Nationwide Building Society

Preliminary Results Announcement
For the year ended
4 April 2016

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Underlying profit
Profit before tax shown on a statutory and underlying basis is set out on page 9. Statutory profit before tax of £1,279 million has been adjusted for a number of items to derive an underlying profit before tax of £1,337 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.

Forward looking statements
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 the Society and will contain detailed information about the Society and management as well as financial statements.

NATIONWIDE BUILDING SOCIETY

RESULTS FOR THE YEAR ENDED 4 APRIL 2016

Nationwide chairman David Roberts said: "These results are a testament to always putting our members first. I would like to thank Graham Beale for his huge contribution to the Society which has left the business in great shape, prospering as a modern mutual and I wish him well for the future. I am delighted to welcome Joe Garner as Nationwide's new Chief Executive. Joe stood out as someone with a deep understanding of the sector, who has championed customer interest throughout his career, and who will set the strategic direction for the Society and our people."

Nationwide chief executive Joe Garner said: "Nationwide has demonstrated that outstanding customer service is the most sustainable path to excellent business performance. It's a credit to the management and people of the Society that they have consistently understood this and organised Nationwide around this principle. As a result, last year we lent more money to help people into a home of their own than since before the financial crisis in 2007. More people are also choosing to manage their money with Nationwide, with over half a million new current accounts opened in the year. And our loyalty accounts and regular savings offering has led to an increase in member deposit balances of £6.3 billion.

"It is my privilege to have been asked to lead an organisation which has consistently demonstrated that it is possible to be successful by doing the right thing. Our mutual status creates an ownership model that allows us to take a long term view and make decisions in the best interests of our members. This, and our talented people, is Nationwide's strength and our opportunity."

KEY HIGHLIGHTS

- Gross mortgage lending up 20% to £32.6 billion (2015: £27.1 billion)
- Net mortgage lending up 28% to £9.1 billion (2015: £7.1 billion)
- Growth in member deposit balances of £6.3 billion (2015: £1.9 billion)
- Expanded current account base with 525,000 new accounts up 12% on 2015
- Net gainer in current account switching - up 38%
- Ranked number one for customer service satisfaction amongst our high street peer group again this year – extending lead to 7.7%[1]
- Underlying profit up 9% at £1.337 billion (2015: £1.227 billion)
- Statutory profit up 23% at £1.279 billion (2015: £1.044 billion)
- CET1 capital ratio up to 23.2% (2015: 19.8%)
- Leverage ratio improved to 4.2% (2015: 4.1%)

[1] © GfK 2016, Financial Research Survey (FRS), 3 months ending 31 March 2016 vs 31 March 2015, proportion of extremely/very satisfied customers minus proportion of extremely/very/fairly dissatisfied customers summed across current account, mortgage and savings, high street peer group defined as providers with main current account market share >6% (Barclays, Halifax, HSBC, Lloyds Bank (inc C&G), NatWest and Santander). Prior to April 2015, Lloyds Bank and TSB combined as Lloyds TSB Group (including Lloyds Bank, TSB and C&G).

FINANCIAL SUMMARY

	Year to 4 April 2016		Year to 4 April 2015 (note i)	
Financial performance	**£m**		£m	
Total underlying income	**3,333**		3,163	
Underlying profit before tax	**1,337**		1,227	
Statutory profit before tax	**1,279**		1,044	
Mortgage lending	**£bn**	**%**	£bn	%
Group residential – gross/*gross market share*	**32.6**	***13.7***	27.1	*13.4*
Group residential – net/*net market share*	**9.1**	***21.4***	7.1	*31.2*
	%		%	
Average loan to value of new residential lending (by value)	**69**		69	
Member deposits (note ii)	**£bn**	**%**	£bn	*%*
Balance movement/*market share*	**6.3**	***8.7***	1.9	*3.4*
Net receipts	**5.1**		0.8	
Key ratios	**%**		%	
Cost income ratio – underlying basis	**53.9**		51.4	
Cost income ratio – statutory basis	**54.8**		54.3	
Net interest margin	**1.52**		1.47	

	4 April 2016	4 April 2015
Balance sheet	**£bn**	£bn
Total assets	**208.9**	195.6
Loans and advances to customers	**178.8**	170.6
Member deposits (note ii)	**138.7**	132.4
Asset quality	**%**	%
Proportion of residential mortgage accounts 3 months+ in arrears	**0.45**	0.49
Average indexed loan to value of residential mortgage book (by value)	**55**	56
Total provision as % of non-performing balances on residential mortgage lending	**3.2**	3.1
Total provision as % of non-performing balances on commercial real estate lending	**26**	47
Key ratios	**%**	%
Capital – CRD IV		
Common Equity Tier 1 ratio (note iii)	**23.2**	19.8
Leverage ratio (note iii)	**4.2**	4.1
Other balance sheet ratios		
Liquidity coverage ratio	**142.6**	119.3
Wholesale funding ratio (note iv)	**24.8**	23.3
Loan to deposit ratio (note v)	**117.2**	115.6

Notes:

i. Comparatives have been restated for the reclassification of foreign currency retranslation amounts from net interest income to gains/losses on derivatives and hedge accounting as described in note 2 to the preliminary results announcement.

ii. Member deposits include current account credit balances.

iii. Reported under CRD IV on an end point basis. The leverage ratio is calculated using the Capital Requirements Regulation (CRR) definition of Tier 1 for the capital amount and the Delegated Act definition of the exposure measure.

iv. The wholesale funding ratio includes all balance sheet sources of funding (including securitisations) but excludes Funding for Lending Scheme (FLS) drawings which are not included on the Group's balance sheet, reflecting the substance of the arrangement. Off balance sheet FLS drawings totalling £8.5 billion are unchanged from the prior year.

v. The loan to deposit ratio represents loans and advances to customers divided by (shares + other deposits + amounts due to customers).

Chief Executive's Review

Long term focus drives strong performance

I am privileged to have been chosen to take over as Chief Executive of Nationwide Building Society. Nationwide is an exceptional organisation, one which has consistently demonstrated that it is possible to be successful by doing the right thing.

This success is manifested in the latest set of results, which show strong mortgage lending, strong savings inflows and over half a million new current accounts opened. These figures are the result of a consistent and sustained focus on the needs of our members and customers, through the provision of excellent service, great products and continued investment in the fabric which underpins the Society.

Our underlying profit of £1,337 million is the culmination of our performance over the past twelve months and the member relationships that we have formed over previous years. We stood by our members' borrowing needs through the difficult financial crisis and over the four year period to March 2016 accounted for 36% of net mortgage lending in the UK. Our capital ratios have further improved, are comfortably ahead of current requirements and broadly in line with our best understanding of the medium term regulatory requirements. This enables us to be secure and to invest in the future for the benefit of members today and tomorrow.

As the new Chief Executive my job will be to build on this success. As the results show, Nationwide is not in need of radical reform, but it is an organisation that should constantly challenge itself on ways it can improve and offer an enhanced level of service to its members.

Helping more members buy their own home

Our heritage is in providing support to the UK housing market, and 2015/16 was no exception. Over the year our gross mortgage advances reached £32.6 billion, while net lending amounted to £9.1 billion. These represent market shares of 13.7% and 21.4% respectively, strengthening our position as the UK's second largest mortgage lender. As ever, we have recognised the importance of helping people take their initial steps onto the housing ladder, and over the year we provided finance for 57,200 first time buyer mortgages, one in six of all such mortgages in the UK.

Our mutual commitment to providing consistently good value to all members has been delivered through competitive products and propositions, with no fees for standard valuations on all of our mortgage products, and we continue to provide our best rates exclusively to our existing mortgage members.

We have played a major role in supporting borrowers in the buy to let market, in which we have maintained our position as the second largest lender. As the pattern of tenure in the UK continues to evolve, we believe it is right that we should offer good value, low risk loans to investors who are able to demonstrate their commitment to the rental market. We recognise that buy to let has come under regulatory and political scrutiny in recent times, including significant changes to the tax regime governing mortgage interest tax relief which come into effect from 2017. We pride ourselves on being a responsible lender, and since the year end we have taken a lead by increasing rental cover requirements to ensure loans are affordable, and by reducing the maximum loan to value for new buy to let loans.

Chief Executive's review (continued)

Rewarding loyal savers

Our strategy of offering a range of long term good value products has resulted in us growing our member deposit balances by £6.3 billion. This is despite significant competition at the start of the year from NS&I, offering rates well above those generally available in the market.

In our drive for transparency and ease of access, we have further simplified our savings range and made it easier for members to select the best product for their needs. The vast majority of main savings products can now be opened online as well as in branch, and members can receive email and SMS updates on the status of their savings application. In addition, around ten million members received their annual statement as part of Nationwide's Savings Promises, providing details of all their savings accounts, their current interest rates and the Society's top variable rates. During the year over 760,000 members subscribed to our free SavingsWatch service, which automatically informs them whenever the interest rate on their account changes or Nationwide launches a new savings account.

We understand that low market interest rates continue to pose challenges for savers and, in response, have offered a number of products aimed at rewarding our loyal and committed members:

- Loyalty Bond, which offered our highest two-year fixed rate exclusively for existing members. Over 96,000 accounts were opened, with members depositing £2.7 billion during the four months the bond was available.
- Loyalty Saver, which pays higher rates of interest according to length of membership. Over 100,000 accounts were opened during the year, with over 1.2 million members now holding these accounts.
- Flexclusive Regular Saver, which offers our current account holders a rate of 5% for a year on monthly deposits of up to £500. In the first four months of the offer being available, over 185,000 members opened an account.

More people choosing Nationwide for their current account

I am very pleased that we have opened 525,000 new current accounts in the last twelve months, up 12% on the previous year. This has taken our market share of main standard and packaged current accounts as at February to 7.1%; our strategic aim is to expand this to 10% to provide an effective balance with our established positions in the mortgage and savings markets.

As testament to the quality of our current account range we have been a net beneficiary of customers seeking to switch their account in each and every month since the introduction of the Current Account Switch Service in September 2013. During the past year over 129,000 customers have switched their accounts to us through this service, up 38% on the previous year and representing a market share of switchers of 12.5%.

Our current accounts are complemented by our high quality, good value credit card and personal loan propositions. We issued 186,000 new cards (2015: 196,000), with the attraction of new customers being impacted by the long term balance transfer products which are dominating the market. We continue to reward our main current account customers with the Select Credit Card cashback, which benefited customers to a total of over £15 million in cash reward payments, and also provides them with fee-free overseas transactions. Our strategy is to meet the unsecured borrowing needs of our existing members, and over the year we have lent £1.2 billion (2015: £0.9 billion) of personal loans.

Chief Executive's review (continued)

Leading service satisfaction

I am delighted that we continue to be ranked number one for customer satisfaction amongst our high street peer group and our lead over our nearest competitor has increased to 7.7% for the quarter ending March 2016 (2015: 4.5%)[2]. Over a longer twelve month period we remain ranked number one with a 6.6% lead[3].

Our service satisfaction lead is a measure of our performance over the last three months compared to the performance of our next nearest competitor, in our high street peer group. As a result, our lead can be volatile as it is dependent on the performance of our competitors.

Despite our size, we account for only 2% of total industry complaints, and we make every attempt to resolve these to members' satisfaction. When cases do get referred to the Financial Ombudsman Service, 82% of our decisions are upheld, compared with the industry average of 47%.

Building a financially strong Society

As a mutual we aim to optimise, rather than maximise, profit, retaining sufficient earnings to support future growth, sustain strong capital ratios and to allow us to invest in the business to provide the services that our members demand. This will help us to deliver a long term, sustainable business that operates in the interests of our members.

Buoyant volumes and an improved net interest margin have contributed to a 5% increase in total underlying income to £3,333 million (2015: £3,163 million). Our underlying profit for the year was £1,337 million (2015: £1,227 million), an increase of 9%, and statutory profit before tax was £1,279 million (2015: £1,044 million), an increase of 23%. Underlying costs have increased by £170 million to £1,796 million, reflecting the growth of our business, our focus on risk and control and continued investment in new and enhanced products and services. This has resulted in our underlying cost income ratio deteriorating slightly to 53.9% (2015: 51.4%).

Our strong financial performance has resulted in our CET1 ratio increasing to 23.2% (2015: 19.8%). The primary driver of the amount of capital we hold is our leverage ratio, which over the year has improved to 4.2% (2015: 4.1%).

Guidance issued by the regulators during the financial year has given us greater certainty of the expected maximum capital requirements for the Society. This has allowed us to develop a financial framework to assess future performance and maintain our financial strength.

The framework is based on the fundamental principle of maintaining our capital in excess of regulatory leverage ratio requirements. Based on our current assumptions, a level of underlying Group profit of approximately £1 billion to £1.5 billion per annum over the medium term would optimise our ability to invest to support members' needs while maintaining our financial strength.

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[2] © GfK 2016, Financial Research Survey (FRS), 3 months ending 31 March 2016 vs 31 March 2015, proportion of extremely/very satisfied customers minus proportion of extremely/very/fairly dissatisfied customers summed across current account, mortgage and savings, high street peer group defined as providers with main current account market share >6% (Barclays, Halifax, HSBC, Lloyds Bank (inc C&G), NatWest and Santander). Prior to April 2015, Lloyds Bank and TSB combined as Lloyds TSB Group (including Lloyds Bank, TSB and C&G).

[3] © GfK 2016, Financial Research Survey (FRS), 12 months ending 31 March 2016, proportion of extremely/very satisfied customers minus proportion of extremely/very/fairly dissatisfied customers summed across current account, mortgage and savings, high street peer group defined as providers with main current account market share >6% (Barclays, Halifax, HSBC, Lloyds Bank (inc C&G), NatWest and Santander).

Chief Executive's review (continued)

Leading employer

Our delivery of great service, great products and great results flows from employing talented and dedicated people and allowing them to make the most of their diverse range of talents. Being a great employer provides a genuine competitive advantage. We pay particular attention to providing a supportive and encouraging working environment, and our success is reflected in our annual employee survey, which continues to show exceptionally high levels of employee engagement and enablement.

Supporting the communities we serve

We have continued to support the communities in which we operate through a broad range of initiatives. The most notable development during the year has been our investment to extend our existing Specialist Support Service for customers affected by cancer; going forward, this will be available for customers facing other life-limiting or long term physical conditions, such as heart disease, stroke and multiple sclerosis. We will phase the roll-out to allow us to gather feedback and refine the service as it is deployed to meet a range of different circumstances.

Outlook

Our financial performance in the period ahead is likely to be influenced by a number of themes in line with the guidance we provided at our half year results:

- clear evidence of more sustained competition within the mortgage market, resulting in further margin pressure during 2016/17
- as a modern mutual we will continue to invest in order to meet our members' current and future needs by providing good, long term value products, services and security
- these two factors combine such that we anticipate profits are likely to moderate in the period ahead.

The continual evolution of technology, changing customer preferences and regulatory change will affect the whole industry, and we will continue to invest to ensure we are able to deliver value to our members and maintain excellent relationships with regulators. The threat of cyber-attacks has increased, and will require ongoing focus and investment as we seek constantly to maintain the resilience of our systems and protect the interests of our members.

Uncertainty surrounding the EU referendum and the global economic outlook are likely to have some impact on UK economic activity in the near term. Our central expectation is that if this uncertainty lifts and the global economy gradually strengthens, UK economic growth will move back towards its long term trend rate of 2% to 2.5% per annum. The household sector is expected to remain a main driving force, underpinned by continued healthy gains in employment and rising real earnings. We expect the housing market to remain resilient, with any dampening of activity from modest increases in interest rates offset by a strengthening labour market and an under-supply of housing.

Nationwide is a unique organisation with a proud history and an optimistic future. We have the potential to build an even stronger Society serving the needs of today's and tomorrow's members, by championing the right thing to do and continuing to deliver tangible service excellence and long term value. We are committed to serving members and the wider society.

2016 Financial Review

OVERALL GROUP PERFORMANCE

Our 2015/16 financial performance has been strong with statutory profit before tax up 23% year on year, reflecting a 7% increase in net interest income, underpinned by our strong operating performance, and an improvement in asset quality with impairments falling 71%.

The underlying cost income ratio has deteriorated to 53.9% (2015: 51.4%) reflecting our investment in new products and services such as Nationwide Now and Apple Pay functionality, our ongoing investment in improving and strengthening our IT infrastructure, increasing sales and service capacity and our response to new regulation.

Total assets have grown by £13 billion to £209 billion at 4 April 2016. This increase is largely attributable to £9.3 billion growth in residential mortgage lending, reinforcing our position as second largest mortgage lender in the UK. The remaining growth is driven by an increase in high quality liquid assets, with the Liquidity Coverage Ratio (LCR) increasing to 142.6% (2015: 119.3%).

Our capital strength has improved during the year through retained earnings and a continued improvement in asset quality. As a result our CET1 and leverage ratios have reached 23.2% and 4.2% respectively (2015: 19.8% and 4.1% respectively), well in excess of current regulatory requirements. We also believe we are well placed to meet foreseeable regulatory capital requirements.

We anticipate that profits are likely to moderate in the period ahead as competition maintains pressure on margins and we focus on delivering value to members, including investment in service enhancements, whilst maintaining our capital strength.

Underlying and statutory results	**Year to 4 April 2016 £m**	Year to 4 April 2015* £m
Net interest income	**3,086**	2,872
Net other income	**247**	291
Total underlying income	**3,333**	3,163
Underlying administrative expenses	**(1,796)**	(1,626)
Impairment losses	**(73)**	(251)
Underlying provisions for liabilities and charges	**(127)**	(59)
Underlying profit before tax	**1,337**	1,227
Bank levy (note i)	**(41)**	(28)
Transformation costs (note i)	**(10)**	(52)
FSCS (note ii)	**(46)**	(83)
Gains/(losses) from derivatives and hedge accounting (note iii)	**39**	(20)
Statutory profit before tax	**1,279**	1,044
Taxation	**(294)**	(205)
Profit after tax	**985**	839

*Comparatives have been restated for the reclassification of foreign currency retranslation amounts from net interest income to gains/losses from derivatives and hedge accounting as described in note 2 to the preliminary results announcement.

Notes:
i. Within the statutory results presented in the preliminary results announcement, bank levy and transformation costs are included within administrative expenses.
ii. Within the statutory results presented in the preliminary results announcement, FSCS costs are included within provisions for liabilities and charges.
iii. Within the statutory results presented in the preliminary results announcement, gains/losses from derivatives and hedge accounting are presented separately within total income.

Financial review (continued)

Underlying profit

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

Underlying profit growth of 9% year on year is largely attributable to our operating performance driving higher net interest income, combined with significantly lower impairment losses. This is partially offset by a reduction in net other income and an increase in administration costs.

Statutory and underlying income	Year to 4 April 2016 £m	Year to 4 April 2015* £m
Net interest income	**3,086**	2,872
Net other income	**247**	291
Total underlying income	**3,333**	3,163
Gains/(losses) from derivatives and hedge accounting	**39**	(20)
Total statutory income	**3,372**	3,143
Weighted average total assets	**203,623**	195,429
Net interest margin (NIM) %	**1.52**	1.47

*Comparatives have been restated for the reclassification of foreign currency retranslation amounts from net interest income to gains/losses from derivatives and hedge accounting as described in note 2 to the preliminary results announcement.

Net interest income and margin

Net interest income has increased 7% to £3,086 million (2015: £2,872 million) due to a 4% growth in average assets, reflecting a 21.4% market share of net residential mortgage lending in the year, and a 5 bps improvement in NIM to 152 bps.

Interest income during the year reflects our consistent support for the housing market over recent years, providing mortgages to customers over a period when a number of our competitors constrained their lending. In the four years to 4 April 2016, the Group accounted for over one third of net lending in the market.

Savings rates have continued to fall across the industry and this reduction in retail funding costs has underpinned our margin performance. We estimate that our average margin on savings balances measured against relevant market indices (swaps or Bank base rate) was circa 50 bps over the year in comparison to circa 70 bps during the year to 4 April 2015. Notwithstanding this, our savings range has been very competitively positioned throughout the year with savings rates often better than, and sometimes significantly so, equivalent products offered by our high street peer group.

The benefit to NIM of lower retail funding costs has been partly offset by a decrease in mortgage margins. Over the last year there has been increased competition in both the prime and buy to let mortgage markets, resulting in new business gross margins falling by an average of 24 bps during 2015/16. In addition, our Base Mortgage Rate (BMR) balances continue to run off, reducing by £8 billion to £35 billion at 4 April 2016. This attrition reflects the highly competitive new business rates available across the market which have increased switching and redemption behaviours of customers, a trend which is likely to continue into 2016/17.

Whilst our average NIM has increased year on year by 5 bps, the quarterly picture for the 2015/16 financial year shows a downward trend, caused by the repricing of assets described above. Our spot margin at the end of the financial year was 10 bps lower than the rate of 152 bps reported for the year as a whole. Whilst we expect the impact to moderate, we nevertheless anticipate further margin compression throughout 2016/17 as competition is sustained and we focus on delivering long term value to members.

The macroeconomic environment could pose further risks to NIM, in particular sustained low interest rates and deterioration in the global economy, which could lead to a downturn in the UK economy, and could have an impact on the cost of wholesale funding.

Financial review (continued)

Net other income

Net other income has reduced by 15% to £247 million (2015: £291 million). We have chosen to improve our current account and credit card propositions during the period by removing unauthorised overdraft fees and removing fees on our credit card associated with spending above authorised credit limits. Interchange income associated with current account and credit card transactions has also reduced following the introduction of regulatory caps. As a result, despite increasing the number of active current accounts and credit cards, fee income has reduced on these products. Reduction in our general insurance income is largely due to lower profit share following a higher level of claims due to adverse weather conditions.

Gains/losses from derivatives and hedge accounting

Although the Group only uses derivatives to hedge risks, income statement volatility can still arise due to hedge accounting ineffectiveness or because hedge accounting is not achievable. This volatility is largely attributable to accounting rules which do not fully reflect the economic reality of the Group's hedging strategy. Details of fair value gains and losses relating to derivatives and hedge accounting are provided in note 5 to the preliminary results announcement.

Administrative expenses	**Year to 4 April 2016 £m**	Year to 4 April 2015* £m
Employee costs	**736**	671
Other administrative expenses	**735**	661
Depreciation and amortisation	**325**	294
Total underlying administrative expenses	**1,796**	1,626
Bank levy	**41**	28
Transformation costs	**10**	52
Total statutory administrative expenses	**1,847**	1,706
	%	%
Cost income ratio – underlying basis*	**53.9**	51.4
Cost income ratio – statutory basis	**54.8**	54.3

*Comparatives have been restated for the reclassification of foreign currency retranslation amounts from net interest income to gains/losses from derivatives and hedge accounting as described in note 2 to the preliminary results announcement.

Total underlying administrative expenses have increased by £170 million to £1,796 million, driven by continued investment in the business. At a statutory level administrative expenses have increased by £141 million to £1,847 million.

