive income	**5**	-	**-**	-
Effect of banking surcharge in other comprehensive income	**42**	(43)	**22**	4
Taxation on items through other comprehensive income	**154**	(164)	**73**	(32)
At 4 April	**3**	(151)	**72**	(16)

Deferred tax assets and liabilities are attributable to the following items:

Deferred tax assets and liabilities

	Group		Society	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Deferred tax assets				
Accelerated capital allowances	**(21)**	(45)	**(21)**	(45)
Property revaluation	**1**	1	**-**	-
Available for sale investment securities	**(23)**	-	**(23)**	-
Cash flow hedges	**19**	1	**19**	1
Retirement benefit obligations	**112**	58	**112**	58
Provisions for loan impairment	**1**	3	**-**	2
Other provisions	**14**	17	**11**	11
	103	35	**98**	27
Deferred tax liabilities				
Property revaluation	**(12)**	(14)	**(12)**	(14)
Cash flow hedges	**(82)**	(166)	**-**	-
Other provisions	**(6)**	(6)	**(14)**	(29)
	(100)	(186)	**(26)**	(43)
Net deferred tax asset/(liability)	**3**	(151)	**72**	(16)

The majority of deferred tax assets are anticipated to be recoverable after one year. The Group considers that there will be sufficient future trading profits in excess of profits arising from the reversal of existing taxable temporary differences to utilise the deferred tax assets.

Notes to the accounts *continued*

11. Taxation *continued*

The deferred tax charge in the income statement comprises the following temporary differences:

Deferred tax charge in the income statement	Group		Society	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Accelerated capital allowances	**(13)**	(13)	**(13)**	(13)
Provisions for loan impairment	**-**	(2)	**-**	(2)
Effect of corporation tax rate change	**(2)**	-	**(2)**	-
Effect of banking surcharge on deferred tax balances	**-**	2	**(5)**	8
Other	**15**	(15)	**5**	6
Total	**-**	(28)	**(15)**	(1)

Tax transparency

The table below reconciles the corporation tax charge in the income statement to the taxation paid in the consolidated cash flow statement:

	Group	
	2017	2016
	£m	£m
Income statement tax charge	**297**	294
Deferred tax and prior year adjustments	**3**	36
Current tax liability	**300**	330
Prior year payments	**137**	116
Current year tax payments due after the end of the year	**(140)**	(192)
Tax paid per consolidated cash flow statement	**297**	254

12. Operating segments

For management reporting purposes, Nationwide is organised into the following business streams:

- Retail
- Commercial
- Head office functions

These business streams reflect how management assesses performance and makes decisions on allocating resources to the business.

Retail

Retail functions include prime residential lending, specialist residential lending, consumer banking, savings, commercial deposits which are managed by the retail business, insurance and investments. The distribution channels supporting these products are also included in this segment.

Commercial

This segment comprises the commercial lending business, including commercial real estate lending, lending to housing associations and project finance lending.

Head office functions

Head office functions include treasury operational activities, head office and central support functions, commercial deposits received and managed by the Treasury function and the result arising from the funds transfer pricing methodology relating to the funding of other segments.

Head office and central support functions include executive management, legal and secretariat services, human resources, strategic planning and external relations, finance, risk management, property services and internal audit.

Certain interest costs and centralised administrative expenses are not allocated to other segments and are instead held centrally within the Head office functions segment.

Notes to the accounts *continued*

12. Operating segments *continued*

Funds transfer pricing methodology

Funds transfer pricing is the mechanism by which the Group recognises the internal cost of funds and allocates this cost between different product groups and business segments to derive individual product margins and net interest receivable. Under the Group's methodology, a single cost of funds representing the weighted average marginal cost of retail and wholesale funding is allocated across the Group, and is reviewed monthly to ensure that the marginal cost of funding, and the relative performance of the different business segments, are based on current market cost of funds.

However, within the commercial segment, the transfer price charged to long term social housing and project finance lending is set to reflect the lower average historic cost of wholesale funding which was available when these loans were originated. This reflects the nature of this lending which did not envisage the current marginal cost of funding, with the additional interest cost reported within the Head office functions segment. All other assets in the commercial segment will continue to be charged the weighted average marginal cost of retail and wholesale funding, in line with other assets.

The retail and commercial business segments are charged for the benefit of free capital as part of the funds transfer pricing mechanism, based upon regulatory capital metrics.

Segmental results are as follows:

2017	Retail	Commercial	Head office functions	Total
	£m	£m	£m	£m
Net income/(expense) from external customers	3,680	403	(1,123)	2,960
(Charge)/revenue from other segments	(785)	(301)	1,086	-
Net interest income	2,895	102	(37)	2,960
Other income (note i)	335	12	(22)	325
Total revenue	3,230	114	(59)	3,285
Administrative expenses (note ii)	(1,834)	(37)	(108)	(1,979)
Impairment and other provisions (note iii)	(262)	(5)	(9)	(276)
Underlying profit/(loss) before tax	1,134	72	(176)	1,030
Bank levy	-	-	(42)	(42)
Gains from derivatives and hedge accounting	-	-	66	66
Profit/(loss) before tax	1,134	72	(152)	1,054
Taxation				(297)
Profit after tax				757
Total assets (note iv)	174,811	12,555	34,304	221,670
Total liabilities	146,918	3,055	60,564	210,537

Notes to the accounts *continued*

12. Operating segments *continued*

2016	Retail	Commercial	Head office functions	Total
	£m	£m	£m	£m
Net income/(expense) from external customers	3,655	454	(1,023)	3,086
(Charge)/revenue from other segments	(634)	(341)	975	-
Net interest income	3,021	113	(48)	3,086
Other income (note i)	251	12	(16)	247
Total revenue	3,272	125	(64)	3,333
Administrative expenses (note ii)	(1,674)	(41)	(81)	(1,796)
Impairment and other provisions (note iii)	(241)	34	7	(200)
Underlying profit/(loss) before tax	1,357	118	(138)	1,337
FSCS levies	(46)	-	-	(46)
Transformation costs	(1)	-	(9)	(10)
Bank levy	-	-	(41)	(41)
Gains from derivatives and hedge accounting	-	-	39	39
Profit/(loss) before tax	1,310	118	(149)	1,279
Taxation				(294)
Profit after tax				985
Total assets (note iv)	165,662	13,138	30,139	208,939
Total liabilities	144,669	2,728	50,612	198,009

Notes:

i. Other income excludes gains from derivatives and hedge accounting which are shown separately. A gain of £100 million relating to the disposal of an investment in Visa Europe Limited in the year ended 4 April 2017 is included in the Retail segment.

ii. Administrative expenses exclude transformation costs and bank levy which are shown separately. Certain centralised costs are not allocated across segments and remain within the Head office functions segment.

iii. Impairment and other provisions include impairment losses on loans and advances, provisions for liabilities and charges (excluding FSCS) and impairment losses/recoveries on investment securities.

iv. Retail assets include goodwill arising on the acquisition of The Mortgage Works (UK) plc.

Notes to the accounts *continued*

13. Classification and measurement

As the majority of the Group's assets and liabilities are held within the Society, the disclosures in this note and notes 24 to 27 are on a consolidated basis. The following table summarises the classification of carrying amounts of the Group's financial assets and liabilities.

Classification of financial assets and liabilities

2017	Available for sale	Loans and receivables	Fair value through income statement	Liabilities at amortised cost	Total
Group	**£m**	**£m**	**£m**	**£m**	**£m**
Financial assets					
Cash	-	13,017	-	-	13,017
Loans and advances to banks	-	2,587	-	-	2,587
Available for sale investment securities	9,764	-	-	-	9,764
Derivative financial instruments	-	-	5,043	-	5,043
Fair value adjustment for portfolio hedged risk	-	746	-	-	746
Loans and advances to customers	-	187,371	-	-	187,371
Investments in equity shares	67	-	-	-	67
Other financial assets (note i)	-	-	7	-	7
Total financial assets	9,831	203,721	5,050	-	218,602
Other non-financial assets					3,068
Total assets					221,670
Financial liabilities					
Shares	-	-	-	144,542	144,542
Deposits from banks	-	-	-	8,734	8,734
Other deposits	-	-	810	5,649	6,459
Due to customers	-	-	-	2,376	2,376
Fair value adjustment for portfolio hedged risk	-	-	-	8	8
Debt securities in issue	-	-	-	40,339	40,339
Derivative financial instruments	-	-	3,182	-	3,182
Subordinated liabilities	-	-	-	2,905	2,905
Subscribed capital	-	-	-	276	276
Total financial liabilities	-	-	3,992	204,829	208,821
Other non-financial liabilities					1,716
Total liabilities					210,537

Notes to the accounts *continued*

13. Classification and measurement *continued*

Classification of financial assets and liabilities

2016	Available for sale	Loans and receivables	Fair value through income statement	Liabilities at amortised cost	Total
Group	£m	£m	£m	£m	£m
Financial assets					
Cash	-	8,797	-	-	8,797
Loans and advances to banks	-	3,591	-	-	3,591
Available for sale investment securities	10,612	-	-	-	10,612
Derivative financial instruments	-	-	3,898	-	3,898
Fair value adjustment for portfolio hedged risk	-	756	-	-	756
Loans and advances to customers	-	178,807	-	-	178,807
Investments in equity shares	126	-	-	-	126
Other financial assets (note i)	-	-	2	-	2
Total financial assets	10,738	191,951	3,900	-	206,589
Other non-financial assets					2,350
Total assets					208,939
Financial liabilities					
Shares	-	-	-	138,715	138,715
Deposits from banks	-	-	-	2,095	2,095
Other deposits	-	-	1,885	5,750	7,635
Due to customers	-	-	-	6,201	6,201
Fair value adjustment for portfolio hedged risk	-	-	-	13	13
Debt securities in issue	-	-	-	36,085	36,085
Derivative financial instruments	-	-	3,463	-	3,463
Subordinated liabilities	-	-	-	1,817	1,817
Subscribed capital	-	-	-	413	413
Total financial liabilities	-	-	5,348	191,089	196,437
Other non-financial liabilities					1,572
Total liabilities					198,009

Note:

i. Other financial assets relate to the fair value of certain mortgage commitments included within other assets on the balance sheet.

Further information on the fair value of financial assets and liabilities is included in notes 24 to 26.

Amounts classified as due to customers do not confer membership rights.

Notes to the accounts *continued*

14. Available for sale investment securities

	Group and Society	
	2017	2016
	£m	£m
Government and supranational investment securities	**6,897**	6,843
Other debt investment securities	**2,867**	3,769
Total	**9,764**	10,612

At 4 April 2017 investment securities of £32 million (2016: £42 million) had been pledged as collateral under UK payment schemes.

At 4 April 2016, £128 million of investment securities had been sold under sale and repurchase agreements. The cash received and accrued interest in relation to these sale and repurchase agreements of £127 million was included within deposits from banks (note 18).

At 4 April 2017 the Group holds no collateral under either reverse sale and repurchase agreements or reverse total return swaps (2016: £577 million).

Further information on available for sale investment securities is included in the 'Treasury assets' section of the Business and Risk Report.

15. Investments in equity shares

	Group and Society	
	2017	2016
	£m	£m
At 5 April	126	26
Additions	**25**	-
Disposals	**(118)**	-
Increase in fair value	**34**	100
At 4 April	**67**	126

Investments in equity shares include investments of £66 million (2016: £125 million) carried at fair value. Of these, £66 million (2016: £107 million) relate to the Group's participation in industry wide banking and credit card service operations.

Disposals of £118 million include £100 million in relation to the disposal of the Group's share in Visa Europe Limited. The Group was a principal member and shareholder of Visa Europe Limited and in exchange for its share received a combination of cash, deferred consideration and preferred stock. The preferred stock of £25 million will be convertible into Visa Inc. common stock at a future date provided certain conditions are met. The conversion of the preferred stock remains subject to potential reduction for certain litigation losses that may be incurred by Visa Europe Limited.

Notes to the accounts *continued*

16. Loans and advances to customers

	Group		Society	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Prime residential mortgages	**137,970**	129,948	**137,427**	129,271
Specialist residential mortgages	**33,149**	32,114	**733**	806
Consumer banking	**3,680**	3,588	**3,680**	3,588
Commercial lending	**11,185**	11,772	**10,677**	11,253
Other lending	**17**	19	**13**	5
	186,001	177,441	**152,530**	144,923
Fair value adjustment for micro hedged risk	**1,370**	1,366	**1,370**	1,366
Total	**187,371**	178,807	**153,900**	146,289

Loans and advances to customers in the table above are shown net of impairment provisions held against them. The fair value adjustment for micro hedged risk relates to commercial lending.

Maturity analysis

The following table shows the residual maturity of loans and advances to customers, based on their contractual maturity:

Residual maturity of loans and advances to customers	Group		Society	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Repayable:				
On demand	**2,013**	1,997	**2,011**	1,994
In not more than three months	**2,196**	2,094	**2,050**	1,977
In more than three months but not more than one year	**5,734**	5,573	**5,559**	5,431
In more than one year but not more than five years	**29,322**	27,363	**27,823**	26,092
In more than five years	**147,174**	140,857	**115,415**	109,794
	186,439	177,884	**152,858**	145,288
Impairment provision on loans and advances (note 10)	**(438)**	(443)	**(328)**	(365)
Fair value adjustment for micro hedged risk	**1,370**	1,366	**1,370**	1,366
Total	**187,371**	178,807	**153,900**	146,289

The maturity analysis is produced on the basis that where a loan is repayable by instalments, each such instalment is treated as a separate repayment. The analysis is based on contractual maturity rather than actual redemption levels experienced, which are likely to be materially different. Arrears are spread across the remaining term of the loan.

Asset backed funding

Certain prime residential mortgages have been pledged to the Group's asset backed funding programmes or utilised as whole mortgage loan pools for the Bank of England's (BoE) Funding for Lending Scheme (FLS) and Term Funding Scheme (TFS). The programmes have enabled the Group to obtain secured funding or to create additional collateral which could be used to source additional funding.

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

Mortgages pledged to asset backed funding programmes					
2017	**Mortgages pledged**	**Notes in issue**			
		Held by third parties	**Held by the Group**		**Total notes in issue**
			Drawn	**Undrawn**	
Group	**£m**	**£m**	**£m**	**£m**	**£m**
Covered bond programme	**19,322**	**14,927**	**-**	**-**	**14,927**
Securitisation programme	**10,412**	**3,622**	**-**	**448**	**4,070**
Whole mortgage loan pools	**16,136**	**-**	**13,505**	**2,631**	**16,136**
Total	**45,870**	**18,549**	**13,505**	**3,079**	**35,133**

Notes to the accounts *continued*

16. Loans and advances to customers *continued*

Mortgages pledged to asset backed funding programmes					
2016	Mortgages pledged	Notes in issue			
		Held by third parties	Held by the Group		Total notes in issue
			Drawn	Undrawn	
Group	£m	£m	£m	£m	£m
Covered bond programme	18,996	13,709	-	-	13,709
Securitisation programme	12,368	4,705	-	1,635	6,340
Whole mortgage loan pools	12,344	-	10,749	1,595	12,344
Total	43,708	18,414	10,749	3,230	32,393

The securitisation programme notes are issued by Silverstone Master Issuer plc and are not included in the accounts of the Society. Silverstone Master Issuer plc is fully consolidated into the accounts of the Group.

The whole mortgage loan pools are pledged at the BoE under the FLS and TFS. Notes are not issued when pledging the mortgage loan pools at the BoE. Instead, the whole loan pool is pledged to the BoE and drawings are made directly against the eligible collateral, subject to a haircut. Therefore, values shown under notes in issue are the whole mortgage loan pool notional balances.

Mortgages pledged include £9.1 billion (2016: £7.4 billion) in the covered bond and securitisation programmes that are in excess of the amount contractually required to support notes in issue.

Mortgages pledged are not derecognised from the Group or Society balance sheets as the Group has retained substantially all the risks and rewards of ownership. The Group and Society continue to be exposed to the liquidity risk, interest rate risk and credit risk of the mortgages. No gain or loss has been recognised on pledging the mortgages to the programmes.

Notes in issue which are held by third parties are included within debt securities in issue (note 21).

Notes in issue, held by the Group and drawn are whole mortgage loan pools securing amounts drawn under the FLS and TFS. At 4 April 2017 the Group had outstanding FLS drawings of £4.8 billion (2016: £8.5 billion) and TFS drawings of £6.0 billion (2016: £nil).

