Nationwide Building Society

Interim Management Statement
Q1 2017/18

11 August 2017

Nationwide Building Society today publishes its Interim Management Statement covering the period from 5 April 2017 to 30 June 2017 ('Q1 2017/18').

Key highlights

- Statutory profit before tax of £322 million (Q1 2016/17: £401 million) and underlying profit before tax of £301 million (Q1 2016/17: £368 million). Profit broadly consistent with the prior period, after allowing for £26 million one-off gain this quarter and non-recurring £100 million gain in Q1 2016/17.[1]
- Capital strength improved with CET1 ratio of 26.4% (4 April 2017: 25.4%) and UK leverage ratio of 4.4% (4 April 2017: 4.4%).
- Remained No.1 for customer satisfaction amongst our high street peer group, with a lead of 3.6%[2]
- More people opened a current account with Nationwide than with any other provider, and more than 1 in 5 of all switchers chose Nationwide.[3]
- Gross mortgage lending of £8.1 billion (Q1 2016/17: £8.6 billion) inclusive of prime mortgage lending of £7.3 billion (Q1 2016/17: £6.9 billion); total market share of 13.0% (Q1 2016/17: 15.0%).
- Member deposit balances[4] increased by £1.3 billion in the period (Q1 2016/17: £2.6 billion), a market share of balance growth of 10.2% (Q1 2016/17: 11.1%).

Nationwide Building Society Chief Executive, Joe Garner, said:

"Profit performance in the first quarter remained comfortably within our strategic target range and, after allowing for one-off items, was broadly consistent with the prior period.

"Nationwide continued to bring the benefits of mutuality to more people. Independent research shows that in the first quarter we remained the UK's top choice[5] for current accounts. Moreover, we ended 2016 as the highest net gainer of current accounts, with more than twice as many net switchers as any other provider, the first time that a building society has overtaken the banks[6].

"We continued to enjoy a healthy share of mortgage lending, with a gross market share of 13.0%. We also introduced new steps to make membership more meaningful, offering an increased choice of preferential rates to loyal savers, and extending our 'recommend a friend' scheme.

"Nationwide remains number one for customer satisfaction among our high street peers, with our lead of 3.6%[2] reflecting our commitment to member value and first class service.

"Consumer confidence is an important barometer for us. Although the UK public has become less optimistic about the outlook for the economy generally, research conducted for our Brexit Consumer Support Panel shows that the majority of consumers expect Brexit to leave their ability to access credit unchanged. It will be important for lenders to balance carefully credit supply with affordability as we seek to support the long-term interests of consumers in a responsible way through any potential economic slowdown ahead. In a period of potentially prolonged economic uncertainty and persistently low interest rates Nationwide continues to invest in products and services to support the long-term needs of our members."

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[1] £26 million one-off gain from sale of investment in VocaLink (Q1 2016/17: £100 million one-off gain from the sale of the Society's investment in Visa Europe).
[2] © GfK 2017, Financial Research Survey (FRS), 12 months ending 30 June 2017 vs 31 March 2017, proportion of extremely/very satisfied customers minus proportion of extremely/very/fairly dissatisfied customers summed across current account, mortgage and savings. High street peer group defined as providers with main current account market share >4% (Barclays, Halifax, HSBC, Lloyds Bank (inc C&G), NatWest, Santander and TSB).
[3] Source: eBenchmarkers, CACI, BACS Payments Schemes monthly CASS switching market data and internal sources.
[4] Member deposits include current account credit balances.
[5] 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 June 2017. Financial brands included Nationwide, Barclays, Co-operative Bank, First Direct, Halifax, HSBC, Lloyds, NatWest, TSB and Santander.
[6] BACS Payments Schemes CASS switching market data (latest participant movement data for switches completing in the 3 months ending 31 December 2016).