Employee costs have increased by £65 million to £736 million reflecting the impact of annual pay awards averaging 3.0% and 2.5% in each of the last two years and higher costs resulting from enhancements to the Nationwide Group Personal Pension Plan. In addition, employee numbers have increased by 3% year on year as the Group continues to build greater capacity to support our members' needs and strengthen risk and control functions.

Other administrative expenses have increased by £74 million to £735 million, driven by increased brand development costs and revenue costs associated with our ongoing commitment to a targeted programme of strategic investment. During the year, this investment has included enhancements in our digital capability, including Nationwide Now, Apple Pay functionality and PayM, IT resilience and investment in core product platforms to meet additional business volumes, and ensuring compliance with UK and European Union regulatory requirements. Depreciation charges have risen by £31 million to £325 million as a consequence of strategic investment in the business.

Transformation costs are significantly lower than the prior year as a result of the successful completion of the integration of the Dunfermline, Cheshire and Derbyshire brands which have resulted in ongoing savings of £20 million per annum. Activities relating to changes in the Group's IT service delivery model have also completed which has enabled the Group to deliver increased investment in the business at a lower cost through the utilisation of strategic partner capabilities.

Financial review (continued)

The cost income ratio, on an underlying basis, has deteriorated to 53.9% (2015: 51.4%) as a result of the growth in administrative expenses described above, which reflects our focus on improving product propositions and services for members whilst remaining strong, safe and secure.

Impairment losses/reversals	**Year to 4 April 2016 £m**	Year to 4 April 2015 £m
Residential lending	**18**	58
Consumer banking	**96**	89
Retail lending	**114**	147
Commercial lending	**(34)**	52
Other lending	**1**	34
Impairment losses on loans and advances	**81**	233
Impairment (reversals)/losses on investment securities	**(8)**	18
Total	**73**	251

Impairment losses for the year of £73 million are 71% lower than in the year ended 4 April 2015 primarily as a result of an improvement in asset quality and divestment of our commercial lending portfolio.

Residential lending impairment charges of £18 million (2015: £58 million) comprise a reduction in provision requirement of £9 million as a result of moderate house price growth combined with the continued reduction in our mortgage arrears to 0.45% (2015: 0.49%). This has been more than offset by increased provisions of £27 million due to refinements in our credit risk impairment assumptions to take account of the impacts of a prolonged period of low interest rates and the risks attaching to interest only mortgages.

Consumer banking impairments have increased by 8% to £96 million (2015: £89 million). Of this charge, £29 million reflects a reassessment of assumptions embedded within provisioning models across each of the consumer banking products to ensure that they remain appropriate in a low interest rate environment. Excluding these model changes, the underlying consumer banking impairment charge has reduced by 25%, predominantly a result of improving economic conditions combined with improved credit underwriting for personal loans.

Commercial lending impairments relate exclusively to commercial real estate (CRE) lending, with no arrears in our registered social landlords and Project Finance portfolios. The continued improvement in market conditions for CRE, as asset values improve and liquidity strengthens, has driven a high level of provision reversals and recoveries.

Provisions for liabilities and charges	**Year to 4 April 2016 £m**	Year to 4 April 2015 £m
Underlying provisions for liabilities and charges – customer redress	**127**	59
FSCS levy	**46**	83
Total provisions for liabilities and charges	**173**	142

Customer redress

We hold provisions for customer redress to cover the costs of remediation and redress in relation to past sales of financial products and post sales administration, including compliance with consumer credit legislation and other regulatory requirements.

The £127 million charge in the period predominantly relates to updated estimates for provisions previously recognised, with £95 million of the increase relating to Payment Protection Insurance (PPI). Of the total charge a significant proportion relates to the cost of administering claims. When assessing the adequacy of our PPI provision we have considered the implications of the proposals published by the Financial Conduct Authority (FCA) in its November 2015 consultation, including the expected impact of the Plevin case. The remainder of the charge for the year is in respect of claims relating to consumer credit legislation.

Financial review (continued)

Financial Services Compensation Scheme (FSCS)

The FSCS charge has reduced by 45% to £46 million, reflecting the Group's expected share of interest costs in relation to the 2016/17 FSCS scheme year and final confirmation of previous scheme year charges. During the year, the FSCS have confirmed that the non-Bradford & Bingley loan was fully repaid and any excess dividends received from the wind-up of these failed institutions will be used to pay the outstanding balance of the Dunfermline capital. As a result no capital costs have been included in the charge.

More information on FSCS is included in note 8 to the preliminary results announcement.

Taxation

The statutory tax charge for the year of £294 million (2015: £205 million) represents an effective tax rate of 23% (2015: 19.6%) which is higher than the statutory rate in the UK of 20% (2015: 21%). The higher effective rate is due principally to the banking surcharge of 8% effective from 1 January 2016, equivalent to £22 million (2015: £nil), together with the tax effect of disallowable bank levy and customer redress costs of £8 million and £7 million (2015: £6 million and £nil) respectively. Further information is provided in note 9 to the preliminary results announcement.

Financial review (continued)

BALANCE SHEET

Total assets have increased 7% year on year to reach £209 billion at 4 April 2016 (2015: £196 billion). This growth largely reflects increases in residential mortgage lending which grew by over £9 billion as a result of the strong operating performance. This is combined with an increase in high quality on balance sheet liquid assets of £4 billion.

In line with our mutual model, strong retail funding flows have largely supported the strategic growth in retail assets as we continue to introduce attractive savings products to both new and existing members. Member balances have grown by £6 billion, of which £2 billion is attributable to our award winning current account proposition as we continue to demonstrate our position as a modern mutual, improving our market share of main current accounts from 6.8% to 7.1%.

ASSETS	**4 April 2016**		4 April 2015	
	£m	**%**	£m	%
Residential mortgages	**162,164**	***91***	152,885	*89*
Commercial lending	**13,197**	***7***	14,594	*9*
Consumer banking	**3,869**	***2***	3,791	*2*
Other lending	**20**	**-**	29	-
	179,250	***100***	171,299	*100*
Impairment provisions	**(443)**		(652)	
Loans and advances to customers	**178,807**		170,647	
Other financial assets	**27,782**		22,721	
Other non-financial assets	**2,350**		2,212	
Total assets	**208,939**		195,580	
Asset quality				
Residential mortgages:	**%**		%	
Proportion of residential mortgage accounts 3 months+ in arrears	**0.45**		0.49	
Average indexed loan to value of residential mortgage book (by value)	**55**		56	
Impairment provisions as a % of non-performing balances	**3.2**		3.1	
Commercial real estate (CRE) lending:	**£m**		£m	
Gross balances	**3,009**		4,043	
Impaired balances	**171**		608	
Individual provisions as a % of impaired balances	**32%**		51%	
Other key ratios	**%**		%	
Loan to deposit ratio (note i)	**117.2**		115.6	
Return on assets	**0.47**		0.43	
Liquidity coverage ratio	**142.6**		119.3	

Note:
i. The loan to deposit ratio represents loans and advances to customers divided by (shares + other deposits + amounts due to customers).

Financial review (continued)

Residential mortgages

Residential mortgages include prime and specialist loans, with the specialist portfolio primarily comprising buy to let (BTL) lending. Gross mortgage lending in the period was £32.6 billion (2015: £27.1 billion), representing an increased market share of 13.7% (2015: 13.4%).

Net of repayment and redemptions, mortgage balances grew by £9.3 billion, of which £5.4 billion was prime lending and £3.9 billion related to specialist lending. The loan to value (LTV) profile of new lending, weighted by value, remained at 69% (2015: 69%). Annual house price growth over the financial year was 5.3%, contributing to the reduction in the average LTV of the total portfolio which fell to 55% (2015: 56%). Our residential mortgage arrears have reduced to 0.45% (2015: 0.49%) and continue to be significantly lower than the Council of Mortgage Lenders industry average which stood at 1.04% at 31 March 2016. The performance of our residential portfolios continues to be underpinned by the sustained low interest rate environment and is also now benefiting from broader market conditions, including low levels of unemployment and a return to growth in household incomes.

The level of impaired balances fell by £117 million to £778 million (2015: £895 million) reflecting lower arrears. Impairment provisions have fallen by £8 million to £102 million (2015: £110 million) reflecting strong underlying asset performance, in part offset by refinements in provision modelling assumptions to take account of the impacts of a prolonged period of low interest rates and the risks attaching to interest only mortgages.

Commercial lending

Commercial lending includes commercial real estate (CRE) loans of £3.0 billion (2015: £4.0 billion), a reduction of 25% during the year achieved through deleveraging and repayment. Commercial lending balances also include loans to housing associations of £7.6 billion (2015: £7.8 billion) and a portfolio of loans made under the Government's Project Finance initiative amounting to £1.2 billion (2015: £1.4 billion). The balance sheet total for commercial lending also includes £1.4 billion (2015: £1.4 billion) of fair value adjustments relating to loans where we have hedged associated financial risks, typically interest rate risk, using derivatives which are carried at fair value on the balance sheet.

We have undertaken minimal amounts of new lending during the year, with activity being concentrated on ongoing management of the existing portfolio and with focus on the managed work out of weak CRE exposures. During the year, we have deleveraged over £1.0 billion of non-core CRE loans and we have reduced other CRE exposures by a further £1.0 billion through repayment and managed workout of individual exposures.

The level of impaired balances as a proportion of our total CRE exposure has fallen from 15% to 6%, reflecting deleveraging and resolution of impaired asset positions. Individual provision coverage against impaired balances has fallen from 51% to 32% reflecting the work out of our higher risk cases.

Consumer banking

There has been particularly intense competition in the consumer banking environment in recent months; however the Group has maintained broadly stable balances reflecting our attractive pricing propositions and loyalty offers. Consumer banking comprises personal loans of £1.9 billion (2015: £1.8 billion), credit cards of £1.7 billion (2015: £1.7 billion) and current account overdrafts of £0.2 billion (2015: £0.2 billion). Asset quality remains high as we see the benefit of improved credit policies contributing to the Group's low risk, high quality asset balance sheet.

Further details of our lending and lending risks are provided in the 'Lending risk' section of the Business and Risk Report.

Financial review (continued)

Other financial assets

Other financial assets total £27.8 billion (2015: £22.7 billion) and comprise liquidity and investment assets held by our Treasury Division amounting to £23.1 billion (2015: £18.8 billion), derivatives with positive fair values of £3.9 billion (2015: £3.3 billion) and fair value adjustments and other assets of £0.8 billion (2015: £0.6 billion). Derivatives largely comprise interest rate and other derivatives with positive fair values, taken out to hedge financial risks inherent in our core lending and funding activities.

The increase in liquidity and investment assets reflects both the transition to Liquidity Coverage Ratio (LCR) requirements and an element of pre-funding of wholesale and Bank of England Funding for Lending Scheme (FLS) maturities to de-risk our funding plans ahead of the EU referendum in June 2016. For all these reasons we have taken opportunities to increase both the quality and duration of wholesale funding on our balance sheet over the last year with a consequent increase in liquidity. This has increased the LCR to 142.6% (2015: 119.3%).

Further details of our treasury portfolios are included in the 'Treasury assets' section of the Business and Risk Report.

Financial review (continued)

LIABILITIES	**4 April 2016 £m**	4 April 2015 £m
Member deposits	**138,715**	132,373
Debt securities in issue	**36,085**	28,105
Other financial liabilities	**21,637**	23,767
Other liabilities	**1,572**	1,594
Total liabilities	**198,009**	185,839
Members' interests and equity	**10,930**	9,741
Total members' interests, equity and liabilities	**208,939**	195,580
Key ratio	**%**	%
Wholesale funding ratio (note i)	**24.8**	23.3

Note:
i. The wholesale funding ratio includes all balance sheet sources of funding (including securitisations) but excludes Funding for Lending Scheme (FLS) drawings which, as an asset swap, are not included on the Group's balance sheet, reflecting the substance of the arrangement. Off balance sheet FLS drawings totalling £8.5 billion are unchanged from the prior year.

Member deposits

Member deposits have increased by £6.3 billion to £138.7 billion (2015: £132.4 billion) as we continue to offer competitive savings and current account propositions which provide long term good value and seek to support members in the current low base rate environment. The Group has continued to attract inflows from both new and existing members through the introduction of successful products such as our Help to Buy ISA and our range of loyalty regular saver products. We estimate our share of the balance growth in the UK deposit market for the year to be 8.7% (2015: 3.4%). Of this balance growth, £2.2 billion relates to inflows into our current account products as we have increased our market share of main standard and packaged accounts from 6.8% to 7.1%, with in-credit balances on those accounts amounting to £14.8 billion (2015: £12.6 billion).

Debt securities in issue

Debt securities in issue of £36.1 billion (2015: £28.1 billion) are used to raise funding in wholesale markets in order to finance core activities. The increase in outstanding amounts reflects increased issuance activity in the wholesale markets during the year to support increased liquidity.

The wholesale funding ratio has increased to 24.8% (2015: 23.3%), as a result of the wholesale issuance activity.

Further details on the Group's wholesale funding mix and liquidity holdings are included in the 'Liquidity and funding risk' section of the Business and Risk Report.

Other financial liabilities

Other financial liabilities include customer and bank deposits of £15.9 billion (2015: £17.2 billion), permanent interest bearing shares (PIBS) of £0.4 billion (2015: £0.4 billion), subordinated debt of £1.8 billion (2015: £2.1 billion) and derivatives and fair value adjustments of £3.5 billion (2015: £4.0 billion). Derivatives and fair value adjustments largely comprise interest rate and other derivatives with negative fair values, taken out to hedge financial risks inherent in our core lending and funding activities.

Financial review (continued)

CAPITAL STRUCTURE

	4 April 2016	4 April 2015
	£m	£m
Capital resources (note i)		
Common Equity Tier 1 (CET1) capital	**8,013**	7,279
Total Tier 1 capital	**9,005**	8,271
Total regulatory capital	**10,654**	9,950
Risk weighted assets (RWAs)	**34,475**	36,804
Leverage exposure	**213,181**	200,665
CRD IV capital ratios	**%**	%
CET1 ratio	**23.2**	19.8
Leverage ratio (note ii)	**4.2**	4.1

Notes:
i. Data in the table is reported under CRD IV on an end point basis.
ii. The leverage ratio is calculated using the Capital Requirements Regulation definition of Tier 1 for the capital amount and the Delegated Act definition of the exposure measure.

CET1 capital resources have increased over the period by approximately £0.7 billion mainly as a result of a strong operating performance with £985 million of profit after tax for the period.

Risk weighted assets (RWAs) reduced over the period by approximately £2.3 billion due to reduced commercial RWAs, lower retail unsecured RWAs (resulting from model development) and lower residential lending RWAs as a result of house price inflation, which more than offset portfolio growth.

The movements described above have resulted in an increase in the CET1 ratio to 23.2% (2015: 19.8%). The leverage ratio has increased to 4.2% (2015: 4.1%) as growth in Tier 1 capital has outstripped the balance sheet growth, which has been driven by increases in residential mortgage and liquidity balances.

The Group continues to monitor regulatory developments that could lead to an increased level of capital requirements. Whilst there are a number of areas where potential requirements are yet to be finalised, regulatory announcements during the financial year mean that we have better visibility of expectations for future capital requirements. The Group will remain engaged in the development of the regulatory approach to ensure we are prepared for any change.

We expect to have a steady state leverage ratio requirement of 3.75% from 2019, which comprises a minimum requirement of 3%, a supplementary leverage ratio buffer of 0.35% and countercyclical leverage ratio buffer of 0.4%. The Financial Policy Committee could set a countercyclical leverage buffer up to 0.9%, but has so far set the buffer at 0.2%, which is expected to apply from March 2017. The Group's strategic leverage ratio target of 4.5% reflects its desire to maintain strong levels of capital relative to maximum regulatory expectations (4.25%).

Further details of the capital position are included in the 'Solvency risk' section of the Business and Risk Report.

BUSINESS AND RISK REPORT

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Introduction

This Business and Risk Report explains the Group's business, the risks it is exposed to and how it manages those risks. As the risks of the organisation are managed on a Group basis, and given the dominant position of the Society within the Group structure, the disclosures in the Business and Risk Report are on a consolidated basis covering the activities of both the Group and the Society.

The Group is organised into three business operating segments: Retail, Commercial and Head office functions. The Group is predominantly a retail focused operation which trades almost exclusively within the UK. Wholesale funding is accessed by the Group from both UK and overseas markets.

The chart below shows the Group's business operating segments and how these activities are reflected in its risk measures. The regulatory risk weighted assets (RWAs) below indicate the relative risks each area carries as at 4 April 2016. Please see the 'Solvency risk' section of this report for further details regarding the Group's capital position.

	Nationwide Building Society		
Operating segment	Retail	Commercial	Head office functions
Business activities	• Prime residential lending • Specialist residential lending • Consumer banking • Savings products • Insurance • Investments	• Commercial real estate lending • Social housing lending • Project Finance lending	• Treasury including funding, liquidity and market risk management • Central support functions
Regulatory risk weighted assets as at 4 April 2016	£m Credit risk 19,707 Operational risk 4,575	£m Credit risk 6,194 Operational risk 29	£m Credit risk 3,970 Operational risk -

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

Principal risks

Whilst the Group accepts that all of its business activities involve risk, it seeks to protect its members by managing the risks that arise from its activities appropriately. The principal risks inherent within the business, and the Group's attitude to managing them, are set out below:

Risk category	Definition	Attitude
Lending	The risk that a borrower or counterparty fails to pay the interest or to repay the principal on a loan or other financial instrument (such as a bond) on time. Lending risk also encompasses extension risk and concentration risk.	• The Group lends responsibly only taking risks that are well understood. • The Group builds prudent portfolios, primarily focused on residential mortgages, without creating undue risk concentrations and controls exposure to higher risk portfolios. • The Group will participate in non-member business only where it has existing capabilities and earns a premium return on capital or provides valuable services to members.
Financial	The risk of the Group having inadequate earnings, cash flow or capital to meet current or future requirements and expectations. This includes loss or damage to the earnings capacity, market value or liquidity of the Group, arising from mismatches between assets, funding and other commitments, and which may be exposed by changes in market rates, market conditions or the Group's credit profile.	• The Group maintains a strong balance sheet with prudent levels of liquidity, diverse sources of funding. • The Group maintains a strong capital base above regulatory requirements and ensuring the Group can withstand a severe stress event without any significant disruption to products and services.
Operational	The risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.	• The Group operates its business to ensure a minimum level of serious disruption to customers, brand and reputation with systems and services designed to achieve defined levels of availability and performance.

Principal risks (continued)

Risk category	Definition	Attitude
Conduct and compliance	The risk that the Group exercises inappropriate judgement or makes errors in the execution of its business activities, leading to non-compliance with regulation or legislation, market integrity being undermined, or an unfair outcome being created for customers.	• The Group never knowingly creates unfair outcomes for customers. • The Group's products, services and distribution channels are designed, monitored and managed to provide value over time, accessibility, and meet the needs and experience expectations of its customers. • The Group aims to have a strong, focused conduct culture, where conduct risk is embedded in governance frameworks, to ensure adequate consideration, identification, management and mitigation of conduct risks. • The Group aims to have customers at the heart of everything it does, and this is reflected in its conduct outcomes of: o protecting customers o meeting customer needs and doing what we say o creating and nurturing fair customer relationships o rebalancing unfair outcomes, and o protecting markets.
Strategic	The risk of significant loss or damage arising from business decisions that impact the long term interests of the membership, or from an inability to adapt to external developments.	• The Group is committed to a mutual business model, and ensuring this model remains sustainable within legal and regulatory requirements. • The Group focuses strategic decisions on achieving the best long term outcome for its membership.

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

In addition to the above principal risks that are inherent in the Group's business, the Group identifies, monitors and manages the top and emerging risks that could affect delivery of the Corporate Plan as an integral element of its risk and management strategy. More details are set out the following section.

Top and emerging risks

The Group's top and emerging risks are identified through the process outlined in the 'Managing risk' section, and are closely tracked throughout the governance structure. The Group continues to keep these risks under close observation through risk reporting.

Whilst the Group accepts that all of its business activities involve risk, it seeks to protect its members by managing risks that arise from its activities appropriately. Against this background, during the last year the Group's financial strength has continued to grow and lending performance has further improved with low arrears, reflecting high quality underwriting and management. Risk management activity has focused on strengthening business resilience and managing regulatory and conduct challenges. As a result the Group's top and emerging risks remain largely unchanged and fall within four themes: macroeconomic, cyber attack and business resilience, the changing face of financial services, and conduct and compliance challenges. These themes are outlined further below.

Macroeconomic

The Group's financial position remains strong, with increasing profitability and robust capital and liquidity positions. However, uncertainty both globally and in the UK present two main areas that could affect the Group:

- **Sustained low interest rates could impact the Group**
  If rates stay at the current low rate for longer, this could constrain margins and, although not expected, a move to zero or negative rates may result in changing customer attitudes to savings, potentially impacting the Group's business model.

- **A deterioration in the global economy could lead to a downturn in the UK economy**
  A number of global factors could impact the UK economy, for example, a divergence in monetary policy between Europe and the US, a slow-down in China as well as the referendum on UK membership of the EU. Any slowdown could temporarily affect access to and pricing of wholesale funding or reduce confidence and activity in property markets. A deterioration in the housing market or unwinding of property hotspots, such as London, could affect new business volumes and credit losses in the Group's mortgage portfolios. The Group's exposure in central London, although within appetite, remains an area that is closely monitored.

Top and emerging risks (continued)

Cyber attack and business resilience

The Group's strategy is to use new and existing technology to deliver a market leading proposition. At the same time cyber security threats are increasing and this, coupled with the pace of technological development, creates risk across the financial services industry. In particular the Group sees two key areas which pose risks to achieving its goals:

- **The increased frequency and sophistication of cyber attacks increases perceived and real exposure**
  Recent high-profile cyber attacks serve to illustrate the increasing sophistication in this area and also prompt greater regulator and member concerns about security. The interconnectivity of banking and payments infrastructures and links between wider business providers and banking data mean that a successful attack anywhere in the supply chain could impact members and damage confidence in the sector as a whole. This requires the Group to ensure that it can defend against attacks and also detect and respond to any threats.

- **Rising customer expectations could exceed the Group's ability to provide a highly reliable and widely available service in an increasingly digital environment**
  Customer and regulator tolerance for service disruption continues to reduce within the financial services industry and, as the business becomes increasingly digital, the reliance on industry-wide systems is greater. Together these issues increase the risks that:
  - planned and unplanned IT outages fail to meet availability expectations, causing financial and reputational damage to the Group
  - the failure of an external system could have a detrimental impact on the Group's operations and the service level that customers expect
  - maintaining IT systems and infrastructure becomes increasingly time-consuming and expensive.

Changing face of financial services

The Group has delivered significant digital change over the past year, including updates to mobile and internet banking and new payment technology. The branch experience has also evolved with the introduction of digital technology such as Nationwide Now, whilst still offering more traditional products and services that are so important to many of the Group's members. The Group will continue to develop new and existing technology to deliver a market-leading proposition. However, there are a number of challenges from new and changing competition and technology, in particular:

- **The Group faces a range of direct and indirect challengers as the financial services industry evolves**
  For example:
  - Traditional banking competitors may pose an increasing challenge to the Group's core markets as the requirement to ring-fence their retail operations leads them to refocus their activities.
  - Collectively, challenger banks may impact product pricing, and accelerate changes in customer expectations.
  - FinTech firms may also impact product pricing and customer propositions.

