

Nationwide Covered Bonds LLP

Annual Report and Financial Statements for  
the year ended 4 April 2016

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<b>Contents</b>	<b>Page</b>
Members and partnership information	2
Members' report for the year ended 4 April 2016	3
Statement of members' responsibilities	6
Strategic report for the year ended 4 April 2016	7
Independent auditors' report	10
Profit and Loss Account for the year ended 4 April 2016	12
Balance sheet as at 4 April 2016	13
Statement of movements in members' interests for the year ended 4 April 2016	14
Notes to the financial statements for the year ended 4 April 2016	15

## **NATIONWIDE COVERED BONDS LLP**

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### **Members and partnership information**

#### **Members**

Nationwide Building Society  
Moulton Capital Finance Limited

#### **Management Board**

Nationwide Building Society  
Moulton Capital Finance Limited

#### **Independent auditors**

PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
1 Embankment Place  
London  
WC2N 6RH

#### **Registered office**

Nationwide House  
Pipers Way  
Swindon  
SN38 1NW

#### **Registered number**

OC313878  
Registered in England and Wales

## NATIONWIDE COVERED BONDS LLP

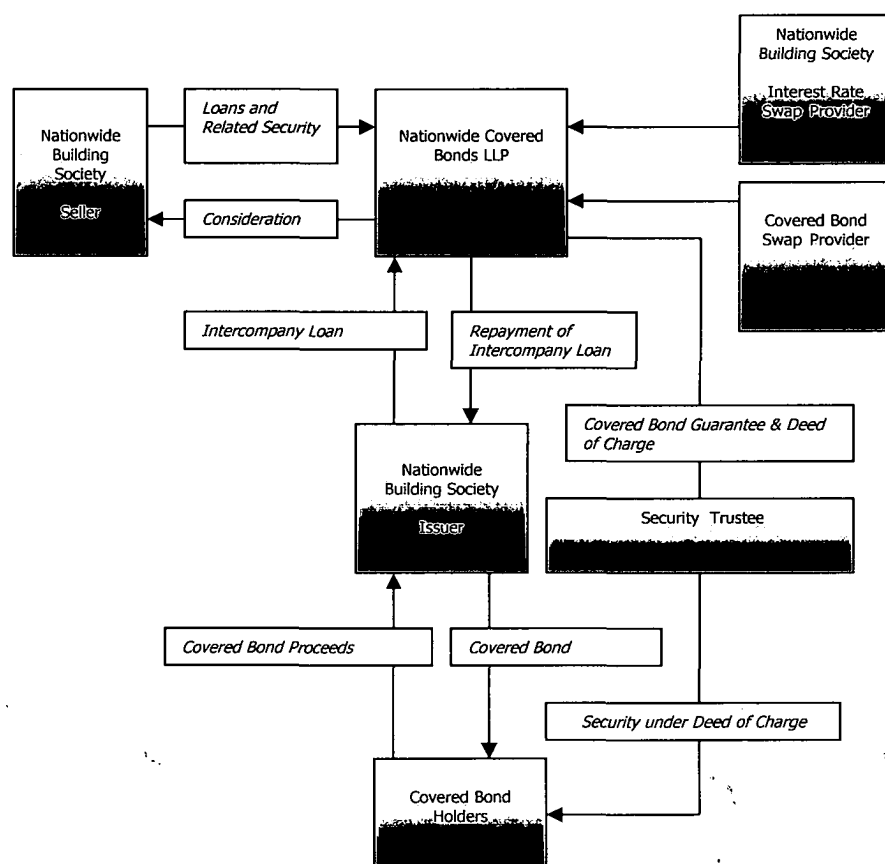
### Members' report for the year ended 4 April 2016

On behalf of the members of Nationwide Covered Bonds LLP (the "LLP"), the Management Board have pleasure in presenting the members' report and the audited financial statements for the LLP for the year ended 4 April 2016. As set out in the accounting policies, the Annual Report and Financial Statements have been prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework. All financial information given in the members' report is taken solely from the statutory results prepared on the above basis. The members consider the financial statements to be fair, balanced and understandable.

#### Business objectives and principal activities

The LLP is a limited liability partnership which was incorporated by Nationwide Building Society ("the Society" or "NBS") and Moulton Capital Finance Limited. The LLP is registered, domiciled and operates solely in England and Wales. The LLP was incorporated on 25 June 2005. The LLP is a special purpose vehicle whose purpose is to guarantee the Covered Bonds issued by the Society by acquiring mortgage loans and their related security from the Society (the "Originator") pursuant to the terms of the Mortgage Sale Agreement entered into on 30 November 2005, when trading commenced. No change in principal activity is envisaged or has occurred during the year.

The LLP enters into interest rate swap agreements with the Society under which it swaps the interest cash flows of the mortgage loans for 3 month Libor plus a spread. The LLP funds the purchase of the mortgage loans by loans from the Society, replicating the issue of Covered Bonds by the Society in currency. Currencies currently in use are Sterling (GBP) (the LLP's functional currency), Euros (EUR) and Norwegian Krona (NOK). The LLP enters into currency swap agreements under which it pays interest cash flows in GBP and receives EUR and NOK cash flows which are used to pay the interest on the loans to Nationwide. The Society is one of the designated members of the LLP, the Covered Bond originator and the LLP's parent undertaking. The Covered Bond structure is set out in diagrammatic form below.



**Main accounting assumptions**

The Society is considered to have retained substantially all the exposure to risks and rewards of ownership of the transferred mortgages. As a result, the acquisition of mortgage loans by the LLP is considered to fail the derecognition criteria of IAS 39, so that the assets sold are retained on the balance sheet of the Society. As described further in note 1 to the financial statements, the LLP therefore treats the transaction as a loan from the Society (the "deemed loan"), secured on a collateral pool of assets, rather than the financial assets that it has legally purchased. The difference between the 'deemed loan' and the balance of mortgage loans is recognised as a capital contribution in the LLP. However, as the mortgage loans fail the derecognition criteria of IAS 39, the capital contribution and the associated element of the deemed loan and interest receivable (referred to as 'over-collateralisation') on it is not recognised in the LLP. The deemed loan is shown net of the over collateralisation adjustment on the face of the balance sheet. The gross amounts are disclosed in the notes.

For accounting purposes the interest rate swap between the LLP and the Society (swapping the interest cash flows of the mortgage loans for 3 month Libor plus a spread) is not separately recognised as a derivative. The effective interest rate accrued by the LLP on the deemed loan due to the LLP from the Society reflects the rate payable under the swap. The swap is consequentially not separately fair valued.

**Employees**

The LLP does not have any employees (2015: none).

**Designated members**

The designated members during the year were:

Nationwide Building Society  
Moulton Capital Finance Limited

The designated members have remained unchanged since the date of incorporation of the LLP on 25 June 2005.

**Going concern**

The LLP's majority member interest is held by Nationwide Building Society. The Society's board of directors has confirmed that it will continue to fund the LLP's activities for the foreseeable future. The foreseeable future is considered for this purpose to be a period at least 12 months forward from the date of approval of the financial statements. Taking this into account, the members have a reasonable expectation that the LLP has adequate resources to continue in business for the foreseeable future and therefore continue to adopt the going concern basis in preparing the financial statements.

**Environment**

Nationwide Building Society and its consolidated subsidiaries (collectively the "Group") recognises the importance of its environmental responsibilities, monitors its impact on the environment, and designs and implements policies to reduce any damage that might be caused by the Group's activities.

The Group has a comprehensive programme of activity on environmental issues. It runs an active carbon-saving programme and has taken action on issues such as transport, lighting, heating and recycling.

**Domicile**

The LLP is registered and domiciled in the United Kingdom. The registered office is Nationwide House, Pipers Way, Swindon, Wiltshire, SN38 1NW.

**Independent auditors**

The auditors, PricewaterhouseCoopers LLP, have expressed their willingness to continue in office.

**Members and members' interests**

The members of the LLP during the year and up to the date of signing the financial statements are shown on page 2.

At no time during the year have the members' executive and non executive directors, or their connected parties, had any beneficial interest in the LLP nor have they had a material interest in any contract significant to the LLP's business.

**Statement of members' responsibilities**

The members are responsible for preparing the Annual Report and the Financial Statements in accordance with applicable law and regulations.