Notes in issue, held by the Group and undrawn, are debt securities issued by the programmes to the Society and mortgage loan pools that have been pledged to the BoE but not utilised.

In accordance with accounting standards, notes in issue and held by the Group are not recognised in the Group's or Society's balance sheets.

The Society established the Nationwide Covered Bond programme in November 2005. Mortgages pledged provide security for issues of covered bonds made by the Society. During the year ended 4 April 2017, £0.8 billion and €1.1 billion (total £1.7 billion sterling equivalent) of notes were issued, and €1.5 billion (£1.4 billion sterling equivalent) of notes matured.

The Society established the Silverstone Master Trust securitisation programme in July 2008. Notes are issued under the programme and the issuance proceeds are used to purchase, for the benefit of note holders, a share of the beneficial interest in the mortgages pledged by the Society. The remaining beneficial interest in the pledged mortgages of £7.0 billion (2016: £6.3 billion) stays with the Society and includes its required minimum seller share in accordance with the rules of the programme. The Group is under no obligation to support losses incurred by the programme or holders of the notes and does not intend to provide such further support. The entitlement of note holders is restricted to payment of principal and interest to the extent that the resources of the programme are sufficient to support such payment and the holders of the notes have agreed not to seek recourse in any other form. During the year ended 4 April 2017 £2.5 billion and $0.5 billion (total £2.9 billion sterling equivalent) of notes matured. During the year ended 4 April 2017 no notes were issued.

The following table sets out the carrying value and fair value of the transferred assets and liabilities for the Silverstone Master Trust.

	Carrying value			Fair value		
	Transferred assets	Associated liabilities	Total	Transferred assets	Associated liabilities	Total
	£m	£m	£m	£m	£m	£m
At 4 April 2017	10,412	(4,088)	6,324	10,030	(4,126)	5,904
At 4 April 2016	12,368	(6,402)	5,966	12,031	(6,424)	5,607

The Society holds cash deposited by the Nationwide Covered Bond programme of £0.4 billion (2016: £1.2 billion) and by the Silverstone programme of £0.4 billion (2016: £0.4 billion).

Notes to the accounts *continued*

17. Derivative financial instruments

All of the Group's derivative financial instruments are held for risk mitigation purposes, although not all of the derivatives are designated as hedging instruments as defined by IAS 39 Financial Instruments: Recognition and Measurement. The table below provides an analysis of the notional amount and fair value of derivatives by instrument type:

Derivatives by instrument type

	2017			2016		
	Contract/ notional amount	Fair value		Contract/ notional amount	Fair value	
		Assets	Liabilities		Assets	Liabilities
	£m	£m	£m	£m	£m	£m
Society:						
Interest rate swaps	162,270	1,484	3,863	150,020	1,769	4,067
Cross currency interest rate swaps	27,272	2,269	929	28,937	1,266	825
Caps, collars and floors	135	-	-	160	-	-
Forward foreign exchange	1,651	16	4	2,249	44	4
Forward rate agreements	401	-	1	400	-	-
Swaptions	240	-	5	248	-	8
Interest rate futures	3,075	-	-	4,225	-	-
Equity index swaps	577	233	-	1,460	436	1
Index linked swaps	280	20	-	280	-	5
	195,901	4,022	4,802	187,979	3,515	4,910
Subsidiaries:						
Interest rate swaps	12,808	1,179	31	12,939	1,383	11
Cross currency interest rate swaps	12,851	1,547	54	13,575	753	291
	25,659	2,726	85	26,514	2,136	302
Intra Group derivative elimination	(31,383)	(1,705)	(1,705)	(43,221)	(1,753)	(1,749)
Group	190,177	5,043	3,182	171,272	3,898	3,463

Contract/notional amount is the amount on which payment flows are derived and does not represent amounts at risk.

The table below provides an analysis of the fair value of derivatives, split between those designated in effective hedging relationships and those which, whilst being economic hedges, are not subject to hedge accounting:

	2017		2016	
	Fair value		Fair value	
	Assets	Liabilities	Assets	Liabilities
Group	£m	£m	£m	£m
Designated as fair value hedges	693	2,823	699	3,035
Designated as cash flow hedges	3,985	249	2,603	343
Not subject to hedge accounting	365	110	596	85
Total	5,043	3,182	3,898	3,463

	2017		2016	
	Fair value		Fair value	
	Assets	Liabilities	Assets	Liabilities
Society	£m	£m	£m	£m
Designated as fair value hedges	611	2,823	699	3,035
Designated as cash flow hedges	168	121	-	5
Not subject to hedge accounting	3,243	1,858	2,816	1,870
Total	4,022	4,802	3,515	4,910

Notes to the accounts *continued*

17. Derivative financial instruments *continued*

Derivative assets and liabilities have remaining contractual maturities as follows:

Derivatives maturities

	2017			2016		
	Contract/ notional amount	Fair value		Contract/ notional amount	Fair value	
		Assets	Liabilities		Assets	Liabilities
Group	£m	£m	£m	£m	£m	£m
Derivatives have remaining maturities as follows:						
In not more than one year	75,054	386	181	66,418	436	180
In more than one year	115,123	4,657	3,001	104,854	3,462	3,283
Total	190,177	5,043	3,182	171,272	3,898	3,463

Derivatives maturities

	2017			2016		
	Contract/ notional amount	Fair value		Contract/ notional amount	Fair value	
		Assets	Liabilities		Assets	Liabilities
Society	£m	£m	£m	£m	£m	£m
Derivatives have remaining maturities as follows:						
In not more than one year	75,489	441	262	69,572	585	214
In more than one year	120,412	3,581	4,540	118,407	2,930	4,696
Total	195,901	4,022	4,802	187,979	3,515	4,910

Cash flow hedge accounting is used primarily for derivatives which economically hedge foreign currency debt issuances. The following table shows the maturity profile of the cash flows designated as hedged items. These cash flows will impact the income statement in the same period in which they are expected to occur and will be offset by cash flows arising from derivative positions.

Maturity of cash flow hedge accounting cash flows

2017	In 0 to 5 years	In 5 to 10 years	In 10 to 20 years	In more than 20 years	Total
	£m	£m	£m	£m	£m
Hedged forecast cash flows expected to occur:					
Group					
Forecast receivable cash flows	408	307	164	11	890
Forecast payable cash flows	(18,250)	(7,609)	(2,395)	(348)	(28,602)
Society					
Forecast receivable cash flows	44	49	-	-	93
Forecast payable cash flows	(1,462)	(1,339)	-	-	(2,801)

Maturity of cash flow hedge accounting cash flows

2016	In 0 to 5 years	In 5 to 10 years	In 10 to 20 years	In more than 20 years	Total
	£m	£m	£m	£m	£m
Hedged forecast cash flows expected to occur:					
Group					
Forecast receivable cash flows	518	400	235	13	1,166
Forecast payable cash flows	(12,115)	(7,052)	(3,191)	(256)	(22,614)
Society					
Forecast payable cash flows	(3)	(58)	-	-	(61)

Notes to the accounts *continued*

18. Deposits from banks

Deposits from banks are repayable from the balance sheet date in the ordinary course of business as follows:

	Group		Society	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Accrued interest	**2**	1	**2**	1
Repayable:				
On demand	**2,497**	1,657	**1,326**	935
In not more than three months	**123**	184	**123**	184
In more than three months but not more than one year	**84**	228	**84**	228
In more than one year but not more than five years	**6,028**	25	**6,028**	25
Total	**8,734**	2,095	**7,563**	1,373

For the Group and Society, deposits from banks include £6.0 billion (2016: £nil) drawn down against the Bank of England Term Funding Scheme (TFS).

At 4 April 2016, deposits from banks for Group and Society included £127 million in respect of sale and repurchase agreements. The corresponding carrying value of assets of £128 million sold under sale and repurchase agreements was included within available for sale investment securities (note 14).

19. Other deposits

Other deposits are repayable from the balance sheet date in the ordinary course of business as follows:

	Group		Society	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Accrued interest	**4**	5	**4**	5
Repayable:				
On demand	**2,314**	1,857	**3,883**	3,019
In not more than three months	**1,639**	2,082	**1,639**	2,082
In more than three months but not more than one year	**2,476**	2,947	**2,476**	2,947
In more than one year but not more than five years	**26**	744	**26**	744
Total	**6,459**	7,635	**8,028**	8,797

The Society's other deposits for the year ended 4 April 2017 include £1,569 million (2016: £1,162 million) of deposits from subsidiary undertakings.

Other deposits comprise wholesale deposits, commercial deposits and amounts relating to the sale of PEBs by the Group on behalf of Legal & General. Further details of the valuation methodology of the PEBs are included in note 25.

20. Due to customers

The Group has announced the closure of its Isle of Man and Republic of Ireland operations. Amounts due to customers include £1,960 million (2016: £5,540 million) in respect of balances deposited with these operations.

Notes to the accounts *continued*

21. Debt securities in issue

	Group		Society	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Certificates of deposit and commercial paper	**7,065**	6,409	**7,065**	6,409
Fixed and floating rate notes	**28,240**	23,451	**28,253**	23,452
Other debt securities	**3,920**	5,014	**290**	286
	39,225	34,874	**35,608**	30,147
Fair value adjustment for micro hedged risk	**1,114**	1,211	**264**	374
Total	**40,339**	36,085	**35,872**	30,521
Debt securities in issue are repayable from the balance sheet date in the ordinary course of business as follows:				
Accrued interest	**178**	178	**168**	151
Residual maturity repayable:				
In not more than one year	**9,932**	9,753	**9,154**	8,403
In more than one year	**29,115**	24,943	**26,286**	21,593
	39,225	34,874	**35,608**	30,147
Fair value adjustment for micro hedged risk	**1,114**	1,211	**264**	374
Total	**40,339**	36,085	**35,872**	30,521

Debt securities in issue in the Group and Society include £18,549 million (2016: £18,414 million) secured on certain loans and advances to customers. Further information is given in note 16.

Certificates of deposit and commercial paper at 4 April 2017 include £619 million (2016: £nil) which was in the course of settlement, with the associated receivable included in other assets on the balance sheet. As a result, reported other assets have increased to £692 million (2016: £129 million). Fixed and floating rate notes at 4 April 2016 included £25 million which was in the course of settlement.

22. Subordinated liabilities

	Group	
	2017	2016
	£m	£m
8.625% subordinated notes due 2018 (£)	**125**	125
6.75% subordinated notes due 2020 (€750m)	**642**	598
6.5% callable reset subordinated notes due 2022 (£)	**30**	30
4.125% subordinated notes due 2023 (€1,250m)	**1,070**	997
4% subordinated notes due 2026 ($1,250m)	**1,004**	-
	2,871	1,750
Fair value hedge accounting adjustments	**45**	77
Unamortised premiums and issue costs	**(11)**	(10)
Total	**2,905**	1,817

The Society's subordinated liabilities are as shown above for the Group, except that they exclude £5 million (2016: £6 million) of fair value hedge adjustments relating to cash flow hedge accounting, with the total balance sheet value amounting to £2,910 million (2016: £1,823 million).

Notes to the accounts *continued*

22. Subordinated liabilities *continued*

All of the Society's subordinated liabilities are unsecured. The Society may, with the prior consent of the Prudential Regulation Authority (PRA), redeem some of the subordinated notes early, at par (100%) unless stated, as follows:

- All or some of the 8.625% notes due in 2018 at any time at the higher of par (100%) or a price determined by reference to an 8.75% 2017 benchmark gilt, by giving not less than 30 days' and not more than 60 days' notice.
- All or some of the 6.5% notes due 2022 on 1 September 2017 by giving not less than 30 days' or more than 60 days' notice. If the notes are not called the rate reverts to the 5 year gilt rate + 3%.
- All or some of the 4.125% notes due 2023 on 20 March 2018 by giving not less than 30 days' or more than 60 days' notice. If the notes are not called the rate reverts to the 5 year swap rate + 3.3%.

On 14 September 2016 the Group issued $1,250 million of subordinated notes.

The 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 permanent interest bearing shares, Additional Tier 1 (AT1) capital and core capital deferred shares (CCDS)) of the Society.

Interest accrued on subordinated liabilities of £35 million (2016: £31 million) is recognised within accruals and deferred income on the balance sheet.

The interest rate risk arising from the issuance of fixed rate subordinated liabilities has been mitigated through the use of interest rate swaps. The foreign exchange risk arising from the issuance of foreign currency subordinated liabilities has been mitigated through the use of cross currency swaps.

23. Subscribed capital

	Group and Society	
	2017	2016
	£m	£m
7.25% permanent interest bearing shares	**33**	33
6.25% permanent interest bearing shares	**44**	44
5.769% permanent interest bearing shares	**84**	84
7.859% permanent interest bearing shares	**38**	38
6% permanent interest bearing shares	**-**	140
6.875% permanent interest bearing shares	**10**	10
Floating rate (3 month Libor + 0.5%) permanent interest bearing shares	**3**	3
Floating rate (6 month Libor + 2.4%) permanent interest bearing shares	**10**	10
	222	362
Fair value hedge accounting adjustments	**57**	68
Unamortised premiums and issue costs	**(3)**	(17)
Total	**276**	413

All permanent interest bearing shares (PIBS) are unsecured and denominated in sterling. The PIBS are only repayable with the prior consent of the PRA as follows:

- The 7.25% PIBS are repayable, at the option of the Society, in whole on 5 December 2021 or every fifth anniversary thereafter.
- The 6.25% PIBS are repayable, at the option of the Society, in whole on 22 October 2024 or every fifth anniversary thereafter.
- The 5.769% PIBS are repayable, at the option of the Society, in whole on 6 February 2026 or every fifth anniversary thereafter.
- The 7.859% PIBS are repayable, at the option of the Society, in whole on 13 March 2030 or every fifth anniversary thereafter.

If the above four tranches of PIBS are not repaid on a call date then the interest rate is reset at a margin to the yield on the then prevailing five year benchmark gilt rate, as follows:

- The 6.875% PIBS are repayable at the option of the Society, in whole on 10 January 2019, or any fifth anniversary thereafter. If the PIBS are not repaid on a call date, then the interest rate is reset at a margin of 3% over the yield on the prevailing five year benchmark gilt rate.
- The floating rate PIBS payable at 0.5% above 3 month Libor are repayable at the option of the Society, at every interest payment date, and if the PIBS are not repaid on 6 February 2018 then the interest resets to 1.5% above 3 month Libor.
- The floating rate PIBS payable at 2.4% above 6 month Libor are only repayable in the event of winding up the Society.

Notes to the accounts *continued*

23. Subscribed capital *continued*

On 15 December 2016, the Group redeemed the £140 million 6% PIBS at par.

PIBS rank pari passu with each other and the Group's AT1 instruments. They are deferred shares of the Society and rank behind the claims against the Society of all subordinated noteholders, depositors, creditors and investing members of the Society, other than the holders of CCDS.

Interest accrued on subscribed capital of £3 million (2016: £6 million) is recognised within accruals and deferred income on the balance sheet.

The interest rate risk arising from the issuance of fixed rate PIBS has been mitigated through the use of interest rate swaps.

24. Fair value hierarchy of financial assets and liabilities held at fair value

As the majority of the Group's assets and liabilities are held within the Society, the disclosures in notes 24 to 27 are on a consolidated basis.