- **New technology and new models, such as peer-to-peer lending or robo-advice, may mean that customer interactions deviate significantly from expectations**
  This could potentially mean that:
  - The cost of keeping up with widespread technology changes may prove unsustainable and require investment choices that do not match member expectations.
  - The economics of branch distribution could be undermined.
  - Retail deposit balances may become more volatile due to a combination of digital savings propositions and responses to adverse social media coverage, impacting the business model and placing a strain on short term liquidity.

Top and emerging risks (continued)

Conduct and compliance challenges

The Group's culture places conduct and compliance as central to its values and behaviours. The Group's risk governance and control framework drives a strong customer-focused conduct culture at each stage of a customer's interaction from product design, through sales and to post-sales servicing.

The member-focused nature of the Group's business model places it in a good position to meet current and future conduct requirements. However, the following are seen as key conduct and compliance risks for the Group:

- **The regulatory landscape is changing**
  The scale and quantity of changing regulation affecting the industry continues apace. This change needs to reflect innovation in the industry that is designed to meet changing customer demands and behaviours. There is a risk that industry developments proceed ahead of regulatory change resulting in uncertainty and potential delays in the development and launch of products designed to meet customers' needs.

- **The Group's digital strategy may not meet the changing behaviours of customers**
  Customers expect to be able to access products and services at a time, and through a medium, of their choosing. It is critical that these services remain resilient to meet demands and prevent customer detriment. As new channels are developed to meet evolving demands it is essential that fair customer outcomes continue to be delivered.

- **The Group's business model may not address the developing needs of its customers**
  There is a risk that the Group's business model fails to develop to meet the changing needs of customers across their life stages. In particular the Group should ensure that it is able to quickly identify customers who may, at any time during their relationship with the Group, be in vulnerable circumstances.

Lending risk

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

This section provides information on the Group's exposure to lending risk arising from loans and advances, together with details of the level of collateral held, and impairment charges raised against these loans during the period. It also provides information about the lead risk factors and key performance indicators for each of the Group's loan portfolios.

The Group manages lending risk for each of the following portfolios:

Portfolio	Definition
Residential mortgages	Loans secured on residential property; the Group separately manages prime and specialist lending
Consumer banking	Unsecured lending including current account overdrafts, personal loans and credit cards
Commercial lending	Commercial real estate, loans to registered social landlords and loans made under the Project Finance initiative
Other lending	Lending in respect of structured portfolios
Treasury	Treasury liquidity and discretionary portfolios

Maximum exposure to lending risk

Lending risk largely arises from the Group's exposure to loans and advances to customers, which account for 87.3% (2015: 88.8%) of the Group's total lending risk exposure. Within this, the Group's exposure relates primarily to residential mortgages, which account for 90.7% (2015: 89.5%) of total loans and advances to customers and which are comprised of high quality assets with low occurrences of arrears and possessions. The increase in the proportion of residential mortgages reflects the continued growth in mortgage lending and the strategic decision to exit from non-core commercial lending.

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

The Group's maximum exposure to lending risk has risen from £207 billion to £220 billion. This is due to the growth in residential mortgage loans described above, as well as an increase in the Group's holding of liquidity assets reflecting the transition to Liquidity Coverage Ratio (LCR) requirements and the decision to pre-fund long term wholesale maturities.

Lending risk (continued)

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

Maximum exposure to lending risk				2015		
	Gross balances	Less: Impairment provisions	Carrying value	Commitments (notes i & iii)	Maximum lending risk exposure	% of total lending risk exposure
	£m	£m	£m	£m	£m	%
Cash	4,325	-	4,325	-	4,325	2
Loans and advances to banks	3,392	-	3,392	408	3,800	2
Investment securities – AFS	11,037	-	11,037	-	11,037	5
Derivative financial instruments	3,337	-	3,337	-	3,337	2
Fair value adjustment for portfolio hedged risk (note ii)	592	-	592	-	592	-
Investments in equity shares	26	-	26	-	26	-
	22,709	-	22,709	408	23,117	11
Loans and advances to customers:						
Residential mortgages	152,885	(110)	152,775	11,796	164,571	79
Consumer banking	3,791	(216)	3,575	32	3,607	2
Commercial lending (note ii)	14,594	(322)	14,272	1,379	15,651	8
Other lending	29	(4)	25	75	100	-
	171,299	(652)	170,647	13,282	183,929	89
Total	194,008	(652)	193,356	13,690	207,046	100

Notes:

i. In addition to the amounts shown above, the Group has, as part of its retail operations, revocable commitments of £8,513 million (2015: £8,081 million) in respect of credit card and overdraft facilities. These commitments represent agreements to lend in the future, subject to certain considerations. Such commitments are cancellable by the Group, subject to notice requirements, and given their nature are not expected to be drawn down to the full level of exposure.

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

iii. Off-balance sheet commitments at 4 April 2015 have been restated from £7,570 million to £13,690 million. The original disclosure omitted commitments of £6,120 million which related to customer overpayments on residential mortgages where the borrower is entitled to drawdown amounts overpaid.

Movements in all impaired loans by lending risk segment

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

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

Movements in impaired loan balances	Prime mortgages £m	Specialist mortgages £m	Consumer banking £m	Commercial lending £m	Other lending £m	Total £m
At 5 April 2014	504	651	182	3,065	107	4,509
Classified as impaired during the year	370	461	118	112	5	1,066
Transferred from impaired to unimpaired	(431)	(513)	(14)	(194)	(8)	(1,160)
Amounts written off	(39)	(102)	(51)	(638)	(42)	(872)
Disposals	-	-	-	(1,452)	(43)	(1,495)
Repayments	(8)	2	(10)	(285)	(9)	(310)
At 4 April 2015	396	499	225	608	10	1,738

Note: Loans that were classified as impaired and loans that have transferred into or out of the impaired classification are based on the relevant status at each month end, when compared to the previous month end. Amounts written off reflect cases where the loan has been removed from the balance sheet, for example a residential property repossessed and sold. Repayments reflect payments made by the customer, reducing the outstanding balance.

Residential mortgages

Summary

The Group's residential mortgages comprise prime and specialist loans. Prime residential mortgages are mainly Nationwide branded advances made through the Group's branch network and intermediary channels; all new specialist lending is limited to buy to let mortgages originated under The Mortgage Works (UK) plc (TMW) brand.

Strong levels of new lending across prime and buy to let have seen the residential mortgage portfolio continue to grow, from £153 billion to £162 billion over the year. The geographical distribution across the UK is unchanged and the average loan to value (LTV), weighted by value, is marginally lower at 55% (2015: 56%), attributable to the increase in house prices over the year.

Buy to let lending has accounted for 22% of total new business, up from 18% in 2015, primarily due to the growing importance of the private rental sector for UK housing needs as a whole, reflecting long term economic and social trends. New lending performance was boosted in the final quarter as many investors sought to complete purchases ahead of the imposition of the additional 3% stamp duty for buy to let properties at the end of March.

Within prime lending, first time buyers accounted for an increased share of overall lending, up to 28% compared to 26% in 2015. The Group has widened its offering of mortgages at 90 to 95% LTV, and revised its existing Save to Buy proposition to align to the government's Help to Buy ISA to give first time buyers a further contribution to a deposit. As a consequence the average LTV of new business, the proportion of lending at higher LTVs and the loan to income metric have increased and are likely to continue to do so as the Group maintains its support for first time buyers, whilst remaining within its risk appetite.

Arrears have continued to fall across both prime and specialist lending over the period reflecting the continuing favourable economic conditions and low interest rate environment, supported by a robust credit assessment and affordability controls at the point of lending. The proportion of loans that are more than three months in arrears fell from 0.49% to 0.45%; the proportion of non-performing loans and overall levels of impairment loss also fell. The Group has taken action during the year to increase the provision for losses which have been incurred but not specifically reported at the balance sheet date; this limited the fall in provisions which ended the year at £102 million (2015: £110 million).

In March of this year the PRA issued a consultation paper aimed at strengthening buy to let underwriting standards across the industry. It would require lenders to ensure their approach to affordability includes a provision for the usual costs associated with a buy to let property together with suitable allowances for tax liabilities. This follows changes to income tax relief on buy to let properties announced by the Chancellor in 2015 which are due to be phased in from April 2017 to March 2021. These changes will impact existing landlords and may also impact investor demand as net rental yields are reduced. As tax will be charged on rental income without deducting mortgage interest payments, it is likely to cause a number of investors to move from a basic rate to high rate tax band, and some borrowers may find that the tax charge exceeds the current net profit they make from rent after interest payments.

The Group's buy to let lending continues to benefit from a number of enhanced controls implemented since the financial crisis, including the use of a stressed interest rate when applying interest cover ratio criteria. However the Group recognises that the changes to tax relief will materially affect the cash flow and affordability of many investors, and has taken steps to ensure that buy to let borrowing remains sustainable and affordable for landlords as the tax changes are phased in. The Group has increased its minimum interest coverage ratio (ICR) from 125% to 145% with effect from 11 May 2016, and also lowered its maximum LTV for buy to let borrowing from 80% to 75%. The Group will continue to review its approach to underwriting as the PRA consultation concludes to ensure that asset quality is maintained and new regulations are met.

Residential mortgages (continued)

House prices in London have been outstripping the wider UK market in recent years. The gap between the price of a typical London house and the UK equivalent is at, or close to, record levels, with London houses worth twice as much on average as houses in the UK as a whole. The house price to earnings ratio for London has increased above 11, above its previous pre-crisis peak of 8.3, and rental yields have dropped below 3.5%. Demand in London has in part been driven by the growth in buy to let activity (which is more heavily concentrated in London) and there is a risk that the stretched affordability and yield metrics, combined with a change in economic conditions or reduced investor demand, could cause a correction to house prices.

Exposures in London are controlled through maximum loan sizes for new business tiered by LTV which limit individual exposures, and mean that where prices are higher, higher equity coverage is required. Both prime and buy to let lending is subject to affordability assessments using stressed interest rates (based on a five year forward view) to ensure that lending will remain affordable for borrowers even in the event of an increase in interest rates. The Group has conducted stress tests which demonstrate that even in the event of a reduction in house prices of around 40%, any losses that were to occur would not undermine the Group's capital strength. The Group continues to monitor potential levels of negative equity should three years' of house price increases reverse, and will take steps to control the concentration of lending in London should this become necessary.

The Group is exposed to higher LTV lending (up to 95% for new business) and is a strong participant in schemes designed to support first time buyers, such as the Help to Buy (Shared Equity) scheme where a deposit of 5% from the borrower is supported by an equity loan of up to 20% from the government. The Group believes that these schemes are well designed and offer valuable support to buyers, as well as providing additional credit protection for the lender. The Group controls its risk exposure to higher LTV business and shared equity schemes through a combination of risk appetite limits, credit scoring controls, and exposure limits on large new build development sites.

The table below summarises the Group's residential mortgages portfolio:

Lending and new business

Residential mortgage lending	**2016**		2015	
	£m	**%**	£m	%
Prime	**129,973**	**80**	124,549	81
Specialist:				
Buy to let	**28,646**	**18**	24,370	16
Self-certified	**2,338**	**1**	2,634	2
Near prime	**859**	**1**	952	1
Sub prime	**348**	**-**	380	-
	32,191	**20**	28,336	19
Total residential mortgages	**162,164**	**100**	152,885	100

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

The Chancellor's autumn statement announced that a 3% stamp duty surcharge on buy to let property was to be introduced from April 2016. This triggered an increase in the volume of applications as investors sought to complete ahead of the deadline and has contributed to the proportion of buy to let lending increasing over the period to 18% (2015: 16%) of total lending.

Residential mortgages (continued)

Distribution of new business by borrower type (by value)	2016 %	2015 %
Prime:		
Home movers	**31**	32
First time buyers	**28**	26
Remortgagers	**18**	23
Other	**1**	1
Total prime	**78**	82
Specialist:		
Buy to let new purchases	**8**	8
Buy to let remortgagers	**14**	10
Total specialist	**22**	18
Total new business	**100**	100

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

In October 2014, the Financial Policy Committee (FPC) introduced a 15% limit on the proportion of new lending that may be written at income multiples of 4.5 and above. This limit applies to residential mortgages, excluding buy to let. The Group's proportion of new lending at income multiples of 4.5 or higher has averaged 7% (2015: 5%). The increase is principally driven by a higher proportion of lending to first time buyers as the Group continues to support this segment of the market. The proportion of new lending at income multiples of 4.5 or higher is likely to continue to increase but will remain within the FPC limit and in line with the Group's overall approach to lending.

Lending risk

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

LTV and lending risk concentration

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

Average LTV of loan stock	2016 %	2015 %
Prime	**54**	54
Specialist	**61**	63
Group	**55**	56

Average LTV of new business	2016 %	2015 %
Prime	**71**	70
Specialist (buy to let)	**65**	67
Group	**69**	69

Note: The LTV of new business excludes further advances.

The average LTV of buy to let new lending reduced by 2%. This is due in part to the impact of stricter affordability checks for higher LTV lending implemented in November 2014.

Residential mortgages (continued)

LTV distribution of new business	2016 %	2015 %
0% to 60%	**26**	26
60% to 75%	**40**	42
75% to 80%	**9**	10
80% to 85%	**12**	10
85% to 90%	**11**	11
90% to 95%	**2**	1
Over 95%	**-**	-
Total	**100**	100

The maximum LTV for new customers is 95%, the proportion of lending greater than 90% LTV has increased to 2% (2015: 1%) as a direct result of the Group's strategy to support the first time buyer market.

Buy to let lending is restricted to a maximum LTV of 80%, with only 4% (2015: 4%) of lending greater than 75% LTV.

Geographical concentration

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

Residential mortgages (continued)

Residential mortgage balances by LTV and region 2015	Greater London £m	Central England £m	Northern England £m	South East England £m	South West England £m	Scotland £m	Wales £m	Northern Ireland £m	Total £m	%
Performing loans										
Fully collateralised										
LTV ratio:										
Up to 50%	21,388	8,168	5,778	6,752	4,528	2,716	1,144	780	51,254	
50% to 60%	11,785	4,345	3,164	3,479	2,283	1,481	572	328	27,437	
60% to 70%	9,490	6,470	4,864	4,594	3,191	2,102	830	381	31,922	
70% to 80%	4,582	5,535	6,079	2,788	2,592	2,688	1,203	392	25,859	
80% to 90%	1,476	2,148	3,000	821	952	1,192	676	236	10,501	
90% to 100%	42	228	860	41	76	249	197	126	1,819	
	48,763	26,894	23,745	18,475	13,622	10,428	4,622	2,243	148,792	97.3
Not fully collateralised										
- LTV more than 100% (A)	9	13	105	3	5	36	23	366	560	0.4
- Collateral value on A	*7*	*11*	*97*	*3*	*4*	*34*	*22*	300	*478*	
- Negative equity on A	*2*	*2*	*8*	-	*1*	*2*	*1*	*66*	*82*	
Total performing loans	48,772	26,907	23,850	18,478	13,627	10,464	4,645	2,609	149,352	97.7
Non-performing loans										
Fully collateralised										
LTV ratio:										
Up to 50%	441	156	111	115	68	44	25	27	987	
50% to 60%	287	98	69	70	44	26	13	12	619	
60% to 70%	210	141	115	90	66	43	20	13	698	
70% to 80%	78	138	148	69	56	53	25	12	579	
80% to 90%	12	93	116	24	35	32	22	13	347	
90% to 100%	1	26	91	1	4	14	18	13	168	
	1,029	652	650	369	273	212	123	90	3,398	2.2
Not fully collateralised										
- LTV more than 100% (B)	1	7	33	2	1	4	9	78	135	0.1
- Collateral value on B	*1*	*6*	*29*	*2*	*1*	*3*	8	59	*109*	
- Negative equity on B	-	*1*	*4*	-	-	*1*	*1*	*19*	*26*	
Total non-performing loans	1,030	659	683	371	274	216	132	168	3,533	2.3
Total residential mortgages	49,802	27,566	24,533	18,849	13,901	10,680	4,777	2,777	152,885	100.0
Geographical concentrations	33%	18%	16%	12%	9%	7%	3%	2%	100%	

The value of partially collateralised non-performing loans has reduced to £99 million (2015: £135 million), following the growth in house prices and a reduction in arrears cases.

Arrears

Number of cases more than 3 months in arrears as % of total book	**2016 %**	2015 %
Prime	**0.35**	0.36
Specialist	**0.90**	1.12
Group	**0.45**	0.49
CML industry average	**1.04**	1.30

Supported by favourable economic conditions and a continued low interest environment, the arrears performance of both the prime and specialist mortgage portfolios continues to improve. The Group's combined arrears rate of 0.45% remains less than half of the Council of Mortgage Lenders' (CML) industry average rate of 1.04%.

Residential mortgages (continued)

Impaired loans

Impaired and non-performing loans are identified primarily by arrears status. Impaired accounts are defined as those greater than three months in arrears and include accounts subject to possession. Non-performing accounts include all impaired loans and also loans which are past due but not impaired, including any asset where a payment due is received late or missed. The non-performing loan amount represents the entire financial asset rather than just the payment overdue.

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

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

Residential mortgages by payment status		**2016**		
	Prime £m	**Specialist £m**	**Total £m**	**%**
Performing:				
Neither past due nor impaired	**127,986**	**30,999**	**158,985**	**98.0**
Non-performing:				
Past due up to 3 months	**1,621**	**780**	**2,401**	**1.5**
Impaired:				
Past due 3 to 6 months	**170**	**188**	**358**	**0.2**
Past due 6 to 12 months	**115**	**115**	**230**	**0.2**
Past due over 12 months	**75**	**91**	**166**	**0.1**
Possessions	**6**	**18**	**24**	**-**
Total non-performing loans	**1,987**	**1,192**	**3,179**	**2.0**
Total residential mortgages	**129,973**	**32,191**	**162,164**	**100.0**
Non-performing loans as a % of total residential mortgages	**1.5%**	**3.7%**	**2.0%**	
Impairment provisions (£m)	**25**	**77**	**102**	
Impairment provisions as a % of non-performing balances	**1.3%**	**6.5%**	**3.2%**	
Impairment provisions as a % of total residential mortgages	**0.02%**	**0.24%**	**0.06%**	

Residential mortgages (continued)

Residential mortgages by payment status	2015			
	Prime £m	Specialist £m	Total £m	%
Performing:				
Neither past due nor impaired	122,424	26,928	149,352	97.7
Non-performing:				
Past due up to 3 months	1,729	909	2,638	1.7
Impaired:				
Past due 3 to 6 months	190	207	397	0.3
Past due 6 to 12 months	120	143	263	0.2
Past due over 12 months	72	97	169	0.1
Possessions	14	52	66	-
Total non-performing loans	2,125	1,408	3,533	2.3
Total residential mortgages	124,549	28,336	152,885	100.0
Non-performing loans as a % of total residential mortgages	1.7%	5.0%	2.3%	
Impairment provisions (£m)	22	88	110	
Impairment provisions as a % of non-performing balances	1.0%	6.3%	3.1%	
Impairment provisions as a % of total residential mortgages	0.02%	0.31%	0.07%	

The improved performance of the book has meant that during the period the Group's proportion of non-performing loans has reduced to 2.0% (2015: 2.3%).

The provision balance has fallen to £102 million (2015: £110 million). This reflects the continued improvement in the quality of the book, evidenced by a continued decline in instances of arrears. However, whilst credit risk metrics have improved, they have reached a level from which the rate of further improvement is likely to slow. In addition, the Group has reviewed and updated its provision models and assumptions to ensure they appropriately reflect incurred losses within the portfolio. Specific areas of focus included interest only loans which are approaching maturity as well as accounts which have recently returned to performing status, supported by the low interest environment. The updates have resulted in provision increases for losses incurred but not identified at the balance sheet date.

The impairment charge for the year reflects both the improved performance of the book and the refinements to provision models and assumptions.

Impairment loss for the year	**2016** **£m**	2015 £m
Prime	**8**	13
Specialist	**10**	45
Total	**18**	58

Residential mortgages (continued)

Possessions

Number of properties in possession as % of total book	**2016 Number of properties**	**%**	2015 Number of properties	%
Prime	**57**	**0.01**	151	0.01
Specialist	**117**	**0.04**	258	0.10
Group	**174**	**0.01**	409	0.03
CML industry average		**0.03**		0.05

Repossession numbers have reduced partly due to the strong performance of the portfolio in the current economic environment, consistent with the low arrears and impairment rates. The Group is also currently reviewing repossession processes which will have delayed possession in some cases and contributed to the drop in volumes over this period. Provisions have been adjusted to ensure they remain adequate in light of this change in process.

Interest only mortgages

The Group does not offer any new advances for prime residential mortgages on an interest only basis. However, the Group has historical balances which were originally advanced as interest only mortgages or where the Group agreed a change in terms to an interest only basis (this option was withdrawn in 2012). The Group manages maturities on interest only mortgages closely, engaging regularly with customers to ensure the loan is redeemed or to agree a strategy for repayment.

The majority of the specialist portfolio is made up of buy to let loans, of which approximately 90% are advanced on an interest only basis.

Interest only mortgages	**Term expired (still open)**	**Due within one year**	**Due after one year and before two years**	**Due after two years and before five years**	**Due after more than five years**	**Total**	**% of total book**
2016	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**%**
Prime	**58**	**396**	**475**	**1,731**	**16,178**	**18,838**	**14.5**
Specialist	**98**	**174**	**254**	**1,002**	**27,084**	**28,612**	**88.9**
Total	**156**	**570**	**729**	**2,733**	**43,262**	**47,450**	**29.3**

Interest only mortgages	Term expired (still open)	Due within one year	Due after one year and before two years	Due after two years and before five years	Due after more than five years	Total	% of total book
2015	£m	£m	£m	£m	£m	£m	%
Prime	57	376	538	1,898	19,217	22,086	17.7
Specialist	95	122	220	953	23,520	24,910	87.9
Total	152	498	758	2,851	42,737	46,996	30.7

The proportion of prime residential interest only mortgages has fallen to 14.5% (2015: 17.7%).

Interest only loans which are ‘term expired (still open)’ are, to the extent they are not otherwise in arrears, considered to be performing. They are included within the ‘Repair: Term extensions’ category in the renegotiated loans tables on the following pages.

Residential mortgages (continued)

Negative equity on non-performing loans

Negative equity of non-performing residential mortgages	**2016**		2015	
	Prime	**Specialist**	Prime	Specialist
	£m	**£m**	£m	£m
Past due but not impaired	**2**	**4**	2	7
Impaired	**1**	**10**	2	9
Possessions	**-**	**1**	-	6
Total	**3**	**15**	4	22

Note: Collateral is capped at the amount outstanding on an individual loan basis.

The improving arrears position and growth in house prices have combined to reduce the value of non-performing loans in negative equity to £18 million (2015: £26 million).