Trading performance

	Quarter ended 30 June 2017		Quarter ended 30 June 2016	
	£bn	%	£bn	%
Gross residential mortgage lending/*market share*	8.1	*13.0*	8.6	*15.0*
Net residential mortgage lending/*market share*	2.4	*21.8*	3.5	*52.8*
Member deposits balance movement[4]/*market share*	1.3	*10.2*	2.6	*11.1*
Number of new current accounts opened[7]	202,000		173,000	

	At 30 June 2017		At 4 April 2017	
	£bn	%	£bn	%
Residential lending balances[8]	173.6		171.1	
Member deposit balances[4] /*market share*	145.8	*10.1*	144.5	*10.1*
Market share of main standard and packaged current accounts[9]		7.7		7.5

The strong trading performance in the first quarter is a continuation of the performance reported at the full year. Gross mortgage lending includes £7.3 billion of prime residential mortgages (Q1 2016/17: £6.9 billion), an increase of 5% compared to same period last year. Following the underwriting criteria changes we made last year for buy to let (BTL) lending and the increase in stamp duty impacting the BTL market, the flow of advances has slowed. BTL gross mortgage lending for the period of £0.8 billion (Q1 2016/17: £1.7 billion) partially reflects the trend seen in the overall BTL market which has decreased by 23%[10] over the 12 month period to March 2017.

Net mortgage lending decreased to £2.4 billion for the period (Q1 2016/17: £3.5 billion) mainly as a result of the reduction in BTL advances. The net lending for the period comprises £2.4 billion for prime lending (Q1 2016/17 £2.7 billion), with no net growth in respect of BTL (Q1 2016/17: £0.8 billion).

The movement in member deposit balances in the period reflects our growth of main standard and packaged current accounts. In a highly competitive market, our market share of member deposit balances remained flat at 10.1% (4 April 2017: 10.1%).

More people are choosing Nationwide Building Society for their everyday banking, attracted by the breadth, value and quality of our current account range. During the period, we opened 202,000[7] new current accounts, 17% more than the same period last year. We continue to benefit from high switching rates through the Current Account Switch Service, attracting 22.4% of all switchers in the period. In total, our market share of main standard and packaged current accounts has increased to 7.7% at May 2017 (February 2017: 7.5%).

[7] Number of new current accounts includes basic bank accounts.
[8] Residential lending balances are stated net of impairment provisions. Residential mortgages include prime and specialist loans, with the specialist portfolio primarily comprising BTL lending.
[9] Based on market data as at May 2017 (comparative based on market data as at February 2017).
[10] Source: UK Finance: market gross lending for 12 month period ended to 31 March 2017: £34.7 billion (31 March 2016: £45.0 billion).

Financial performance

	Quarter ended 30 June 2017 £m	%	Quarter ended 30 June 2016 £m	%
Underlying profit before tax	301		368	
Statutory profit before tax	322		401	
Statutory profit after tax	240		292	
Net interest margin		1.35		1.35
Underlying cost income ratio		58.8		53.6
Statutory cost income ratio		57.4		51.7

	At 30 June 2017 £bn	%	At 4 April 2017 £bn	%
Total assets	228.9		221.7	
Loans and advances to customers	189.5		187.4	
Common Equity Tier 1 (CET1) ratio[11]		26.4		25.4
UK leverage ratio[12]		4.4		4.4
CRR leverage ratio[13]		4.1		4.2
Liquidity coverage ratio		133.6		124.0
Wholesale funding ratio		29.4		27.1

Underlying profit represents management's view of underlying performance and is presented to aid comparability across reporting periods. More details on how we define underlying profit can be found on page 5.

Underlying profit before tax of £301 million for the quarter has reduced 18% on the same period last year, predominantly due to the prior period impact of a one-off gain of £100 million from the sale of our investment in Visa Europe in June 2016. Underlying profit for Q1 2017/18 includes a gain of £26 million from the sale of the Society's investment in VocaLink. Statutory profit before tax is 20% below the prior period at £322 million and includes £20 million (Q1 2016/17: £31 million) of derivative and hedge accounting gains which are excluded from underlying profit.

Net interest income was 5% higher than for the same period last year driven by balance sheet growth from net lending, with reported net interest margin consistent at 135bps. Competition in retail lending markets remains intense and the progressive decline in our legacy base mortgage rate (BMR) balances[14] continues in line with both recent experience and our expectations. Given these trends we currently expect our net interest margin to continue to be relatively stable but with the potential for limited downward pressure during the remainder of the year.