The following tables show the Group's financial assets and liabilities that are held at fair value by fair value hierarchy, balance sheet classification and product type:

2017	Fair values based on			
	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
Financial assets				
Government and supranational investments	6,897	-	-	6,897
Other debt investment securities	931	1,936	-	2,867
Available for sale investment securities	7,828	1,936	-	9,764
Investments in equity shares (note i)	-	-	66	66
Interest rate swaps	-	1,859	-	1,859
Cross currency interest rate swaps	-	2,915	-	2,915
Forward foreign exchange	-	16	-	16
Equity index swaps	-	-	233	233
Index linked swaps	-	20	-	20
Total derivative financial instruments	-	4,810	233	5,043
Other financial assets (note ii)	-	7	-	7
Total financial assets	7,828	6,753	299	14,880
Financial liabilities				
Interest rate swaps	-	(3,096)	(5)	(3,101)
Cross currency interest rate swaps	-	(71)	-	(71)
Forward foreign exchange	-	(4)	-	(4)
Forward rate agreements	-	(1)	-	(1)
Swaptions	-	(5)	-	(5)
Total derivative financial instruments	-	(3,177)	(5)	(3,182)
Other deposits – PEBs (note iii)	-	-	(810)	(810)
Total financial liabilities	-	(3,177)	(815)	(3,992)

Notes to the accounts *continued*

24. Fair value hierarchy of financial assets and liabilities held at fair value *continued*

2016	Fair values based on			
	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
Financial assets				
Government and supranational investments	6,843	-	-	6,843
Other debt investment securities	1,011	2,758	-	3,769
Available for sale investment securities	7,854	2,758	-	10,612
Investments in equity shares (note i)	-	-	125	125
Interest rate swaps	-	2,180	-	2,180
Cross currency interest rate swaps	-	1,238	-	1,238
Forward foreign exchange	-	44	-	44
Equity index swaps	-	-	436	436
Total derivative financial instruments	-	3,462	436	3,898
Other financial assets (note ii)	-	2	-	2
Total financial assets	7,854	6,222	561	14,637
Financial liabilities				
Interest rate swaps	-	(3,103)	(4)	(3,107)
Cross currency interest rate swaps	-	(338)	-	(338)
Forward foreign exchange	-	(4)	-	(4)
Swaptions	-	(8)	-	(8)
Equity index swaps	-	-	(1)	(1)
Index linked swaps	-	(5)	-	(5)
Total derivative financial instruments	-	(3,458)	(5)	(3,463)
Other deposits – PEBs (note iii)	-	-	(1,885)	(1,885)
Total financial liabilities	-	(3,458)	(1,890)	(5,348)

Notes:

i. Investments in equity shares exclude £1 million of investments in equity shares which are held at cost.

ii. Other financial assets represent the fair value of certain mortgage commitments included within other assets in the balance sheet.

iii. Other deposits comprise PEBs which are held at fair value through the income statement. The remaining other deposits are held at amortised cost and are included in note 26.

The Group's Level 1 portfolio comprises liquid securities for which traded prices are readily available.

Asset valuations for Level 2 available for sale investment securities are sourced from consensus pricing or other observable market prices. None of the Level 2 available for sale assets 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.

More detail on the Level 3 portfolio is provided in note 25.

Transfers between fair value hierarchies

Instruments move between fair value hierarchies primarily due to increases or decreases in market activity or changes to the significance of unobservable inputs to valuation. There were no significant transfers between the Level 1 and Level 2 portfolios during the year.

Notes to the accounts *continued*

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

The main constituents of the Level 3 portfolio are as follows:

Investments in equity shares

The Level 3 investments in equity shares include investments of £66 million (2016: £125 million) in industry wide banking and credit card service operations.

Derivative financial instruments

Level 3 assets and liabilities in this category are primarily equity linked derivatives with external counterparties which economically match the investment return payable by the Group to investors in Protected Equity Bonds (PEBs). The derivatives are linked to the performance of specified stock market indices and have been valued by an external third party. Fair value changes are recognised within gains/losses from derivatives and hedge accounting. Upon maturity the gain/loss is transferred to interest expense and similar charges.

Other deposits – PEBs

This category relates to deposit accounts with the potential for stock market correlated growth linked to the performance of specified stock market indices. The PEBs liability of £810 million (2016: £1,885 million) is valued at a discount to reflect the time value of money, overlaid by a fair value adjustment representing the expected return payable to the customer. The fair value adjustment has been constructed from the valuation of the associated derivatives as valued by an external third party. Fair value changes are recognised within gains/losses from derivatives and hedge accounting. Upon maturity the gain/loss is transferred to interest expense and similar charges.

The minimum amount on an undiscounted basis that the Group and Society are contractually required to pay at maturity for the PEBs is £621 million (2016: £1,551 million). The maximum additional amount which would also be payable at maturity in respect of additional investment returns is £250 million (2016: £636 million). The payment of additional investment returns is dependent upon performance of certain specified stock indices during the period of the PEBs. As noted above, the Group has entered into equity linked derivatives with external counterparties which economically match the investment returns on the PEBs.

The tables below set out movements in the Level 3 portfolio, including transfers in and out of Level 3.

Movements in Level 3 portfolio	Investments in equity shares	Net derivative financial instruments	Other deposits - PEBs
	£m	£m	£m
At 5 April 2016	125	431	(1,885)
Gains/(losses) recognised in the income statement:			
Net interest income/(expense)	-	308	(327)
(Losses)/gains from derivatives and hedge accounting	-	(205)	201
Other operating income	100	-	-
Losses recognised in other comprehensive income:			
Fair value movement taken to members' interests and equity	(66)	-	-
Settlements	-	(306)	1,201
Acquisitions	25	-	-
Disposals	(118)	-	-
At 4 April 2017	**66**	**228**	**(810)**

Movements in Level 3 portfolio	Available for sale investment securities	Investments in equity shares	Net derivative financial instruments	Other deposits - PEBs
	£m	£m	£m	£m
At 5 April 2015	12	25	910	(3,332)
Gains/(losses) recognised in the income statement:				
Net interest income/(expense)	-	-	398	(439)
(Losses)/gains from derivatives and hedge accounting	-	-	(476)	465
Gains recognised in other comprehensive income:				
Fair value movement taken to members' interests and equity	-	100	-	-
Settlements	-	-	(401)	1,421
Transfers out of Level 3 portfolio	(12)	-	-	-
At 4 April 2016	-	125	431	(1,885)

Notes to the accounts *continued*

25. Fair value of financial assets and liabilities held at fair value – Level 3 portfolio *continued*

Level 3 portfolio sensitivity analysis of valuations using unobservable inputs

The fair value of financial instruments is, in certain circumstances, measured using valuation techniques based on market prices that are not observable in an active market or significant unobservable market inputs.

Reasonable alternative assumptions can be applied for sensitivity analysis, taking account of the nature of valuation techniques used, as well as the availability and reliability of observable proxy and historic data. The following table shows the sensitivity of the Level 3 fair values to reasonable alternative assumptions (as set out in the table of significant unobservable inputs below) and the resultant impact of such changes in fair value on the income statement or members' interests and equity:

Sensitivity of Level 3 fair values

2017	Fair value	Members' interests and equity: Favourable changes	Members' interests and equity: Unfavourable changes
	£m	£m	£m
Investments in equity shares	66	12	(24)
Net derivative financial instruments (note i)	228	-	-
Other deposits – PEBs (note i)	(810)	-	-
Total	(516)	12	(24)

Sensitivity of Level 3 fair values

2016	Fair value	Members' interests and equity: Favourable changes	Members' interests and equity: Unfavourable changes
	£m	£m	£m
Investments in equity shares	125	41	(32)
Net derivative financial instruments (note i)	431	-	-
Other deposits – PEBs (note i)	(1,885)	-	-
Total	(1,329)	41	(32)

Note:

i. Changes in fair values of the equity index swaps included in net derivative financial instruments will be largely offset by the change in fair value of the PEBs deposits. Any resultant impact is deemed by the Group to be insignificant; therefore these sensitivities have been excluded from the table above.

The Level 3 portfolio at 4 April 2017 did not include any impaired assets (2016: £nil). The sensitivity analysis on fair values in the tables above therefore does not impact on the income statement.

Alternative assumptions are considered for each product and varied according to the quality of the data and variability of the underlying market.

The following table discloses the significant unobservable inputs underlying the above alternative assumptions for assets and liabilities recognised at fair value and classified as Level 3, along with the range of values for those significant unobservable inputs. Where sensitivities are described the inverse relationship will also generally apply.

Significant unobservable inputs

2017	Total assets	Total liabilities	Valuation technique	Significant unobservable inputs	Range (note ii)		Weighted average (note iii)	Units
	£m	£m						
Investments in equity shares	66	-	Discounted cash flows	Discount rate	6.41	7.75	7.08	%
				Share conversion	-	100.00	77.76	%
Net derivative financial instruments (note i)	228	-						
Other deposits – PEBs (note i)	-	(810)						

Notes to the accounts *continued*

25. Fair value of financial assets and liabilities held at fair value – Level 3 portfolio *continued*

Significant unobservable inputs

2016	Total assets	Total liabilities	Valuation technique	Significant unobservable inputs	Range (note ii)		Weighted average (note iii)	Units (note iv)
	£m	£m						
Investments in equity shares	18	-	Mark to market	Price	93.30	107.00	98.00	Points
	107	-	Discounted cash flows	Discount rate	10.00	12.00	11.00	%
				Share conversion	-	100.00	77.30	%
				Execution risk	-	30.00	12.41	%
	125	-						
Net derivative financial instruments (note i)	431	-						
Other deposits – PEBs (note i)	-	(1,885)						

Notes:

i. Changes in fair values of the equity index swaps included in net derivative financial instruments will be largely offset by the change in fair value of the PEBs deposits. Any resultant impact is deemed by the Group to be insignificant; therefore these sensitivities have been excluded from the table above.

ii. 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.

iii. Weighted average represents the input values used in calculating the fair values for the above financial instruments.

iv. Points are a percentage of par; for example 100 points equals 100% of par. One basis point (bps) equals 0.01%; for example, 125 basis points (bps) equals 1.25%.

Some of the significant unobservable inputs used in fair value measurement are interdependent. Where this is the case, a description of those interrelationships is included below.

Discount rate

The discount rate is used to determine the present value of future cash flows. The level of the discount rate takes into account the time value of money, but also the risk or uncertainty of future cash flows. Typically, the greater the uncertainty, the higher the discount rate. A higher discount rate leads to a lower valuation and vice versa.

Share conversion

Where the conversion of a security into an underlying instrument is subject to underlying security market pricing and contingent litigation risk, share conversion is factored into the fair value. The higher the share conversion, the higher the valuation and vice versa.

Execution risk

Where a security's value is dependent on a future transaction taking place, and the occurrence of this is not certain, execution risk is factored into the security's valuation. The greater the execution risk, the lower the valuation and vice versa.

Price

Prices for securities that are marked to market, where the market is illiquid and supporting price information is scarce, are typically subject to significant uncertainty. An increase in the price will directly cause an increase in fair value and vice versa.

Notes to the accounts *continued*

26. Fair value of financial assets and liabilities measured at amortised cost

The following table summarises the carrying value and fair value of financial assets and liabilities measured at amortised cost on the Group's balance sheet:

2017	Carrying value	Fair values based on			Total fair value
		Level 1	Level 2	Level 3	
	£m	£m	£m	£m	£m
Financial assets					
Loans and advances to banks	2,587	-	2,587	-	2,587
Loans and advances to customers:					
Residential mortgages	171,119	-	-	170,542	170,542
Consumer banking	3,680	-	-	3,546	3,546
Commercial lending	12,555	-	-	11,284	11,284
Other lending	17	-	5	12	17
Total	189,958	-	2,592	185,384	187,976
Financial liabilities					
Shares	144,542	-	144,664	-	144,664
Deposits from banks	8,734	-	8,736	-	8,736
Other deposits (note i)	5,649	-	5,651	-	5,651
Due to customers	2,376	-	2,377	-	2,377
Debt securities in issue	40,339	15,399	25,837	-	41,236
Subordinated liabilities	2,905	-	3,053	-	3,053
Subscribed capital	276	-	244	-	244
Total	204,821	15,399	190,562	-	205,961

2016	Carrying value	Fair values based on			Total fair value
		Level 1	Level 2	Level 3	
	£m	£m	£m	£m	£m
Financial assets					
Loans and advances to banks (note ii)	3,591	-	3,591	-	3,591
Loans and advances to customers:					
Residential mortgages	162,062	-	-	161,766	161,766
Consumer banking	3,588	-	-	3,458	3,458
Commercial lending	13,138	-	-	13,077	13,077
Other lending (note ii)	19	-	5	14	19
Total	182,398	-	3,596	178,315	181,911
Financial liabilities					
Shares	138,715	-	138,896	-	138,896
Deposits from banks	2,095	-	2,096	-	2,096
Other deposits (note i)	5,750	-	5,752	-	5,752
Due to customers (note ii)	6,201	-	6,204	-	6,204
Debt securities in issue	36,085	13,582	23,195	-	36,777
Subordinated liabilities	1,817	-	1,949	-	1,949
Subscribed capital	413	-	381	-	381
Total	191,076	13,582	178,473	-	192,055

Notes:

i. Other deposits exclude PEBs which are held at fair value through the income statement and which are included in note 24.

ii. The comparative fair values for loans and advances to banks, amounts due to customers and an element of other lending relating to the fair value of cash collateral posted with non-bank counterparties have been moved to Level 2. This better reflects the valuation approach, consistent with the current year presentation.

Notes to the accounts *continued*

26. Fair value of financial assets and liabilities measured at amortised cost *continued*

The fair values of loans and advances to customers may be further analysed, between those impaired and those not impaired, as follows:

2017	**Impaired**		**Not impaired**		**Total**	
	Carrying value	**Fair value**	**Carrying value**	**Fair value**	**Carrying value**	**Fair value**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Residential mortgages	713	705	170,406	169,837	171,119	170,542
Consumer banking	37	37	3,643	3,509	3,680	3,546
Commercial lending	25	17	12,530	11,267	12,555	11,284
Other lending	-	-	17	17	17	17
Total	775	759	186,596	184,630	187,371	185,389

2016	Impaired		Not impaired		Total	
	Carrying value	Fair value	Carrying value	Fair value	Carrying value	Fair value
	£m	£m	£m	£m	£m	£m
Residential mortgages	729	707	161,333	161,059	162,062	161,766
Consumer banking	38	38	3,550	3,420	3,588	3,458
Commercial lending	117	114	13,021	12,963	13,138	13,077
Other lending	4	4	15	15	19	19
Total	888	863	177,919	177,457	178,807	178,320

Loans and advances to banks

The fair value of loans and advances to banks is estimated by discounting expected cashflows at a market discount rate. The carrying amount is considered a reasonable approximation of fair value.

Loans and advances to customers

The fair value of loans and advances to customers is estimated by discounting expected cash flows to reflect current rates for similar lending.

Consistent modelling techniques are used across the different loan books. The estimates take into account expected future cash flows and future lifetime expected losses, based on historic trends and discount rates appropriate to the loans, to reflect a hypothetical exit price value on an asset by asset basis. Variable rate loans are modelled on estimated future cash flows, discounted at current market interest rates. Variable rate retail mortgages are discounted at the currently available market standard variable interest rate (SVR) which, for example, in the case of the Group's residential base mortgage rate (BMR) mortgage book, generates a fair value lower than the amortised cost value as those mortgages are priced below the SVR.

For fixed rate loans, discount rates have been based on the expected funding and capital cost applicable to the book. When calculating fair values on fixed rate loans, no adjustment has been made to reflect interest rate risk management through internal natural hedges or external hedging via derivatives.

Shares, deposits and amounts due to customers

The estimated fair value of shares, deposits and amounts due to customers with no stated maturity, including non-interest bearing deposits, is the amount repayable on demand. For items without quoted market prices the estimated fair value represents the discounted amount of estimated future cash flows based on expectations of future interest rates, customer withdrawals and interest capitalisation. For variable interest rate items, estimated future cash flows are discounted using current market interest rates for new debt with similar remaining maturity. For fixed rate items, the estimated future cash flows are discounted based on market offer rates currently available for equivalent deposits.

Debt securities in issue

The estimated fair values of longer dated liabilities are calculated based on quoted market prices where available or using similar instruments as a proxy for those liabilities that are not of sufficient size or liquidity to have an active market quote. For those notes for which quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity.

Subordinated liabilities and subscribed capital

The fair value of subordinated liabilities and subscribed capital is determined by reference to quoted market prices of similar instruments.

Notes to the accounts *continued*

27. Offsetting financial assets and financial liabilities

The Group has financial assets and liabilities for which there is a legally enforceable right to set off the recognised amounts, and there is an intention to settle on a net basis, or realise the asset and liability simultaneously. In accordance with IAS 32 'Financial Instruments: Presentation', where the right to set off is not unconditional in all circumstances this does not result in an offset of balance sheet assets and liabilities.

In accordance with IFRS 7 'Financial Instruments: Disclosures', the following table shows the impact on derivative financial instruments relating to transactions where:

- there is an enforceable master netting arrangement or similar agreement in place and an unconditional right to offset is in place,
- there is an enforceable master netting arrangement or similar agreement in place but the offset criteria are otherwise not satisfied, and
- financial collateral is paid and received.

Master netting arrangements consist of agreements such as an ISDA Master Agreement, global master repurchase agreements and global master securities lending agreements, whereby outstanding transactions with the same counterparty can be offset and settled net, either unconditionally or following a default or other predetermined event.