Residential mortgages (continued)

Renegotiated loans

Mortgages may be renegotiated in a number of ways, including a change in terms, applying forbearance, or repairing arrears that have built up. Some of these changes are initiated by the customer, where the terms of the mortgage allow a revision to the payment schedule to suit the customer's needs (such as a payment holiday or term extension); other changes are specifically applicable where a customer is in or has been in financial difficulties.

The table below provides details of the current balances of loans which have been renegotiated at any point since January 2008, by region. It is possible for a loan to have more than one category and in the table below both are shown and multiple events are then eliminated.

Residential mortgage balances subject to renegotiation since January 2008 (note i) 2016	Greater London £m	Central England £m	Northern England £m	South East England £m	South West England £m	Scotland £m	Wales £m	Northern Ireland £m	Total £m
Change in terms:									
Payment holidays	**890**	**686**	**627**	**459**	**287**	**234**	**112**	**130**	**3,425**
Term extensions (within term)	**2,003**	**1,259**	**1,087**	**878**	**633**	**427**	**230**	**208**	**6,725**
Payment concessions	**292**	**179**	**190**	**111**	**75**	**41**	**39**	**27**	**954**
Interest only conversions	**625**	**311**	**292**	**219**	**163**	**81**	**61**	**79**	**1,831**
	3,810	**2,435**	**2,196**	**1,667**	**1,158**	**783**	**442**	**444**	**12,935**
Elimination of multiple events	**(396)**	**(285)**	**(243)**	**(186)**	**(121)**	**(73)**	**(48)**	**(65)**	**(1,417)**
Total change in terms	**3,414**	**2,150**	**1,953**	**1,481**	**1,037**	**710**	**394**	**379**	**11,518**
Forbearance:									
Temporary interest only concessions	**356**	**335**	**350**	**182**	**115**	**100**	**56**	**59**	**1,553**
Repair:									
Capitalisations	**180**	**105**	**110**	**72**	**43**	**17**	**22**	**9**	**558**
Term extensions (at term expiry)	**175**	**95**	**78**	**67**	**53**	**35**	**19**	**19**	**541**
	355	**200**	**188**	**139**	**96**	**52**	**41**	**28**	**1,099**
Elimination of multiple events	**(3)**	**(1)**	**(2)**	**(1)**	**(1)**	**-**	**-**	**-**	**(8)**
Total repairs	**352**	**199**	**186**	**138**	**95**	**52**	**41**	**28**	**1,091**
Elimination of multiple events	**(290)**	**(236)**	**(235)**	**(133)**	**(85)**	**(55)**	**(43)**	**(44)**	**(1,121)**
Total renegotiated loans	**3,832**	**2,448**	**2,254**	**1,668**	**1,162**	**807**	**448**	**422**	**13,041**
Of which prime/specialist lending:									
Prime	**3,183**	**2,106**	**1,895**	**1,436**	**988**	**747**	**381**	**362**	**11,098**
Specialist	**649**	**342**	**359**	**232**	**174**	**60**	**67**	**60**	**1,943**
Total	**3,832**	**2,448**	**2,254**	**1,668**	**1,162**	**807**	**448**	**422**	**13,041**
Of which loans are still on special terms: (note ii)									
Prime	**42**	**34**	**27**	**23**	**14**	**15**	**6**	**3**	**164**
Specialist	**5**	**5**	**7**	**3**	**1**	**1**	**1**	**1**	**24**
Total	**47**	**39**	**34**	**26**	**15**	**16**	**7**	**4**	**188**
Impairment provisions on renegotiated loans:									
Individually assessed	**-**	**-**	**1**	**-**	**-**	**-**	**-**	**1**	**2**
Collectively assessed	**-**	**2**	**4**	**1**	**1**	**1**	**1**	**3**	**13**
Total impairment provisions	**-**	**2**	**5**	**1**	**1**	**1**	**1**	**4**	**15**

Residential mortgages (continued)

Residential mortgage balances subject to renegotiation since January 2008 (note i) 2015 (note iii)	Greater London £m	Central England £m	Northern England £m	South East England £m	South West England £m	Scotland £m	Wales £m	Northern Ireland £m	Total £m
Change in terms:									
Payment holidays	1,011	781	712	522	329	265	126	144	3,890
Term extensions (within term)	2,059	1,337	1,159	927	662	453	248	220	7,065
Payment concessions	302	191	194	114	79	41	39	29	989
Interest only conversions	693	339	315	253	186	89	67	85	2,027
	4,065	2,648	2,380	1,816	1,256	848	480	478	13,971
Elimination of multiple events	(438)	(316)	(267)	(208)	(134)	(78)	(55)	(67)	(1,563)
Total change in terms	3,627	2,332	2,113	1,608	1,122	770	425	411	12,408
Forbearance:									
Temporary interest only concessions	379	361	371	196	125	102	61	64	1,659
Repair:									
Capitalisations	188	110	113	74	46	17	23	9	580
Term extensions (at term expiry)	172	91	68	63	48	34	18	17	511
	360	201	181	137	94	51	41	26	1,091
Elimination of multiple events	(3)	-	(1)	(1)	(1)	-	-	-	(6)
Total repairs	357	201	180	136	93	51	41	26	1,085
Elimination of multiple events	(303)	(251)	(246)	(139)	(91)	(56)	(45)	(47)	(1,178)
Total renegotiated loans	4,060	2,643	2,418	1,801	1,249	867	482	454	13,974
Of which prime/specialist lending:									
Prime	3,420	2,309	2,071	1,568	1,076	810	416	392	12,062
Specialist	640	334	347	233	173	57	66	62	1,912
Total	4,060	2,643	2,418	1,801	1,249	867	482	454	13,974
Of which loans are still on special terms: (note ii)									
Prime	72	50	47	33	23	15	12	6	258
Specialist	13	13	14	7	4	1	2	4	58
Total	85	63	61	40	27	16	14	10	316
Impairment provisions on renegotiated loans:									
Individually assessed	-	1	1	-	-	-	-	2	4
Collectively assessed	-	2	5	1	1	1	2	4	16
Total impairment provisions	-	3	6	1	1	1	2	6	20

Notes:

i. Information on renegotiated balances is reported since January 2008, reflecting the point in time from which this data was captured for reporting purposes.

ii. Special terms refer to loans which are actively subject to a payment holiday, a payment concession or a temporary interest only concession. They do not include term extensions, permanent interest only conversions or capitalisations.

iii. Comparatives have been restated to include data from the Dunfermline, Derbyshire and Cheshire mortgage portfolios which had not previously been included. Consequently the value of total renegotiated loans has increased by 2.7% to £13,974 million from the previously disclosed £13,613 million.

The value of renegotiated loans has fallen to £13,041 million (2015: £13,974 million) underlining the favourable economic conditions. For those cases that remain on special terms the average LTV is comparable with the overall stock position at 55% (2015: 57%).

Consumer banking

Summary

The Group's consumer banking portfolio includes balances relating to the unsecured portfolios for overdrawn current accounts, personal loans and credit cards. Total balances across these portfolios have grown by 2.1% during the period to £3,869 million (2015: £3,791 million), despite the continued intense competition across all lenders in the unsecured market. This is evident in the increasing duration of introductory offers for credit cards, switching incentives for current accounts and lower rates for personal loans.

Portfolio performance and risk profile has continued to improve as a result of previous policy and pricing changes, alongside the favourable economic environment. This has led to a 13.5% reduction in non-performing balances (excluding charged off accounts), from £171 million to £148 million, and forbearance levels have remained stable over this period.

The Group actively monitors and manages emerging risks in the UK and the potential impacts on its exposure to lending risk, including the potential effect of interest rate rises and a reversal in current trends, such as unemployment. Due to the prolonged low interest environment and the associated improvement in portfolio performance, the Group has conducted a comprehensive review of its credit risk impairment assumptions to ensure they remain appropriate. This has led to an increase in provisions of £29 million in relation to the up to date book and total provisions have increased to £281 million (2015: £216 million).

The regulatory environment for unsecured lending continues to evolve with the Competition & Markets Authority assessment of competitive practices, fees charged and assistance for vulnerable customers, alongside the FCA market review due for publication later this year. The Group considers that its focus on responsible lending and its commitment to ensuring good outcomes for customers will be consistent with the direction of any regulatory changes.

The table below summarises the Group's consumer banking portfolio:

Consumer banking balances	**2016**		2015	
	£m	**%**	£m	%
Overdrawn current accounts	**247**	**6**	248	7
Personal loans	**1,901**	**49**	1,799	47
Credit cards	**1,721**	**45**	1,744	46
Total consumer banking	**3,869**	**100**	3,791	100

Consumer banking (continued)

Lending risk

Impaired loans

The Group monitors and reports lending risk on consumer banking portfolios primarily on delinquency status, since no security is held against the loans. Impaired accounts are defined as those greater than three months in arrears. Non-performing accounts include all impaired loans and also loans which are past due but not impaired, including any asset where a payment due is received late or missed. The non-performing loan amount represents the entire financial asset rather than just the payment overdue.

The performance of the portfolios is closely monitored, with corrective action taken when appropriate to ensure adherence with risk appetite.

The Group holds impairment provisions for both the performing and non-performing segments of the consumer banking portfolio. Provisions reflect losses which have been incurred at the balance sheet date, based on objective evidence. For currently performing loans, the provision reflects the Group's assessment of losses arising from impairment events that have occurred but which have not been specifically identified at the reporting date.

Consumer banking by payment due status	**2016**				
	Overdrawn current accounts	**Personal loans**	**Credit cards**	**Total**	
	£m	**£m**	**£m**	**£m**	**%**
Performing:					
Neither past due nor impaired	**206**	**1,742**	**1,576**	**3,524**	**91**
Non-performing:					
Past due up to 3 months	**16**	**42**	**27**	**85**	
Impaired:					
Past due 3 to 6 months	**4**	**11**	**11**	**26**	
Past due 6 to 12 months	**3**	**11**	**3**	**17**	
Past due over 12 months	**4**	**16**	**-**	**20**	
	27	**80**	**41**	**148**	**4**
Charged off (note i)	**14**	**79**	**104**	**197**	**5**
Total non-performing	**41**	**159**	**145**	**345**	
Total consumer banking lending	**247**	**1,901**	**1,721**	**3,869**	**100**
Non-performing loans as % of total (excluding charged off balances)	**11%**	**4%**	**2%**	**4%**	
Impairment provisions excluding charged off balances	**13**	**46**	**38**	**97**	
Impairment provisions on charged off balances	**12**	**75**	**97**	**184**	
Total impairment provisions	**25**	**121**	**135**	**281**	
Provision coverage ratio on total non-performing loans (excluding charged off balances)	**48%**	**58%**	**93%**	**66%**	
Provision coverage ratio on total non-performing loans (including charged off balances)	**61%**	**76%**	**93%**	**81%**	
Impairment provisions as % of total consumer banking lending	**10%**	**6%**	**8%**	**7%**	

Consumer banking (continued)

Consumer banking by payment due status	2015				
	Overdrawn current accounts	Personal loans	Credit cards	Total	
	£m	£m	£m	£m	%
Performing:					
Neither past due nor impaired	198	1,646	1,623	3,467	91
Non-performing:					
Past due up to 3 months	16	53	30	99	
Impaired:					
Past due 3 to 6 months	4	14	12	30	
Past due 6 to 12 months	4	18	3	25	
Past due over 12 months	3	14	-	17	
	27	99	45	171	5
Charged off (note i)	23	54	76	153	4
Total non-performing	50	153	121	324	
Total consumer banking lending	248	1,799	1,744	3,791	100
Non-performing loans as % of total (excluding charged off balances)	11%	6%	3%	5%	
Impairment provisions excluding charged off balances	11	37	29	77	
Impairment provisions on charged off balances	20	50	69	139	
Total impairment provisions	31	87	98	216	
Provision coverage ratio on total non-performing loans (excluding charged off balances)	41%	37%	64%	45%	
Provision coverage ratio on total non-performing loans (including charged off balances)	62%	57%	81%	67%	
Impairment provisions as % of total consumer banking lending	13%	5%	6%	6%	

Note:
i. Charged off balances relate to accounts which are closed to future transactions and are held on the balance sheet for an extended period (up to 36 months, depending on the product) whilst recovery procedures take place.

Total non-performing balances excluding charged off balances have decreased to £148 million (2015: £171 million). This is largely due to improved quality across the current account and personal loan portfolios following the implementation of enhanced pricing and risk policies, together with a favourable economy.

Whilst metrics indicating the quality of the Group's consumer banking portfolio have improved, a review of the credit risk impairment assumptions was undertaken during the year, with particular focus on up to date accounts. This has led to an increase in provision of £29 million as a consequence of changes to model assumptions.

Total balances in charge off and the provisions held against these balances continue to grow across the personal loan and credit card portfolios. This is in line with expectations following the change, during 2014, to hold balances on the balance sheet for an extended period of up to 36 months, whilst recovery activity is completed. It is expected that charged off balances and associated provisions will reduce in the next financial year as accounts which have met the 36 month threshold are written off.

Consumer banking (continued)

Charged off balances for current account overdrafts have fallen to £14 million (2015: £23 million). This is due to a higher value of accounts being written off, having reached the 24 month threshold during the year, than new accounts entering charge off.

Impairment losses

Impairment losses for the period	**Overdrawn current accounts £m**	**Personal loans £m**	**Credit cards £m**	**Total £m**
Year to 4 April 2016	**14**	**38**	**44**	**96**
Year to 4 April 2015	16	34	39	89

The provision charge is £7 million higher than the previous year, reflecting the impact of the assumption changes referred to above.

Renegotiated loans

The Group's approach is to reduce lending risk through good lending decisions. Where it is considered likely that a customer may face financial difficulty the Group seeks to find a solution to support the customer and to mitigate losses, including proactive management of exposure, forbearance or arrears management.

The balances at the balance sheet date which have been subject to a change in terms, forbearance or repair at any point since March 2010 are summarised in the table below. It is possible for borrowers to have more than one type of renegotiation and in this instance they are shown in both categories and multiple events are eliminated.

Balances subject to renegotiation since March 2010 (note i) **2016**	**Overdrawn current accounts £m**	**Personal loans £m**	**Credit cards £m**	**Total £m**
Change in terms	**29**	**126**	**8**	**163**
Forbearance	**16**	**30**	**23**	**69**
Repair	**21**	**1**	**19**	**41**
Gross total	**66**	**157**	**50**	**273**
Elimination of multiple events	**(32)**	**(19)**	**(8)**	**(59)**
Total	**34**	**138**	**42**	**214**
Of which loans still on renegotiated terms	**21**	**95**	**17**	**133**

Balances subject to renegotiation since March 2010 (note i) 2015	Overdrawn current accounts £m	Personal loans £m	Credit cards (note ii) £m	Total £m
Change in terms	31	131	11	173
Forbearance	15	27	24	66
Repair	18	1	20	39
Gross total	64	159	55	278
Elimination of multiple events	(30)	(18)	(10)	(58)
Total	34	141	45	220
Of which loans still on renegotiated terms	21	106	22	149

Notes:
i. Renegotiated balances information for consumer banking is reported since March 2010, reflecting the point in time from which this data was captured for reporting purposes.
ii. Amounts have been restated following a review of the balances reported for credit cards. The previously reported total of £87 million was found to have included accounts which had been written-off.

Commercial lending

Summary

The Group has continued its strategy of developing a diverse commercial real estate portfolio by selectively entering into new lending, whilst reducing exposures which are outside of its current risk appetite or do not align to its existing lending strategy.

The Group's commercial loan portfolio comprises the following:

Commercial lending balances	**2016**		2015	
	£m	**%**	£m	%
Commercial real estate (CRE)	**3,009**	**25**	4,043	31
Registered social landlords (note i)	**7,625**	**65**	7,786	59
Project Finance (note ii)	**1,197**	**10**	1,383	10
Total commercial lending	**11,831**	**100**	13,212	100
Fair value adjustment for micro hedged risk	**1,366**		1,382	
Total	**13,197**		14,594	

Notes:
i. Loans to registered social landlords are secured on residential property.
ii. Loans advanced in relation to Project Finance are secured on cash flows from government or local authority backed contracts.

CRE loans have reduced, net of new lending, by £1,034 million to £3,009 million (2015: £4,043 million). This reduction, which includes managed exit activity, scheduled repayments and redemptions, has resulted in an increase in the percentage of commercial lending represented by the registered social landlord and Project Finance portfolios to 75% (2015: 69%).

Over the year the commercial property market has remained buoyant with investor confidence holding up well, supported by the availability of lending for commercial real estate. Non-performing loans have reduced to £226 million (2015: £685 million), non-performing loans over 100% LTV have reduced to £126 million (2015: £506 million) and impaired negative equity has fallen to £38 million (2015: £241 million). These improvements result from both previous deleveraging activity and the improvement in market conditions.

The registered social landlord portfolio, which represents 65% (2015: 59%) of total commercial lending balances, is fully performing and remains stable, reflecting its long term, low risk nature. The portfolio is risk rated using the Group's internal rating models with the major drivers being financial strength, independent viability assessment ratings provided by the Homes and Communities Agency and the type and size of the registered social landlord. The distribution of exposures is weighted more towards the stronger risk ratings and, against a backdrop of a long history of zero defaults, the risk profile of the portfolio has remained low even through the recent economic downturn.

There have been no losses incurred on either the registered social landlord or Project Finance portfolios, no amounts are in arrears and there are no instances of forbearance.

The remaining core CRE portfolio is well spread across geographic locations and property sectors and is of robust credit quality.

Over the period since 2012 the Group has concluded its deleveraging of non-core CRE assets and given the small residual non-core balances, no longer separates the management of its non-core and core businesses.

Commercial lending (continued)

Lending risk

Lending risk in the commercial loan portfolio is linked to delinquency and the availability of collateral to cover any loan balances. The Group adopts robust credit management policies and processes designed to recognise and manage the risks arising, or likely to arise, from the portfolio.

Loan to Value

The following table shows the CRE portfolio split by LTV and region:

CRE lending balances by LTV and region	London	South East	Rest of UK (note i)	Non-UK	Total	
2016	£m	£m	£m	£m	£m	%
Performing loans						
Fully collateralised						
LTV ratio (note ii):						
Less than 25%	136	24	60	-	220	
25% to 50%	1,021	219	419	-	1,659	
51% to 75%	329	111	390	-	830	
76% to 90%	3	13	46	-	62	
91% to 100%	1	-	5	-	6	
	1,490	367	920	-	2,777	92
Not fully collateralised						
- Over 100% LTV (A)	-	3	3	-	6	-
- Collateral value on A	*-*	*2*	*2*	*-*	*4*	
- Negative equity on A	*-*	*1*	*1*	*-*	*2*	
Total performing loans	1,490	370	923	-	2,783	92
Non-performing loans						
Fully collateralised						
LTV ratio (note iii):						
Less than 25%	17	-	2	-	19	
25% to 50%	10	9	5	-	24	
51% to 75%	8	5	17	-	30	
76% to 90%	3	-	18	-	21	
91% to 100%	-	-	6	-	6	
	38	14	48	-	100	4
Not fully collateralised						
- Over 100% LTV (B)	7	52	67	-	126	4
- Collateral value on A	*5*	*36*	*47*	*-*	*88*	
- Negative equity on A	*2*	*16*	*20*	*-*	*38*	
Total non-performing loans	45	66	115	-	226	8
Total CRE loans	1,535	436	1,038	-	3,009	100
Geographical concentration	51%	14%	35%	-	100%	

Commercial lending (continued)

CRE lending balances by LTV and region	London	South East	Rest of UK (note i)	Non-UK	Total	
2015	£m	£m	£m	£m	£m	%
Performing loans						
Fully collateralised						
LTV ratio (note ii)						
Less than 25%	255	19	47	-	321	
25% to 50%	877	189	351	-	1,417	
51% to 75%	510	249	449	-	1,208	
76% to 90%	117	25	220	-	362	
91% to 100%	-	6	17	-	23	
	1,759	488	1,084	-	3,331	82
Not fully collateralised						
- Over 100% LTV (A)	2	-	25	-	27	1
- Collateral value on A	*1*	-	*24*	-	*25*	
- Negative equity on A	*1*	-	*1*	-	*2*	
Total performing loans	1,761	488	1,109	-	3,358	83
Non-performing loans (note iii)						
Fully collateralised						
LTV ratio:						
Less than 25%	-	-	1	-	1	
25% to 50%	18	14	20	-	52	
51% to 75%	14	16	15	-	45	
76% to 90%	5	6	39	-	50	
91% to 100%	3	2	26	-	31	
	40	38	101	-	179	4
Not fully collateralised						
- Over 100% LTV (B)	3	140	354	9	506	13
- Collateral value on B	*2*	*92*	*162*	*9*	*265*	
- Negative equity on B	*1*	*48*	*192*	-	*241*	
Total non-performing loans	43	178	455	9	685	17
Total CRE loans	1,804	666	1,564	9	4,043	100
Geographical concentration	45%	16%	39%	-	100%	

Notes:
i. Includes lending to borrowers in the Channel Islands.
ii. The LTV ratio is calculated using the on-balance sheet carrying amount of the loan divided by the indexed value of the most recent independent external collateral valuation. The Investment Property Databank (IPD) monthly index is used.
iii. Non-performing loans include impaired loans and loans with arrears of less than three months which are not impaired.

There have been no significant changes to geographic concentrations in the book and overall credit quality has improved over the year.

In particular, non-performing loans have reduced and now represent 8% of CRE balances (2015: 17%), whilst both the proportion of partially collateralised non-performing loans and the shortfall on collateral for non-performing loans have also reduced. These improvements reflect the impact of improving book performance and previous deleveraging activity to reduce exposure to assets that are outside of the Group’s current risk appetite or do not align to the Group’s current lending strategy.

Commercial lending (continued)

Registered social landlords

The registered social landlord portfolio is secured against portfolios of residential real estate owned and let by UK housing associations. Collateral is typically re-valued at least every five years based on standard social housing methodologies, which generally assume that the properties continue to be let. If the valuation were based upon normal residential use the valuation would be considerably higher. In all cases, registered social landlord collateral is in excess of the loan balance.

Project Finance

The Project Finance portfolio is secured against contractual cash flows from projects procured under the UK Private Finance Initiative rather than physical assets. The majority of loans are secured on projects which are now operational and benefiting from secure long term cash flows, with only one case remaining in the construction phase.