Company law requires the members to prepare financial statements for each financial year. Under that law the members have prepared the financial statements in accordance with applicable law and United Kingdom Accounting Standards (UK GAAP), including Financial Reporting Standard 101 Reduced Disclosure Framework (FRS 101). Under company law the members must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the LLP and of the profit of the LLP for that period. In preparing these financial statements, the members are required to:

- select suitable accounting policies and then apply them consistently
- make judgements and accounting estimates that are reasonable and prudent
- state whether applicable United Kingdom Accounting Standards, including FRS 101, have been followed, subject to any material departures disclosed and explained in the financial statements
- notify the LLP's members in writing about the use of disclosure exemptions, if any, of FRS 101 used in the preparation of financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the LLP will continue in business.


The members are responsible for keeping adequate accounting records that are sufficient to show and explain the LLP's transactions and disclose with reasonable accuracy at any time the financial position of the LLP and enable them to ensure that the financial statements comply with the Companies Act 2006 as applicable to limited liability partnerships. They are also responsible for safeguarding the assets of the LLP and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

**Statement of disclosure of information to auditors**

In accordance with Section 418 of the Companies Act 2006 as applicable to limited liability partnerships, for each member in office at the date the members' report is approved:

- (a) so far as the members are aware, there is no relevant audit information of which the LLP's auditors are unaware, and
- (b) each member has taken all the steps that he/she ought to have taken as a member in order to make himself/herself aware of any relevant audit information and to establish that the LLP's auditors are aware of that information.

By order of the Management Board



**Stephen Tyrie**

For and on behalf of the LLP

Date: 28<sup>th</sup> July 2016

## NATIONWIDE COVERED BONDS LLP

### Strategic report for the year ended 4 April 2016

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As set out in the accounting policies, the Annual Report and Financial Statements have been prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework.

#### Business review

In the year to 4 April 2016, the LLP structure serviced an additional £3,923,924,678 of covered bond issuances:

<u>Note</u>	<u>Amount</u>	<u>Date</u>
Cov Bond 55	£750 million	Apr-15
N Bond 16	€25 million	Apr-15
Cov Bond 56	€50 million	May-15
Cov Bond 57	€105 million	Jun-15
N Bond 17	€50 million	Jul-15
Cov Bond 59	€1,000 million	Jul-15
N Bond 18	€45 million	Jul-15
Cov Bond 58	€100 million	Jul-15
Cov Bond 60	€1,000 million	Oct-15
Cov Bond 61	€35 million	Nov-15
Cov Bond 2015-13	€50 million	Dec-15
Cov Bond 2015-14	€25 million	Dec-15
Cov Bond 2015-15	€100 million	Dec-15
CB 2016-1	€25 million	Jan-16
CB 2016-2	€30 million	Jan-16
CB 2016-3	€51 million	Feb-16
CB 2016-4	€50 million	Feb-16
CB 2016-5	€40 million	Feb-16
CB 2016-6	€25 million	Mar-16
CB 2016-7	€1,250 million	Mar-16
CB 2016-8	€30 million	Mar-16
CB 2016-9	€50 million	Mar-16
CB 2016-10	€50 million	Mar-16
CB 2016-11	€40 million	Mar-16
CB 2016-12	€80 million	Mar-16

During the year, the following notes matured:

<u>Note</u>	<u>Amount</u>	<u>Date</u>
Cov Bond 1	€2,000 million	Dec 2015
Cov Bond 32	€1,250 million	Sept 2015

The balance sheet on page 13 of the financial statements shows the LLP's financial position at the year end.

#### Future developments

The LLP will continue to guarantee covered bonds issued by the Society by acquiring mortgage loans and their related security from the Society.



**Strategic goals**

Although strategic goals are set at Group level, the board of directors is aware of the Company's active role in supporting the Group's ambition to meet these targets. The key performance indicators (KPIs) in relation to the Group's strategic goals are set out below:

- Market leading customer satisfaction
- Grow the membership with members who have a meaningful relationship
- Protect and grow our market shares in: mortgages, savings and current accounts
- Next generation banking offering a choice of access for members
- Being 1<sup>st</sup> choice with an iconic brand, effective in digital and traditional media
- Engage and enable our people to maintain industry leading levels of customer service and to grow the business
- A commitment to being a leading corporate citizen
- Delivering optimum profitability by targeting £1.0 - £1.5 billion underlying profit per annum
- Deliver operational efficiency and prudent cost management, targeting a medium term cost income ratio of less than 55%
- Ensure capital strength with a minimum leverage ratio of 4.5%

Further information on the Group's performance against these, and also the strategic goals for the next five years can be found in the Overview section of the Group Annual Report and Accounts.

The programme performance is monitored monthly for financial and non-financial indicators including covenants and tests for managing risk which are published within the monthly investor report (available via Nationwide Building Society website), for example: the Asset Coverage Test (ACT); Interest Coverage Test; Servicer Trigger (which monitors the servicer's ratings to required levels); and Yield Shortfall Test (which checks that the portfolio yield does not fall below LIBOR plus 0.15%).

The level of over-collateralisation is central to the contractual mechanics and to credit rating agencies oversight. The level of over-collateralisation can be estimated using the ACT which is carried out each month and is deemed to establish the level of over-collateralisation for the LLP.

To date, all loan and note repayments have been made in accordance with the scheduled repayment dates.

**Results**

The profit for the year was £19.1 million (2015: £56.4 million profit). This is composed primarily of net interest expense of £2.1 million (2015: £1.7 million) and gains from derivatives and hedge accounting of £19.1 million (2015: £56.4 million profit).

Profits on a cash flow basis are pre-determined under the Covered Bonds LLP programme documentation. The cash flow profits before tax, which exclude gains/(losses) from derivatives and hedge accounting and foreign exchange gains/(losses), are fixed to a maximum of £1 per annum.

At 4 April 2016, the amount of beneficial interests in the mortgage loan portfolio was £19.0 billion (2015: £17.2 billion) and the amount of the deemed loan was £13.4 billion (2015: £11 billion). The major difference of £5.6 billion (2015: £6.2 billion) represents the amount of over collateralisation in the structure.

**Risk management and control of the Group**

The Group's mutual model ensures focus on securing the long-term needs of its members whilst maintaining a balance sheet primarily invested in UK residential property and an investment grade liquidity portfolio. Sound management has reduced our exposure to higher risk assets over recent years and retained profits have allowed investment in ongoing service development and strengthened the capital position.

While the Group is a low risk organisation, inevitably it faces challenges that pose strategic risks to the delivery of planned objectives and operational risks as it continues to embrace the digital revolution.

Although the Group's financial position continues to strengthen, risks remain. A number of factors could affect the Group's financial and lending risks. These include ongoing political uncertainty in the Eurozone and potential economic weakness that could adversely impact the operating environment of the Group.

The Group continues to focus on oversight of macroeconomic and market uncertainty. On 23 June 2016 the UK held a referendum on whether the UK should remain a member of the European Union. The UK voted to leave the European Union and, as a result, there are a number of uncertainties in connection with the future of the UK and its relationship with the European Union. The negotiation of the UK's exit terms is likely to take a number of years. Until the terms and timing of the UK's exit from the European Union are confirmed it is not possible to determine the impact that the referendum, the UK's departure from the European Union and/or any related matters may have on general economic conditions in the UK and on the Group.

It is also almost certain that regulators' and customers' expectations will increase, and their tolerance for failure will reduce. Dealing effectively with regulation is an important part of running a modern financial institution. The Group's business model and member focus put it in a good position to meet regulatory expectations of conduct.

The Group has not been subject to the same level of regulatory censure as its main competitors, reflecting its commitment to delivering good conduct and fair customer outcomes. This is borne out by the Group having far fewer complaints to the Financial Ombudsman Service upheld when compared to the industry as a whole.

In common with other retail financial services organisations, our business model results in a number of inherent risks which are continuously monitored and managed. These are categorised as follows:

- Lending risk
- Financial risk
- Operational risk
- Compliance, conduct and customer experience
- Strategic risk, and
- Model risk.

The risk management objectives and policies which correspond to these risks and uncertainties and details on how these are managed and mitigated can be found in the 'Business and Risk Report' section of the 2016 Annual Report and Accounts.