Financial collateral on derivative financial instruments consists of cash settled, typically daily or weekly, to mitigate the mark to market exposures. Financial collateral on total return swaps 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 below 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.

2017	**Gross amounts recognised**	**Amounts offset (note i)**	**Net amounts reported on the balance sheet**	**Master netting arrangements**	**Financial collateral**	**Net amounts after offsetting under IFRS 7**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Financial assets						
Derivative financial instruments	5,067	(24)	5,043	(2,216)	(2,799)	28
Total financial assets	5,067	(24)	5,043	(2,216)	(2,799)	28
Financial liabilities						
Derivative financial liabilities	3,210	(28)	3,182	(2,216)	(921)	45
Total financial liabilities	3,210	(28)	3,182	(2,216)	(921)	45

2016	Gross amounts recognised	Amounts offset (note i)	Net amounts reported on the balance sheet	Master netting arrangements	Financial collateral	Net amounts after offsetting under IFRS 7
	£m	£m	£m	£m	£m	£m
Financial assets						
Derivative financial instruments	3,898	-	3,898	(2,020)	(1,804)	74
Total return swaps	87	-	87	-	(87)	-
Reverse repurchase agreements	450	-	450	-	(450)	-
Total financial assets	4,435	-	4,435	(2,020)	(2,341)	74
Financial liabilities						
Derivative financial liabilities	3,463	-	3,463	(2,020)	(1,391)	52
Repurchase agreements	127	-	127	-	(127)	-
Total financial liabilities	3,590	-	3,590	(2,020)	(1,518)	52

Note:

i. Amounts offset for derivative financial assets of £24 million include cash collateral netted of £3 million (2016: £nil). Amounts offset for derivative financial liabilities of £28 million include cash collateral netted of £7 million (2016: £nil). Excluding the cash collateral netted, the remaining amounts represent £21 million of derivative financial assets and derivative financial liabilities which are offset. At 4 April 2016, whilst there were netting arrangements in place, the offset criteria were otherwise not satisfied and therefore no amounts were offset.

The financial collateral in the table above is presented at fair value, except for the total return swaps collateral at 4 April 2016 which had a fair value of £127 million and the repurchase agreements collateral at 4 April 2016 which had a fair value of £128 million.

Notes to the accounts *continued*

28. Intangible assets

2017	**Computer software**		**Total computer software**	**Other intangible assets**	**Goodwill**	**Total**
	Externally acquired	**Internally developed**				
Group	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Cost						
At 5 April 2016	449	1,301	1,750	40	12	1,802
Additions	189	84	273	-	-	273
Disposals	(47)	(14)	(61)	-	-	(61)
At 4 April 2017	591	1,371	1,962	40	12	2,014
Accumulated amortisation and impairment						
At 5 April 2016	154	420	574	37	-	611
Amortisation charge	48	153	201	2	-	203
Impairment in the year	-	31	31	-	-	31
Disposals	(47)	(14)	(61)	-	-	(61)
At 4 April 2017	155	590	745	39	-	784
Net book value						
At 4 April 2017	436	781	1,217	1	12	1,230

2016	Computer software		Total computer software	Other intangible assets	Goodwill	Total
	Externally acquired	Internally developed				
Group	£m	£m	£m	£m	£m	£m
Cost						
At 5 April 2015	448	996	1,444	40	12	1,496
Additions	19	320	339	-	-	339
Disposals	(18)	(15)	(33)	-	-	(33)
At 4 April 2016	449	1,301	1,750	40	12	1,802
Accumulated amortisation and impairment						
At 5 April 2015	128	294	422	34	-	456
Amortisation charge	44	139	183	3	-	186
Impairment in the year	-	2	2	-	-	2
Disposals	(18)	(15)	(33)	-	-	(33)
At 4 April 2016	154	420	574	37	-	611
Net book value						
At 4 April 2016	295	881	1,176	3	12	1,191

Intangible assets at 4 April 2017 include £248 million (2016: £274 million) of assets in the course of construction. These assets relate mainly to the Group's investment in infrastructure, new applications and software to meet the future needs of the business. To the extent that these investments are not yet ready for use by the business, no amortisation has been charged against these assets.

Software costs capitalised during the year ended 4 April 2017 primarily relate to new applications and operating system enhancements to support the Group's products and activities. The items capitalised are being amortised over estimated useful lives of predominantly 5 years.

Goodwill is held at cost less accumulated impairment; goodwill is not amortised but is tested for impairment at least annually. Other intangible assets are held at cost less accumulated amortisation and impairment and are amortised using the straight line method over their estimated useful lives of between 5 and 10 years.

In the year ended 4 April 2017 £4 million (2016: £4 million) of borrowing costs have been capitalised using a capitalisation rate of 1.13% (2016: 1.30%).

An impairment loss of £31 million (2016: £2 million) was recognised in the year in respect of certain development work relating to internal systems which has now been superseded.

The Society's intangible assets are as shown above for the Group, except that they exclude £12 million (2016: £12 million) of goodwill relating to the acquisition of The Mortgage Works (UK) plc, which is only recognised at Group level.

Notes to the accounts *continued*

29. Property, plant and equipment

2017	Branches and non-specialised buildings	Specialised administration buildings	Short leasehold buildings	Total land and buildings	Plant and machinery	Equipment, fixtures, fittings and vehicles	Total
Group	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Cost or valuation							
At 5 April 2016	221	189	34	444	172	802	1,418
Additions	-	-	-	-	50	146	196
Revaluation	-	-	-	-	-	-	-
Disposals	(2)	(7)	-	(9)	-	(95)	(104)
At 4 April 2017	219	182	34	435	222	853	1,510
Accumulated depreciation and impairment							
At 5 April 2016	-	85	24	109	110	376	595
Depreciation charge	-	3	1	4	22	136	162
Disposals	-	(7)	-	(7)	-	(91)	(98)
At 4 April 2017	-	81	25	106	132	421	659
Net book value							
At 4 April 2017	219	101	9	329	90	432	851

2016	Branches and non-specialised buildings	Specialised administration buildings	Short leasehold buildings	Total land and buildings	Plant and machinery	Equipment, fixtures, fittings and vehicles	Total
Group	£m	£m	£m	£m	£m	£m	£m
Cost or valuation							
At 5 April 2015	224	183	34	441	157	819	1,417
Additions	2	6	-	8	15	89	112
Revaluation	1	-	-	1	-	-	1
Disposals	(6)	-	-	(6)	-	(106)	(112)
At 4 April 2016	221	189	34	444	172	802	1,418
Accumulated depreciation and impairment							
At 5 April 2015	-	82	22	104	93	364	561
Depreciation charge	-	3	2	5	17	115	137
Disposals	-	-	-	-	-	(103)	(103)
At 4 April 2016	-	85	24	109	110	376	595
Net book value							
At 4 April 2016	221	104	10	335	62	426	823

Group property, plant and equipment at 4 April 2017 includes £2 million (2016: £2 million) of land and buildings held by subsidiary undertakings.

Property, plant and equipment includes £17 million (2016: £13 million) of assets in the course of construction.

In the year ended 4 April 2016 £1 million of borrowing costs were capitalised using a rate of 1.30%. In the year ended 4 April 2017 borrowing costs capitalised were less than £1 million, based on a rate of 1.13%.

Branches and non-specialised buildings are valued annually by independent surveyors. The current use of all branches and non-specialised buildings equates to highest and best use, and there have been no changes to the valuation technique during the year.

IFRS 13 requires that all assets held at fair value are classified according to a hierarchy that reflects the significance of observable market inputs in calculating those fair values. Branches and non-specialised buildings valuations are classified within Level 2 of the fair value hierarchy.

Notes to the accounts *continued*

30. Provisions for liabilities and charges

Group	Bank levy £m	FSCS £m	Customer redress £m	Other provisions £m	Total £m
At 5 April 2016	22	84	227	10	343
Provisions utilised	(48)	(42)	(58)	(5)	(153)
Charge for the year	42	15	152	21	230
Release for the year	-	(15)	(16)	(2)	(33)
Net income statement charge	42	-	136	19	197
At 4 April 2017	**16**	**42**	**305**	**24**	**387**
At 5 April 2015	13	126	140	16	295
Provisions utilised	(32)	(88)	(40)	(5)	(165)
Charge for the year	41	46	138	3	228
Release for the year	-	-	(11)	(4)	(15)
Net income statement charge	41	46	127	(1)	213
At 4 April 2016	22	84	227	10	343

The income statement charge for provisions for liabilities and charges of £136 million (2016: £173 million) includes the customer redress net income statement charge of £136 million (2016: £127 million), and the FSCS charge of £nil (2016: £46 million).

The income statement charge for bank levy of £42 million (2016: £41 million) and other provisions charge of £19 million (2016: credit of £1 million) are included within administrative expenses in the income statement.

The Group provisions for liabilities and charges include £1 million (2016: £3 million) of customer redress held by subsidiary company The Mortgage Works (UK) plc; all other amounts are held by the Society.

Financial Services Compensation Scheme (FSCS)

The FSCS, the UK's independent statutory compensation fund for customers of authorised financial services firms, pays compensation if a firm is unable to pay claims against it.

Following the default of a number of deposit takers, the FSCS borrowed funds from HM Treasury, approximately £16 billion of which was outstanding at 4 April 2017, relating solely to the failure of Bradford & Bingley plc. The FSCS recovers the interest costs associated with this loan, together with ongoing management expenses, by way of annual levies on member firms.

UK Asset Resolution Limited (UKAR) oversees the management of the closed books of Bradford & Bingley plc. On 31 March 2017, UKAR confirmed that it had agreed to sell two separate asset portfolios of Bradford & Bingley plc in order to repay the £16 billion loan outstanding to HM Treasury. The first asset portfolio sale transaction was completed on 25 April 2017, reducing the loan outstanding to HM Treasury to approximately £5 billion. As a result, the annual FSCS charge in relation to interest costs and management expenses has reduced significantly to £15 million (2016: £46 million) for the 2017/18 scheme year. The second sales transaction is anticipated to be completed by March 2018.

The FSCS income statement charge of £nil for the year ended 4 April 2017 comprises the £15 million FSCS 2017/18 scheme year charge (2016: £46 million), offset by £13 million (2016: £nil) of recoveries in relation to previous Icelandic banking failures and a £2 million release relating to lower than anticipated interest costs for the 2016/17 scheme year.

The balance sheet amount provided by the Group of £42 million (2016: £84 million) comprises £27 million of levies relating to the 2016/17 FSCS scheme year and £15 million relating to the 2017/18 scheme year.

Customer redress

During the course of its business, the Group receives complaints from customers in relation to past sales or conduct. The Group is also subject to enquiries from and discussions with its regulators, governmental and other public bodies, including the Financial Ombudsman Service (FOS), on a range of matters. Customer redress provisions are recognised where the Group considers it is probable that payments will be made as a result of such complaints and other matters.

The Group holds provisions of £305 million (2016: £227 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 income statement charge for the year mainly reflects updated assumptions for provisions previously recognised. This includes a £128 million charge in relation to PPI, largely in response to the announcements made by the Financial Conduct Authority (FCA) during the year and specifically the policy statement PS17/03 issued in March 2017. In this policy statement the FCA confirmed an industry-funded communications campaign, combined with a deadline for any further complaints. It also proposed new rules and guidance in light of the Supreme Court's decision in the case of Plevin v Paragon Personal Finance Limited ('Plevin'), part of which was a requirement to proactively mail previously refuted mis-sale complainants who will now be eligible to claim under Plevin.

In light of these latest developments, it is considered appropriate for the Group to provide for the estimated total amount required to deal with all ongoing and future PPI complaints. The amount provided at 4 April 2017 therefore reflects the compensation and administrative costs associated with cases that the Group expects to uphold and the cost of processing invalid claims which the Group expects to receive. This estimate will be re-assessed on an ongoing basis in the light of actual claims levels observed.

Notes to the accounts *continued*

30. Provisions for liabilities and charges *continued*

Other provisions

Other provisions include provisions for severance costs and a number of property related provisions. Provisions are made for the expected severance costs in relation to the Group's restructuring activities where there is a present obligation and it is probable that the expenditure will be made.

Critical accounting estimates and judgements

Customer redress provisions

Judgement is involved in determining whether a present obligation exists for customer redress, and in estimating the probability, timing and amount of any associated outflows.

The amount of the provision related to past sales of PPI is calculated based upon management's best estimate of complaint volumes incorporating the expected impact of the 2017 FCA policy statement, referral rates to the Financial Ombudsman Service (FOS), uphold rates internally and with the FOS, response rates from customer contact activity relating to previous sales, average redress payments and complaint handling costs.

At 4 April 2017, the Group held a PPI provision of £212 million (2016: £117 million). This represents management's best estimate of future costs including the expected impact of Plevin v Paragon Personal Finance Limited. The principal uncertainty in this calculation is the impact of the proposed FCA media campaign on complaints volumes.

The table below shows the sensitivity of the PPI provision to changes in complaints volumes, along with other significant assumptions used in calculating the provision.

	Cumulative to 31 March 2017	Future expected	Sensitivity
Claims ('000s of policies) (note i)	317	153	10 = £10m
Average uphold rate (note ii)	32%	52%	5% = £11m
Average redress per claim (note iii)	£1,329	£736	£100 = £15m

Notes:

i. Claims include responses to proactive mailing.

ii. Future expected average uphold rate includes an anticipated increase in uphold rate for Plevin related complaints.

iii. Future expected average redress includes redress for future claims upheld for Plevin.

31. Capital and leasing commitments

Capital expenditure contracted for but not accrued is as follows:

Capital commitments at 4 April	Group and Society	
	2017 £m	2016 £m
Capital expenditure relating to:		
Intangibles	71	100
Property, plant and equipment	16	24
Total	87	124

Notes to the accounts *continued*

31. Capital and leasing commitments *continued*

The Group leases various offices, branches and other premises under non-cancellable operating lease arrangements. The leases have various terms, rent escalation clauses, renewal rights, and in some cases contingent rent payable. Future minimum payments under operating leases relating to land and buildings were as follows:

Leasing commitments at 4 April	Group and Society	
	2017	2016 (note i)
	£m	£m
Amounts falling due:		
Within one year	**32**	31
Between one and five years	**96**	94
After five years	**133**	143
Total	**261**	268

Note:

i. The prior year values for future minimum lease payments under non-cancellable leases have been restated to take into account contractual break clauses, to be consistent with the current year presentation.

At the balance sheet date, future minimum lease payments receivable under non-cancellable operating leases were as follows:

Leasing payments receivable as lessor at 4 April	Group and Society	
	2017	2016 (note i)
	£m	£m
Amounts falling due:		
Within one year	**4**	4
Between one and five years	**7**	7
After five years	**3**	3
Total	**14**	14
At the balance sheet date, future minimum sublease payments receivable under non-cancellable subleases	**4**	5

Note:

i. The prior year values for future minimum lease and sublease payments receivable under non-cancellable leases have been restated to take into account contractual break clauses, to be consistent with the current year presentation.

32. Contingent liabilities

During the ordinary course of business, the Group receives complaints, is subject to threatened or actual legal proceedings, and manages regulatory enquiries, reviews, challenges and investigations. It also receives and reviews allegations of wrongdoing raised by employees and others and provides support and assistance, when it is appropriate to do so, to relevant Law Enforcement Agencies in connection with investigations they may undertake. All such material matters are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of incurring a liability. Where it is concluded that it is more likely than not that a payment will be made a provision is recognised based on management's best estimate of the amount that will be payable. For other matters no provision is recognised but disclosure is made of items which are potentially material, either individually or in aggregate, except in cases where the likelihood of a liability crystallising is considered to be remote. Currently the Group does not expect the ultimate resolution of any such matters to have a material adverse impact on its financial position.

Notes to the accounts *continued*

33. Retirement benefit obligations

Retirement benefit obligations on the balance sheet	Group	
	2017	2016
	£m	£m
Present value of funded obligations	**6,039**	4,645
Present value of unfunded obligations	**12**	12
	6,051	4,657
Fair value of fund assets	**(5,628)**	(4,444)
Deficit at 4 April	**423**	213

Defined contribution pension schemes

The Group operates two defined contribution pension schemes in the UK – the Nationwide Group Personal Pension Plan (GPP) and the Nationwide Temporary Workers Pension Scheme. New employees are automatically enrolled into one of these schemes, with both schemes being administered by Friends Life.

Outside of the UK, there are defined contribution pension schemes for employees in the Isle of Man and Ireland.