Credit risk concentrations

The following table provides details of the Group's sectoral and regional CRE concentrations together with an impairment analysis in respect of these concentrations:

CRE lending balances and impairment provisions by type and region	London	South East	Rest of UK (note i)	Non-UK	Total
2016	**£m**	**£m**	**£m**	**£m**	**£m**
Retail	**459**	**235**	**317**	**-**	**1,011**
Office	**201**	**69**	**208**	**-**	**478**
Residential	**666**	**71**	**256**	**-**	**993**
Industrial and warehouse	**29**	**36**	**158**	**-**	**223**
Leisure and hotel	**88**	**25**	**87**	**-**	**200**
Other	**92**	**-**	**12**	**-**	**104**
Total CRE lending	**1,535**	**436**	**1,038**	**-**	**3,009**
Impairment provision:					
Retail	**2**	**12**	**8**	**-**	**22**
Office	**4**	**1**	**3**	**-**	**8**
Residential	**1**	**-**	**5**	**-**	**6**
Industrial and warehouse	**-**	**-**	**12**	**-**	**12**
Leisure and hotel	**1**	**-**	**7**	**-**	**8**
Other	**-**	**-**	**3**	**-**	**3**
Total impairment provisions	**8**	**13**	**38**	**-**	**59**

Commercial lending (continued)

CRE lending balances and impairment provisions by type and region 2015	London £m	South East £m	Rest of UK (note i) £m	Non-UK £m	Total £m
Retail	596	376	422	9	1,403
Office	223	105	339	-	667
Residential	613	103	309	-	1,025
Industrial and warehouse	55	46	331	-	432
Leisure and hotel	185	34	151	-	370
Other	132	2	12	-	146
Total CRE lending	1,804	666	1,564	9	4,043
Impairment provision:					
Retail	2	41	39	4	86
Office	2	18	64	-	84
Residential	1	2	25	-	28
Industrial and warehouse	-	1	84	-	85
Leisure and hotel	1	1	36	-	38
Other	-	-	1	-	1
Total impairment provisions	6	63	249	4	322

Note:
i. Includes lending to borrowers based in the Channel Islands.

Notwithstanding the reduction in CRE lending, the Commercial lending exposure remains well spread across sectors, and geographic regions.

Arrears and impairment

The Group holds impairment provisions in relation to both the performing and non-performing segments of the commercial lending portfolio. Provisions reflect losses which have been incurred at the balance sheet date, based on objective evidence. Individual impairment provisions are assigned to facilities exhibiting signs of financial difficulty and a collective provision is assigned to all other accounts. For currently performing loans, the collective provision reflects losses arising from impairment events that have occurred within the portfolio but are not identifiable at the reporting date.

No losses have been experienced on the registered social landlord or Project Finance portfolios and there is no non-performance within these portfolios. As a result, impairment provisions are only needed against the CRE portfolio.

Commercial lending (continued)

The table below sets out the payment due status and impairment provisions for the CRE portfolio:

CRE lending balances by payment due status	2016 £m	2016 %	2015 £m	2015 %
Performing:				
Neither past due nor impaired	**2,783**	**92**	3,358	83
Non-performing:				
Past due up to 3 months but not impaired (note i)	**55**	**2**	77	2
Impaired: (note ii)				
Past due up to 3 months	**115**	**4**	413	11
Past due 3 to 6 months	**21**	**1**	59	1
Past due 6 to 12 months	**4**	**-**	56	1
Past due over 12 months	**28**	**1**	79	2
Possessions (note iii)	**3**	**-**	1	-
Total non-performing balances	**226**	**8**	685	17
Total	**3,009**	**100**	4,043	100
Impairment provisions				
Individual	**54**	**92**	313	97
Collective	**5**	**8**	9	3
Total impairment provisions	**59**	**100**	322	100
Provision coverage ratios				
Individual provisions as % of impaired balances		**32**		51
Total provisions as % of non-performing balances		**26**		47
Total provisions as % of total gross balances		**2**		8
Estimated collateral:				
Against loans past due but not impaired	**55**	**100**	77	100
Against impaired loans	**133**	**78**	367	60
Total collateral	**188**	**83**	444	65

Notes:
i. The status 'past due up to 3 months but not impaired' includes any asset where a payment due under strict contractual terms is received late or missed. The amount included is the entire financial asset rather than just the payment overdue.
ii. Impaired loans include those balances which are more than three months in arrears, or against which an individual provision is held.
iii. Possession balances represent loans for which the Group has taken ownership of security pending sale. Assets in possession are realised to derive the maximum benefit for all interested parties. The Group does not occupy or otherwise use for any purposes the repossessed assets.

Total non-performing loans, before provisions, have reduced by £459 million to £226 million, with a corresponding reduction of £263 million in total impairment provisions reflecting the deleveraging activity in 2015/16 and an improvement in market conditions. These loans now represent 6% of the total CRE exposure (2015:15%).

Impairment (reversal)/loss for the year	2016 £m	2015 £m
Total	**(34)**	52

The improved CRE market conditions, including increased liquidity and capital values, have resulted in a net impairment reversal of £34 million. The £52 million charge in the prior period reflected accelerated disposals as part of the deleveraging activity.

Commercial lending (continued)

Negative equity loans

The level of negative equity based upon indexed property values for the non-performing and impaired assets is detailed below:

Negative equity on CRE lending	**2016**	2015
	£m	£m
Past due but not impaired	**-**	-
Impaired	**38**	240
Possessions	**-**	1
Total	**38**	241

The reduction in impaired negative equity reflects the improving book performance, previous deleveraging activity and positive economic environment where commercial properties have increased in value.

Forbearance

Forbearance occurs when concessions are made, on the contractual terms of a loan, when the borrower is facing or about to face difficulties in meeting its financial commitments.

Exposures are only removed from being in forbearance when specified conditions have been met including:

- a minimum 2 year probation period has passed from the date the forborne exposure was classified as performing;
- at least 1 years repayments of capital or interest have been made;
- none of the exposures to the borrower are more than 30 days past-due.

The table below provides details of the CRE lending that is currently subject to forbearance, split by the concession events agreed:

Lending subject to forbearance	**2016**		2015	
	£m	**%**	£m	%
Covenant breach	**54**	**9**	180	18
Extension at maturity	**42**	**7**	87	9
Multiple forbearance events	**484**	**82**	639	63
Other	**8**	**2**	106	10
Total	**588**	**100**	1,012	100

There are no instances of forbearance in either the registered social landlord or Project Finance portfolios.

CRE exposures currently subject to forbearance have decreased to £588 million, principally as a result of the controlled exit from non-core, higher risk loans, and now represent 20% of CRE loan balances (2015: 25%).

Treasury assets

Summary

The Group's treasury portfolio is held primarily for liquidity management purposes and, in the case of derivatives, for market risk management. As at 4 April 2016 treasury assets represent 12.9% (2015: 11.3%) of the Group's total assets.

Treasury asset balances	2016 £m	2015 £m
Cash	**8,797**	4,325
Loans and advances to banks	**3,591**	3,392
Investment securities	**10,738**	11,063
Treasury liquidity and investment portfolio	**23,126**	18,780
Derivative assets	**3,898**	3,337
Total treasury portfolio	**27,024**	22,117

Note: Derivatives are classified as assets where their fair value is positive and liabilities where their fair value is negative. At 4 April 2016, the Group had derivative liabilities of £3,463 million (2015: £4,048 million).

Investment activity is restricted to high quality primary liquidity securities comprising central bank reserves and highly rated debt securities issued by a limited range of governments, central banks and multilateral development banks. A secondary portfolio is also held offering access to central bank funding operations and a second tier of liquidity.

The total balance of out of policy legacy assets (investment securities acquired prior to the financial crisis and no longer approved within the Group's risk appetite) has reduced from £640 million to £423 million during the year through ongoing sales, maturities and amortisation. An £8 million reversal of impairment (2015: £18 million charge) has been recognised in the income statement from legacy asset disposals.

Although the out of policy portfolio risk profile has improved, opportunities to exit positions continue to be assessed against prevailing market conditions and the financial implications for the Group.

As part of the Group's risk management, derivatives are used to reduce exposure to market risks; the Group does not use any derivatives for trading or speculative purposes. The Group has no exposure to emerging markets, hedge funds or credit default swaps.

Managing treasury credit risks

Liquidity and investment portfolio

The Group's liquidity and investment portfolio held on the balance sheet at 4 April 2016 of £23,126 million (2015: £18,780 million) is held in three separate portfolios: primary liquidity, other central bank eligible assets and other securities. The size of the portfolio has increased, predominantly via higher cash balances held as a strategic response to potential market volatility in the run up to the EU referendum in June 2016.

Primary liquidity comprises cash held at central banks and highly rated debt securities issued by governments or multi-lateral development banks. The remaining two portfolios comprise available for sale investment securities, with movements reflecting legacy asset disposals, market prices and the Group's operational and strategic liquidity requirements.

Treasury assets (continued)

The Group's Treasury Credit Policy ensures all credit risk exposures align to the Board's risk appetite with investments restricted to low risk assets and proven market counterparties; an analysis of the on-balance sheet portfolios by credit rating and geographical location of the issuers is set out below.

Liquidity and investment portfolio by credit rating 2016	£m	AAA %	AA %	A %	Other %	UK %	US %	Europe %	Other %
Primary liquidity:									
Cash	**8,797**	**99**	**-**	**1**	**-**	**90**	**-**	**10**	**-**
Gilts	**4,731**	**100**	**-**	**-**	**-**	**100**	**-**	**-**	**-**
Non-domestic government bonds	**1,590**	**28**	**72**	**-**	**-**	**-**	**57**	**43**	**-**
Supranational bonds	**522**	**90**	**10**	**-**	**-**	**-**	**-**	**-**	**100**
Primary liquidity total	**15,640**	**92**	**8**	**-**	**-**	**81**	**6**	**10**	**3**
Other Central Bank eligible:									
Residential mortgage backed securities (RMBS)	**1,153**	**96**	**1**	**3**	**-**	**64**	**-**	**36**	**-**
Covered bonds	**1,011**	**97**	**-**	**3**	**-**	**52**	**-**	**36**	**12**
Other (secondary liquidity)	**365**	**87**	**13**	**-**	**-**	**54**	**-**	**46**	**-**
Other Central Bank eligible total	**2,529**	**95**	**3**	**2**	**-**	**58**	**-**	**37**	**5**
Other securities:									
Loans and advances to banks	**3,591**	**25**	**19**	**31**	**25**	**68**	**9**	**11**	**12**
RMBS	**487**	**16**	**15**	**55**	**14**	**77**	**-**	**20**	**3**
Commercial mortgage backed securities (CMBS)	**40**	**-**	**16**	**67**	**17**	**16**	**84**	**-**	**-**
Collateralised loan obligations	**528**	**84**	**13**	**3**	**-**	**78**	**22**	**-**	**-**
Student loans	**136**	**19**	**53**	**28**	**-**	**-**	**100**	**-**	**-**
Other	**175**	**-**	**9**	**63**	**28**	**36**	**64**	**-**	**-**
Other securities total	**4,957**	**29**	**18**	**32**	**21**	**66**	**15**	**10**	**9**
Total	**23,126**	**79**	**10**	**7**	**4**	**75**	**7**	**13**	**5**

Treasury assets (continued)

Liquidity and investment portfolio by credit rating 2015	£m	AAA %	AA %	A %	Other %	UK %	US %	Europe %	Other %
Primary liquidity:									
Cash	4,325	100	-	-	-	100	-	-	-
Gilts	5,031	100	-	-	-	100	-	-	-
Non-domestic government bonds	1,200	21	79	-	-	-	25	75	-
Supranational bonds	495	90	10	-	-	-	-	-	100
Primary liquidity total	11,051	91	9	-	-	85	3	8	4
Other Central Bank eligible:									
Residential mortgage backed securities (RMBS)	1,189	82	12	6	-	38	-	62	-
Covered bonds	993	96	-	-	4	44	-	48	8
Other (secondary liquidity)	239	90	-	-	10	35	-	65	-
Other Central Bank eligible total	2,421	88	6	3	3	40	-	57	3
Other securities:									
Loans and advances to banks	3,392	10	30	60	-	49	16	15	20
RMBS	876	35	7	53	5	86	-	11	3
Commercial mortgage backed securities (CMBS)	60	-	19	70	11	15	78	7	-
Collateralised loan obligations	556	75	21	4	-	59	41	-	-
Covered bonds	40	100	-	-	-	100	-	-	-
Student loans	163	-	64	36	-	-	100	-	-
Other	221	42	25	13	20	40	13	47	-
Other securities total	5,308	22	26	50	2	55	19	13	13
Total	18,780	71	13	15	1	70	7	16	7

Note: Ratings used are obtained from Standard & Poor's in the majority of cases, from Moody's if there is no Standard & Poor's rating available, and internal ratings are used if neither is available.

The above analysis does not include off balance sheet funding, including £8.5 billion (2015: £8.5 billion) of primary liquidity representing short dated UK Treasury bills held as a result of FLS drawings. These are included in the analysis of funding in the 'Financial Risk' section of this report.

Credit quality has improved with 79% of investments rated at AAA (2015: 71%). Primary liquidity exposure makes up 68% of the total portfolio (2015: 59%).

Collateral held as security for treasury assets is determined by the nature of the instrument. Treasury liquidity portfolio assets are generally unsecured with the exception of reverse repos, asset backed securities and similar instruments, which are secured by pools of financial assets. Within loans and advances to banks is a reverse repo of £0.1 billion (2015: £0.1 billion) which is secured by gilts.

Available for sale reserve

Out of a total of £23,126 million (2015: £18,780 million) on balance sheet treasury liquidity and investment portfolio, £10,738 million (2015: £11,063 million) is held as available for sale (AFS). Under IFRS, AFS assets are marked to market through other comprehensive income and fair value movements are accumulated in reserves.

Of the £10,738 million of AFS assets, £125 million (2015: £12 million) are classified as Level 3 (valuation not based on observable market data) for the purposes of IFRS 13. This increase is primarily caused by an £81 million gain connected with the impending disposal of the Society's investment in Visa Europe, further details of which can be found in note 21 to the preliminary results announcement. Details of fair value movements can be found in notes 12 and 13 to the preliminary results announcement.

Treasury assets (continued)

The table below shows the fair value carrying amount and AFS reserve for the treasury liquidity and investment portfolio.

Fair value of treasury assets and AFS reserve	**2016**		2015	
	Fair value on balance sheet £m	**Cumulative AFS reserve £m**	Fair value on balance sheet £m	Cumulative AFS reserve £m
Cash	**8,797**	**(note i)**	4,325	(note i)
Gilts	**4,731**	**(374)**	5,031	(468)
Non-domestic government bonds	**1,590**	**(48)**	1,200	(91)
Supranational bonds	**522**	**(3)**	495	(6)
Primary liquidity portfolio total	**15,640**	**(425)**	11,051	(565)
Residential mortgage backed securities (RMBS)	**1,153**	**10**	1,189	4
Covered bonds	**1,011**	**(15)**	993	(21)
Other investments	**365**	**1**	239	-
Other central bank eligible liquidity portfolio total	**2,529**	**(4)**	2,421	(17)
Loans and advances to banks	**3,591**	**(note i)**	3,392	(note i)
RMBS	**487**	**23**	876	(2)
Commercial mortgage backed securities (CMBS)	**40**	**6**	60	8
Covered bonds	**-**	**-**	40	-
Collateralised loan obligations (CLO)	**528**	**5**	556	1
Student loans	**136**	**11**	163	7
Other investments	**175**	**(97)**	221	(1)
Other portfolio total	**4,957**	**(52)**	5,308	13
Total treasury liquidity portfolio	**23,126**	**(481)**	18,780	(569)
AFS reserve before hedge accounting and taxation		**(481)**		(569)
Hedge accounting adjustment for interest rate risk		**498**		544
Taxation		**(9)**		(1)
AFS reserve (net)		**8**		(26)

Note:
i. Not applicable for ‘Cash’ and ‘Loans and advances to banks’.

As at 4 April 2016, the balance on the AFS reserve had moved to an £8 million loss, net of tax (2015: £26 million gain). The movements in the AFS reserve reflect general market movements and the disposal of legacy assets. The fair value movement of AFS assets that are not impaired has no effect on the Group’s profit.

Treasury assets (continued)

Country exposures

The Group holds £162 million (2015: £315 million) of securities which are domiciled in the peripheral Eurozone countries; these are held outside of primary liquidity. Of the £162 million, 79% is rated single A or above (2015: 74%). This exposure has reduced by 49% in the year to 4 April 2016 due primarily to the disposal of legacy Spanish assets, maturities and fair value and exchange rate movements. The Group continues to actively manage these exposures which remain outside of current credit policy.

The following table summarises the Group's exposure to issuers in the peripheral Eurozone countries; the Group has no direct sovereign exposure to these countries. The exposures are shown at their balance sheet carrying values.

Country exposures (peripheral Eurozone) 2016	**Italy £m**	**Portugal £m**	**Spain £m**	**Total £m**
Mortgage backed securities	**21**	**22**	**85**	**128**
Covered bonds	**-**	**-**	**31**	**31**
Other corporate	**3**	**-**	**-**	**3**
Total	**24**	**22**	**116**	**162**

Country exposures (peripheral Eurozone) 2015	Italy £m	Portugal £m	Spain £m	Total £m
Mortgage backed securities	45	32	206	283
Covered bonds	-	-	29	29
Other corporate	3	-	-	3
Total	48	32	235	315

None of the Group's exposures to the peripheral Eurozone countries detailed in the table above are in default, and the Group has not incurred any impairment on these assets in the period.

In addition to exposure to peripheral Eurozone countries, the Group's total exposure in respect of the other Eurozone and rest of the world countries is shown below at the balance sheet carrying value.

Country exposures (other than peripheral Eurozone) 2016	**Finland £m**	**France £m**	**Germany £m**	**Netherlands £m**	**USA £m**	**Rest of world £m**	**Total £m**
Government bonds	**242**	**-**	**365**	**82**	**902**	**-**	**1,591**
Mortgage backed securities	**-**	**-**	**-**	**385**	**35**	**17**	**437**
Covered bonds	**23**	**52**	**-**	**-**	**-**	**383**	**458**
Senior debt	**-**	**-**	**-**	**-**	**-**	**522**	**522**
Loans to banks	**-**	**60**	**107**	**-**	**350**	**627**	**1,144**
Other corporate	**-**	**4**	**3**	**-**	**-**	**-**	**7**
Other assets	**-**	**66**	**102**	**-**	**365**	**-**	**533**
Total	**265**	**182**	**577**	**467**	**1,652**	**1,549**	**4,692**

Country exposures (other than peripheral Eurozone) 2015	Finland £m	France £m	Germany £m	Netherlands £m	USA £m	Rest of world £m	Total £m
Government bonds	231	-	253	411	305	-	1,200
Mortgage backed securities	-	4	-	551	49	27	631
Covered bonds	21	125	37	27	-	315	525
Senior debt	-	-	-	-	-	495	495
Loans to banks	-	146	229	-	527	823	1,725
Other corporate	2	7	5	3	-	-	17
Other assets	-	88	169	-	420	-	677
Total	254	370	693	992	1,301	1,660	5,270

Note: Rest of world exposure is to Australia, Canada, Denmark, Norway, Sweden and Switzerland.

Treasury assets (continued)

Derivative financial instruments

The Group uses derivatives to reduce exposure to market risks, although the application of accounting rules can create volatility in the income statement in a particular financial year. The fair value of derivative assets at 4 April 2016 was £3.9 billion (2015: £3.3 billion) and the fair value of derivative liabilities was £3.5 billion (2015: £4.0 billion).

The International Swaps and Derivatives Association (ISDA) Master Agreement is the Group's preferred agreement for documenting derivative transactions. A Credit Support Annex (CSA) is always executed in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between parties to mitigate the market contingent counterparty risk inherent in the outstanding positions. The Group's CSAs are two-way agreements where both parties post collateral dependent on the exposure of the derivative. Collateral is paid or received on a regular basis (typically daily) to mitigate the mark to market exposures on derivatives.

The Group's CSA legal documentation for derivative transactions grants legal rights of set off for transactions with the same overall counterparty. Accordingly, the credit risk associated with such positions is reduced to the extent that negative mark to market values offset positive mark to market values in the calculation of credit risk within each netting agreement.

As a result of CSA netting arrangements, outstanding transactions with the same counterparty can be offset and settled net following a default or other predetermined event. Under CSA arrangements netting benefits of £2.0 billion (2015: £1.9 billion) are available and £1.8 billion of collateral is held (2015: £1.3 billion) is available; cash is the only collateral held.

The following table shows the exposure to counterparty credit risk for derivative contracts after netting benefits and collateral:

Derivative credit exposure		**2016**			2015	
Counterparty credit quality	**AA**	**A**	**Total**	AA	A	Total
	£bn	**£bn**	**£bn**	£bn	£bn	£bn
Gross positive fair value of contracts	**1.1**	**2.8**	**3.9**	0.4	2.9	3.3
Netting benefits	**(0.5)**	**(1.5)**	**(2.0)**	(0.3)	(1.6)	(1.9)
Net current credit exposure	**0.6**	**1.3**	**1.9**	0.1	1.3	1.4
Collateral held	**(0.6)**	**(1.2)**	**(1.8)**	(0.1)	(1.2)	(1.3)
Net derivative credit exposure	**-**	**0.1**	**0.1**	-	0.1	0.1

Financial risk

The Group is exposed to financial risks as follows:

Risk category	Definition
Liquidity and funding	Liquidity risk is the risk that the Group is unable to meet its liabilities as they fall due and maintain member and stakeholder confidence. Funding risk is the risk that the Group is unable to maintain diverse funding sources in wholesale and retail markets and manage retail funding risk that can arise from excessive concentrations of higher risk deposits.
Solvency	The risk that the Group fails to maintain sufficient capital to absorb losses throughout a full economic cycle and sufficient to maintain the confidence of current and prospective investors, the Board and regulators.
Market	The risk that the net value of, or net income arising from, the Group's assets and liabilities is impacted as a result of market price or rate changes.
Pension	The risk that the value of the Fund's assets will be insufficient to meet the estimated liabilities of the Fund. Pension risk can adversely impact the Group's capital position and/or result in increased cash funding obligations to the Fund.
Earnings	The risk that a source of income or value is unable to continue to add the expected value, due to changes in market, regulatory or other environmental factors.

Financial risk is managed within a framework of approved assets, currencies and capital instruments supported by detailed limits set by either the Board or the Assets and Liabilities Committee (ALCO) under its delegated mandate. The Board retains responsibility for approval of derivative classes that may be used for market risk management purposes, restrictions over the use of such derivative classes (within the limitations imposed under the Building Societies Act, Section 9A) and for asset classes that may be classified as liquidity.

Liquidity and funding risk

Summary

The Group's liquidity and funding levels continue to be within Board risk appetite and regulatory requirements.

The Group monitors its position relative to internal risk appetite and the regulatory short term liquidity stress metric, the Liquidity Coverage Ratio (LCR), which was implemented on 1 October 2015. The Group's LCR at 4 April 2016 was 142.6% (2015: 119.3%), which reflects the Group's strategy of maintaining a LCR of at least 100% and represents a surplus to the UK regulatory minimum requirement of 80%, rising to 100% by January 2018.

The Group also monitors its position against the longer-term funding metric, the Net Stable Funding Ratio (NSFR), which is due to become a regulatory standard in January 2018. Based on current interpretations of regulatory requirements and guidance, the Group's NSFR at 4 April 2016 was 127.9% (2015: 121.9%) which exceeds the expected 100% minimum future requirement.

The Group monitors liquidity and funding risks on an ongoing basis. This includes the current geopolitical uncertainty, such as a sustained economic slowdown in China and the Eurozone and the forthcoming EU referendum, which could have an impact on funding markets.