The underlying cost income ratio[15] in the first quarter was 58.8% (Q1 2016/17: 53.6%). This reflects cost growth of 5%, together with a small decline in total income resulting from the one-off factors referred to above and our continuing commitment to making conscious and balanced decisions which serve the interests of our members. Cost growth was driven by higher pension costs, resulting from low long term interest rates and credit spreads, and the depreciation impact of prior year investment in line with our strategy to enhance proposition and service; the remainder of our cost base was essentially flat compared with a year ago despite volume growth. Our efficiency programme is a key priority and we remain committed to a lower trajectory of cost growth in the future and a broadly flat cost position for the current year, as described in our last year end results announcement.

We continue to review compliance with ongoing and emerging regulatory matters with no significant charge in the period in respect of potential customer redress. Current provisions reflect latest experience and the estimated impact of industry consultation.

[11] Common Equity Tier 1 (CET1) ratio has been calculated under CRD IV on an end point basis.
[12] 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.
[13] 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.
[14] BMR balances relate to our mortgages reserved on or before 29 April 2009 which revert to a rate guaranteed to be no more than 2% above the Bank of England base rate.
[15] Underlying cost income ratio was 60.2% for the year ended to 4 April 2017.

Asset quality remains strong, with an average loan to value (LTV) of loan stock for total residential lending of 55% at the end of the period, consistent with that reported at the year end. The average LTV of new lending in the period is 70%, consistent with the average for the same period last year.

The number of cases more than three months in arrears as a percentage of the total book remains broadly consistent with the position reported at 4 April 2017, being 0.35% (4 April 2017: 0.36%) for prime lending and 0.88% (4 April 2017: 0.89%) for specialist lending.

Impairment losses on loans and advances were higher than the corresponding period last year at £36 million (Q1 2016/17: £16 million) but reflect a rate of incurred losses broadly in line with the full year performance for 2016/17. We continue to review the retail lending portfolios to ensure incurred losses are appropriately reflected in the provision amounts.

Capital and leverage ratios have remained well in excess of regulatory requirements with a CET1 ratio of 26.4% (4 April 2017: 25.4%) and a UK leverage ratio of 4.4% (4 April 2017: 4.4%). The CET1 ratio increased due to profit after tax for the period. The UK leverage ratio has remained stable with profits offsetting the increase in the UK leverage exposure, which was mainly driven by higher liquidity and mortgage balances. Further information on our capital position can be found in Appendix 1.

The UK regulatory capital framework continues to develop. The Financial Policy Committee (FPC) recently announced the implementation of a 0.5% countercyclical buffer from June 2018, with an intention to increase this to 1% from November 2018. The Basel Committee on Banking Supervision is working towards finalisation of reforms to Basel III, including revisions to the standardised approach for credit and operational risks. The revised standardised approach is expected to be used as a basis for a floor for minimum capital requirements, although calibration of the floor and the timeline for its introduction have not yet been finalised. In addition, the PRA has issued a Policy Statement on residential mortgage risk weights, proposing revised expectations for IRB models. Whilst this will lead to higher risk weights when the new models are implemented (by no later than 2020), our current view is that these developments will not lead to a material increase in overall regulatory capital requirements for the Group as the UK leverage ratio framework is expected to remain the binding requirement.

Outlook

After performing relatively strongly in the second half of 2016, the UK economy slowed in the first half of 2017. Like most forecasters, we expect the economy to slow a little further this year as rising inflation squeezes household budgets.

In terms of consumer sentiment, an important barometer for us, research conducted for our Brexit Consumer Support Panel shows that, although the UK public has become less optimistic about the outlook for the economy generally, most consumers don't expect Brexit to change their access to credit. It will be important for lenders to balance carefully credit supply with affordability in a responsible way to support the long-term interests of consumers through any potential economic slowdown ahead.

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

Additional information

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

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Underlying profit

Profit before tax shown on a statutory and underlying basis is set out on page 3. Statutory profit before tax of £322 million has been adjusted for a number of items to derive an underlying profit before tax of £301 million. The purpose of this measure is to reflect management's view of the Group's underlying performance and to assist with like for like comparisons of performance across years. 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.

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

Forward looking statements

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

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

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

Appendix 1 – Capital position

Capital structure and ratios

Common Equity Tier 1 (CET1) capital resources have increased by approximately £0.2 billion as a result of profit after tax for the period. Risk weighted assets (RWAs) decreased over the period by approximately £0.4 billion mainly due to the continued deleveraging of the commercial portfolio. These movements have resulted in a CET1 ratio of 26.4% (4 April 2017: 25.4%).