Defined benefit pension schemes

The Group has funding obligations to several defined benefit pension schemes, which are administered by boards of trustees. Trustees are required by law to act in the interests of all relevant beneficiaries and are responsible for the investment policy with regard to the assets of the pension schemes as well as the day to day administration.

The Group's most significant pension scheme is the Nationwide Pension Fund (the Fund). This is a contributory defined benefit pension arrangement, with both final salary and career average revalued earnings (CARE) sections. The Fund was closed to new entrants in 2007 and since that date employees have been able to join the GPP.

Eligible employees in the Fund are entitled to annual pensions after normal retirement at age 65 of one sixtieth of career average revalued earnings (revalued to retirement) for each year of service after 1 April 2011. Benefits accrued prior to 1 April 2011 varied with the majority being one fifty fourth of final salary for each year of service. Benefits are also payable on death and following other events such as leaving employment. No other post-retirement benefits are provided to these employees.

Approximately 31% of the defined benefit obligations are attributable to current employees, 37% to former employees and 32% to current pensioners and dependants. The average duration of the obligation is approximately 22 years reflecting the split of the obligation between current employees (27 years), deferred members (25 years) and current pensioners (15 years).

The Group's retirement benefit obligations include £4 million (2016: £2 million) recognised in a subsidiary company, Nationwide (Isle of Man) Limited. This obligation relates to a defined benefit arrangement providing benefits based on both final salary and CARE which was closed to new entrants in 2009.

The Group's retirement benefit obligations also include £12 million (2016: £12 million) in respect of unfunded legacy defined benefit arrangements.

The amounts recognised in the income statements are as follows:

Retirement benefit obligations recognised in the income statement	Group	
	2017	2016
	£m	£m
Defined benefit current service cost	**60**	64
Defined contribution cost	**73**	50
Past service cost	**4**	3
Curtailment gains	**(4)**	(2)
Administrative expenses	**4**	4
Included in employee costs (note 8)	**137**	119
Interest on net defined benefit liability (note 4)	**5**	7
Total	**142**	126

The Group operates a salary sacrifice arrangement and under this arrangement employees' salaries are reduced by an amount equivalent to their pension contributions. Therefore, employee contributions are reflected within the defined benefit current service cost and defined contribution cost in the table above.

Notes to the accounts *continued*

33. 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	Group	
	2017	2016
	£m	£m
Deficit at 5 April	213	286
Current service cost	**60**	64
Past service cost	**4**	3
Curtailment gains	**(4)**	(2)
Interest on net defined benefit liability	**5**	7
Return on assets (greater)/less than discount rate	**(951)**	122
Contributions by employer	**(206)**	(107)
Administrative expenses	**4**	4
Actuarial losses/(gains) on defined benefit obligations	**1,298**	(164)
Deficit at 4 April	**423**	213

Current service cost represents the increase in liabilities resulting from employee service over the period. Past service cost represents the increase in liabilities of the Fund arising from members of the Fund electing to pay additional contributions to receive additional benefits.

Curtailment gains represent a reduction in the defined benefit liabilities arising from future pensions increasing in line with the Consumer Price Index (CPI), instead of estimated salary increases (for final salary benefits) or the Retail Price Index (for CARE benefits), in respect of members made redundant during the year.

The interest on net defined benefit liability includes the interest expense on the retirement obligation, representing the annual interest accruing on the liabilities over the period. This is partially offset by the interest income on plan assets.

The £951 million relating to the return on assets being greater than the discount rate (2016: £122 million return less than the discount rate) is driven by positive returns from listed equities, partially offset by a reduction in bonds yields over the year. As a result, the value of plan assets increased compared to the prior year, where there was a small increase in bond yields and a small increase in the value of plan assets.

The £206 million of employer contributions includes deficit contributions of £149 million (2016: £49 million), with the remainder relating to employer contributions in respect of future benefit accrual. The Group estimates that its contributions to the defined benefit pension schemes (including deficit contributions under the current deficit recovery plan) during the year ending 4 April 2018 will be £101 million.

The £1,298 million actuarial loss on the liabilities shown above is driven by:

- a £1,441 million loss (2016: £86 million gain) from changes in financial assumptions, including a 1.05% decrease in the discount rate and a 0.30% increase in assumed Retail Price Index inflation, both of which increase the value of the liabilities.
- a £144 million gain (2016: £29 million) due to updating the mortality base tables and updating to the latest industry standard model for projecting future longevity improvements.
- an experience loss on the assumptions of £1 million (2016: £49 million gain) reflecting the differential between the long term assumptions and the actual observed pension increases and deferred revaluations during the year ended 4 April 2017.

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

Movements in the defined benefit obligations	Group	
	2017	2016
	£m	£m
At 5 April	4,657	4,698
Current service cost	**60**	64
Past service cost	**4**	3
Curtailment gains	**(4)**	(2)
Interest expense on retirement obligation	**158**	158
Experience losses/(gains) on plan assumptions	**1**	(49)
Changes in demographic assumptions	**(144)**	(29)
Changes in financial assumptions	**1,441**	(86)
Benefits paid	**(122)**	(100)
At 4 April	**6,051**	4,657

Notes to the accounts *continued*

33. Retirement benefit obligations *continued*

Changes in the fair value of plan assets for the pension schemes are as follows:

Movements in the plan assets	Group	
	2017	2016
	£m	£m
At 5 April	4,444	4,412
Interest income on assets	**153**	151
Return on assets greater/(less) than discount rate	**951**	(122)
Administrative expenses	**(4)**	(4)
Contributions by employer	**206**	107
Benefits paid	**(122)**	(100)
At 4 April	**5,628**	4,444

The Group operates a salary sacrifice arrangement and therefore there are no employee contributions reported in the table above as employee contributions are reflected in the contributions by employer.

In line with UK pensions legislation, a formal actuarial valuation ('triennial valuation') of the assets and liabilities of the Fund is carried out at least every three years by independent actuaries. The latest triennial valuation of the Fund, which has an effective date of 31 March 2016, is currently underway. As part of the process, a new schedule of regular and deficit contributions payable by the Group will be agreed with the trustees of the Fund (the Trustee).

The major categories of assets held for the pension schemes, stated at fair value, are as follows:

Categories of plan assets	Group	
	2017	2016
	£m	£m
Listed equities (quoted)	**812**	1,326
Government bonds (quoted)	**2,444**	1,883
Corporate bonds and other credit investments (quoted)	**949**	470
Infrastructure (unquoted)	**410**	322
Property (unquoted)	**403**	371
Private equity investments (unquoted)	**330**	251
Cash	**365**	137
Liability relating to repurchase agreement	**(207)**	(357)
Other assets and liabilities	**122**	41
Total	**5,628**	4,444

The pension schemes do not invest in the Group's own financial instruments or property.

Assets described as quoted are based on unadjusted prices quoted in an active market and represent Level 1 assets as defined by IFRS 13. All private equity, infrastructure and property investments are Level 3 assets as defined by IFRS 13. These assets have been valued using a combination of industry practice approaches, for example discounted cashflow models.

The Fund's liabilities are partly hedged by matching assets, primarily index linked government bonds and fixed rate government and corporate bonds. In addition, the Fund invests in alternative matching assets such as property ground rents receivable and property leases (included in property above) that are expected to generate inflation linked income over the long term.

The Fund also holds return-seeking assets which are primarily listed equities. These are expected to generate a return over and above the Fund's liabilities in the long term, but may create risk and volatility in the short to medium term. During the year, £712 million of equities were sold and reinvested into credit and liability matching assets to reduce risk and increase investment diversification. Furthermore, the Fund entered into £246 million of long-dated inflation swaps to further reduce its exposure to inflation risk. The investment in these assets is monitored by both the Trustee and the Group to ensure it remains appropriate given the Fund's long term objectives.

The proceeds of sale and repurchase agreements are included in the table above as a liability of £207 million (2016: £357 million). The securities, which have been sold under these sale and repurchase agreements, are included in government bonds, as the Fund has retained substantially all the risks and rewards of ownership of the securities.

Notes to the accounts *continued*

33. Retirement benefit obligations *continued*

The principal actuarial assumptions used are as follows:

Principal actuarial assumptions	2017 %	2016 %
Discount rate	**2.40**	3.45
Future salary increases	**3.20**	2.90
Future pension increases (maximum 5%)	**2.95**	2.75
Retail price index (RPI) inflation	**3.20**	2.90
Consumer price index (CPI) inflation	**2.20**	1.90

The assumptions for mortality rates are based on standard mortality tables which allow for future improvements in life expectancies. The assumptions made are illustrated by the following years of life expectancy at age 60:

Life expectancy assumptions	2017 years	2016 years
Age 60 at 4 April 2017		
Males	**27.4**	28.3
Females	**28.6**	30.0
Age 60 at 4 April 2037		
Males	**28.3**	29.7
Females	**29.9**	31.5

Critical accounting estimates and judgements

Retirement benefit obligations

The key assumptions used to calculate the defined benefit obligation are the discount rate, inflation assumptions (including salary increases) and mortality assumptions. If different assumptions were used, this could have a material effect on the reported obligation. The sensitivity of the results to these assumptions are as follows:

Change in key assumptions at 4 April 2017	(Decrease)/increase in deficit from assumption change £m
0.1% increase in discount rate	(137)
0.1% increase in inflation assumption	121
1 year increase in life expectancy at age 60 in respect of all members	218

The above sensitivities apply to changing individual assumptions in isolation; in practice assumptions are likely to be related, especially between the discount rate and inflation. Furthermore, a change in market yields could impact asset values (in particular bonds) in the opposite direction to the obligations. The sensitivity to the inflation assumption includes a corresponding 0.1% increase in assumptions for future salary and pension increases.

Notes to the accounts *continued*

34. Core capital deferred shares (CCDS)

Group and Society	Number of shares	CCDS	Share premium	Total
		£m	£m	£m
At 4 April 2017	**5,500,000**	**6**	**525**	**531**
At 4 April 2016	5,500,000	6	525	531

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 £100 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 £15.67 per share and is adjusted annually in line with CPI.

A final distribution of £28 million (£5.125 per share) for the financial year ended 4 April 2016 was paid on 20 June 2016 and an interim distribution of £28 million (£5.125 per share) in respect of the period to 30 September 2016 was paid on 20 December 2016. These distributions have been recognised in the statement of movements in members' interests and equity.

The directors have declared an unconditional final distribution of £5.125 per share in respect of the financial year ended 4 April 2017, amounting in aggregate to £28 million. The distribution will be recognised in the statement of movements in members' interests and equity in the financial year ending 4 April 2018.

35. Other equity instruments

Group and Society	Total
	£m
At 4 April 2017	**992**
At 4 April 2016	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 2016, was paid on 20 June 2016 and a coupon of £34 million, covering the period to 19 December 2016, was paid on 20 December 2016. These payments have been recognised in the statement of movements in members' interests and equity.

A coupon payment of £34 million, covering the period to 19 June 2017, is expected to be paid on 20 June 2017 and will be recognised in the statement of movements in members' interests and equity in the financial year ending 4 April 2018.

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.

Notes to the accounts *continued*

36. Investments in Group undertakings

The Society's investments in Group undertakings are as follows:

2017	**Shares**	**Loans**	**Total**
	£m	**£m**	**£m**
At 5 April 2016	313	31,089	31,402
Additions	**-**	**1,280**	**1,280**
Release of impairment	**-**	**18**	**18**
Redemptions and repayments	**-**	**(943)**	**(943)**
At 4 April 2017	**313**	**31,444**	**31,757**

2016	Shares	Loans	Total
	£m	£m	£m
At 5 April 2015	313	27,419	27,732
Additions	-	4,391	4,391
Release of impairment	-	16	16
Redemptions and repayments	-	(737)	(737)
At 4 April 2016	313	31,089	31,402

The Society received no dividends from Group undertakings during the year ended 4 April 2017 (2016: £10 million).

The impairment release of £18 million (2016: £16 million) relates to a Group undertaking that holds a corporate loan portfolio. Loans to Group undertakings of £31,444 million at 4 April 2017 are reported net of a £3 million provision in relation to this Group undertaking.

Significant subsidiaries

Audited accounts are prepared for all of the Group's principal subsidiaries. The interests of the Society in its principal subsidiary undertakings as at 4 April 2017 are set out below:

Subsidiary name	**Ownership interest 2017 and 2016**
Derbyshire Home Loans Limited	**100%**
E-MEX Home Funding Limited	**100%**
Nationwide Syndications Limited	**100%**
The Mortgage Works (UK) plc	**100%**
UCB Home Loans Corporation Limited	**100%**

The above subsidiary undertakings, with the exception of Nationwide Syndications Limited, are regulated entities.

Other subsidiaries

The Group has adopted the audit exemption for the following subsidiary undertakings for the year ended 4 April 2017 under Section 479A of the Companies Act 2006:

Subsidiary name	**Ownership interest 2017 and 2016**
Dunfermline BS Nominees Limited	**100%**
First Nationwide	**100%**
Jubilee Mortgages Limited	**100%**
Monument (Sutton) Limited	**100%**
The Derbyshire (Premises) Limited	**100%**

In order to fulfil the requirements of these regulations the Society guarantees all outstanding liabilities of the exempted subsidiary undertakings.

Notes to the accounts *continued*

36. Investments in Group undertakings *continued*

The interests of the Society in its other subsidiary undertakings, as at 4 April 2017, are set out below:

Subsidiary name	Ownership interest 2017 and 2016
Ashton Employment Limited	100%
at.home nationwide Limited	100%
Confederation Mortgage Services Limited	100%
Ethos Independent Financial Services Limited	100%
Exeter Trust Limited	100%
LBS Mortgages Limited	100%
Moulton Finance Overseas B.V.	100%
Nationwide Anglia Property Services Limited	100%
Nationwide Financial Service Limited	100%
Nationwide Home Loans Limited	100%
Nationwide Housing Trust Limited	100%
Nationwide International Limited	100%
Nationwide Investments (No.1) Limited	100%
Nationwide (Isle of Man) Limited	100%
Nationwide Lease Finance Limited	100%
Nationwide Mortgage Corporation Limited	100%
Nationwide Overseas (UK) Limited	100%
Nationwide Property Services (NBS) Limited	100%
Nationwide Trust Limited	100%
NBS Fleet Services Limited	100%
Staffordshire Leasing Limited	100%

The subsidiary undertakings in the table above, with the exceptions of Ashton Employment Limited, Moulton Finance Overseas B.V. and Nationwide (Isle of Man) Limited, were dormant companies during the year ended 4 April 2017.

All of the subsidiary undertakings are limited liability companies, with the exception of First Nationwide which is an unlimited company.

The registered office for all subsidiary undertakings, other than those listed in the table below, is Nationwide House, Pipers Way, Swindon, SN38 1NW.

Subsidiary name	Registered office
Ashton Employment Limited	39/40 Upper Mount Street, Dublin 2, 662881
Dunfermline BS Nominees Limited	Caledonia House, Carnegie Avenue, Dunfermline, KY11 8PJ
Nationwide (Isle of Man) Limited	5-11 St. Georges Street, Douglas, Isle of Man, IM99 1RN

There are no significant restrictions on any of the Society's subsidiaries in paying dividends or repaying loans, subject to their financial and operating performance and availability of distributable reserves.

The Group has no material shares in associates. See note 15 for further details regarding the Group's interests in equity shares.

Subsidiaries by virtue of control

Details of consolidated and unconsolidated structured entities are provided in note 37.

Notes to the accounts *continued*

37. Structured entities

A structured entity is an entity in which voting or similar rights are not the dominant factor in deciding control. Structured entities are consolidated when the substance of the relationship indicates control.

Consolidated structured entities

Structured entities are assessed for consolidation in accordance with the accounting policy set out in note 1. The following structured entities are consolidated in the Group's results:

Structured entity name	Nature of business	Registered office
Cromarty CLO Limited	Investment in a portfolio of European loans	6th Floor, Pinnacle 2, Eastpoint Business Park, Clontarf, Dublin 3, 662882
Nationwide Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds	Nationwide House, Pipers Way, Swindon, SN38 1NW
Silverstone Master Issuer plc Silverstone Funding (No.1) Limited	Funding vehicle Funding vehicle	Wilmington Trust SP Services (London) Limited, Third Floor, 1 King's Arms Yard, London, EC2R 7AF

Further details on the activities of Nationwide Covered Bonds LLP, Silverstone Master Issuer plc and Silverstone Funding (No.1) Limited are given in note 16. As at 4 April 2017 the total assets of Cromarty CLO Limited were £4 million (2016: £14 million). The Group has no contractual arrangements that would require it to provide financial or other support to Cromarty CLO Limited, nor does the Group have current intentions to provide such support to the entity.