The Bank of England has recently consulted on the UK framework for banks and building societies to hold a minimum level of liabilities which can be bailed-in to recapitalise it in the event of failure, known as the minimum requirement for own funds and eligible liabilities (MREL). The Group is confident that it will be able to meet the full requirements when implemented in 2020.

Overall, the Group's stable and diverse funding base and sufficient holdings of high-quality liquid assets combine to ensure that there is no significant risk that liabilities cannot be met as they fall due.

Funding risk

Funding strategy

The Group's strategy is to remain predominantly retail funded; retail customer loans and advances are therefore largely funded by customer deposits. Non-retail lending, including treasury assets and commercial customer loans, are largely funded by wholesale debt, as set out below.

Funding profile

Assets	**2016 £bn**	2015 £bn	**Liabilities**	**2016 £bn**	2015 £bn
Retail mortgages	**162.1**	152.8	Retail funding	**144.9**	138.5
Treasury assets (including liquidity portfolio)	**23.1**	18.8	Wholesale funding	**45.8**	39.2
Other retail lending	**3.6**	3.6	Capital and reserves	**13.2**	12.3
Commercial/Other lending	**13.1**	14.2	Other liabilities	**5.0**	5.6
Other assets	**7.0**	6.2			
	208.9	195.6		**208.9**	195.6

The Group's loan to deposit ratio at 4 April 2016 was 117.2% (2015: 115.6%).

Liquidity and funding risk (continued)

Wholesale funding

On-balance sheet wholesale funding has increased by £6.6 billion to £45.8 billion, as set out in the table below. This reflects the ongoing management of the Group’s liquidity and an element of pre-funding of wholesale and Bank of England Funding for Lending Scheme (FLS) maturities to de-risk our funding plans ahead of the EU referendum in June 2016. The wholesale funding portfolio is made up of a range of unsecured and secured instruments to ensure the Group has a diversified funding base across a range of currencies, maturities and investor types.

Wholesale funding sources	**2016**		2015	
	£bn	**%**	£bn	%
Deposits, including PEB balances	**9.7**	**21.2**	11.0	28.1
Certificates of deposit	**5.1**	**11.2**	3.1	7.9
Commercial paper	**1.3**	**2.8**	2.4	6.1
Covered bonds	**13.8**	**30.1**	11.3	28.8
Medium term notes	**9.9**	**21.6**	5.2	13.3
Securitisations	**4.7**	**10.3**	4.8	12.2
Other	**1.3**	**2.8**	1.4	3.6
Total	**45.8**	**100.0**	39.2	100.0

At 4 April 2016 ‘Deposits, including PEB balances’ comprised deposits of £3.6 billion (2015: £4.5 billion), PEBS of £1.9 billion (2015: £3.3 billion), business savings of £2.4 billion (2015: £1.3 billion) and other deposits of £1.8 billion (2015: £1.9 billion).

The table below sets out an analysis by currency of the Group’s wholesale funding.

Wholesale funding currency	**2016**					2015				
	GBP £bn	**EUR £bn**	**USD £bn**	**Other £bn**	**Total £bn**	GBP £bn	EUR £bn	USD £bn	Other £bn	Total £bn
Deposits, including PEB balances	**9.0**	**0.5**	**0.2**	**-**	**9.7**	10.1	0.6	0.3	-	11.0
Certificates of deposit	**4.7**	**-**	**0.4**	**-**	**5.1**	2.9	0.1	0.1	-	3.1
Commercial paper	**0.2**	**-**	**1.1**	**-**	**1.3**	0.1	0.6	1.7	-	2.4
Covered bonds	**2.5**	**11.1**	**-**	**0.2**	**13.8**	1.8	9.4	-	0.1	11.3
Medium term notes	**2.3**	**4.8**	**2.2**	**0.6**	**9.9**	1.2	2.4	1.4	0.2	5.2
Securitisations	**1.9**	**1.2**	**1.6**	**-**	**4.7**	1.7	1.3	1.8	-	4.8
Other	**0.2**	**1.0**	**0.1**	**-**	**1.3**	0.3	1.0	0.1	-	1.4
Total	**20.8**	**18.6**	**5.6**	**0.8**	**45.8**	18.1	15.4	5.4	0.3	39.2

To mitigate cross-currency refinancing risk, the Group ensures it holds liquidity in each currency to cover at least the next ten business days of wholesale funding maturities.

Liquidity and funding risk (continued)

Managing the maturity profile is crucial to maintaining the Group's ongoing liquidity position. The residual maturity of the wholesale funding book, on a contractual maturity basis, is set out below.

Wholesale funding – residual maturity	**Not more than one month**	**Over one month but not more than three months**	**Over three months but not more than six months**	**Over six months but not more than one year**	**Subtotal less than one year**	**Over one year but not more than two years**	**Over two years**	**Total**
2016	**£bn**	**£bn**	**£bn**	**£bn**	**£bn**	**£bn**	**£bn**	**£bn**
Deposits, including PEB balances	**4.1**	**1.2**	**1.6**	**1.9**	**8.8**	**0.9**	**-**	**9.7**
Certificates of deposit	**1.3**	**1.6**	**1.7**	**0.5**	**5.1**	**-**	**-**	**5.1**
Commercial paper	**0.3**	**0.9**	**0.1**	**-**	**1.3**	**-**	**-**	**1.3**
Covered bonds	**0.1**	**-**	**-**	**1.2**	**1.3**	**0.8**	**11.7**	**13.8**
Medium term notes	**-**	**-**	**-**	**0.9**	**0.9**	**0.6**	**8.4**	**9.9**
Securitisations	**-**	**-**	**-**	**1.4**	**1.4**	**0.7**	**2.6**	**4.7**
Other	**-**	**-**	**-**	**-**	**-**	**-**	**1.3**	**1.3**
Total	**5.8**	**3.7**	**3.4**	**5.9**	**18.8**	**3.0**	**24.0**	**45.8**
Of which secured	**0.1**	**-**	**-**	**2.6**	**2.7**	**1.5**	**15.3**	**19.5**
Of which unsecured	**5.7**	**3.7**	**3.4**	**3.3**	**16.1**	**1.5**	**8.7**	**26.3**
% of total	**12.6**	**8.1**	**7.4**	**12.9**	**41.0**	**6.6**	**52.4**	**100.0**

Wholesale funding – residual maturity	Not more than one month	Over one month but not more than three months	Over three months but not more than six months	Over six months but not more than one year	Subtotal less than one year	Over one year but not more than two years	Over two years	Total
2015	£bn	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Deposits, including PEB balances	3.8	1.8	1.3	2.1	9.0	1.2	0.8	11.0
Certificates of deposit	0.5	1.3	0.8	0.5	3.1	-	-	3.1
Commercial paper	1.1	1.2	0.1	-	2.4	-	-	2.4
Covered bonds	-	-	0.9	1.5	2.4	1.1	7.8	11.3
Medium term notes	-	-	0.2	-	0.2	-	5.0	5.2
Securitisations	-	-	-	1.2	1.2	1.3	2.3	4.8
Other	-	-	-	-	-	-	1.4	1.4
Total	5.4	4.3	3.3	5.3	18.3	3.6	17.3	39.2
Of which secured	-	-	0.9	2.7	3.6	2.4	10.1	16.1
Of which unsecured	5.4	4.3	2.4	2.6	14.7	1.2	7.2	23.1
% of total	13.8	11.0	8.4	13.5	46.7	9.2	44.1	100.0

The Group's wholesale funding ratio (wholesale funding as a proportion of total funding liabilities) was 24.8% at 4 April 2016 (2015: 23.3%). The wholesale funding ratio includes all balance sheet sources of funding (including securitisations) and therefore excludes off-balance sheet FLS drawings.

The proportion of on-balance sheet funding categorised as long term (more than one year to maturity) is 59.0% (2015: 53.3%), which increased as a result of long term wholesale funding issuance during the year.

FLS drawings have a flexible and maximum maturity of four years. After including off-balance sheet FLS drawings, the residual maturity profile of the Group's wholesale funding portfolio was 50 months (2015: 40 months) and the total proportion of funding that is categorised as long term was 60.8% (2015: 61.6%).

At 4 April 2016, cash, government and supranational bonds included in the liquidity pool, including FLS treasury-bills, represented 128% (2015: 107%) of wholesale funding maturing in less than one year, assuming no rollovers.

Liquidity and funding risk (continued)

Liquidity risk

Total liquidity

The Group ensures it has sufficient resources to meet day-to-day cash flow needs and to meet internal and regulatory liquidity requirements which are calibrated to ensure the Group has sufficient liquidity, both in terms of amount and quality, in a range of stress scenarios and across multiple time horizons.

The table below sets out the sterling equivalent fair value of the liquidity portfolio, categorised by issuing currency. It includes off-balance sheet liquidity (FLS treasury bills) and excludes encumbered assets.

Liquid assets	**2016**				2015			
	GBP £bn	**EUR £bn**	**USD £bn**	**Total £bn**	GBP £bn	EUR £bn	USD £bn	Total £bn
Cash and reserves at central banks	**7.9**	**0.9**	**-**	**8.8**	4.3	-	-	4.3
Government bonds	**13.4**	**0.5**	**0.9**	**14.8**	13.7	0.8	0.3	14.8
Supranational bonds	**0.4**	**-**	**0.1**	**0.5**	0.4	-	0.1	0.5
Other Central Bank eligible assets	**1.4**	**1.0**	**0.1**	**2.5**	0.7	1.5	0.1	2.3
Other securities	**0.4**	**0.6**	**0.3**	**1.3**	1.5	0.6	0.5	2.6
Total	**23.5**	**3.0**	**1.4**	**27.9**	20.6	2.9	1.0	24.5

The Group's liquid assets are held and managed centrally by the Group's Treasury Division. The Group maintains a high quality liquidity portfolio through continued investment in highly liquid assets, predominantly comprising:

- reserves held at central banks, and
- highly rated debt securities issued by a restricted range of governments, central banks and supranationals/multilateral development banks.

Government bonds in the table above include £8.5 billion of off-balance sheet treasury bills held through FLS participation. The average combined month end balance of cash and reserves at central banks, government and supranational bonds during the year was £22.8 billion (2015: £22.0 billion).

The Group also holds a portfolio of other central bank eligible covered bonds and asset backed securities that are eligible for use in the funding operations of those central banks that it has access to. In terms of their relative liquidity characteristics, these assets may be viewed as the second tier of liquidity after cash reserves and highly rated debt securities.

Other securities, such as RMBS, are held that are not eligible for central bank operations but can be monetised through repurchase agreements with third parties or through sale.

For contingent funding purposes, unencumbered mortgage assets are pre-positioned at the Bank of England and represent eligible collateral which can be used in the Bank of England's liquidity operations if market liquidity is severely disrupted.

Liquidity and funding risk (continued)

Residual maturity of liquidity assets and liabilities

The table below segments the carrying value of financial assets and financial liabilities into relevant maturity groupings based on the final contractual maturity date (residual maturity). In practice, customer behaviours mean that liabilities are often retained for longer than their contractual maturities and assets are repaid faster. This gives rise to funding gaps on the Group's balance sheet.

The balance sheet structure and risks are managed and monitored by ALCO. For forecasting purposes, the Group uses judgement and past behavioural performance of each asset and liability class to anticipate likely cash flow requirements of the Group.

The analysis below excludes certain non-financial assets (including property, plant and equipment, intangible assets, investment property, other assets, deferred tax assets and accrued income and expenses prepaid) and non-financial liabilities (including provisions for liabilities and charges, accruals and deferred income, current tax liabilities, other liabilities and retirement benefit obligations).

Residual maturity 2016	Due less than one month (note i) £m	Due between one and three months £m	Due between three and six months £m	Due between six and nine months £m	Due between nine and twelve months £m	Due between one and two years £m	Due between two and five years £m	Due after more than five years £m	Total £m
Financial assets:									
Cash	**8,797**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**8,797**
Loans and advances to banks	**3,179**	**87**	**-**	**-**	**-**	**-**	**-**	**325**	**3,591**
Available for sale investment securities	**6**	**15**	**14**	**1**	**178**	**352**	**3,680**	**6,366**	**10,612**
Loans and advances to customers	**2,825**	**1,256**	**1,929**	**1,810**	**1,823**	**7,124**	**20,237**	**141,803**	**178,807**
Derivative financial instruments	**25**	**151**	**128**	**102**	**30**	**227**	**994**	**2,241**	**3,898**
Other financial assets	**5**	**15**	**107**	**17**	**65**	**142**	**234**	**299**	**884**
Total financial assets	**14,837**	**1,524**	**2,178**	**1,930**	**2,096**	**7,845**	**25,145**	**151,034**	**206,589**
Financial liabilities:									
Shares	**103,296**	**1,632**	**5,875**	**4,608**	**5,122**	**10,731**	**6,251**	**1,200**	**138,715**
Deposits from banks	**1,658**	**184**	**168**	**41**	**19**	**-**	**25**	**-**	**2,095**
Of which repo	***122***	***-***	***5***	***-***	***-***	***-***	***-***	***-***	***127***
Other deposits	**2,549**	**1,392**	**1,843**	**716**	**391**	**737**	**7**	**-**	**7,635**
Due to customers	**3,563**	**543**	**1,347**	**345**	**215**	**126**	**62**	**-**	**6,201**
Secured funding – ABS and covered bonds	**65**	**19**	**43**	**2,238**	**323**	**1,524**	**7,002**	**8,263**	**19,477**
Senior unsecured funding	**1,637**	**2,478**	**1,810**	**315**	**1,040**	**632**	**3,878**	**4,818**	**16,608**
Derivative financial instruments	**31**	**9**	**23**	**33**	**84**	**338**	**647**	**2,298**	**3,463**
Other financial liabilities	**2**	**2**	**1**	**1**	**(1)**	**-**	**8**	**-**	**13**
Subordinated liabilities	**-**	**-**	**-**	**-**	**-**	**114**	**669**	**1,034**	**1,817**
Subscribed capital (note ii)	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**413**	**413**
Total financial liabilities	**112,801**	**6,259**	**11,110**	**8,297**	**7,193**	**14,202**	**18,549**	**18,026**	**196,437**
Off-balance sheet commitments (note iii)	**13,630**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**13,630**
Net liquidity difference	**(111,594)**	**(4,735)**	**(8,932)**	**(6,367)**	**(5,097)**	**(6,357)**	**6,596**	**133,008**	**(3,478)**
Cumulative liquidity difference	**(111,594)**	**(116,329)**	**(125,261)**	**(131,628)**	**(136,725)**	**(143,082)**	**(136,486)**	**(3,478)**	

Liquidity and funding risk (continued)

Residual maturity 2015	Due less than one month (note i) £m	Due between one and three months £m	Due between three and six months £m	Due between six and nine months £m	Due between nine and twelve months £m	Due between one and two years £m	Due between two and five years £m	Due after more than five years £m	Total £m
Financial assets:									
Cash	4,325	-	-	-	-	-	-	-	4,325
Loans and advances to banks	2,923	2	-	61	-	87	-	319	3,392
Available for sale investment securities	5	14	19	1	122	219	1,830	8,827	11,037
Loans and advances to customers	2,450	1,198	1,713	1,893	1,739	7,272	19,361	135,021	170,647
Derivative financial instruments	42	115	153	322	110	452	573	1,570	3,337
Other financial assets	-	12	-	2	10	126	224	256	630
Total financial assets	9,745	1,341	1,885	2,279	1,981	8,156	21,988	145,993	193,368
Financial liabilities:									
Shares	97,712	1,464	5,837	5,380	6,353	8,353	6,326	948	132,373
Deposits from banks	1,479	391	10	64	6	-	24	-	1,974
Of which repo	-	-	-	-	-	-	-	-	-
Other deposits	2,582	1,458	1,565	923	584	1,205	759	-	9,076
Due to customers	3,727	441	1,318	254	224	42	113	-	6,119
Secured funding – ABS and covered bonds	4	15	944	2,810	22	2,514	3,153	8,071	17,533
Senior unsecured funding	1,640	2,467	1,005	339	235	746	2,676	1,464	10,572
Derivative financial instruments	64	31	13	27	25	345	791	2,752	4,048
Other financial liabilities	1	2	-	1	1	1	8	-	14
Subordinated liabilities (note iv)	-	-	266	-	-	-	122	1,733	2,121
Subscribed capital (notes ii and iv)	-	-	-	-	-	-	-	415	415
Total financial liabilities	107,209	6,269	10,958	9,798	7,450	13,206	13,972	15,383	184,245
Off-balance sheet commitments (note iii)	13,690	-	-	-	-	-	-	-	13,690
Net liquidity difference	(111,154)	(4,928)	(9,073)	(7,519)	(5,469)	(5,050)	8,016	130,610	(4,567)
Cumulative liquidity difference	(111,154)	(116,082)	(125,155)	(132,674)	(138,143)	(143,193)	(135,177)	(4,567)	

Notes:
i. Due less than one month includes amounts repayable on demand.
ii. The principal amount for undated subscribed capital is included within the due more than five years column.
iii. Off-balance sheet commitments include amounts payable on demand for unrecognised loan commitments and customer overpayments on residential mortgages, where the borrower is able to drawdown the amount overpaid.
iv. Comparatives have been restated for the reclassification of certain amounts based on contractual maturity date rather than call date for financial instruments callable at the Group's option.

Liquid assets include cash, loans and advances to banks, and available for sale investment securities, which in aggregate have increased by £4,246 million to £23,000 million over the period. Other financial assets and liabilities include the fair value adjustments for portfolio hedged risk and investments in equity shares.

Liquidity and funding risk (continued)

Financial liabilities – gross undiscounted contractual cash flows

The tables below provide an analysis of gross contractual cash flows. The totals differ from the analysis of residual maturity as they include interest, accrued at current rates for the average period until maturity, on the balances outstanding at the balance sheet date.

Amounts are allocated to the relevant maturity band based on the timing of individual contractual cash flows.

Gross contractual cash flows 2016	Due less than one month (note i) £m	Due between one and three months £m	Due between three and six months £m	Due between six and nine months £m	Due between nine and twelve months £m	Due between one and two years £m	Due between two and five years £m	Due after more than five years £m	Total £m
Shares	103,296	1,723	5,956	4,675	5,177	10,866	6,387	1,369	139,449
Deposits from banks	1,657	184	169	41	19	-	25	-	2,095
Other deposits	2,550	1,398	1,846	717	391	737	7	-	7,646
Due to customers	3,563	549	1,351	347	216	127	63	-	6,216
Secure funding – ABS and covered bonds	70	23	68	2,282	503	1,832	7,683	8,444	20,905
Senior unsecured funding	1,638	2,583	1,769	332	1,152	854	4,292	5,336	17,956
Subordinated liabilities	-	-	38	-	49	212	233	1,704	2,236
Subscribed capital (note ii)	1	5	4	7	4	22	67	362	472
Total non-derivative financial liabilities	112,775	6,465	11,201	8,401	7,511	14,650	18,757	17,215	196,975
Derivative financial liabilities:									
Gross settled derivatives – outflows	*26*	*244*	*101*	*27*	*889*	*1,221*	*2,079*	*1,015*	*5,602*
Gross settled derivatives – inflows	*(25)*	*(234)*	*(88)*	*(14)*	*(830)*	*(1,088)*	*(1,858)*	*(897)*	*(5,034)*
Gross settled derivatives – net flows	*1*	*10*	*13*	*13*	*59*	*133*	*221*	*118*	*568*
Net settled derivatives liabilities	*56*	*119*	*188*	*163*	*170*	*489*	*840*	*1,257*	*3,282*
Total derivative financial liabilities	57	129	201	176	229	622	1,061	1,375	3,850
Total financial liabilities	112,832	6,594	11,402	8,577	7,740	15,272	19,818	18,590	200,825
Off-balance sheet commitments (note iii)	13,630	-	-	-	-	-	-	-	13,630
Total financial liabilities including off-balance sheet commitments	126,462	6,594	11,402	8,577	7,740	15,272	19,818	18,590	214,455

Liquidity and funding risk (continued)

Gross contractual cash flows 2015	Due less than one month (note i) £m	Due between one and three months £m	Due between three and six months £m	Due between six and nine months £m	Due between nine and twelve months £m	Due between one and two years £m	Due between two and five years £m	Due after more than five years £m	Total £m
Shares	97,712	1,568	5,930	5,456	6,411	8,494	6,478	977	133,026
Deposits from banks	1,479	392	10	64	6	-	25	-	1,976
Other deposits	2,582	1,477	1,579	933	591	1,223	773	-	9,158
Due to customers	3,727	448	1,322	256	225	44	115	-	6,137
Secure funding – ABS and covered bonds	36	20	971	2,846	187	2,797	3,771	8,068	18,696
Senior unsecured funding	1,640	2,471	1,048	344	337	897	3,053	1,640	11,430
Subordinated liabilities (note iv)	-	4	315	4	50	96	390	1,811	2,670
Subscribed capital (notes ii and iv)	1	5	4	7	4	22	68	363	474
Total non-derivative financial liabilities	107,177	6,385	11,179	9,910	7,811	13,573	14,673	12,859	183,567
Derivative financial liabilities:									
Gross settled derivatives – outflows	*1,503*	*1,653*	*29*	*101*	*38*	*1,026*	*3,634*	*5,649*	*13,633*
Gross settled derivatives – inflows	*(1,452)*	*(1,610)*	*(15)*	*(70)*	*(19)*	*(815)*	*(3,021)*	*(4,912)*	*(11,914)*
Gross settled derivatives – net flows	*51*	*43*	*14*	*31*	*19*	*211*	*613*	*737*	*1,719*
Net settled derivatives liabilities	*50*	*123*	*212*	*150*	*185*	*487*	*712*	*1,319*	*3,238*
Total derivative financial liabilities	101	166	226	181	204	698	1,325	2,056	4,957
Total financial liabilities	107,278	6,551	11,405	10,091	8,015	14,271	15,998	14,915	188,524
Off-balance sheet commitments (note iii)	13,690	-	-	-	-	-	-	-	13,690
Total financial liabilities including off-balance sheet commitments	120,968	6,551	11,405	10,091	8,015	14,271	15,998	14,915	202,214

Notes:

i. Due less than one month includes amounts repayable on demand.

ii. The principal amount for undated subscribed capital is included within the due more than five years column.

iii. Off-balance sheet commitments include amounts payable on demand for unrecognised loan commitments and customer overpayments on residential mortgages, where the borrower is able to drawdown the amount overpaid.

iv. Comparatives have been restated for the reclassification of certain amounts based on contractual maturity date rather than call date for financial instruments callable at the Group's option.

Liquidity and funding risk (continued)

Asset encumbrance

Asset encumbrance arises from collateral pledged against secured funding and other collateralised obligations. The majority of asset encumbrance within the Group arises from the use of prime mortgage pools to collateralise the Covered Bond and Silverstone asset-backed funding programmes and from participation in the FLS. Encumbrance also results from repurchase transactions, voluntary excess collateral balances, participation in payment schemes and collateral posted for derivative margin requirements. Assets that have been used for any of these purposes cannot be utilised for other purposes and are classified as encumbered.