By order of the Management Board

**Stephen Tyrie**



For and on behalf of the LLP

Date: 28<sup>th</sup> July 2016

## **NATIONWIDE COVERED BONDS LLP**

### **Independent auditors' report to the members of Covered Bonds LLP**

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#### **Report on the financial statements**

##### **Our opinion**

In our opinion, Nationwide Covered Bonds LLP's financial statements (the "financial statements"):

- give a true and fair view of the state of the limited liability partnership's affairs as at 4 April 2016 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006 as applied to limited liability partnerships by the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008.

##### **What we have audited**

Nationwide Covered Bonds LLP's financial statements comprise:

- the Balance Sheet as at 4 April 2016;
- the Profit and Loss Account for the year then ended;
- the Statement of movements in members' interests for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS 101 "Reduced Disclosure Framework".

In applying the financial reporting framework, the members have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

##### **Other matters on which we are required to report by exception**

##### **Adequacy of accounting records and information and explanations received**

Under the Companies Act 2006 as applicable to limited liability partnerships we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

##### **Responsibilities for the financial statements and the audit**

##### **Our responsibilities and those of the members**

As explained more fully in the Statement of members' responsibilities set out on page 6, the members are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

## **NATIONWIDE COVERED BONDS LLP**

### **Independent auditors' report to the members of Covered Bonds LLP**

#### **Our responsibilities and those of the members (continued)**

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinion, has been prepared for and only for the members of the partnership as a body in accordance with the Companies Act 2006 as applied to limited liability partnerships by the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

#### **What an audit of financial statements involves**

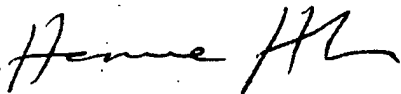
We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the limited liability partnership's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the designated members; and
- the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the members' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report and Financial Statements to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.



Hemione Hudson (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London  
28 July 2016

- (a) The maintenance and integrity of the Nationwide Building Society website is the responsibility of the members; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.
- (b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

**Profit and Loss Account for the year ended 4 April 2016**

	Note	2016 £'000	2015 £'000
Interest receivable and similar income	3	172,459	214,310
Interest payable and similar charges	4	(170,373)	(212,583)
<b>Net interest expense</b>		<b>2,086</b>	<b>1,727</b>
Gains/(Losses) from derivatives and hedge accounting	5	19,050	56,432
Administrative expenses	6	(2,086)	(1,727)
<b>Profit/(Loss) for the year</b>		<b>19,050</b>	<b>56,432</b>

No other comprehensive income was earned during the year (2015: £nil).

The notes on pages 15 to 34 form part of these financial statements.

**NATIONWIDE COVERED BONDS LLP****Balance Sheet as at 4 April 2016**

	Note	2016 £'000	2015* £'000
<b>Assets</b>			
Cash and cash equivalents	7	1,328,306	1,804,109
Loans and other debts due from members	8	13,159,342	11,171,271
Derivative financial instruments	9	1,895,043	1,535,493
<b>Total assets</b>		<b>16,382,691</b>	<b>14,510,873</b>
<b>Liabilities</b>			
Loans from members	10	15,051,842	12,599,434
Other debts due to members	11	-	229,681
Derivative financial instruments	9	281,757	846,052
Accruals		-	147
Other liabilities	12	1,000,948	806,465
<b>Total liabilities</b>		<b>16,334,547</b>	<b>14,481,779</b>
<b>Members' other interests</b>			
General reserve		48,144	29,094
<b>Total members' other interests</b>		<b>48,144</b>	<b>29,094</b>
<b>Total members' other interests and liabilities</b>		<b>16,382,691</b>	<b>14,510,873</b>
<b>Total members' interests</b>			
Members' interests in general reserves		48,144	29,094
Loans from members		15,051,842	12,599,434
Other debts due to members		-	229,681
Loans and other debts due from members		(13,159,342)	(11,171,271)
<b>Total members' interests</b>		<b>1,940,644</b>	<b>1,686,938</b>

\*Comparatives have been restated as detailed in note 1.

The notes on pages 15 to 34 form part of these financial statements.

The members acknowledge their responsibility for complying with the requirements of the Companies Act 2006 with respect to accounting records and for the preparation of financial statements.

The financial statements were approved by the members on 28 July 2016.

Signed on behalf of the members

**Stephen Tyrrie**



**NATIONWIDE COVERED BONDS LLP****Statement of movements in members' interests for the year ended 4 April 2016**

	<b>General reserve £'000</b>	<b>Loans from/(to) members £'000</b>	<b>Total £'000</b>
<b>General reserve at 5 April 2015</b>	<b>29,094</b>	<b>-</b>	<b>29,094</b>
<b>Profit for the year</b>	<b>19,050</b>	<b>-</b>	<b>19,050</b>
<b>Balance carried forward at 4 April 2016</b>	<b>48,144</b>	<b>-</b>	<b>48,144</b>
Loans from members	-	15,051,842	15,051,842
Other debts due to members	-	-	-
Loans and other debts due from members	-	(13,159,342)	(13,159,342)
<b>Members' interests as at 4 April 2016</b>	<b>48,144</b>	<b>1,892,500</b>	<b>1,940,644</b>

	<b>General reserve £'000</b>	<b>Loans from/(to) members* £'000</b>	<b>Total £'000</b>
<b>General reserve at 5 April 2014</b>	<b>(27,338)</b>	<b>-</b>	<b>(27,338)</b>
<b>Profit for the year</b>	<b>56,432</b>	<b>-</b>	<b>56,432</b>
<b>Balance carried forward at 4 April 2015</b>	<b>29,094</b>	<b>-</b>	<b>29,094</b>
Loans from members	-	12,599,434	12,599,434
Other debts due to members	-	229,681	229,681
Loans and other debts due from members	-	(11,171,271)	(11,171,271)
<b>Members' interests as at 4 April 2015</b>	<b>29,094</b>	<b>1,657,844</b>	<b>1,686,938</b>

\*Comparatives have been restated as detailed in note 1.

The notes on pages 15 to 34 form part of these financial statements.

**1 Accounting policies****Basis of preparation**

The LLP financial statements have been prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework.

The LLP's ultimate parent undertaking is Nationwide Building Society. The Society's board of directors has confirmed that it will continue to fund the LLP's activities for the foreseeable future. The foreseeable future is considered for this purpose to be a period at least 12 months forward from the date of approval of the financial statements. Taking this into account, the members have a reasonable expectation that the LLP has adequate resources to continue in business for the foreseeable future and therefore continue to adopt the going concern basis in preparing the financial statements.

The principal accounting policies applied in the preparation of these financial statements are set out below.

The preparation of financial statements in conformity with general accepted accounting principles 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.

The financial information has been prepared under the historical cost convention as modified by revaluations of derivative financial instruments.

**Changes in accounting policy**

The following pronouncement, relevant to the LLP, was adopted with effect from 5 April 2014:

Financial Reporting Standard 101 Reduced Disclosure Framework (FRS 101). This standard allows exemption from specific disclosures in the financial statements of qualifying entities that otherwise apply EU-adopted IFRS, the most significant of which removes the requirement to prepare a cash flow statement, the requirement to disclose related party transactions entered into between two or more members of a group, provided that any subsidiary party to the transaction is wholly owned by such a member, and the disclosure of future relevant accounting standards that are not yet in effect. FRS 101 is effective for qualifying entities for accounting periods beginning on or after 1 January 2015. Early adoption is permitted before this date, of which the above exemptions have been implemented by Nationwide Covered Bonds LLP.

**Foreign Exchange translation**

Covered Bonds LLP holds monetary items denominated in foreign currencies which are translated to sterling at the reporting date. Any resulting foreign exchange gains and losses from the retranslation have previously been presented within 'interest receivable and similar charges' in the income statement. The group utilises derivatives to economically hedge this foreign exchange exposure with fair value gains and losses on these derivatives presented within 'gains/losses from derivatives and hedge accounting' in the income statement. To provide a more meaningful presentation of Covered Bonds LLP residual economic foreign exchange exposure, amounts in relation to the retranslation of foreign currency monetary items have been reclassified from 'interest receivable and similar charges' to 'gains/losses from derivatives and hedge accounting' in the income statement to offset against the movement in derivative values.