Unconsolidated structured entities

The Group has interests in structured entities which it does not sponsor or control. These largely consist of holdings of mortgage backed securities, covered bonds and CLOs issued by entities that are sponsored by other unrelated financial institutions. The entities are financed primarily by investments from investors, such as the purchase of issued notes.

The Group's direct interests in unconsolidated structured entities comprise primarily investments in asset backed securities which are reported within available for sale investment securities on the balance sheet. The total carrying value of these interests at 4 April 2017 is £2,845 million (2016: £3,764 million). Further details on the lending risk that the Group is exposed to in respect of these asset backed securities can be found in the 'Treasury assets' section of the Business and Risk Report.

Management has concluded that the Group has no control or significant influence over these entities and that the carrying value of the interests held in these entities represents the maximum exposure to loss. During the year the Group has not provided any non-contractual financial or other support to these entities and has no current intention of providing any such support. There were no transfers to or from these unconsolidated structured entities during the year.

38. Related party transactions

Subsidiary, parent and ultimate controlling party

The Group is controlled by Nationwide Building Society, the ultimate parent, which is registered in England and Wales. Details of subsidiary undertakings are shown in note 36.

Key management compensation

The directors of the Society are considered to be the key management personnel as defined by IAS 24 'Related Party Disclosures'.

Total compensation for key management personnel for the year was as follows:

Key management personnel compensation	2017 £'000	2016 £'000
Short term employee benefits	5,046	4,970
Other long term benefits	1,012	3,263
Share based payments	1,311	1,273
Contractual/other settlements	-	1,278
Total key management personnel compensation for the year	7,369	10,784

Other long term benefits include amounts relating to long term bonus schemes, some of which will be paid in future periods. Further information on these can be found in note 8. Share based payments include amounts that are dependent on the performance of the CCDS. Contractual/other settlements include compensation for loss of office. Further information is included in the Report of the directors on remuneration.

Notes to the accounts *continued*

38. Related party transactions *continued*

Transactions with related parties

A number of transactions are entered into with related parties in the normal course of business. These include derivatives, loans, deposits and the payment and recharge of administrative expenses. Further details of derivative balances outstanding between the Society and its subsidiaries are included in note 17. The outstanding balances for other related party transactions at the year end, and the associated income and expenses for the year are as follows:

Transactions with related parties	Society subsidiaries		Key management personnel	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Loans payable to the Society				
Loans outstanding at 5 April	31,089	27,419	1.4	0.9
Loans issued during the year	**1,280**	4,391	**0.2**	1.2
Loan impairment release	**18**	16	**-**	-
Loan repayments during the year	**(943)**	(737)	**(0.5)**	(0.7)
Loans outstanding at 4 April	**31,444**	31,089	**1.1**	1.4
Deposits payable by the Society				
Deposits outstanding at 5 April	1,162	948	6.3	5.9
Deposits issued during the year	**409**	228	**4.6**	9.1
Deposit repayments during the year	**(2)**	(14)	**(8.7)**	(8.7)
Deposits outstanding at 4 April	**1,569**	1,162	**2.2**	6.3
Net interest income				
Interest receivable	**901**	855	**-**	-
Interest expense	**74**	98	**-**	0.1
Other income and expenses				
Dividends payable to the Society	**-**	10	**-**	-
Fees and expenses paid to the Society	**22**	15	**-**	-
Other balance sheet items				
Accrued income and expenses prepaid due to the Society	**1,122**	258	**-**	-
Other liabilities payable by the Society	**2,805**	4,367	**-**	-

Transactions with key management personnel

Transactions with key management personnel are on the same terms and conditions applicable to other employees within the Group.

A register is maintained by the Society containing details of loans, transactions and arrangements made between the Society or its subsidiary undertakings and directors of the Society or persons connected with directors of the Society.

The register will be available for inspection by members at the Annual General Meeting on 20 July 2017 and during normal office hours at the Society's principal office (Nationwide House, Pipers Way, Swindon) during the period of 15 days prior to the meeting.

Transactions with Group companies

Transactions with Group companies arise in the normal course of business. Interest on outstanding loans and deposits accrues at a transfer price rate agreed between the Society and its subsidiary undertakings.

The Society does not charge the net defined benefit cost to the subsidiary undertakings that participate in the Nationwide Pension Fund. The pension cost to these subsidiary undertakings equals the contributions payable to the Fund.

Notes to the accounts *continued*

39. Notes to the cash flow statements

	Group		Society	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Non-cash items included in profit before tax				
Net decrease in impairment provisions	**(5)**	(209)	**(37)**	(198)
Net increase in provisions for liabilities and charges	**44**	48	**46**	48
Impairment losses/(recoveries) on investment securities	**9**	(8)	**9**	(8)
Depreciation, amortisation and impairment	**396**	325	**396**	325
Profit on sale of property, plant and equipment	**(4)**	(5)	**(4)**	(5)
Loss on the revaluation of land and buildings	**1**	3	**1**	3
Interest on subordinated liabilities	**128**	99	**128**	99
Interest on subscribed capital	**34**	26	**34**	26
Gains from derivatives and hedge accounting	**(66)**	(39)	**(69)**	(129)
Total	**537**	240	**504**	161
Changes in operating assets and liabilities				
Loans and advances to banks	**(36)**	142	**(36)**	142
Net derivative financial instruments and fair value adjustment for portfolio hedged risk	**(1,602)**	(971)	**(595)**	(10)
Loans and advances to customers	**(8,559)**	(7,951)	**(7,574)**	(4,197)
Other operating assets	**(1,023)**	(420)	**(2,238)**	(4,348)
Shares	**5,827**	6,342	**5,827**	6,342
Deposits from banks, customers and others	**1,638**	(1,238)	**1,596**	(938)
Debt securities in issue	**2,509**	1,613	**2,196**	1,777
Deferred taxation	**(154)**	136	**(88)**	31
Retirement benefit obligations	**210**	(73)	**208**	(72)
Other operating liabilities	**(137)**	7	**(1,673)**	(1,025)
Total	**(1,327)**	(2,413)	**(2,377)**	(2,298)
Cash and cash equivalents				
Cash	**13,017**	8,797	**13,017**	8,797
Loans and advances to banks repayable in 3 months or less (note i)	**2,226**	3,266	**2,206**	3,217
Total	**15,243**	12,063	**15,223**	12,014

Note:

i. Cash equivalents include £1,959 million (2016: £2,620 million) of cash collateral posted with bank counterparties.

The Group is required to maintain balances with the Bank of England and certain other central banks which, at 4 April 2017, amounted to £361 million (2016: £325 million). These balances are included within loans and advances to banks on the balance sheet and are not included in the cash and cash equivalents in the cash flow statement as they are not liquid in nature.

Notes to the accounts *continued*

40. Capital management

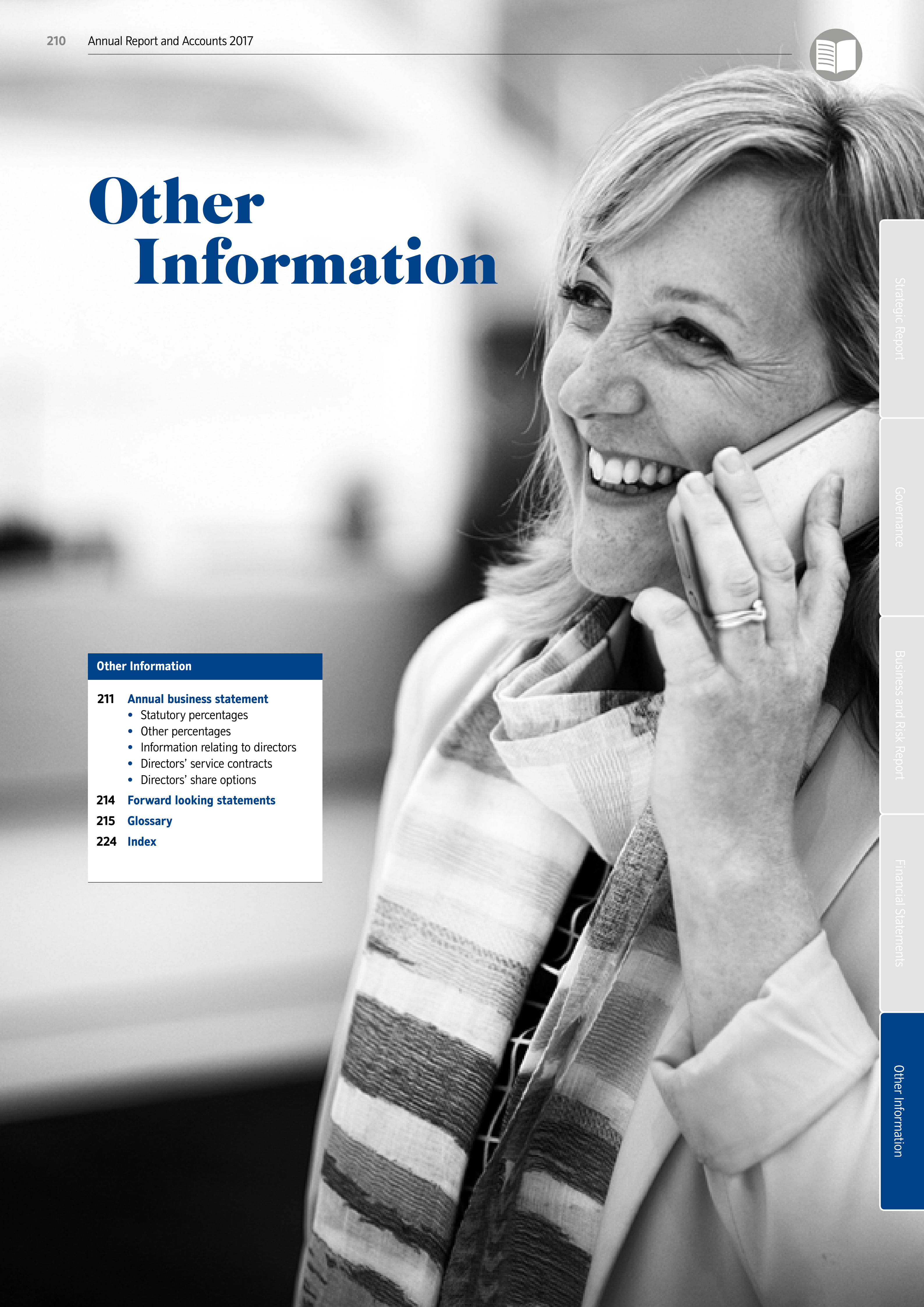
The Group is subject to the regulatory capital requirements applied by its regulator the Prudential Regulation Authority (PRA). Regulatory capital comprises the Group's general reserve, revaluation reserve, core capital deferred shares, other equity instruments, permanent interest bearing shares (PIBS) and subordinated debt, subject to various adjustments and transitional arrangements required by the capital rules.

During the year the Group complied with the capital requirements applied by the PRA. Further unaudited details about the Group's capital position can be found in the 'Solvency risk' section of the Business and Risk Report.

41. Registered office

Nationwide is a building society, incorporated and domiciled in the United Kingdom. The address of its registered office is:

Nationwide Building Society
Nationwide House
Pipers Way, Swindon
SN38 1NW



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Other Information

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Annual business statement For the year ended 4 April 2017

1. Statutory percentages

Statutory percentages	2017	Statutory limit
	%	%
Lending limit	7.92	25.00
Funding limit	28.26	50.00

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986 as amended by the Building Societies Act 1997 and the Modification of the Lending Limit and Funding Limit Calculations Order 2004.

The lending limit measures the proportion of business assets not in the form of loans fully secured on residential property and is calculated as (X-Y)/X where:

X = business assets, being the total assets of the Group plus impairment provisions on loans and advances to customers less liquid assets, property, plant and equipment, intangible fixed assets and investment properties as shown in the Group balance sheet.

Y = the principal of, and interest accrued on, loans owed to the Group which are fully secured on residential property.

The funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals and is calculated as (X-Y)/X where:

X = shares and borrowings, being the aggregate of:

i) the principal value of, and interest accrued on, shares in the Society,

ii) the principal of, and interest accrued on, sums deposited with the Society or any subsidiary undertaking of the Society excluding offshore deposits in an EEA subsidiary, and

iii) the principal value of, and interest accrued under, bills of exchange, instruments or agreements creating or acknowledging indebtedness and accepted, made, issued or entered into by the Society or any such undertaking, less any amounts qualifying as own funds.

Y = the principal value of, and interest accrued on, shares in the Society held by individuals otherwise than as bare trustees (or, in Scotland, simple trustees) for bodies corporate or for persons who include bodies corporate.

The statutory limits are as laid down under the Building Societies Act 1986 as amended by the Building Societies Act 1997 and ensure that the principal purpose of a building society is that of making loans which are secured on residential property and are funded substantially by its members.

2. Other percentages

Other percentages	2017	2016
	%	%
As a percentage of shares and borrowings:		
• Gross capital	7.1	6.9
• Free capital	6.2	6.0
• Liquid assets	12.5	12.1
Profit for the financial year as a percentage of mean total assets	0.35	0.49
Management expenses as a percentage of mean total assets	0.94	0.91

The above percentages have been prepared from the Society's consolidated accounts and in particular:

- 'Shares and borrowings' represent the total of shares, deposits from banks, other deposits, amounts due to customers and debt securities in issue
- 'Gross capital' represents the aggregate of general reserve, revaluation reserve, available for sale reserve, cash flow hedge reserve, CCDS, Additional Tier 1 capital, subscribed capital and subordinated liabilities
- 'Free capital' represents the aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment and intangible assets
- 'Liquid assets' represent the total of cash, loans and advances to banks and available for sale investment securities
- 'Mean total assets' represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year
- 'Management expenses' represent administrative expenses including depreciation, amortisation and impairment of property, plant and equipment and intangible assets.

Annual business statement *continued*

3. Information relating to directors at 4 April 2017

Information relating to directors at 4 April 2017			
Name and date of birth	**Occupation**	**Date of appointment**	**Other directorships**
D L Roberts BSc (Hons), MBA, PhD (Honorary), CFifs Chairman 12 September 1962	Non Executive Director	1 September 2014	Campion Willcocks Limited Dr Challoner's Grammar School (Governor) NHS England
J D Garner MA (Cantab) 23 June 1969	Chief Executive Officer	5 April 2016	British Triathlon Foundation Trust
T P Prestedge 12 February 1970	Chief Relationships and Distribution Officer	28 August 2007	Nationwide Anglia Property Services Limited Dunfermline BS Nominees Limited Monument (Sutton) Limited The Derbyshire (Premises) Limited The Nationwide Foundation
M M Rennison BA, FCA 9 August 1960	Chief Financial Officer	1 February 2007	Confederation Mortgage Services Limited Exeter Trust Limited First Nationwide LBS Mortgages Limited Nationwide Anglia Property Services Limited Nationwide Housing Trust Limited Nationwide Investments (No.1) Limited Nationwide Lease Finance Limited Nationwide Mortgage Corporation Limited Nationwide Syndications Limited NBS Fleet Services Limited Staffordshire Leasing Limited Arkose Funding Limited
C S Rhodes BSc (Hons), ACA 17 March 1963	Chief Products and Propositions Officer	20 April 2009	at.home nationwide limited Derbyshire Home Loans Limited E-Mex Home Funding Limited Jubilee Mortgages Limited The Mortgage Works (UK) plc UCB Home Loans Corporation Limited National Numeracy (Trustee) The Lending Standards Board Limited
R A Clifton CBE, MA (Cantab), FRSA 30 January 1958	Non Executive Director	1 July 2012	Populus Limited Populus Group Limited Henley Festival Limited The Conservation Volunteers BrandCap Limited Rita Clifton Limited ASOS plc Ascential plc
R M Fyfield MA, BA (Hons) 3 May 1969	Non Executive Director	2 June 2015	
M A Lenson MBA, BA (Hons), ACIB, FSI 17 September 1954	Company Director	18 July 2011	Eclipse Film Partners No.39 LLP (Designated Member) The Invicta Film Partnership No.37 LLP (Designated Member) The Currency Cloud Group Limited

Annual business statement *continued*

3. Information relating to directors at 4 April 2017 *continued*

Information relating to directors at 4 April 2017

Name and date of birth	Occupation	Date of appointment	Other directorships
K A H Parry MA (Cantab), FCA 29 January 1962	Company Director	23 May 2016	Daily Mail and General Trust plc Intermediate Capital Group plc KAH Parry Limited Royal National Children's Foundation Standard Life plc
L M Peacock BA (Hons) 26 December 1953	Company Director	18 July 2011	AXA Portfolio Services Limited Hawkins Residents Limited Scottish Water Scottish Water Business Stream Holdings Limited Scottish Water Horizons Holdings Limited Standard Life plc Standard Life Assurance Limited Standard Life Savings Limited The Westminster Society for People with Learning Disabilities
Baroness U K Prashar CBE PC 29 June 1948	Member of House of Lords	18 January 2017	Philharmonia Trust Limited British Council (Trustee) UK Community Foundations (Honorary President)
T J W Tookey BSc (Hons), FCA 17 July 1962	Non Executive Director	2 June 2015	Alliance Trust Savings Limited (resigned 30 April 2017) Old Mutual Wealth Management Limited Westmoreland Court Management (Beckenham) Limited

Documents may be served on any of the Directors c/o Addleshaw Goddard, One St Peter's Square, Manchester M2 3DE.