All other assets are by definition unencumbered. These comprise assets that are readily available to secure funding or meet collateral requirements, and assets that are capable of being encumbered with a degree of further management action. Any remaining assets which do not fall into either of these categories are classified as not being capable of being encumbered.

An analysis of the Group's encumbered and unencumbered on-balance sheet assets is set out below. The table does not include off-balance sheet assets received by the Group as part of its participation in the FLS, which the Group is permitted to re-use. This disclosure is not intended to identify assets that would be available in the event of a resolution or bankruptcy.

Asset encumbrance	**Assets encumbered as a result of transactions with counterparties other than central banks**				**Other assets (comprising assets encumbered at the central bank and unencumbered assets)**					**Total**
	As a result of covered bonds	**As a result of securitis-ations**	**Other**	**Total**	**Assets positioned at the central bank (i.e. preposit-ioned and encumbered)**	**Assets not positioned at the central bank**			**Total**	
						Readily available for encumbrance	**Other assets that are capable of being encumbered**	**Cannot be encumbered**		
2016	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Cash	**1,328**	**397**	**-**	**1,725**	**-**	**6,851**	**-**	**221**	**7,072**	**8,797**
Loans and advances to banks	**-**	**-**	**1,511**	**1,511**	**765**	**-**	**-**	**1,315**	**2,080**	**3,591**
Available for sale investment securities	**-**	**-**	**128**	**128**	**42**	**10,442**	**-**	**-**	**10,484**	**10,612**
Loans and advances to customers	**18,996**	**12,368**	**-**	**31,364**	**28,387**	**70,312**	**48,744**	**-**	**147,443**	**178,807**
Derivative financial instruments		**-**	**-**	**-**	**-**	**-**	**-**	**3,898**	**3,898**	**3,898**
Other financial assets	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**884**	**884**	**884**
Non-financial assets	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**2,350**	**2,350**	**2,350**
Total	**20,324**	**12,765**	**1,639**	**34,728**	**29,194**	**87,605**	**48,744**	**8,668**	**174,211**	**208,939**

Asset encumbrance	Assets encumbered as a result of transactions with counterparties other than central banks				Other assets (comprising assets encumbered at the central bank and unencumbered assets)					Total
	As a result of covered bonds	As a result of securitis-ations	Other	Total	Assets positioned at the central bank (i.e. preposit-ioned and encumbered)	Assets not positioned at the central bank			Total	
						Readily available for encumbrance	Other assets that are capable of being encumbered	Cannot be encumbered		
2015	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Cash	1,804	414	-	2,218	-	1,947	-	160	2,107	4,325
Loans and advances to banks	-	-	2,308	2,308	327	-	-	757	1,084	3,392
Available for sale investment securities	-	-	-	-	266	10,771	-	-	11,037	11,037
Loans and advances to customers	17,161	14,902	-	32,063	29,797	62,548	46,239	-	138,584	170,647
Derivative financial instruments	-	-	-	-	-	-	-	3,337	3,337	3,337
Other financial assets	-	-	-	-	-	-	-	630	630	630
Non-financial assets	-	-	-	-	-	-	-	2,212	2,212	2,212
Total	18,965	15,316	2,308	36,589	30,390	75,266	46,239	7,096	158,991	195,580

Liquidity and funding risk (continued)

External credit ratings

The Society's short and long term credit ratings from the major rating agencies at 23 May 2016 are as follows:

Credit ratings	Long term	Short term	Tier 2	Date of last rating action / confirmation	Outlook
Standard & Poor's	A	A-1	BBB	January 2016	Stable
Moody's	A1	P-1	Baa1	February 2016	Positive
Fitch	A	F1	A-	June 2015	Stable

Standard & Poor's affirmed the Society's A long term and A-1 short term ratings with a stable outlook in January 2016.

In February 2016, Moody's affirmed the Society's A1 long term and P-1 short term ratings and changed the outlook to positive from stable. The positive outlook reflects the potential for increased senior and subordinated debt issuance to result in lower expected loss levels for the Society's deposits and senior unsecured debt.

The table below sets out the amount of additional collateral the Group would need to provide in the event of a one and two notch downgrade by external credit rating agencies.

	Cumulative adjustment for a one notch downgrade £bn	Cumulative adjustment for a two notch downgrade £bn
2016	**4.1**	**4.5**
2015	3.8	4.2

The contractually required cash outflow would not necessarily match the actual cash outflow as a result of management actions that could be taken to reduce the impact of the downgrades.

Solvency risk

Summary

Solvency risk is the risk that the Group fails to maintain sufficient capital to absorb losses throughout a full economic cycle and sufficient to maintain the confidence of current and prospective investors, members, the Board and regulators. Capital is held by the Group to protect its depositors, cover its inherent risks, provide a buffer for stress events and support its business strategy. In assessing the adequacy of its capital resources, the Group considers its risk appetite in the context of the material risks to which it is exposed and the appropriate strategies required to manage those risks.

Capital strategy

The Group manages its capital structure to ensure it continues to meet minimum regulatory requirements, as well as meeting the expectations of other key stakeholders. As part of the risk appetite framework, the Group targets strong capital ratios relative to both regulatory requirements and major banking peers. Any planned changes to the balance sheet, potential regulatory developments and other factors (such as trading outlook, movements in the available for sale reserve and pension deficit) are all considered. The Group's strategic leverage ratio target is 4.5%.

The capital strategy is to manage capital ratios through retained earnings, supplemented by external capital where appropriate. In recent years, the Group has demonstrated its ability to supplement retained earnings through the issuance of Common Equity Tier 1 (CET1), Additional Tier 1 and Tier 2 capital instruments and has delivered significant deleveraging of its non-core commercial real estate portfolio and out of policy treasury assets.

Capital position

The capital disclosures included in this report are reported on a CRD IV end point basis unless otherwise stated. This assumes that all CRD IV requirements are in force during the period, with no transitional provisions permitted. In addition, the disclosures are on a Group (consolidated) basis, including all subsidiary entities, unless otherwise stated.

The Group's capital and leverage ratios have increased since 4 April 2015 mainly as a result of a strong trading performance with £985 million of profit after tax for the year and a reduction in risk weighted assets of £2,329 million. The Group's key capital measures at 4 April 2016 are summarised in the table below:

Key capital ratios	**2016**	2015
Solvency (note i)	**%**	%
Common Equity Tier 1 (CET1) ratio	**23.2**	19.8
Total Tier 1 ratio	**26.1**	22.5
Total regulatory capital ratio	**30.9**	27.0
Leverage (note ii)	**£m**	£m
Exposure	**213,181**	200,665
Total Tier 1 capital	**9,005**	8,271
Leverage ratio	**4.2%**	4.1%

Notes:
i. The solvency ratios are on an end point basis.
ii. The Group's 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.

On a transitional basis the CET1 ratio is 23.2% (2015: 19.8%). The CET1 ratio on an Individual (solo) consolidated basis at 4 April 2016 is 23.3% (2015: 19.6%) and is marginally greater than the Group's CET1 ratio due to higher general reserves as a result of cash flow hedge accounting. The majority of cash flow hedge accounting affects the Group accounts only, with gains or losses on derivatives being deferred to the cash flow hedge reserve in the Group accounts, but not the Individual (solo) consolidation accounts. The cash flow hedge reserve is not included in CET1 capital.

Solvency risk (continued)

CET1 capital has increased from £7,279 million to £8,013 million over the year primarily due to increased retained earnings, driven by a strong trading performance for the year and a reduction in the pension deficit. This was partly offset by an increase in intangible assets and the prudent valuation adjustment as well as a reduction in the value of the available for sale reserve. The increases in total Tier 1 capital and total regulatory capital include the increase in CET1 resources, offset at a total regulatory capital level by a reduction in Tier 2 capital, due to amortisation of subordinated debt.

Total exposure used to calculate the leverage ratio, which consists of balance sheet assets, off-balance sheet items and other regulatory adjustments, has increased by £12,516 million to £213,181 million. Balance sheet assets have grown by £13,359 million to £208,939 million since 4 April 2015, mainly driven by increases in mortgage balances, together with higher deposits with central banks held for liquidity purposes as a result of the Group's pre-funding of wholesale maturities ahead of the EU referendum. The leverage ratio has increased to 4.2% (2015: 4.1%) as growth in Tier 1 capital has outstripped the balance sheet growth. The leverage ratio at 4 April 2016 is lower than that reported at 31 December 2015 (4.3%) due to balance sheet growth during the fourth quarter.

The Group holds capital to meet Pillar 1 requirements (for credit, operational and market risks). In addition, the PRA requires firms to hold capital to meet Pillar 2A requirements, which are set out in the Individual Capital Guidance (ICG). This is a point in time estimate, set by the PRA on an annual basis, of the amount of capital required to be held to meet risks partly covered by Pillar 1 such as credit concentration and operational risk, and risks not covered by Pillar 1 such as pension and interest rate risk.

The Group's current ICG equates to £2.2 billion, of which at least £1.2 billion must be met by CET1 capital (previously around £1.9 billion, of which at least approximately £1.1 billion had to be met by CET1 capital). This amount is equivalent to 6.4% of RWAs as at 4 April 2016 (2015: 5.2%), reflecting the Group's low average risk weight given that approximately 76% (2015: 76%) of the Group's exposure is in the form of secured residential mortgages, of which 80% (2015: 81%) are prime.

In order to protect against the risk of consuming Pillar 1 or Pillar 2A requirements (thereby breaching ICG), firms are subject to regulatory capital buffers which are set out in CRD IV. In addition, the PRA may set a firm-specific buffer based upon supervisory judgement informed by the impact of stress scenarios on a firm's capital requirements and resources, and taking into account other factors including leverage, systemic importance and any weaknesses in firms' risk management and governance procedures.

Solvency risk (continued)

The table below reconciles the general reserves to total regulatory capital. Both 2016 and 2015 have been presented on an end point basis and so do not include grandfathered instruments.

Total regulatory capital	**2016**	2015
	£m	£m
General reserve (note i)	**8,921**	7,995
Core capital deferred shares (CCDS)	**531**	531
Revaluation reserve	**64**	68
Available for sale reserve	**(8)**	26
Regulatory adjustments and deductions:		
Foreseeable distributions (note ii)	**(42)**	(44)
Prudent valuation adjustment (note iii)	**(55)**	(1)
Own credit and debit valuation adjustments (note iv)	**(2)**	(11)
Intangible assets (note v)	**(1,120)**	(982)
Goodwill (note v)	**(12)**	(12)
Excess of regulatory expected losses over impairment provisions (note vi)	**(264)**	(291)
Total regulatory adjustments and deductions	**(1,495)**	(1,341)
Common Equity Tier 1 capital	**8,013**	7,279
Additional Tier 1 capital securities (AT1)	**992**	992
Total Tier 1 capital	**9,005**	8,271
Dated subordinated debt (note vii)	**1,628**	1,653
Collectively assessed impairment allowances	**21**	26
Tier 2 capital	**1,649**	1,679
Total regulatory capital	**10,654**	9,950

Notes:

i. The general reserve includes independently verified profits for the year to 4 April 2016.
ii. Foreseeable distributions in respect of CCDS and AT1 securities are deducted from CET1 capital under CRD IV.
iii. A prudent valuation adjustment (PVA) is applied in respect of fair valued instruments as required under regulatory capital rules. Following publication of the PVA Regulatory Technical Standard in January 2016, this revised methodology has been applied for April 2016 reporting which accounts for the increase.
iv. Own credit and debit valuation adjustments are applied to remove balance sheet gains or losses of fair valued liabilities and derivatives that result from changes in the Group's own credit standing and risk, in accordance with CRD IV rules.
v. Intangible assets and goodwill do not qualify as capital for regulatory purposes.
vi. Under CRD IV the net regulatory capital expected loss in excess of accounting impairment provisions is deducted from CET1 capital, gross of tax.
vii. Subordinated debt includes fair value adjustments related to changes in market interest rates, adjustments for unamortised premiums and discounts that are included in the consolidated balance sheet, and any amortisation of the capital value of Tier 2 instruments required by regulatory rules for instruments with less than five years to maturity. It does not include instruments that are subject to CRD IV grandfathering provisions, as this table is presented on an end point basis.

Solvency risk (continued)

Risk weighted assets

The table below shows the breakdown of the Group's risk weighted assets (RWAs):

Risk weighted assets	2016 £m	2015 £m
Credit risk:		
Retail mortgages	**14,086**	14,372
Retail unsecured lending	**5,621**	7,023
Commercial loans	**6,194**	7,646
Treasury	**1,039**	1,375
Counterparty credit risk (note i)	**1,296**	826
Other (note ii)	**1,635**	1,334
Total credit risk	**29,871**	32,576
Operational risk	**4,604**	4,228
Market risk (note iii)	**-**	-
Total risk weighted assets	**34,475**	36,804

Notes:
i. Counterparty credit risk relates to derivative financial instruments.
ii. Other relates to fixed and other assets held on the balance sheet.
iii. The Group elected to set this to zero in 2016 and 2015, as permitted by the CRR, as exposure was below the threshold of 2% of own funds.

RWAs have decreased by £2,329 million since 4 April 2015, to £34,475 million. Commercial RWAs have continued to decrease driven by continued run-off of the commercial book and improvements in the credit quality of the remaining exposures. The implementation of a redeveloped Internal Ratings Based (IRB) model for personal loans, to better reflect the risk in the portfolio, has resulted in lower RWAs for the retail unsecured portfolios. Credit risk RWAs have also been further reduced by an improvement in credit quality, notably in specialist mortgage lending, due to the increase in house prices; this has more than offset the RWA increase from the portfolio growth. Treasury RWAs have decreased due to a reduction in exposures to other banks and securitisation assets; however, an increase in derivative values has resulted in higher RWAs for counterparty credit risk. Other RWAs are higher mainly due to an increase in the value of the Visa Europe Limited equity holding (more information on Visa Europe Limited is included in note 21 to the preliminary results announcement). Operational risk RWAs, calculated on the standardised approach, have increased due to higher income.

Solvency risk (continued)

Regulatory developments

The Group continues to monitor regulatory developments that could lead to an increased level of capital requirements. Whilst there are a number of areas where potential requirements are yet to be finalised, regulatory announcements during the financial year mean that we have better visibility on expectations for future capital requirements. However, the Group will remain engaged in the development of the regulatory approach to ensure it is prepared for any change.

We expect to have a steady state leverage ratio requirement of 3.75% from 2019, which comprises a minimum requirement of 3%, a supplementary leverage ratio buffer of 0.35% and countercyclical leverage ratio buffer of 0.4%. Whilst the Financial Policy Committee could set a countercyclical leverage buffer up to 0.9%, in March 2016 it set the buffer at 0.2%, which is expected to apply from March 2017. The Basel Committee on Banking Supervision and the European Banking Authority are currently reviewing the leverage ratio requirement for banks and building societies, but it is expected that the PRA leverage framework will remain the Group's binding requirement. The Group's strategic leverage ratio target of 4.5% reflects its desire to maintain strong levels of capital relative to maximum regulatory expectations (4.25%).

As part of the European BRRD, the Bank of England, in its capacity as the UK resolution authority, has consulted on setting the Minimum Requirement for Eligible Liabilities (MREL). This consultation proposed that a firm of Nationwide's size should, from 2020, have a MREL requirement equal to double minimum capital requirements. The Group is confident it has a strong foundation from which to meet MREL requirements.

The Basel Committee is expected to finalise its revisions to the standardised approach for credit and operational risks in late 2016. We do not believe that these will lead to a material increase in capital requirements for the Group. Whilst the revised standardised approach is due to be used as a basis for a floor for minimum capital requirements, the precise calibration of this has not yet been published. In addition, a Basel Committee consultation proposing constraints on the use of IRB approaches for credit risk was published in March 2016, which could lead to higher risk weights for certain portfolios.

In October 2015, the Bank of England published its medium term approach to concurrent stress testing: 'The Bank of England's approach to stress testing the UK banking system'. Two additional hurdle rates have been introduced for this year's exercise (firms must meet Pillar 2A capital requirements and Global Systemically Important Bank (G-SIB) buffers in addition to CET1 and leverage ratios), and the Bank of England has clarified its approach to scenario setting. Each year the participating firms will be required to model a stress scenario that is linked to the UK's position in the economic cycle, and on a biannual basis an additional 'exploratory scenario' will be published that will explore specific areas of risk or vulnerability in the economy that may not be captured in the annual scenario.

The Group continues to develop its approach to stress testing to ensure it responds to increasing regulatory expectations and it remains a valuable tool for the management of risk within its business.

CONSOLIDATED FINANCIAL STATEMENTS

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CONSOLIDATED INCOME STATEMENT
For the year ended 4 April 2016

	Notes	2016 £m	2015* £m
Interest receivable and similar income	3	**5,294**	5,347
Interest expense and similar charges	4	**(2,208)**	(2,475)
Net interest income		**3,086**	2,872
Fee and commission income		**428**	447
Fee and commission expense		**(192)**	(169)
Income from investments		**3**	4
Other operating income		**8**	9
Gains/(losses) from derivatives and hedge accounting	5	**39**	(20)
Total income		**3,372**	3,143
Administrative expenses	6	**(1,847)**	(1,706)
Impairment losses on loans and advances	7	**(81)**	(233)
Impairment recoveries/(losses) on investment securities		**8**	(18)
Provisions for liabilities and charges	8	**(173)**	(142)
Profit before tax		**1,279**	1,044
Taxation	9	**(294)**	(205)
Profit after tax		**985**	839

*Comparatives have been restated as detailed in note 2.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
For the year ended 4 April 2016

	2016 £m	2015 £m
Profit after tax	**985**	839
Other comprehensive income/(expense):		
Items that will not be reclassified to the income statement		
Remeasurements of retirement benefit obligations:		
Retirement benefit remeasurements before tax	**42**	(136)
Taxation	**9**	21
	51	(115)
Revaluation of property:		
Revaluation before tax	**4**	5
Taxation	**(7)**	1
	(3)	6
Other items through the general reserve, including effect of corporation tax rate change	**(1)**	(1)
	47	(110)
Items that may subsequently be reclassified to the income statement		
Cash flow hedge reserve:		
Fair value movements taken to members' interests and equity	**2,099**	(503)
Amount transferred to income statement	**(1,666)**	664
Taxation	**(132)**	(32)
	301	129
Available for sale reserve:		
Fair value movements taken to members' interests and equity	**(60)**	(79)
Amount transferred to income statement	**19**	183
Taxation	**7**	(27)
	(34)	77
Other comprehensive income	**314**	96
Total comprehensive income	**1,299**	935

CONSOLIDATED BALANCE SHEET
At 4 April 2016

	Notes	2016 £m	2015 £m
Assets			
Cash		**8,797**	4,325
Loans and advances to banks		**3,591**	3,392
Available for sale investment securities		**10,612**	11,037
Derivative financial instruments		**3,898**	3,337
Fair value adjustment for portfolio hedged risk		**756**	592
Loans and advances to customers	10	**178,807**	170,647
Investments in equity shares		**126**	26
Intangible assets		**1,191**	1,040
Property, plant and equipment		**823**	856
Investment properties		**8**	8
Accrued income and expenses prepaid		**166**	192
Deferred tax		**35**	38
Other assets		**129**	90
Total assets		**208,939**	195,580
Liabilities			
Shares		**138,715**	132,373
Deposits from banks		**2,095**	1,974
Other deposits		**7,635**	9,076
Due to customers		**6,201**	6,119
Fair value adjustment for portfolio hedged risk		**13**	14
Debt securities in issue		**36,085**	28,105
Derivative financial instruments		**3,463**	4,048
Other liabilities		**414**	475
Provisions for liabilities and charges	8	**343**	295
Accruals and deferred income		**288**	369
Subordinated liabilities	11	**1,817**	2,121
Subscribed capital	11	**413**	415
Deferred tax		**186**	53
Current tax liabilities		**128**	116
Retirement benefit obligations		**213**	286
Total liabilities		**198,009**	185,839
Members' interests and equity			
Core capital deferred shares	16	**531**	531
Other equity instruments	17	**992**	992
General reserve		**8,921**	7,995
Revaluation reserve		**64**	68
Cash flow hedge reserve		**430**	129
Available for sale reserve		**(8)**	26
Total members' interests and equity		**10,930**	9,741
Total members' interests, equity and liabilities		**208,939**	195,580

CONSOLIDATED STATEMENT OF MOVEMENTS IN MEMBERS' INTERESTS AND EQUITY
For the year ended 4 April 2016

	Core capital deferred shares	Other equity instruments	General reserve	Revaluation reserve	Cash flow hedge reserve	Available for sale reserve	Total
	£m	£m	£m	£m	£m	£m	£m
At 5 April 2015	531	992	7,995	68	129	26	9,741
Profit for the year	**-**	**-**	**985**	**-**	**-**	**-**	**985**
Net movement in available for sale reserve	**-**	**-**	**-**	**-**	**-**	**(34)**	**(34)**
Net movement in cash flow hedge reserve	**-**	**-**	**-**	**-**	**301**	**-**	**301**
Net revaluation of property	**-**	**-**	**-**	**(3)**	**-**	**-**	**(3)**
Reserve transfer	**-**	**-**	**1**	**(1)**	**-**	**-**	**-**
Effect of tax rate change on other items through the general reserve	**-**	**-**	**(1)**	**-**	**-**	**-**	**(1)**
Net remeasurements of retirement benefit obligations	**-**	**-**	**51**	**-**	**-**	**-**	**51**
Total comprehensive income	**-**	**-**	**1,036**	**(4)**	**301**	**(34)**	**1,299**
Distribution to the holders of core capital deferred shares	**-**	**-**	**(56)**	**-**	**-**	**-**	**(56)**
Distribution to the holders of Additional Tier 1 capital*	**-**	**-**	**(54)**	**-**	**-**	**-**	**(54)**
At 4 April 2016	**531**	**992**	**8,921**	**64**	**430**	**(8)**	**10,930**

CONSOLIDATED STATEMENT OF MOVEMENTS IN MEMBERS' INTERESTS AND EQUITY
For the year ended 4 April 2015

	Core capital deferred shares	Other equity instruments	General reserve	Revaluation reserve	Cash flow hedge reserve	Available for sale reserve	Total
	£m	£m	£m	£m	£m	£m	£m
At 5 April 2014	531	992	7,363	71	-	(51)	8,906
Profit for the year	-	-	839	-	-	-	839
Net movement in available for sale reserve	-	-	-	-	-	77	77
Net movement in cash flow hedge reserve	-	-	-	-	129	-	129
Net revaluation of property	-	-	-	6	-	-	6
Reserve transfer	-	-	9	(9)	-	-	-
Effect of tax rate change on other items through the general reserve	-	-	(1)	-	-	-	(1)
Net remeasurements of retirement benefit obligations	-	-	(115)	-	-	-	(115)
Total comprehensive income	-	-	732	(3)	129	77	935
Distribution to the holders of core capital deferred shares	-	-	(58)	-	-	-	(58)
Distribution to the holders of Additional Tier 1 capital*	-	-	(42)	-	-	-	(42)
At 4 April 2015	531	992	7,995	68	129	26	9,741

*The distribution to holders of Additional Tier 1 capital is shown net of an associated tax credit of £14 million (2015: £11 million).