## NATIONWIDE COVERED BONDS LLP

### Notes to the financial statements for the year ended 4 April 2016

#### 1 Accounting policies (continued)

Comparatives have been restated to reflect this reclassification as shown below:

	Note	Previously Published £'000	Adjustment £'000	Restated £'000
<b>Covered Bond</b>				
Interest receivable and similar income	3	174,376	39,934	214,310
Gains/(Losses) from derivatives and hedge accounting	5	96,366	(39,934)	56,432

This reclassification has no impact on net assets or members' interest at 4 April 2015 and no impact on net cash flows generated from operating activities or cash and cash equivalents for the year ended 4 April 2016.

#### Other adjustments to comparative information

The 2015 balance sheet and statement of movements in members' interests comparatives include a restatement of £193,338,000 which increased both 'Loans and other debts due from members' and 'Other debts due to members'. These items had previously been incorrectly presented. This restatement has no impact on net assets, members' interest or the income statement.

#### Derecognition

If a transferor retains substantially all the risks and rewards associated with the transferred assets, the transaction is accounted for as a financing transaction, notwithstanding that it is a sale transaction from a legal perspective. The members of the LLP have concluded that the Originator has retained substantially all the exposure to risks and rewards of the pool of mortgage loans and as a consequence, the LLP does not recognise the mortgage loans on its balance sheet but rather a loan due from the Originator.

The basis swaps between the LLP and the Originator are not recognised separately as financial derivative instruments, as the amounts payable under the swaps reflect interest flows from the mortgage loans which are not recognised by the LLP for accounting purposes. Instead, the deemed loan to the Originator is recognised with an effective interest rate which reflects the amount receivable under the swap receiving leg.

#### Contributions and drawings

Under the terms of the transaction documents for the sale of the mortgage loans, Nationwide Building Society is legally treated as having made a capital contribution to the LLP in an amount equal to the difference between the current balance of the loans sold at transfer date and the cash payment made by the LLP for the loans and relevant security on that transfer date.

If so requested by the Management Board, the members may, from time to time, make cash contributions to the LLP which will constitute cash capital contributions. The liquidation member, Moulton Capital Finance Limited, will not make any capital contributions to the LLP. No interest is paid on the members' capital balances.

As the sale of the beneficial interest in the mortgage portfolio does not pass the derecognition criteria as described in IAS 39, capital contributions in the financial statements only consist of cash capital contributions.

Capital distributions may only be made in accordance with the LLP Deed where sufficient principal receipts are available and higher priority payments have been made.

**1 Accounting policies (continued)****Contributions and drawings (continued)**

Under the priority of payments, payment pro rata and pari passu to the members of the sum of £3,000 in aggregate (or such other sum as may be agreed by members from time to time) is allocated and paid to each member in proportion to their respective capital contribution balances as at the relevant calculation date, subject to a minimum of £1 each, as their profit for their respective interests as members in the LLP.

**Deferred consideration**

Under the terms of the mortgage sale agreement, Nationwide Building Society, as the Originator of the mortgage loans, retains the right to receive excess income (deferred consideration) arising on those loans, after certain higher priority payments have been met by the LLP. Deferred consideration is treated as a reduction in the interest due from the Nationwide Building Society on the loan arising from the failure to derecognise the sale of the mortgages. Deferred consideration is presented within other debts due to members where not paid.

**Interest receivable and interest expense**

Interest income and expense are recognised in the profit and loss account on an effective interest rate (EIR) basis. The EIR 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 LLP estimates cash flows considering all contractual terms of the financial instrument 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 EIR and all other premiums or discounts above or below market rates.

Interest income on derivatives is included in interest receivable and similar income and interest expense and similar charges in the profit and loss account.

Interest receivable is presented net of amounts payable for profits in excess of the £1 per annum limit set out in the programme documents. The associated amounts payable are presented net within loans and other debts due to members.

**Fees and commissions**

Direct fees and costs incremental to generating a financial instrument are deferred and spread as interest receivable or expense on an effective interest basis.

Other fees and commissions are recognised on the accruals basis as services are provided, or on the performance of a significant act.

**Segmental reporting**

The LLP has only one business segment and operates wholly in the UK. Accordingly no segmental analysis is presented in these financial statements.

**Taxation including deferred tax**

Taxation on all partnership profits is solely the liability of members. Consequently, neither taxation nor related deferred taxation in the LLP is accounted for in these financial statements.

**1 Accounting policies (continued)****Loans and other debts due from members**

The entity classifies its loans and other debts due from members as loans and receivables which are held at amortised cost. As described above the sale of the beneficial interest in the mortgage portfolio; even though legally acquired from the Nationwide Building Society, does not pass the derecognition criteria as described in IAS 39 and therefore a deemed loan is shown in the balance sheet.

**Impairment of financial assets**

At each balance sheet date the LLP assesses whether, as a result of one or more events occurring after initial recognition, there is objective evidence that a financial asset has become impaired. Evidence of impairment may include indications that the counterparty is experiencing significant financial difficulty, default or delinquency in interest or principal payments.

The carrying amount of the asset is reduced by the amount of any impairment loss. Any losses are recognised in the profit and loss account.

**Derivatives and hedge accounting**

Derivatives are entered into to reduce exposure to fluctuations in interest rates and exchange rates and are not used for speculative purposes.

**a) Derivative financial instruments**

Other than as noted in (c) below, derivatives are carried at fair value with movements in fair value recorded in the profit and loss account. 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 counterparties. For collateralised positions the LLP uses discount curves based on overnight indexed swap rates, as detailed in note 5, and for non-collateralised positions the LLP uses discount curves based on term Libor rates.

In the first instance fair values are calculated using mid prices. 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.

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 a legal ability 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 LLP, it is included as a liability. Where cash collateral is given, to mitigate the risk inherent in amounts due from the LLP, it is included as an asset.

**1 Accounting policies (continued)****Derivatives and hedge accounting (continued)****b) Hedge accounting**

When transactions meet the criteria specified in IAS 39, the LLP applies fair value hedge accounting so that changes in the fair value of the underlying asset or liability that are attributable to the hedged risk are recorded in the profit and loss account to offset the fair value movement of the related derivative.

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. Effectiveness must be tested throughout the life of the hedge relationship.

The LLP 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; or
- iii) the underlying item matures or is sold or repaid.

The LLP 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.

If the derivative no longer meets the criteria for hedge accounting, the cumulative fair value hedging 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 reflected in the profit and loss account.

**c) Derivatives hedging beneficial interest in the mortgage portfolio**

The LLP holds derivatives to hedge interest rate risk associated with the beneficial interest on the mortgage portfolio. These derivatives are not fair valued as under IAS 39 they are accounted for on an accruals basis as part of the deemed loan to originator included in loans and other debts due from members of the LLP.

**2 Judgements in applying accounting policies and critical accounting estimates**

No judgements, estimates or assumptions have been made that are considered critical to the preparation of these financial statements.

**3 Interest receivable and similar income**

	<b>2016</b>	<b>2015</b>
	<b>£'000</b>	<b>£'000</b>
Interest receivable from members	<b>291,344</b>	329,001
Excess profits payable	<b>(120,302)</b>	(119,382)
Bank interest receivable	<b>1,417</b>	4,691
	<b>172,459</b>	214,310

**NATIONWIDE COVERED BONDS LLP****Notes to the financial statements for the year ended 4 April 2016**

<b>4 Interest payable and similar charges</b>	<b>2016 £'000</b>	<b>2015 £'000</b>
Interest payable on loans from members	330,909	416,781
Interest receivable on derivative financial instruments	(160,536)	(204,198)
	<b>170,373</b>	<b>212,583</b>
<b>5 Gains/(Losses) from derivatives and hedge accounting</b>	<b>2016 £'000</b>	<b>2015 £'000</b>
Derivatives designated as fair value hedges	(24,109)	448,134
Fair value movement attributable to hedged risk	1,349	(445,149)
(Losses)/ Gains/ from fair value hedge accounting (note i)	(22,760)	2,985
Fair value gains/(losses) from other derivatives (note ii)	6,745	93,381
Foreign exchange gain/(loss) *	35,065	(39,934)
	<b>19,050</b>	<b>56,432</b>

**Foreign currency risk**

The current operating currencies of the LLP are in Sterling, Euros and Norwegian Krona. As the LLP prepares its financial statements in Sterling these will be affected by movements in the currency exchange rates. This exposure is mitigated by the use of cross currency derivatives. In particular the LLP hedges all of its exposure on its currency borrowings back to Sterling by the use of cross currency derivatives and it therefore does not have a material economic exposure to foreign exchange gains and losses. Accordingly it does not separately monitor value at risk arising from open foreign currency positions.