	30 June 2017 £m	4 April 2017 £m
Common Equity Tier 1 capital before regulatory adjustments	10,137	9,915
Total regulatory adjustments to Common Equity Tier 1	(1,368)	(1,360)
Common Equity Tier 1 capital	8,769	8,555
Additional Tier 1 capital before regulatory adjustments	992	992
Total regulatory adjustments to Additional Tier 1 capital	-	-
Additional Tier 1 capital	992	992
Total Tier 1 capital	9,761	9,547
Tier 2 capital before regulatory adjustments	2,547	2,582
Total regulatory adjustments to Tier 2 capital	-	-
Tier 2 capital	2,547	2,582
Total capital	12,308	12,129
Ratios:	%	%
Common Equity Tier 1	26.4	25.4
Tier 1	29.4	28.4
Total capital	37.1	36.1

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

Overview of RWAs (EU OV1)

		RWAs		Minimum capital requirements[16]	
		30 June 2017 £m	4 April 2017 £m	30 June 2017 £m	4 April 2017 £m
1	Credit risk	26,448	26,802	2,116	2,144
2	Of which standardised approach	2,529	2,548	202	204
3	Of which the foundation IRB approach	6,556	6,969	525	557
4	Of which the advanced IRB approach	17,222	17,163	1,378	1,373
5	Of which Equity IRB under the simple risk-weight or the internal models approach	141	122	11	10
6	Counterparty credit risk	1,314	1,221	106	98
7	Of which marked to market	581	546	47	44
9	Of which standardised approach for counterparty credit risk	22	19	2	2
11	Of which risk exposure for contributions to the default fund of a CCP	3	6	-	-
12	Of which CVA	708	650	57	52
13	Settlement risk	-	-	-	-
14	Securitisation exposures in banking book (after cap)	267	434	21	35
15	Of which IRB ratings-based approach	267	434	21	35
19	Market risk[17]	-	-	-	-
23	Operational risk	4,865	4,865	389	389
25	Of which Standardised approach	4,865	4,865	389	389
27	Amounts below the thresholds for deduction (subject to 250% risk weight)	303	319	24	25
29	**Total**	33,197	33,641	2,656	2,691

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

RWA flow statements of credit risk exposures (EU CR8)

		IRB credit risk		Standardised credit risk		Counterparty credit risk	
		RWA amounts £m	Capital requirements £m	RWA amounts £m	Capital requirements £m	RWA amounts £m	Capital requirements £m
1	RWA as at 4 April 2017	24,254	1,940	2,548	204	1,221	98
2	Asset size	(116)	(9)	(19)	(2)	138	11
3	Asset quality	(219)	(17)	-	-	(45)	(3)
9	RWA as at 30 June 2017	23,919	1,914	2,529	202	1,314	106

Leverage ratio

The UK leverage ratio[12] is 4.4% at 30 June 2017 (4 April 2017: 4.4%). Minimum leverage requirements are monitored by the PRA on this basis, with the current regulatory threshold set at 3% as the countercyclical leverage ratio buffer is currently 0%. Following the Financial Policy Committee's (FPC) announcement on the countercyclical buffer (June 2018: 0.5%, November 2018: 1%), the countercyclical leverage ratio buffer will be 0.2% from June 2018, increasing to 0.4% from November 2018. In addition, the PRA has proposed to recalibrate the minimum leverage ratio requirement to 3.25% to adjust for the impact of excluding central bank holdings from the exposure measure.

The average UK leverage ratio for the three months to 30 June 2017 is 4.4%, with an average exposure measure of £218,285 million[18].

The CRR leverage ratio has decreased to 4.1% (4 April 2017: 4.2%) due to an increase in liquid assets and mortgage balances.

	30 June 2017 £m	4 April 2017 £m
Tier 1 capital	9,761	9,547
UK leverage exposure	219,693	215,894
CRR leverage exposure	236,675	228,428
	%	%
UK leverage ratio[12]	4.4	4.4
CRR leverage ratio[13]	4.1	4.2

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