Directors' service contracts

Executive directors' terms and conditions of employment are detailed in their individual contracts which include a notice period of 12 months from the Society to the individual and a notice period of six months from the individual to the Society. The notice period offered to any new recruit would be in line with this approach.

Directors' share options

A proportion of executive directors' variable pay is linked to the value of the Society's core capital deferred shares (CCDS), details of which have been provided in the Report of the directors on remuneration. For 2016/17, the Directors' Performance Award (DPA) was the only variable pay plan in which directors participated. 40% of awards under the DPA will be paid upfront in June 2017 and the remaining 60% is deferred, payable in five equal amounts between years three and seven following the date of the award. 50% of the upfront portion (i.e. 20% overall) and 60% of the deferred portion (i.e. 36% overall) is linked to the value of the Society's CCDS. These elements, totalling 56% of the overall award under the DPA, are also subject to a six month retention period and so will be paid in the following December. For 2015/16, 50% of outstanding awards under the 2015/16 DPA and the legacy 2013-16 Medium Term Performance Pay Plan are also linked to the value of the Society's CCDS.

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, 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 including, amongst other things, UK domestic and global economic and business conditions, market related risks such as fluctuation in interest rates and exchange rates, inflation/deflation, the impact of competition, changes in customer preferences, risks concerning borrower credit quality, delays in implementing proposals, the timing, impact and other uncertainties of future acquisitions or other combinations within relevant industries, the policies and actions of regulatory authorities, the impact of tax or other legislation and other regulations in the jurisdictions in which Nationwide operates. As a result, Nationwide's actual future financial condition, business performance and results may differ materially from the plans, goals and expectations expressed or implied in these forward looking statements. Due to such risks and uncertainties Nationwide cautions readers not to place undue reliance on such forward looking statements.

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

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

Glossary

Additional Tier 1 (AT1) capital	Capital that meets certain criteria set out in Capital Requirements Directive IV (CRD IV). In particular, the criteria require that upon the occurrence of a trigger event, the AT1 capital instrument converts to Common Equity Tier 1 capital or the principal is written down on a permanent or temporary basis.
Additional Tier 1 (AT1) securities	Securities that pay a fixed annual coupon at the discretion of the Society. In the event of insolvency, AT1 securities rank the same as permanent interest bearing shares (PIBS) but behind the claims of all subordinated debt holders, creditors and investing members of the Society, but ahead of core capital deferred shares (CCDS) investors. These securities are eligible as Tier 1 capital.
Arrears	Amounts that are unpaid at their contractual date. A customer is in arrears when they are behind in fulfilling their obligations such that an outstanding loan payment is overdue. Such a customer can also be said to be in a state of delinquency. When a customer is in arrears, the entire outstanding balance is said to be delinquent, meaning that delinquent balances are the total outstanding loans on which payments are overdue.
Asset backed securities (ABS)	Securities that represent an interest in an underlying pool of referenced assets. The referenced pool can comprise any assets which attract a set of associated cash flows, including credit card assets, but are commonly pools of residential or commercial mortgages. Investors in these securities have the right to cash received from future payments (interest and/or principal) on the underlying asset pool.
Available for sale (AFS)	Financial assets that are not classified as loans and receivables, held to maturity investments or financial assets at fair value through the income statement.
Bank levy	A levy that applies to certain UK financial institutions (including Nationwide) and the UK operations of foreign banks since 1 January 2011. The levy is based on a percentage of the chargeable equity and liabilities of the institution at the balance sheet date.
Banking book	The banking book contains all assets and liabilities held as part of Nationwide's core banking activities. These assets and liabilities are held with no intention to trade.
Base mortgage rate (BMR)	The Society's standard variable rate, which is guaranteed to be no more than 2% above the Bank of England base rate. This is the revert rate for existing customers at the end of a deal reserved on or before 29 April 2009, at which point the Standard Mortgage Rate (SMR) was introduced.
Basel II	The Basel Committee on Banking Supervision's statement of best practice that defines the methods by which firms should calculate their regulatory capital requirements to retain sufficient capital to protect the financial system against unexpected losses. Basel II is comprised of three pillars.
Basel III	The Basel Committee rules text, issued in December 2010, which presents the details of strengthened global regulatory standards on bank capital adequacy and liquidity. This has been implemented via the Capital Requirements Directive IV (CRD IV) legislation.
Basis point (bp)	One hundredth of a percent (0.01 percent). 100 basis points is one percent. Used, for example, in quoting movements in interest rates.
Buy to let mortgages	Mortgages offered to customers purchasing residential property as a rental investment.
Capital ratios	Key financial ratios measuring the Group's capital adequacy or financial strength. These include the Common Equity Tier 1 ratio, Tier 1 ratio, total capital ratio, CRR leverage ratio and UK leverage ratio.
Capital requirements	The amount of capital that the Group is required to hold based upon the risks to which the business is exposed.
Capital Requirements Directive (CRD)	The supervisory framework in the European Union which reflects the Basel II and Basel III rules on capital measurement and capital standards.
Capital Requirements Directive IV (CRD IV)	European legislation to implement Basel III in the European Union, which includes the Capital Requirements Regulation (CRR) and Capital Requirements Directive (CRD).
Capital Requirements Regulation (CRR)	European regulation that is directly applicable to European Union member states, defining prudential requirements for capital, liquidity and credit risk for credit institutions and investment firms.
Capital Requirements Regulation (CRR) leverage ratio	A ratio defined by the Capital Requirements Regulation (CRR) which measures Tier 1 capital as a proportion of total CRR leverage ratio exposures.

Glossary *continued*

Capital Requirements Regulation (CRR) leverage ratio exposure	The denominator used in the Capital Requirements Regulation (CRR) leverage ratio. Exposure is measured as the sum of on-balance sheet exposures, adjusted for derivative and securities financing transaction exposures, and off-balance sheet items.
Capital resources	Capital held, allowable under regulatory rules, less certain regulatory adjustments and deductions that are required to be made.
Career average revalued earnings (CARE)	A defined benefit pension arrangement where the pension accrued is based on pensionable pay across an employee's career. The pension earned each year is based on pensionable pay in that year and is increased by a set revaluation rate, linked to inflation, for each year up to retirement (or, if earlier, the date the employee leaves the scheme).
Certificates of deposit	Bearer-negotiable instruments acknowledging the receipt of a fixed term deposit at a specified interest rate.
Charge off	The point at which the customer relationship is transferred to being one of recovery only, due to significant levels of arrears or through placement with a debt collection agency or litigation.
Collateral	Security pledged for repayment of a loan.
Collateralised debt obligations (CDO)	A securitisation of debt securities. CDOs can include a mix of corporate, bank and ABS/RMBS securities (see separate definition of 'Securitisation').
Collateralised loan obligations (CLO)	A securitisation of loans and bonds issued by sub-investment grade rated companies (see separate definition of 'Securitisation').
Collectively assessed impairments	Where a portfolio comprises assets with similar characteristics, collective impairment assessment takes place using appropriate statistical techniques. The collective assessment takes account of losses that will have taken place but are not yet identified.
Commercial lending	Loans secured on commercial property, loans to registered social landlords and loans relating to project finance.
Commercial mortgage backed securities (CMBS)	A securitisation of commercial real estate loans (see separate definition of 'Securitisation').
Commercial paper (CP)	An unsecured promissory note issued to finance short term credit needs, which specifies the face amount paid to investors on the maturity date.
Commercial real estate (CRE)	Includes office buildings, industrial property, medical centres, hotels, retail stores, shopping centres, multifamily housing buildings, warehouses, garages and industrial properties.
Common Equity Tier 1 capital	The highest quality form of capital as defined in Capital Requirements Directive IV (CRD IV), comprising accumulated reserves and qualifying instruments after regulatory deductions.
Common Equity Tier 1 (CET1) ratio	Common Equity Tier 1 capital expressed as a percentage of risk weighted assets.
Conduct and compliance risk	The risk that the Group exercises inappropriate judgement or makes errors in the execution of its business activities, leading to non-compliance with regulation or legislation, market integrity being undermined, or an unfair outcome being created for customers.
Consumer banking	Comprises credit card, unsecured personal lending and the Group's FlexAccount (current account) products.
Contractual maturity	The final payment date of a loan or other financial instrument, at which point the entire remaining outstanding principal and interest is due to be repaid.
Core capital deferred shares (CCDS)	A form of Common Equity Tier 1 (CET1) capital which has been developed to enable the Society to raise capital from the capital markets. Holders of CCDS receive periodic distributions from the Society. Distributions are discretionary and capped in any financial year. In the event of insolvency, CCDS holders rank behind the claims of all other depositors, creditors and investing members of the Society.
Cost income ratio (CIR)	A ratio that represents the proportion of administrative expenses to total income.
Covered bonds	Debt securities backed by a portfolio of mortgages that are segregated from the issuer's other assets to be solely for the benefit of the holders of the covered bonds. The Group issues covered bonds as part of its funding activities.

Glossary *continued*

Credit risk	The risk that a borrower or counterparty fails to pay the interest or to repay the principal on a loan or other financial instrument (such as a bond) on time.
Credit spread	The premium over the benchmark or risk-free rate required by the market to accept a lower credit quality.
Credit valuation adjustment (CVA)	The difference between the risk-free value of a portfolio of trades and the market value which takes into account the counterparty's risk of default. The CVA therefore represents an estimate of the change to fair value that a market participant would make to incorporate inherent credit risk.
Cross currency interest rate swap	An arrangement in which two parties exchange specific principal amounts of different currencies at inception and subsequent interest payments on the principal amounts. Often one party will pay a fixed rate of interest, while the other will pay a floating rate (though there are also fixed-fixed and floating-floating arrangements). At the maturity of the swap, the principal amounts are usually re-exchanged.
Customer deposits	Money deposited by personal account holders. Such funds are recorded as liabilities in the balance sheet within shares or amounts due to customers.
Customer redress	Compensation for loss as a result of past sales or other consequence (including technical breaches) of financial products.
Debit valuation adjustment (DVA)	The difference between the risk-free value of a portfolio of trades and the market value which takes into account the Group's risk of default. The DVA therefore represents an estimate of the adjustment to fair value that a market participant would make to incorporate the credit risk of the Group.
Debt securities	See 'Investment securities'.
Debt securities in issue	Transferable certificates of indebtedness of the Group to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit.
Default	Circumstances in which the probability of default is taken as 100% for the purposes of the calculation of regulatory capital and compliance with the Capital Requirements Directive IV (CRD IV) legislation. This is defined as when a borrower reaches a predefined arrears status or where a borrower is considered unlikely to repay the credit obligation in full without the lender taking action such as realising security.
Deferred tax asset	Corporate income taxes recoverable in future periods as a result of deductible temporary differences (being differences between the accounting and tax bases of an asset or liability that will result in tax deductible amounts in future periods) and the carry forward of unused tax credits.
Deferred tax liability	Corporate income taxes payable in future periods as a result of taxable temporary differences (being differences between the accounting and tax bases of an asset or liability that will result in taxable amounts in future periods).
Defined benefit obligation	The present value of expected future benefit payments resulting from past service of employees in the defined benefit pension plan.
Defined benefit pension plan	A pension or other post-retirement benefit plan under which the Group has an obligation to provide agreed benefits to current and former employees. The Group bears the risk that its obligation may increase or that the value of the assets in the pension fund may fall.
Defined contribution pension plan	A pension plan under which the Group pays fixed contributions as they fall due into a separate entity (a fund) and has no further legal or constructive obligations.
Delinquency	See 'Arrears'.
Derivative	A contract or agreement whose value changes with movements in an underlying index such as interest rates, foreign exchange rates, share prices or indices, and which requires no initial investment or an initial investment that is smaller than would be required for other types of contracts with a similar response to market factors. The principal types of derivatives are swaps, forwards, futures and options.
Earnings risk	The risk that a source of income or value is unable to continue to add the expected value, due to changes in market, regulatory or other environmental factors.

Glossary *continued*

Effective interest rate method (EIR)	The method used to measure the carrying value of a financial asset or liability. EIR allocates associated income or expense to produce a level yield, over the expected life of the financial asset or liability, or a shorter period when appropriate.
Effective tax rate	The tax charge in the income statement as a percentage of profit before tax.
Encumbered assets	Assets on the balance sheet which are pledged in order to secure, collateralise or credit-enhance a financial transaction from which they cannot be freely withdrawn.
End point	Full implementation of Capital Requirements Directive IV (CRD IV) with no transitional provisions.
Enterprise Risk Management Framework (ERMF)	A framework that seeks to provide the context and guidance for cohesive risk management activity across the Group.
European Banking Authority (EBA)	The independent EU authority which works to ensure effective and consistent prudential regulation and supervision across the European banking sector.
Expected loss (EL)	A calculation to estimate the potential losses on current exposures due to potential defaults. It is the product of probability of default (PD), loss given default (LGD) and exposure at default (EAD).
Exposure	The maximum loss that a financial institution might suffer if a borrower, counterparty or group fails to meet their obligations or if assets and off-balance sheet positions have to be realised.
Exposure at default (EAD)	An estimation of the amount of exposure that will be outstanding at the time of default.
Final salary pension arrangements	A defined benefit pension arrangement where the pension payable is based on the employee's final pensionable salary.
Financial Conduct Authority (FCA)	The statutory body responsible for conduct of business regulation and supervision of UK authorised firms from 1 April 2013. The FCA also has responsibility for the prudential regulation of firms that do not fall within the Prudential Regulation Authority's (PRA's) scope.
Financial Ombudsman Service (FOS)	An independent service in the UK for settling disputes between businesses providing financial services and their customers.
Financial performance framework	Sets out the financial parameters that the Group calibrates future performance against to achieve the right balance between distributing value to members, investing in the business and maintaining our financial strength.
Financial Policy Committee (FPC)	A Bank of England committee charged with identifying, monitoring and taking action to reduce or remove systemic risks with a view to protect and enhance the resilience of the UK financial system. It is also responsible for supporting the economic policy of the UK Government.
Financial risk	The risk of the Group having inadequate earnings, cash flow or capital to meet current or future requirements and expectations. This includes loss or damage to the earnings capacity, market value or liquidity of the Group, arising from mismatches between assets, funding and other commitments, and which may be exposed by changes in market rates, market conditions or the Group's credit profile.
Financial Services Compensation Scheme (FSCS)	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry.
Fitch	Rating agency, Fitch Ratings Limited.
Forbearance	Forbearance takes place when a concession is made on the contractual terms of a loan to a customer that is experiencing or about to experience financial difficulties.
Foundation internal ratings based (IRB) approach	A method of calculating credit risk capital requirements using internal probability of default (PD) models but with regulators' supervisory estimates of loss given default (LGD) and conversion factors for the calculation of exposure at default (EAD).
Free capital	The aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment and intangible assets.
Funding for Lending Scheme (FLS)	A scheme launched by the Bank of England in July 2012 to incentivise banks and building societies to lend to UK households and non-financial companies through reduced funding costs, the benefits of which are passed on to UK borrowers in the form of cheaper and more easily available loans.