\*An accounting gain of £35.1 million is included in the profit and loss account in respect of open foreign currency positions for the year ended 4 April 2016. (2015: £39.9 million loss).

**Notes**

(i) Gains or losses from fair value hedges can arise where there is a hedge accounting relationship in place and either:

- the relationship passed all the monthly effectiveness tests but the fair value of the derivative was not exactly offset by the change in fair value of the liability being hedged (sometimes referred to as hedge effectiveness) 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) 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 applied at the LLP.

## **NATIONWIDE COVERED BONDS LLP**

### **Notes to the financial statements for the year ended 4 April 2016**

#### **5 Gains/(Losses) from derivatives and hedge accounting (continued)**

##### **Foreign currency risk (continued)**

Although the LLP uses derivatives exclusively to hedge risk exposures in interest rates or exchange rates, volatility in the profit and loss account can still arise due to hedge accounting ineffectiveness or because hedge accounting is not achievable. Management recognise that this arises from the application of accounting rules which do not reflect the economic reality of the business and as such this volatility will continue period on period but will always trend back to zero over time.

A gain of £19.1 million (2015: £56.4 million gain) has been recognised in the year ended 4 April 2016 for derivatives and hedge accounting. Included within this result was the impact of the following:

- Losses of £22.8 million (2015: £2.9 million gain) on micro hedge relationships; and
- Gains of £6.7 million (2015: £93.4 million gain), principally a result of volatility in sterling: euro interest rates on cross currency interest rate swaps used to economically hedge non-sterling wholesale funding.
- Foreign Exchange gains of £35.1 million (2015: £39.9 million loss) as a result of the revaluation of currency items

<b>6 Administrative expenses</b>	<b>2016 £'000</b>	<b>2015 £'000</b>
Credit Rating Agency fees	958	911
Legal fees	474	271
Non audit fees payable to auditor	215	273
Audit fees payable as auditor	22	17
Other administrative expenses	417	255
	<b>2,086</b>	<b>1,727</b>

#### **7 Cash and cash equivalents**

The LLP has placed its deposit account with the Nationwide Building Society as a provider of a Guaranteed Investment Contract. Withdrawals from this account are restricted by the detailed priority of payments set out in the transaction documents. The cash balance includes £1,001 million (2015: £806 million) collateral support to the derivatives deposited with the Covered Bonds LLP as at 4 April 2016 by swap providers other than Nationwide Building Society.

#### **8 Loans and other debts due from members**

The loan to members of £13,159 million (2015: £11,171 million) represents a deemed loan to the Nationwide Building Society, generated as a result of the beneficial interest in the mortgage portfolio failing the derecognition criteria described in IAS 39. The deemed loan replaces the beneficial interest in the mortgage portfolio legally held by the LLP, and represents the substance of the transaction for accounting purposes.

# NATIONWIDE COVERED BONDS LLP

## Notes to the financial statements for the year ended 4 April 2016

### 8 Loans and other debts due from members (continued)

If the derecognition criteria had been met the LLP would have shown a beneficial interest in a mortgage portfolio of £18,996 million as at 4 April 2016 (2015: £17,161 million). The mortgages are secured on residential property and are all designated in sterling at either fixed rates or at variable rates of interest, based on the standard variable rate of the Society. As discussed in note 1, the LLP has entered into a basis swap with the Society to swap the interest flow from these mortgages into a floating rate of return based on LIBOR. This swap is not recognised as a separate derivative financial instrument.

	2016 £'000	2015* £'000
Loans and other debts due from members	13,159,342	11,171,271
Over-collateralisation	4,963,065	5,460,329
Deferred consideration presented in other debts due to members	-	(229,681)
Excess profits payable	859,036	738,707
Accrued interest on basis swap	14,836	20,173
<b>Beneficial interest in a mortgage portfolio</b>	<b>18,996,279</b>	<b>17,160,799</b>

\*Comparatives have been restated as detailed in note 1.

### 9 Derivative financial instruments

All derivative financial instruments are held for economic hedging purposes although not all derivatives are designated as hedging instruments under the terms of IAS 39. The table below analyses derivatives between those designated as hedging instruments and those which, whilst in economic hedging relationships, are not designated as hedging instruments.

	2016			2015		
	Contract/ notional amount £'000	Fair value Asset £'000	Fair value Liability £'000	Contract/ notional amount £'000	Fair value Asset £'000	Fair value Liability £'000
Derivatives designed as fair value hedging instruments						
Interest rate swaps	11,938,587	1,301,230	11,432	10,304,833	1,283,976	8,177
Other derivatives not designated in hedge accounting relationship						
Cross currency interest rate swaps	10,976,025	593,813	270,325	10,179,727	251,517	837,875
<b>Total</b>	<b>22,914,612</b>	<b>1,895,043</b>	<b>281,757</b>	<b>20,484,560</b>	<b>1,535,493</b>	<b>846,052</b>

**9 Derivative financial instruments (continued)**

The fair values in the above table are inclusive of accrued interest as follows:

- Cross currency interest rate swaps asset includes £1,336,069 interest payable (2015: £611,764 interest payable).
- Interest rate swaps asset includes £76,180,243 interest receivable (2015: £91,753,564 interest receivable).
- Cross currency interest rate swaps liability includes £2,530,759 interest receivable (2015: £2,445,793 interest receivable).
- Interest rate swaps liability includes £572,582 interest receivable (2015: £69,801 interest receivable).

An analysis of the maturity profiles of the derivatives can be found in note 14.

Contract / notional amount indicates the amount outstanding at the balance sheet date and does not represent amounts at risk.

**Offsetting**

The LLP has financial assets and liabilities for which there is a legally enforceable right to set off the recognised amounts, and which may be settled net. However the netting arrangements do not result in an offset of balance sheet assets and liabilities for accounting purposes as the right to set off is not unconditional in all circumstances. Therefore, in accordance with IAS 32 Financial Instruments: Presentation, there are no financial assets or liabilities which are offset with the net amount presented on the balance sheet. All financial assets and liabilities are presented on a gross basis on the balance sheet.

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 but the Offset Criteria are otherwise not satisfied, and
- Financial collateral is paid and received.

Master netting arrangements consist of agreements such as an International Swaps and Derivatives Association (ISDA) Master Agreement, whereby outstanding transactions with the same counterparty can be offset and settled net following a default or other predetermined event.

Financial collateral on derivative financial instruments consists of cash and securities settled, typically daily or weekly, to mitigate the mark to market exposures. Where cash collateral is received to mitigate the risk inherent in amounts due to the LLP, it is included as a liability. Where cash collateral is given to mitigate the risk inherent in amounts due from the LLP, it is included as an asset.

The 'Net amounts after offsetting under IFRS 7' presented below shows the exposure to counterparty credit risk for derivative contracts after netting benefits, and are not necessarily intended to represent the LLP's actual exposure to credit risk due to a variety of credit mitigation strategies which may be employed in addition to netting and collateral arrangements. Any such credit mitigation strategies are discussed further in the Credit Risk section of the note 14.



# NATIONWIDE COVERED BONDS LLP

## Notes to the financial statements for the year ended 4 April 2016

### 9 Derivative financial instruments (continued)

	Gross and net amounts reported on the balance sheet £'000	Master netting arrangements £'000	Financial collateral £'000	Net amounts after offsetting under IFRS 7 £'000
<b>4 April 2016</b>				
<b>Financial assets</b>				
Derivative financial instruments	1,895,043	(292,033)	(1,593,067)	9,943
<b>Total assets</b>	<b>1,895,043</b>	<b>(292,033)</b>	<b>(1,593,067)</b>	<b>9,943</b>
<b>Financial liabilities</b>				
Derivative financial liabilities	281,757	(292,033)	-	10,276
<b>Total liabilities</b>	<b>281,757</b>	<b>(292,033)</b>	<b>-</b>	<b>10,276</b>

<b>4 April 2015</b>				
<b>Financial assets</b>				
Derivative financial instruments	1,535,493	(846,052)	(686,639)	2,802
<b>Total assets</b>	<b>1,535,493</b>	<b>(846,052)</b>	<b>(686,639)</b>	<b>2,802</b>
<b>Financial liabilities</b>				
Derivative financial liabilities	846,052	(846,052)	-	-
<b>Total liabilities</b>	<b>846,052</b>	<b>(846,052)</b>	<b>-</b>	<b>-</b>

### 10 Loans from LLP members

The amount owing to members represents advances equivalent to the amounts borrowed by LLP under its Secured Loan Programme, as follows:

Coupon Rate	Maturity	Notional	2016 £'000	2015 £'000
3.500%	due 2015	(EUR 2000m)	-	1,467,108
2.875%	due 2015	(EUR 1250m)	-	917,150
3.125%	due 2016	(EUR 1500m)	1,195,654	1,099,392
4.100%	due 2017	(EUR 58m)	46,249	42,563
3.810%	due 2017	(EUR 116m)	92,314	84,951
Libor + 0.200%	due 2017	(GBP 750m)	749,713	749,491
5.270%	due 2018	(NOK 400m)	33,722	33,919
Libor + 0.500%	due 2018	(GBP 750m)	750,000	-
0.750%	due 2019	(EUR 1000m)	796,627	732,963
4.890%	due 2020	(NOK 500m)	42,147	42,393
0.375%	due 2020	(EUR 1000m)	793,367	-
0.277%	due 2020	(EUR 100m)	79,751	-
5.560%	due 2021	(NOK 500m)	42,119	42,359
4.625%	due 2021	(EUR 1250m)	992,388	912,633
5.695%	due 2021	(NOK 500m)	42,150	42,397
0.750%	due 2021	(EUR 1000m)	797,078	733,557
0.125%	due 2021	(EUR 1250m)	992,554	-
0.185%	due 2021	(EUR 80m)	63,801	-
4.375%	due 2022	(EUR 2000m)	1,592,449	1,465,337
0.750%	due 2022	(EUR 1000m)	795,738	-

# NATIONWIDE COVERED BONDS LLP

Notes to the financial statements for the year ended 4 April 2016

## 10 Loans from LLP members (continued)

Coupon Rate	Maturity	Notional	2,016	2,015
			£'000	£'000
4.699%	due 2023	(EUR 50m)	39,865	36,689
0.000%	due 2023	(EUR 25m)	20,664	-
4.924%	due 2025	(EUR 132m)	105,074	96,686
5.625%	due 2026	(GBP 750m)	744,457	744,045
4.565%	due 2026	(EUR 100m)	79,735	73,385
4.120%	due 2026	(EUR 50m)	39,838	36,663
Libor + 1.500%	due 2026	(GBP 100m)	99,987	99,995
3.770%	due 2027	(EUR 103m)	82,131	75,591
0.625%	due 2027	(EUR 750m)	590,978	543,358
Libor + 1.500%	due 2028	(GBP 100m)	99,995	99,995
3.555%	due 2028	(EUR 158m)	125,590	115,589
4.433%	due 2029	(EUR 40m)	31,892	29,352
3.750%	due 2029	(EUR 40m)	31,894	29,354
2.250%	due 2029	(EUR 750m)	593,011	545,502
3.832%	due 2030	(EUR 88m)	70,167	64,580
1.000%	due 2030	(EUR 50m)	39,876	36,701
4.740%	due 2031	(EUR 30m)	23,900	21,994
Libor + 1.500%	due 2031	(GBP 50m)	49,998	49,997
1.703%	due 2031	(EUR 100m)	79,751	-
1.195%	due 2031	(EUR 50m)	39,876	-
5.010%	due 2032	(EUR 50m)	39,855	36,679
3.900%	due 2032	(EUR 77m)	61,385	56,495
1.620%	due 2032	(EUR 50m)	39,876	-
1.351%	due 2034	(EUR 105m)	83,739	-
0.746%	due 2035	(EUR 25m)	19,938	-
0.750%	due 2035	(EUR 50m)	39,876	-
1.760%	due 2035	(EUR 45m)	35,888	-
1.770%	due 2035	(EUR 50m)	39,876	-
1.540%	due 2035	(EUR 35m)	27,913	-
1.680%	due 2035	(EUR 25m)	19,938	-
1.395%	due 2036	(EUR 51m)	40,673	-
1.345%	due 2036	(EUR 50m)	39,876	-
1.331%	due 2036	(EUR 30m)	23,925	-
1.390%	due 2036	(EUR 40m)	31,900	-
1.425%	due 2038	(EUR 50m)	39,876	-
1.940%	due 2039	(EUR 56m)	44,661	41,105
2.067%	due 2039	(EUR 50m)	39,876	36,701
1.693%	due 2039	(EUR 50m)	39,876	36,701
1.673%	due 2041	(EUR 25m)	19,938	-
1.618%	due 2041	(EUR 30m)	23,925	-
1.336%	due 2041	(EUR 40m)	31,900	-
			<b>13,671,210</b>	<b>11,273,370</b>
Fair Value adjustment for Micro hedged risk			<b>1,293,089</b>	<b>1,222,894</b>
Accrued Interest			<b>87,543</b>	<b>103,170</b>
			<b>15,051,842</b>	<b>12,599,434</b>

## NATIONWIDE COVERED BONDS LLP

### Notes to the financial statements for the year ended 4 April 2016

#### 11 Other debts due to members

All of the other debts due to members fall due after a minimum of 5 years (2015: all debts fell due after a minimum of 5 years).

#### 12 Other liabilities

The liabilities below relate to collateral support deposited with the Covered Bonds LLP by swap providers following credit rating downgrades of those counterparties.

	2016 £'000	2015 £'000
Collateral support	1,000,948	806,465
	1,000,948	806,465

#### 13 Related party transactions

##### Key management personnel

The LLP Management Committee (comprised of Members and/or employees of the Nationwide Building Society and the representatives of the Moulton Capital Finance Limited) manage and conduct the business of the LLP and have all the rights, power and authority to act at all times for and on behalf of the LLP.

##### Transactions with related parties

A number of transactions are entered into with related parties as part of the LLP's normal business.

	2016 £'000	2015* £'000
<b>Balances</b>		
Loans and other debts due from members	13,159,342	11,171,271
Loans from members	(15,051,842)	(12,599,434)
Other debts due to members	-	(229,681)
<b>Transactions</b>		
Bank interest receivable	1,417	4,691
Interest receivable from members	171,042	209,619
Interest payable on loans from members	(330,909)	(416,781)

\*Comparatives have been restated as detailed in note 1.

#### 14 Risk management and control of the Group

The LLP's activities expose it to a number of financial risks including credit risk and liquidity risk. For this reason, Nationwide Building Society devotes considerable resource to maintaining effective controls to manage, measure and mitigate these risks. The LLP uses derivative financial instruments to hedge certain risk exposures.

Risk management is carried out by a central risk management function of the Nationwide Building Society on a group wide basis.

**14 Risk management and control of the Group (continued)****Control of derivatives**

The LLP uses derivative financial instruments to hedge some of its financial risks but not for any speculative purposes. The Nationwide Building Society's Asset and Liabilities Committee is responsible for setting limits and conditions over the use of derivative products. Any exchange traded instruments are subject to cash requirements under the standard margin arrangements applied by the individual exchanges. Such instruments are not subject to significant credit risk.

Credit exposures arising on derivative contracts with certain counterparties are collateralised with cash deposits to mitigate credit exposure where the credit rating of these counterparties is downgraded below a certain level. Cash collateral received on certain derivatives is disclosed in note 12. For valuing collateralised derivatives the LLP uses discount curves based on overnight indexed swap (OIS) rates, whilst for non-collateralised derivatives the LLP continues to use discount curves based on term Libor rates.

**Credit risk**

Credit risk arises where there is a possibility that a counterparty may default.

The LLP assesses its counterparties for credit risk before contracting with them. Credit rating is the main method used to measure counterparty credit risk. In accordance with the criteria of the rating agencies that rate the Notes, the Programme Documentation contains various rating triggers linked to each counterparty, which require certain actions to be taken if triggers are breached, including the posting of collateral or the replacement of a counterparty.