Glossary *continued*

Gross capital	The aggregate of general reserve, revaluation reserve, available for sale reserve, core capital deferred shares (CCDS), Additional Tier 1 (AT1) capital, subscribed capital and subordinated liabilities.
Gross mortgage lending	New lending advanced to customers during the period.
House price index (HPI)	An index monitoring changes in house prices both monthly and annually, providing a comprehensive view of the property market.
Help to Buy shared equity scheme	A Government scheme which helps house purchasers obtain a mortgage with a 5% deposit. The property is part financed (up to 20% and a minimum of 10%) by an equity loan from the Homes and Communities Agency.
Impaired loans	Loans which are more than three months in arrears, or which have individual provisions raised against them.
Impairment provisions	Provisions held against assets on the balance sheet. The provisions represent management's best estimate of losses incurred in the loan portfolio at the balance sheet date.
Impairment losses	When an impairment review determines that the amount expected to be recovered is less than the current carrying value, an impairment loss is recognised to reduce the asset's value to its recoverable amount.
Internal Liquidity Adequacy Assessment Process (ILAAP)	The process and document that defines Nationwide's liquidity and funding risk management framework, including risk appetite and measurement of these risks.
Individual liquidity guidance (ILG)	Guidance from the Prudential Regulation Authority (PRA) on a firm's required quantity of liquidity resources and funding profile.
Individually assessed impairments	Residential loans are assessed individually for impairment when they are in possession. Commercial loans are assessed individually for impairment when there is objective evidence that an impairment loss has occurred.
Interest rate swap	A contract under which two counterparties agree to exchange periodic interest payments on a predetermined monetary principal, the notional amount.
Internal capital adequacy assessment process (ICAAP)	The Group's own assessment of the levels of capital that it needs to hold in respect of its regulatory capital requirements for credit, market and operational risks as well as for other risks including stress events.
Internal ratings based approach (IRB)	An approach for measuring exposure to credit risks. IRB approaches are more sophisticated and risk sensitive than the Standardised approach and may be Foundation or Advanced. IRB approaches may only be used with Prudential Regulation Authority (PRA) permission.
International Accounting Standards Board (IASB)	The independent standard setting body of the IFRS Foundation. Its members are responsible for the development and publication of International Financial Reporting Standards (IFRSs) and for approving interpretations of IFRS as developed by the IFRS Interpretations Committee (IFRIC).
International Swaps and Derivatives Association (ISDA) master agreement	A standardised contract developed by ISDA and used to enter into bilateral derivative transactions. The contracts grant legal rights of set off for derivative transaction with the same counterparty. This reduces the credit risk of the derivatives to the extent that negative values offset positive values.
Investment grade	The highest range of credit ratings, from AAA to BBB, as measured by external credit rating agencies.
Investment securities	Assets representing certificates of indebtedness of credit institutions, public bodies or other undertakings excluding those issued by central banks. Sometimes referred to as debt securities.
Investment Property Databank (IPD) index	A measurement of the performance of the prime commercial real estate (CRE) market in the UK on a monthly basis, reporting on a number of key data series (including capital value returns, total returns, income returns, rental values and void rates) against the performance of other key asset classes including UK equities and UK gilts.
Lending risk	The risk that a borrower or counterparty fails to pay the interest or to repay the principal on a loan or other financial instrument (such as a bond) on time. Lending risk also encompasses extension risk and concentration risk.
Level 1 fair values	Fair values derived from unadjusted quoted prices for identical assets or liabilities in active markets where the quoted price is readily available, such as for high quality government securities.

Glossary *continued*

Level 2 fair values	Fair values derived from models whose inputs are observable in an active market, such as for most investment grade and liquid bonds, asset backed securities, certain collateralised debt obligations (CDOs), collateralised loan obligations (CLOs) and over the counter (OTC) derivatives.
Level 3 fair values	Fair values derived from inputs that are not based on observable market data (unobservable inputs), such as for private equity investments, derivatives including an equity element, deposits including an equity element, some collateralised debt obligations (CDOs) and certain asset backed securities and bonds.
Leverage ratio	A ratio which measures Tier 1 capital as a proportion of exposures on a non risk weighted basis. There are two bases of calculation. For further details refer to UK leverage ratio and Capital Requirements Regulation (CRR) leverage ratio.
Libor (London Interbank Offered Rate)	A benchmark interest rate at which banks can borrow funds from other banks in the London interbank market.
Liquid asset buffer (LAB)	A portfolio of high quality, unencumbered liquid assets that are held to meet internal and regulatory liquidity stress requirements.
Liquidity and funding risk	Liquidity risk is the risk that the Group is unable to meet its liabilities as they fall due and maintain member and stakeholder confidence. Funding risk is the risk that the Group is unable to maintain diverse funding sources in wholesale and retail markets and manage retail funding risk that can arise from excessive concentrations of higher risk deposits.
Liquidity Contingency Plan (LCP)	A document that can be used to identify an emerging liquidity and funding stress, and which details the procedures to be followed and the actions which can be taken to withstand such a stress.
Liquidity coverage ratio (LCR)	A regulatory liquidity metric which aims to ensure that a firm maintains an adequate level of liquidity to meet its requirements in a severe-but-plausible stress lasting for 30 calendar days.
Loan to value ratio (LTV)	A ratio which expresses the amount of exposure as a percentage of the value of the property on which it is secured. The Group calculates LTV on an indexed basis such that the value of the property is updated on a regular basis to reflect changes in the market using either the house price or commercial real estate indices.
Loss given default (LGD)	An estimate of the difference between exposure at default (EAD) and the net amount of the expected recovery expressed as a percentage of EAD.
Loyalty Saver	A distinctive set of savings products which pay enhanced rates as membership length increases.
Main current account	The primary or sole current account used by the customer.
Market risk	The risk that the net value of, or net income arising from, the Group's assets and liabilities is impacted as a result of market prices or rate changes.
Medium term notes	Corporate notes continuously offered by a company to investors, through a dealer, across a range of maturity periods.
Member	A person who has a share investment or a mortgage loan with the Society as set out in the Society's Memorandum of rules.
Moody's	Rating agency, Moody's Investors Service Limited.
Near prime	Loans to borrowers with marginally weakened credit histories such as a County Court Judgement (CCJ) or default of less than or equal to £1,000 or with one missed mortgage payment in the last 12 months.
Negative equity	The difference between the outstanding balance on a loan and the current value of any security held where the security value is lower than the outstanding balance.
Net assets	The difference between total assets and total liabilities.
Net interest income	The difference between interest receivable on assets and similar income and interest paid on liabilities and similar charges.
Net interest margin	Net interest income as a percentage of weighted average total assets.
Net mortgage lending	The net amount of new lending advanced to customers during the period offset by customer balances settled during the period.

Glossary *continued*

Net stable funding ratio (NSFR)	A regulatory funding metric which is used to promote a stable funding profile by assessing the proportion of long term assets that are funded by stable long term funding sources (eg customer deposits and long term wholesale funding).
Non-performing loans	Loans which are in arrears, including impaired loans with individually assessed impairments.
Open banking	The collective term used to describe the combined impact of new regulations such as the Competition and Markets Authority Order (CMA) and Payments Services Directive II (PSD2), where financial institutions such as Nationwide will provide registered third party organisations with transactional information where the consent of customer or member is provided. The aim of Open Banking will be to create more transparency and fairness in banking and financial services through greater competition and innovation.
Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.
Overnight indexed swap (OIS) rate	A rate reflecting the overnight interest typically earned or paid in respect of collateral exchanged. OIS is used in valuing collateralised interest rate derivatives.
Over the counter (OTC)	Contracts that are traded (and privately negotiated) directly between two parties, without going through an exchange or other intermediary. They offer flexibility because, unlike standardised exchange-traded products, they can be tailored to fit specific needs.
Past due loans	Loans where a counterparty has failed to make a payment when contractually due.
Pension risk	The risk that the value of the Fund's assets will be insufficient to meet the estimated liabilities of the Fund. Pension risk can adversely impact the Group's capital position and/or result in increased cash funding obligations to the Fund.
Performing loans	Loans which are neither past due nor impaired.
Permanent interest bearing shares (PIBS)	Unsecured, deferred shares of the Society that, in the event of insolvency, rank equally with the claims of Additional Tier 1 (AT1) securities, behind the claims of all subordinated debt holders, depositors, creditors and investing members of the Group, and ahead of the claims of core capital deferred shares (CCDS) investors. PIBS are also known as subscribed capital.
Pillar 1/2/2A/3	Components of the Basel capital framework. Pillar 1 covers the minimum capital requirements, largely in relation to credit and operational risks. Pillar 2/2A covers additional firm-specific capital requirements for risks not covered in full by Pillar 1 requirements. Pillar 3 covers disclosures about the firm's capital and risk position.
Prime residential mortgages	Mainstream residential loans, which typically have a higher credit quality and fit standard underwriting processes. As such, they are likely to have a good credit history, and pass a standard affordability assessment at the point of origination.
Private equity investments	Equity investments in operating companies that are not quoted on a public exchange.
Probability of default (PD)	An estimate of the probability that a borrower will default on their credit obligations in the next 12 months.
Protected equity bonds (PEBs)	Deposit accounts with the potential for stock market correlated growth linked to the performance of specified stock market indices. PEBs protect an investor's original investment amount against reductions in the linked stock market indices, whilst providing potential for upside from movements in the stock markets over a fixed term.
Provision coverage ratio	The ratio of impairment provisions to the corresponding portfolio of loans and advances to which they relate.
Prudential Regulation Authority (PRA)	The statutory body responsible for the prudential supervision of banks, building societies, insurers and a small number of significant investment firms in the UK from 1 April 2013. The PRA is a subsidiary of the Bank of England.
Regulatory capital	Capital allowable under regulatory rules, less certain required regulatory adjustments and deductions.
Renegotiated loans	Loans and advances may be renegotiated either as part of an ongoing customer relationship with a creditworthy customer or in response to a borrower's financial difficulties. In the latter case, the renegotiated loan may no longer be treated as past due or impaired if there is no change to the estimated present value of future cash flows. Individually significant loans whose terms have been renegotiated are subject to ongoing review to determine if they remain past due or impaired.

Glossary *continued*

Repurchase agreement (repo)/reverse repurchase agreement (reverse repo)	An agreement that allows a borrower to use a financial security as collateral for a cash loan. In a repo, the borrower agrees to sell a security to the lender subject to a commitment to repurchase the asset on a given date. For the party selling the security (and agreeing to repurchase it in the future) it is a repurchase agreement or repo; for the counterparty to the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or reverse repo.
Residential mortgage backed securities (RMBS)	A securitisation of residential mortgage loans. RMBS can be backed by either prime, buy to let or sub-prime residential mortgage loans (see separate definition of 'Securitisation').
Residual maturity	The remaining period to the contractual maturity date of a financial asset or financial liability.
Retail funding	Funding obtained from individuals rather than institutions.
Retail internal ratings based (IRB) approach	An approach for measuring exposure to retail credit risks. The method of calculating credit risk capital requirements uses internal probability of default (PD), loss given default (LGD) and exposure at default (EAD) models. Internal ratings based (IRB) approaches may only be used with Prudential Regulation Authority (PRA) permission.
Retail loans	Loans to individuals rather than institutions, including residential mortgage lending and consumer banking.
Risk appetite	The level and type of risk that the Group is willing to assume in pursuit of its strategic goals.
Risk weighted assets (RWA)	The value of assets, after adjustment under the capital rules to reflect the degree of risk they represent.
Securitisation	A process where a group of assets, usually loans, is aggregated into a pool, which is used to back the issuance of new securities. A company transfers assets to a special purpose entity (SPE) which then issues securities backed by the assets. The cash flows from the assets are used to pay interest on and repay the debt securities.
Shares	Funds deposited by a person in a retail savings or current account with the Society. Such funds are recorded as liabilities for the Society.
Shares and borrowings	The total of shares, deposits from banks, other deposits, amounts due to customers and debt securities in issue.
Solo surplus	Total capital on an individual consolidated basis less capital requirements. Individual consolidation is a consolidation basis for regulatory purposes which only includes those subsidiaries meeting particular criteria contained within Capital Requirements Directive IV (CRD IV).
Solvency risk	The risk that the Group 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.
Sovereign exposures	Exposures to governments, ministries, departments of governments, embassies, consulates and exposures on account of cash balances and deposits with central banks.
Special purpose entities (SPEs)	Entities that are created to accomplish a narrow and well defined objective. There are often specific restrictions or limits around their ongoing activities. The Group uses a number of SPEs, including those set up under securitisation programmes. This term is used interchangeably with SPV (special purpose vehicle).
Specialist residential lending	Consists of buy to let, self-certified and other non-standard mortgages.
Standard & Poor's (S&P)	Rating agency, Standard & Poor's Credit Market Services Europe Limited.
Standard mortgage rate (SMR)	The revert rate for existing mortgage customers at the end of a deal reserved on or after 30 April 2009.
Standardised approach	The basic method used to calculate credit risk capital requirements. In this approach the risk weights used in the capital calculation are determined by regulators' supervisory parameters. The Standardised approach is less risk-sensitive than the internal ratings based (IRB) approach.
Strategic risk	The risk of significant loss or damage arising from business decisions that impact the long-term interests of the membership, or from an inability to adapt to external developments.
Stress testing	A process which involves identifying possible future adverse events or changes in economic conditions that could have unfavourable effects on the Group (either financial or non-financial), assessing the Group's ability to withstand such changes, and identifying management actions to mitigate the impact.

Glossary *continued*

Structured entity (SE)	An entity in which voting or similar rights are not the dominant factor in deciding control. Structured entities are consolidated when the substance of the relationship indicates control.
Subordinated debt/liabilities	A form of Tier 2 capital that is unsecured and ranks behind the claims of all depositors, creditors and investing members but before the claims of holders of Additional Tier 1 (AT1) securities, permanent interest bearing shares (PIBS) and core capital deferred shares (CCDS).
Sub prime	Loans to borrowers that typically have weakened credit histories such as payment delinquencies and potentially more severe problems such as County Court Judgements (CCJs) or default greater than £1,000, more than one missed mortgage payment in the last 12 months or discharged bankruptcies. Sub prime borrowers may also display higher risk characteristics as measured by credit scores, or other criteria indicating heightened risk of default.
Subscribed capital	See 'Permanent interest bearing shares (PIBS)'.
Swap rate	The fixed interest rate in a fixed to floating interest rate swap.
Term Funding Scheme	A scheme launched by the Bank of England in August 2016 within a package of monetary stimulus measures, with the purpose of encouraging lending institutions to pass on base rate cuts, by providing an efficient source of funding.
Tier 1 capital	A measure of the Group's financial strength. Tier 1 capital comprises Common Equity tier 1 capital and additional Tier 1 capital instruments.
Tier 1 capital ratio	Tier 1 capital as a percentage of risk weighted assets.
Tier 2 capital	A further measure of the Group's financial capital that meets the Tier 2 requirements set out in the Capital Requirements Regulation (CRR), comprising qualifying subordinated debt and other securities and eligible impairment allowances after regulatory deductions.
Trading book	A regulatory classification consisting of positions in financial instruments or commodities held by a bank with the intention of profiting from short term fluctuations in price.
Transformation costs	Costs, included within administrative expenses, which are directly related to business combinations or the restructuring of parts of the business to transform the way activities are performed.
UK leverage ratio	A ratio defined by the Capital Requirements Regulation (CRR) which measures Tier 1 capital as a proportion of total CRR leverage ratio exposures, modified by the PRA to exclude eligible central bank holdings.
Unaudited	Financial information that has not been subjected to the audit procedures undertaken by the Group's external auditor.
Underlying profit	A measure which aims to present management's view of the Group's underlying performance for the reader of the Annual Report and Accounts with like for like comparisons of performance across years without the distortion of one off volatility and items which are not reflective of the Group's ongoing business activities. 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.
Value at risk (VaR)	A technique that estimates the potential loss that could occur on risk positions as a result of future movements in market rates and prices over a specified time horizon and to a given level of statistical confidence. In its day to day monitoring, the Group uses a 10 day horizon and a 99% confidence level.
Wholesale funding	Funding received from larger businesses, financial institutions and sovereign entities.
Wholesale funding ratio	Wholesale funding as a percentage of total funding.
Wholesale lending	Lending to larger businesses, financial institutions and sovereign entities.
Write off	The point where it is determined that an asset is irrecoverable, or it is no longer considered economically viable to try and recover the asset or final settlement is reached and the shortfall written off. In the event of write off, the customer balance and any related impairment balance are removed from the balance sheet.

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