The maximum exposure to credit risk is the carrying amount of the loans and other debts due from members of £13,159 million (2015: £11,171 million), the derivative financial instruments of £1,895 million (2015: £1,535 million) and cash and cash equivalents with Nationwide Building Society of £1,328 million (2015: £1,804 million).

The primary credit risk of the LLP relates to the credit risk associated with the pool of mortgages originated by Nationwide Building Society.

**NATIONWIDE COVERED BONDS LLP****Notes to the financial statements for the year ended 4 April 2016****14 Risk management and control of the Group (continued)**

The current counterparty credit ratings (short-term/long-term) are included below:

Function	Counterparty	Rating as at 4 April 2016 S&P/Moody's/ Fitch	Rating Trigger Breached	Breach Remedy	Updated rating S&P/Moody's/ Fitch (1)
Account Bank	Nationwide Building Society	A-1/P-1/F1 A/Aa3/A	N	-	A-1/P-1/F1 A/A1/A
Swap Provider	Barclays Bank plc	A-1/P-1/F1 A-/A2/A	Y	Collateral Posted	A-2/P-1/F1 A-/A2/A
Swap Provider	BNP Paribas	A-1/P-1/F1 A/A1/A+	Y	Collateral Posted	A-1/P-1/F1 A+/A1/A+
Swap Provider	Deutsche Bank	A-1/P-2/F1+ BBB+/A3/A-	Y	Collateral Posted	A-2/P-2/F1 BBB+/A3/A
Swap Provider	Nationwide Building Society	A-1/P-1/F1 A/Aa3/A	N	-	A-1/P-1/F1 A/A1/A
Swap Provider	Societe General Paris	A-1/P-1/F1 A/A2/A	Y	Collateral Posted	A-1/P-1/F1 A/A2/A
Swap Provider	HSBC	A-1+/P-1/F1+ AA-/Aa2/AA-	Y	Collateral Posted	A-1+/P-1/F1+ AA-/Aa2/AA-
Swap Provider	Wells Fargo	A-1+/P-1/F1+ AA-/Aa1/AA	Y	Collateral Posted	A-1+/P-1/F1+ AA-/Aa2/AA-

Note (1) As at date of approval of the financial statements

The loans and other debts due from members are secured on residential property. At year end, there was £nil impairment provision against the loans and other debts due from members (2015: £nil). For the LLP, credit risk is additionally mitigated by the over collateralisation of the beneficial interest in mortgages (see note 8) and by eligibility criteria for selection under the secured loan covenants. Subsequent to selection, credit risk is monitored through the application of a monthly asset coverage test. More information on mortgage assets is set out below.

**NATIONWIDE COVERED BONDS LLP****Notes to the financial statements for the year ended 4 April 2016****14 Risk management and control of the Group (continued)**

The tables below present the characteristics of the total mortgage loans pool:

	2016	2015
Aggregate loan balance	<b>£18,966m</b>	<b>£17,161m</b>
Number of loans	<b>211,630</b>	<b>197,860</b>
Largest loan	<b>£958,391</b>	<b>£918,794</b>
Average balance of mortgage loan	<b>£89,762</b>	<b>£86,732</b>
Longest dated mortgage legal maturity	<b>42 years</b>	<b>41 years</b>

Distribution by current loan to value ratio (indexed):

	2016	2015
	%	%
<70%	<b>84</b>	<b>81</b>
70% - 80%	<b>11</b>	<b>13</b>
80% - 90%	<b>4</b>	<b>5</b>
90% - 100%	<b>1</b>	<b>1</b>
>100%	<b>-</b>	<b>-</b>
<b>Total book</b>	<b>100</b>	<b>100</b>
Average loan to value of book (indexed)	<b>49</b>	<b>51</b>

The values of residential property on which the mortgage loans are secured are updated quarterly to reflect changes in the house prices index.

Mortgage loans and advances by payment due status:

	2016		2015	
	£'000	%	£'000	%
Not impaired:				
Neither past due nor impaired	<b>18,791,312</b>	<b>99</b>	<b>16,999,663</b>	<b>99</b>
Past due up to 3 months but not impaired	<b>128,920</b>	<b>1</b>	<b>100,536</b>	<b>1</b>
Impaired	<b>76,047</b>	<b>-</b>	<b>60,600</b>	<b>-</b>
	<b>18,996,279</b>	<b>100</b>	<b>17,160,799</b>	<b>100</b>

A mortgage loan is classified as "impaired" if it is more than 3 months past due or in possessions. Impaired mortgage loans are further analysed as follows:

**NATIONWIDE COVERED BONDS LLP****Notes to the financial statements for the year ended 4 April 2016****14 Risk management and control of the Group (continued)**

	2016 £'000	%	2015 £'000	%
Impaired status:				
Past due 3 to 6 months	44,141	58	35,009	58
Past due 6 to 12 months	21,047	28	16,957	28
Past due over 12 months	10,859	14	8,634	14
Possessions	-	-	-	-
	<b>76,047</b>	<b>100</b>	<b>60,600</b>	<b>100</b>
Residential mortgage accounts by locations:				
		2016 %		2015 %
South-east England (excluding Greater London)		29		28
Central England		18		18
Northern England		16		17
Greater London		14		14
South-west England		9		9
Scotland		6		8
Wales and Northern Ireland		8		6
		<b>100</b>		<b>100</b>

**Liquidity risk**

Liquidity risk is the risk that the LLP is unable to meet the payment obligations associated with its financial liabilities when they fall due.

The LLP liquidity policy is to maintain sufficient liquid resources in the Reserve Bank account to service the swap payments for the next month forward, interest on the loan and any service fees. This is reviewed by the cash manager and any shortfall is funded from the general bank account. Liquidity risk is also mitigated through the additional income collected on the over collateralisation of the beneficial interest in mortgages. All derivatives have the same notional amount and maturity date as the corresponding loans from LLP members. The table below analyses assets and liabilities into relevant maturity ratings based on the remaining period at the balance sheet date to the contractual maturity date.

# NATIONWIDE COVERED BONDS LLP

## Notes to the financial statements for the year ended 4 April 2016

### 14 Risk management and control of the Group (continued)

At 4 April 2016  
Residual maturity

	Due In								Total £000's
	Less than 1 month* £000's	1-3 months £000's	3-6 months £000's	6-9 months £000's	9-12 months £000's	1-2 years £000's	2-5 years £000's	Over 5 years £000's	
<b>Assets</b>									
Cash and cash equivalents	1,328,306	-	-	-	-	-	-	-	1,328,306
Loan and other debts due from members	(14,836)	-	-	1,316,625	-	876,500	5,097,084	5,883,969	13,159,342
Derivative financial instruments	-	-	-	26,084	-	3,314	336,054	1,529,591	1,895,043
<b>Total assets</b>	<b>1,313,470</b>	<b>-</b>	<b>-</b>	<b>1,342,709</b>	<b>-</b>	<b>879,814</b>	<b>5,433,138</b>	<b>7,413,560</b>	<b>16,382,691</b>
<b>Liabilities</b>									
Loans from LLP members	5,244	18,607	9,677	1,239,640	24,477	798,263	4,854,709	8,101,225	15,051,842
Other debts due to members	-	-	-	-	-	-	-	-	-
Derivative financial instruments	-	-	-	111,087	-	5,450	122,547	42,673	281,757
Other liabilities	1,001,025	(77)	-	-	-	-	-	-	1,000,948
<b>Total liabilities</b>	<b>1,006,269</b>	<b>18,530</b>	<b>9,677</b>	<b>1,350,727</b>	<b>24,477</b>	<b>803,713</b>	<b>4,977,256</b>	<b>8,143,898</b>	<b>16,334,547</b>
<b>Net assets/(liabilities)</b>	<b>307,201</b>	<b>(18,530)</b>	<b>(9,677)</b>	<b>(8,018)</b>	<b>(24,477)</b>	<b>76,101</b>	<b>455,882</b>	<b>(730,338)</b>	<b>48,144</b>

\*Includes repayable on demand

At 4 April 2015  
Residual maturity

	Due In								Total* £000's
	Less than 1 month* £000's	1-3 months £000's	3-6 months £000's	6-9 months £000's	9-12 months £000's	1-2 years £000's	2-5 years £000's	Over 5 years* £000's	
<b>Assets</b>									
Cash and cash equivalents	1,804,109	-	-	-	-	-	-	-	1,804,109
Loan and other debts due from members	(20,172)	-	1,119,500	1,790,757	-	1,341,961	1,902,861	5,036,364	11,171,271
Derivative financial instruments	-	-	20,324	151,355	-	40,062	25,841	1,297,911	1,535,493
<b>Total assets</b>	<b>1,783,937</b>	<b>-</b>	<b>1,139,824</b>	<b>1,942,112</b>	<b>-</b>	<b>1,382,023</b>	<b>1,928,702</b>	<b>6,334,275</b>	<b>14,510,873</b>
<b>Liabilities</b>									
Loans from LLP members	3,865	15,558	936,655	1,508,963	22,297	1,175,254	1,577,306	7,359,536	12,599,434
Other debts due to members	-	-	-	-	-	-	-	229,681	229,681
Derivative financial instruments	-	-	124,174	-	-	209,361	84,537	427,980	846,052
Other liabilities	806,465	147	-	-	-	-	-	-	806,612
<b>Total liabilities</b>	<b>810,330</b>	<b>15,705</b>	<b>1,060,829</b>	<b>1,508,963</b>	<b>22,297</b>	<b>1,384,615</b>	<b>1,661,843</b>	<b>8,017,197</b>	<b>14,481,779</b>
<b>Net assets/(liabilities)</b>	<b>973,607</b>	<b>(15,705)</b>	<b>78,995</b>	<b>433,149</b>	<b>(22,297)</b>	<b>(2,592)</b>	<b>266,859</b>	<b>(1,682,922)</b>	<b>29,094</b>

\*Comparatives have been restated as detailed in note 1.



## NATIONWIDE COVERED BONDS LLP

### Notes to the financial statements for the year ended 4 April 2016

#### Prepayment risk

Cash flows are dependent on the underlying mortgage loans originated within Nationwide Building Society. In the normal course of business, a proportion of mortgage borrowers repay their loan in advance of contractual maturity. As a result, the weighted average life of the deemed loan is likely to be significantly less than that implied by the contractual maturity dates of the mortgage pool.

The terms of the loans from LLP members are that repayments of principal will only be made to the extent that sufficient cash flows have been received from the LLP's assets. In the event that prepayment rates in the mortgage pool reduce, principal repayments and the notes may be spread over a longer period.

The table below presents the cash flows payable by the LLP under financial liabilities by remaining contractual maturities at the balance sheet date. The amounts disclosed in the table are the contractual undiscounted cash flows of all financial liabilities (i.e. nominal values).

At 4 April 2016  
Gross contractual  
cash flows

	Due In								Total £000's
	Less than 1 month* £000's	1-3 months £000's	3-6 months £000's	6-9 months £000's	9-12 months £000's	1-2 years £000's	2-5 years £000's	Over 5 years £000's	
Loans from LLP members	5,244	18,607	9,677	1,225,195	24,477	795,969	4,628,777	7,051,329	13,759,275
Other debts due to members**	-	-	-	-	-	-	-	-	-
Derivative financial instruments	1,535	8,939	11,413	118,324	8,084	39,817	217,866	124,353	530,331
Other liabilities	1,001,025	-	-	-	-	-	-	-	1,001,025
<b>Total liabilities</b>	<b>1,007,804</b>	<b>27,546</b>	<b>21,090</b>	<b>1,343,519</b>	<b>32,561</b>	<b>835,786</b>	<b>4,846,643</b>	<b>7,175,682</b>	<b>15,290,631</b>

At 4 April 2015  
Gross contractual  
cash flows

	Due In								Total*** £000's
	Less than 1 month* £000's	1-3 months £000's	3-6 months £000's	6-9 months £000's	9-12 months £000's	1-2 years £000's	2-5 years £000's	Over 5 years*** £000's	
Loans from LLP members	3,876	15,580	936,687	1,508,986	22,319	1,099,425	1,558,951	6,231,350	11,377,174
Other debts due to members**	-	-	-	-	-	-	-	229,681	229,681
Derivative financial instruments	3,762	10,078	138,171	12,724	10,606	265,884	279,425	691,253	1,411,903
Other liabilities	806,465	-	-	-	-	-	-	-	806,465
<b>Total liabilities</b>	<b>814,103</b>	<b>25,658</b>	<b>1,074,858</b>	<b>1,521,710</b>	<b>32,925</b>	<b>1,365,309</b>	<b>1,838,376</b>	<b>7,152,284</b>	<b>13,825,223</b>

\*Includes repayable on demand

\*\* Other debts due to members represent excess revenue receipts currently held by Covered Bonds LLP and are repayable upon the winding up of the structure

\*\*\*Comparatives have been restated as detailed in note 1.

**14 Risk management and control of the Group (continued)****Interest rate risk**

The LLP is exposed to interest rate risk in that its multiple currency interest expense is at fixed and floating rates, whilst its interest income originates from its beneficial interest in a pool of the Nationwide Building Society's mortgages at Sterling fixed and floating rates.

The LLP hedges its exposure to fixed and floating currency rate risk through entering into derivative contracts with Nationwide Building Society and external counterparties. Through a combination of basis, interest rate and cross currency swaps, the LLP is able to swap the interest receivable from its beneficial interest in the pool of the mortgages and the interest payable on its loan liabilities such that the resulting cash flows are matched. Therefore the LLP's exposure to interest rate risk is minimal. Only the interest rate swaps are utilised for hedge accounting.

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

The following table summarises the carrying amounts and fair values of those financial assets and liabilities not presented on the balance sheet at fair value.

At 4 April	2016		2015*	
	Carrying value £'000	Fair value £'000	Carrying value £'000	Fair value £'000
<b>Assets</b>				
Loans and other debts due from members	13,159,342	13,133,711	11,171,271	10,199,565
<b>Liabilities</b>				
Loans from LLP members	15,051,842	15,022,087	12,599,434	12,578,442
Other debts due to members	-	-	229,681	229,681
Accruals and other liabilities	1,000,948	1,000,948	806,612	806,612

\*Comparatives have been restated as detailed in note 1.

The fair value of other debts due to members and accruals and other liabilities approximates carrying value.

The estimated fair value of loans and other debts due from members represents the discounted amount of estimated future cash flows expected to be received based on the underlying mortgage pool assets. Expected cash flows are discounted at current market rates to determine fair value. These are considered to be level 3 within the fair value hierarchy.

The estimated fair value of loans from LLP members represents the discounted amount of cash flows expected to be paid. Expected cash flows are discounted at current market rates to determine fair value.

**Fair value of financial assets and liabilities held at fair value**

The fair value of the derivatives falls within level 2 of the fair value hierarchy. Financial instruments classified as level 2 have been valued using models whose inputs are observable in an active market. Valuations based on observable inputs include swap derivative financial instruments which are valued using market standard pricing techniques. There are no instruments that fall within level 3 of the fair value hierarchy as at 4 April 2016 (2015: none). There have been no movements in and out of level 3 throughout the year.

## **NATIONWIDE COVERED BONDS LLP**

### **Notes to the financial statements for the year ended 4 April 2016**

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#### **16 Capital management**

Capital comprises the retained earnings and is managed on a Group basis.

The Group is subject to the capital requirements imposed by its regulator, the Prudential Regulation Authority (PRA). During the year the Group complied with the capital requirements set by the PRA.

#### **17 Parent undertaking and ultimate controlling entity**

The member companies of the LLP are Nationwide Building Society and Moulton Capital Finance Limited. Both companies are incorporated in the UK and registered in England and Wales.

Nationwide Building Society is the ultimate parent and controlling party which prepares the consolidated financial statements.

It is registered at Nationwide House, Pipers Way, Swindon, Wiltshire, SN38 1NW. The Group Annual Report and Accounts can be obtained from this address or at [www.nationwide.co.uk](http://www.nationwide.co.uk).

#### **18 Post balance sheet events**

The following covered bond issuances were made post 4 April 2016:

<u>Note</u>	<u>Amount</u>	<u>Date</u>
CB 2016 – 14	EUR 60M	23 April 2016
CB 2016 – 13	GBP 750M	25 April 2016
CB 2016 – 15	EUR 25M	07 May 2016