CONSOLIDATED CASH FLOW STATEMENT
For the year ended 4 April 2016

	Notes	2016 £m	2015* £m
Cash flows (used in)/generated from operating activities			
Profit before tax		**1,279**	1,044
Adjustments for:			
Non-cash items included in profit before tax	20	**240**	(164)
Changes in operating assets and liabilities	20	**(2,413)**	427
Interest paid on subordinated liabilities		**(102)**	(117)
Interest paid on subscribed capital		**(26)**	(38)
Taxation		**(254)**	(165)
Net cash flows (used in)/generated from operating activities		**(1,276)**	987
Cash flows generated from/(used in) investing activities			
Purchase of investment securities		**(4,202)**	(4,385)
Sale and maturity of investment securities		**4,905**	4,204
Purchase of property, plant and equipment		**(134)**	(142)
Sale of property, plant and equipment		**14**	20
Purchase of intangible assets		**(334)**	(246)
Dividends received		**3**	4
Net cash flows generated from/(used in) investing activities		**252**	(545)
Cash flows generated from/(used in) financing activities			
Distributions paid to the holders of core capital deferred shares		**(56)**	(58)
Distributions paid to the holders of Additional Tier 1 capital		**(68)**	(53)
Issue of debt securities		**35,350**	32,465
Redemption of debt securities in issue		**(28,983)**	(32,335)
Redemption of subordinated liabilities		**(406)**	-
Redemption of subscribed capital		**-**	(200)
Net cash flows generated from/(used in) financing activities		**5,837**	(181)
Net increase in cash and cash equivalents		**4,813**	261
Cash and cash equivalents at start of year		**7,250**	6,989
Cash and cash equivalents at end of year	20	**12,063**	7,250

*Comparatives have been restated as detailed in note 2.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

1 Reporting period

These results have been prepared as at 4 April 2016 and show the financial performance for the year from, and including, 5 April 2015 to this date.

2 Basis of preparation

The 2016 preliminary results have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations (IFRICs) issued by the Interpretations Committee, as published by the International Accounting Standards Board (IASB), and adopted by the European Union, and with those parts of the Building Societies (Accounts and Related Provisions) Regulations 1998 (as amended) applicable to organisations reporting under IFRS. The accounting policies adopted for use in the preparation of this Preliminary Results Announcement and which will be used in preparing the Annual Report and Accounts for the year ended 4 April 2016 were included in the 'Annual Report and Accounts 2015' document except as detailed below. Copies of this document are available at
nationwide.co.uk/about_nationwide/results_and_accounts

Adoption of new and revised IFRSs

The following IFRS pronouncements, relevant to the Group, were adopted with effect from 5 April 2015:

- Amendments to IAS 19 Employee Benefits: The amendments clarify the requirements for attributing employee/third party contributions that are linked to service to the relevant accounting period. Applying the requirements of the amendments to IAS 19 has had no impact for the Group.

- Annual improvements to IFRSs 2010-2012 and 2011-2013 cycles: Several small amendments were adopted with no significant impact for the Group.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

2 Basis of preparation (continued)

Change of accounting policy

Foreign exchange retranslation

The Group holds monetary items denominated in foreign currencies which are retranslated to sterling at the reporting date. Any resulting foreign exchange gains and losses from the retranslation have previously been presented within 'interest expense 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 the Group's residual economic foreign exchange exposure, amounts in relation to the retranslation of foreign currency monetary items have been reclassified from 'interest expense and similar charges' to 'gains/losses from derivatives and hedge accounting' in the income statement to offset against the movement in derivative values.

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

Income statement extract for the year ended 4 April 2015	Notes	Previously published	Adjustment	Restated
		£m	£m	£m
Interest expense and similar charges	4	(2,486)	11	(2,475)
Losses from derivatives and hedge accounting	5	(9)	(11)	(20)

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

Other adjustments to comparative information

Off balance sheet commitments

Off balance sheet commitments at 4 April 2015, shown in the 'maximum exposure to lending risk' and the 'residual maturity' tables within the 'Lending risk' and 'Liquidity and funding risk' sections of the Business and Risk Report respectively, have been updated to include commitments of £6,120 million which relate to customer overpayments on residential mortgages where the borrower is entitled to drawdown amounts overpaid. Commitments in respect of loans and advances to customers have been restated from £7,162 million to £13,282 million and total commitments have been restated from £7,570 million to £13,690 million.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

2 Basis of preparation (continued)

Future accounting developments

An overview of pronouncements that will be relevant to the Group in future periods was provided in the 2015 Annual Report and Accounts. The IASB has issued further pronouncements; however other than the areas listed below, the Group does not expect adoption of the new requirements to have a significant impact on its results.

As at 23 May 2016, the pronouncements listed below are awaiting EU endorsement.

IFRS 9 Financial Instruments

IFRS 9 will be implemented in the financial statements for the year ending 4 April 2019 and will replace IAS 39 Financial Instruments: Recognition and Measurement. It includes requirements for the classification and measurement of financial instruments, impairment of financial assets and hedge accounting.

The principal requirements of IFRS 9 are as follows:

Classification and measurement
The classification of financial assets will be based on the objectives of the Group's business model and the contractual cash flow characteristics of the instruments. Financial assets will then be classified as held at amortised cost, at fair value through other comprehensive income (FVOCI), or at fair value through profit or loss (FVTPL). The changes from the accounting treatment under IAS 39 are not expected to be significant. There are a limited number of financial assets with contractual cash flow characteristics that will result in a reclassification from amortised cost to FVTPL. The only changes to the classification and measurement of financial liabilities are where liabilities are elected to be measured at fair value, in which case changes in valuation relating to changes in the entity's own credit risk will be presented separately in other comprehensive income rather than in the income statement.

Impairment of financial assets
IFRS 9 changes the basis of recognition of impairment on financial assets from an incurred loss to an expected credit loss (ECL) approach for amortised cost and FVOCI financial assets. This introduces a number of new concepts and changes to the approach to provisioning compared with the current methodology under IAS 39:

- Expected credit losses are based on an assessment of the probability of default, loss given default and exposure at default, discounted to give a net present value. The estimation of ECL should be unbiased and probability-weighted, taking into account all reasonable and supportable information, including forward looking economic assumptions and a range of possible outcomes. IFRS 9 has the effect of bringing forward recognition of impairment losses relative to IAS 39 which requires provisions to be recognised only when there is objective evidence of credit impairment.
- On initial recognition, and for financial assets where there has not been a significant increase in credit risk since the date of advance, IFRS 9 provisions will be made for expected credit default events within the next 12 months.
- A key requirement of IFRS 9 compared with the existing provision approach under IAS 39 relates to assets where there has been a significant increase in credit risk since the date of origination. Provisions will be made for those assets expected to default at any point over their lifetime reflecting the asset's full expected loss. This change to lifetime loss provisions for significantly credit deteriorated assets is expected to lead to increases in impairment provisions, and to increased volatility in provisions, although the size of the change will depend on a number of factors, including the composition of asset portfolios and the view of the economic outlook at the date of implementation.
- For assets where there is evidence of credit impairment, provisions will be made under IFRS 9 on the basis of lifetime expected credit losses, taking account of forward looking economic assumptions and a range of possible outcomes. Under IAS 39 provisions are based on the asset's carrying value and the present value of the estimated future cash flows. IAS 39 does not explicitly take account of a range of possible economic outcomes including forecasts of any downturn of the economic cycle.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

2 Basis of preparation (continued)

Hedge accounting
The hedge accounting requirements of IFRS 9 are designed to create a stronger link with financial risk management. A separate financial reporting standard will be developed on accounting for dynamic risk management (macro hedge accounting) and IFRS 9 allows the option to continue to apply the existing hedge accounting requirements of IAS 39 until this is implemented. Therefore no changes are currently being implemented to hedge accounting policies and methodologies.

Implementation Strategy
The Group's implementation strategy for IFRS 9 is based on an integrated solution using common systems, tools and data to assess credit risk and account for ECLs. This is consistent with guidance issued by the Basel Committee on Banking Supervision which sets an expectation of a high quality strategic implementation, and will entail changes to the governance, controls, models and business processes relating to credit loss provisioning. An extensive period of internal dual reporting is planned in advance of the implementation date.

Responsibilities and accountabilities
The Group has an established IFRS 9 implementation programme with formal governance reporting to the Group Finance Director and Chief Risk Officer. Progress is reported regularly to the Audit Committee. Extensive work is being carried out to complete technical analysis, including methodologies for ECL models, develop models and design the required changes to systems, data, business processes, reporting and governance of impairment provisions. During the next financial year work will include building and testing of models and validating outputs, development of management information and implementation of business process changes. The financial impact of IFRS 9 will be quantified once models and systems allow the Group to provide reliable estimates, and expected impacts will be disclosed in the financial statements no later than the year ending 4 April 2018.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

2 Basis of preparation (continued)

Other pronouncements

Pronouncement	Nature of change	Effective date
Disclosure Initiative (Amendments to IAS 7)	The initiative amends IAS 7 Statement of Cash Flows to clarify that entities shall provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities. The Group is currently assessing the impact of this amendment.	AP beginning on or after 1 January 2017
IFRS 15 Revenue from Contracts with Customers	IFRS 15 was issued in May 2014. The new standard provides a principles-based approach for revenue recognition, and introduces the concept of recognising revenue for obligations as they are satisfied. The standard requires retrospective application, with certain practical expedients available. During July 2015, the IASB confirmed the deferral of the effective date by one year to 1 January 2018. During April 2016 the IASB issued amendments to IFRS 15 to clarify the guidance on identifying performance obligations, licences of intellectual property and principal versus agent considerations. The Group is currently assessing the impact of this standard; however, it is expected that it will result in the earlier recognition of certain types of income.	AP beginning on or after 1 January 2018
IFRS 16 Leases	In January 2016, the IASB issued IFRS 16 to replace IAS 17 Leases. Under IFRS 16, accounting for finance leases will remain substantially the same. Operating leases will be brought on balance sheet through the recognition of assets representing the contractual rights of use and liabilities will be recognised for the contractual payments. The Group is currently assessing the impact of this standard.	AP beginning on or after 1 January 2019

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

2 Basis of preparation (continued)

Judgements in applying accounting policies and critical accounting estimates

The Group has to make judgements in applying its accounting policies which affect the amounts recognised in the Preliminary Results Announcement. In addition, estimates and assumptions are made that could affect the reported amounts of assets and liabilities within the following financial year. Disclosure of significant areas where judgements and estimates are made is included in the related notes.

Going concern

The Group's business activities and financial position, the factors likely to affect its future development and performance, its objectives and policies in managing the financial risks to which it is exposed, and its capital, funding and liquidity positions are discussed in the Business and Risk Report in this document.

In the light of current and anticipated economic conditions, the Directors have assessed the Group's ability to continue as a going concern. The Directors confirm they are satisfied that the Group has adequate resources to continue in business for the foreseeable future and that therefore, it is appropriate to adopt the going concern basis in preparing this preliminary financial information.

3 Interest receivable and similar income

	2016 £m	2015 £m
On residential mortgages	**5,009**	4,981
On other loans	**835**	953
On investment securities	**403**	412
On other liquid assets	**33**	28
Net expense on financial instruments hedging assets	**(986)**	(1,027)
Total	**5,294**	5,347

Included within interest receivable and similar income is interest income on impaired financial assets of £41 million (2015: £82 million).

4 Interest expense and similar charges

	2016 £m	2015* £m
On shares held by individuals	**1,577**	1,897
On subscribed capital	**26**	42
On deposits and other borrowings:		
Subordinated liabilities	**99**	115
Other	**577**	171
On debt securities in issue	**690**	725
Net income on financial instruments hedging liabilities	**(768)**	(481)
Interest on net defined benefit pension liability	**7**	6
Total	**2,208**	2,475

*Comparatives have been restated as detailed in note 2.

Other interest on deposits and other borrowings includes an expense of £439 million (2015: £50 million) in relation to the redemption and maturity of PEB deposits which have returns linked to the performance of specified stock market indices. The PEBs are economically hedged using equity-linked derivatives. Net income on financial instruments hedging liabilities includes income of £398 million (2015: £1 million) in relation to the associated derivatives. Further details are included in note 13.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

5 Gains/losses from derivatives and hedge accounting

	2016 £m	2015* £m
Gains/(losses) from fair value hedge accounting (note i)	**85**	(46)
Ineffectiveness from cash flow hedge accounting (note ii)	**1**	(3)
Net loss from mortgage pipeline (note iii)	**(46)**	(53)
Fair value (losses)/gains from other derivatives (note iv)	**(37)**	93
Foreign exchange differences	**36**	(11)
Total	**39**	(20)

*Comparatives have been restated as detailed in note 2.

Notes:

i. Gains or losses from fair value hedges can arise where there is an IFRS hedge accounting relationship in place and either:
   - the relationship passed all the monthly effectiveness tests but the fair value movement of the derivative was not exactly offset by the change in fair value of the asset or liability being hedged (sometimes referred to as hedge ineffectiveness); or
   - the relationship failed a monthly effectiveness test which, for that month, disallows recognition of the change in fair value of the underlying asset or liability being hedged and in following months leads to the amortisation of existing balance sheet positions.

ii. The Group commenced cash flow hedge accounting in the year ended 4 April 2015, deferring the effective portion of the fair value movement of designated derivatives to the cash flow hedge reserve. The fair value movement is subsequently recycled to the income statement when the underlying hedged asset or liability is recognised in the income statement. The ineffective portion of the fair value movement is recognised immediately in the income statement.

iii. The Group elects to fair value certain mortgage commitments in order to reduce the accounting mismatch caused when derivatives are used to hedge these commitments.

iv. Other derivatives are those used for economic hedging but which are not in an IAS 39 hedge accounting relationship because hedge accounting is not currently achievable.

Although the Group only uses derivatives for the hedging of risks, income statement volatility can still arise due to hedge accounting ineffectiveness or because hedge accounting is either not currently applied or is not currently achievable. This volatility does not reflect the economic reality of the Group's hedging strategy.

Included within the gain of £39 million (2015: loss of £20 million) was the impact of the following:

- Gains of £85 million (2015: losses of £46 million) from fair value hedge accounting. This includes gains of £66 million (2015: losses of £30 million) from macro hedges, due to hedge ineffectiveness and the amortisation of existing balance sheet amounts. In addition, further gains of £19 million relate to micro hedges (2015: losses of £16 million) due to a combination of hedge ineffectiveness, maturities and disposals.
- Losses of £46 million (2015: £53 million) relating to the mortgage pipeline. The income statement includes the full fair value movement of forward starting interest rate swaps economically hedging the pipeline; however the Group only elects to fair value certain underlying mortgage business within the pipeline.
- Losses of £37 million (2015: gains of £93 million) from portfolio valuation adjustments and volatility on other derivatives which are not currently in an IAS 39 hedge accounting relationship.
- Gains of £36 million (2015: losses of £11 million) from the retranslation of foreign currency monetary items.

The overall impact of derivatives will remain volatile from period to period as new derivative transactions replace those which mature to ensure that interest rate and other market risks are continually managed.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

6 Administrative expenses

	2016 £m	2015 £m
Employee costs:		
Wages and salaries	**486**	456
Bonuses	**76**	74
Social security costs	**55**	54
Pension costs	**119**	87
	736	671
Other administrative expenses	**745**	713
Bank levy (note 8)	**41**	28
	1,522	1,412
Depreciation, amortisation and impairment	**325**	294
Total	**1,847**	1,706

Administrative expenses include £10 million (2015: £52 million) of transformation costs. The reduction in transformation costs is driven primarily by the completion of the integration of the Derbyshire, Cheshire and Dunfermline brands and activities relating to the strategic change to the Group's IT service delivery model.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

7 Impairment provisions on loans and advances to customers

The following provisions have been deducted from the appropriate asset values in the balance sheet:

	2016 £m	2015 £m
Impairment charge for the year		
Prime residential	**8**	13
Specialist residential	**10**	45
Consumer banking	**96**	89
Commercial lending	**(34)**	52
Other lending	**1**	34
Total	**81**	233
Impairment provision at the end of the year		
Prime residential	**25**	22
Specialist residential	**77**	88
Consumer banking	**281**	216
Commercial lending	**59**	322
Other lending	**1**	4
At 4 April 2016	**443**	652

The Group impairment provision of £443 million at 4 April 2016 (2015: £652 million) comprises individual provisions of £75 million (2015: £341 million) and collective provisions of £368 million (2015: £311 million).

The impairment provision charges for prime and specialist residential loans include £27 million in relation to a refinement of provision model assumptions to ensure they continue to reflect appropriately the incurred losses within the portfolio.

The impairment charge for consumer banking impairment includes £29 million resulting from a reassessment of provision model assumptions in relation to up to date accounts.

The decrease in impairment provisions held against commercial lending is driven by continued improvement in market conditions for commercial real estate, together with deleveraging activity undertaken during the prior year which has resulted in a reduction in the size of the commercial real estate portfolio.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

7 Impairment provisions on loans and advances to customers (continued)

Critical accounting estimates and judgements

Impairment provisions on loans and advances

Impairment is measured as the difference between an asset's carrying amount and the present value of management's estimate of future cash flows.

Key assumptions included in the measurement of impairment include the probability of any account going into default, the probability of defaulted accounts progressing to possession and the eventual loss incurred in the event of forced sale or write off. These assumptions are based on observed historical data and updated as management considers appropriate to reflect current conditions and the Group's strategy for the book. The accuracy of the impairment provision will therefore be affected by unexpected changes in these assumptions.

To the extent that actual cash flows in relation to the Group's retail loans and advances differ from those estimated by 10%, the impairment provision would change by an estimated £41 million.

For residential mortgages the estimate of future house price index (HPI) movements is also a key assumption in estimating the eventual loss. The Group does not take account of projected future HPI increases in establishing provisions. If future HPI increases do materialise then this will reduce the amount of actual loss incurred. If provisions were based on an assumption that future HPI would decrease by 10%, the provision at the balance sheet date would increase by an estimated £9 million.

In calculating the provisions for commercial loans, estimates of discounted cash flows are made on the basis of the planned strategy for each loan. These estimates include assumptions for underlying property values and future expected cash flows for rental income and any maintenance, redevelopment or refurbishment expenditure on the properties. To the extent that actual cash flows differ from those estimated by 10% on impaired loans, the impairment provision would change by an estimated £13 million.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

8 Provisions for liabilities and charges

	Bank levy	FSCS	Customer redress	Other provisions	Total
	£m	£m	£m	£m	£m
At 5 April 2015	13	126	140	16	295
Provisions utilised	**(32)**	**(88)**	**(40)**	**(5)**	**(165)**
Charge for the year	**41**	**46**	**138**	**3**	**228**
Release for the year	**-**	**-**	**(11)**	**(4)**	**(15)**
Net income statement charge	**41**	**46**	**127**	**(1)**	**213**
At 4 April 2016	**22**	**84**	**227**	**10**	**343**
At 5 April 2014	6	142	124	38	310
Provisions utilised	(21)	(99)	(43)	(24)	(187)
Charge for the year	28	83	72	3	186
Release for the year	-	-	(13)	(1)	(14)
Net income statement charge	28	83	59	2	172
At 4 April 2015	13	126	140	16	295

The income statement charge for provisions for liabilities and charges of £173 million (2015: £142 million) includes the FSCS charge of £46 million (2015: £83 million) and the customer redress net income statement charge of £127 million (2015: £59 million).

The income statement charge for bank levy of £41 million (2015: £28 million) and other provisions credit of £1 million (2015: charge of £2 million) are included within administrative expenses in the income statement.

Financial Services Compensation Scheme (FSCS)

The FSCS, the UK's independent statutory compensation fund for customers of authorised financial services firms, pays compensation if a firm is unable to pay claims against it. Following the default of a number of deposit takers, the FSCS borrowed funds from HM Treasury; approximately £16 billion of borrowings remain outstanding relating to the default of Bradford & Bingley plc.

The FSCS recovers the interest cost, together with ongoing management expenses, by way of annual levies on member firms. In addition, over the last three years, member firms have been funding expected shortfalls in recoveries from the failed institutions to repay the borrowings.

All known shortfalls have now been met, resulting in a reduction in the annual charge to £46 million (2015: £83 million). This includes £41 million of interest and management expenses relating to FSCS scheme year 2016/17 and £5 million relating to the final confirmation of previous scheme year charges. The prior year amount included £41 million in relation to expected shortfalls.

The balance sheet amount provided by the Group of £84 million (2015: £126 million) comprises £41 million of levies relating to the 2016/17 FSCS scheme year and £43 million relating to the 2015/16 scheme year. The amount relating to the 2015/16 scheme year is payable by 1 September 2016.

In the March 2016 Budget, HM Treasury confirmed that UK Asset Resolution (UKAR) is exploring the possibility of a major sales programme of Bradford & Bingley plc. The Group will continue to monitor the progress of this and will assess the financial impact as more information becomes available.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

8 Provisions for liabilities and charges (continued)

Customer redress

During the course of its business, the Group receives complaints from customers in relation to past sales or conduct. The Group is also subject to enquiries from and discussions with its regulators, governmental and other public bodies, including the Financial Ombudsman Service (FOS), on a range of matters. Customer redress provisions are recognised where the Group considers it is probable that payments will be made as a result of such complaints and other matters.

The Group holds provisions of £227 million (2015: £140 million) in respect of the potential costs of remediation and redress in relation to historic sales of financial products and post sales administration. This includes amounts for past sales of PPI, non-compliance with consumer credit legislation and other regulatory matters.

The income statement charge for the year mainly reflects the Group's updated assumptions for provisions previously recognised. This includes a £95 million charge in relation to PPI, largely in response to the announcements made by the Financial Conduct Authority (FCA) during the year and specifically the consultation paper CP15/39 issued in November 2015. In this consultation the FCA proposed an industry-funded communications campaign, combined with a deadline for any further complaints. It also proposed new rules and guidance in light of the Supreme Court's decision in the case of Plevin v Paragon Personal Finance Limited ('Plevin').

In light of these latest developments, it is considered appropriate for the Group to provide for the estimated total amount required to deal with all ongoing and future PPI complaints. The amount provided at 4 April 2016 therefore reflects the compensation and administrative costs associated with cases that the Group expects to uphold and the cost of processing invalid claims which the Group expects to receive. This estimate will be re-assessed on an ongoing basis as the FCA finalises its position and actual claims levels are observed. Previously, costs relating to the processing of invalid claims were expensed as incurred.

The remainder of the charge for the year is in respect of claims relating to consumer credit legislation.

Other provisions

Other provisions include provisions for severance costs and a number of property related provisions. Provisions are made for the expected severance costs in relation to the Group's restructuring activities where there is a present obligation and it is probable that the expenditure will be made.

Critical accounting estimates and judgements

Customer redress provisions

The amount of the provision related to past sales of PPI is calculated based upon management's best estimate of complaint volumes incorporating the expected impact of the 2015 FCA consultation paper, referral rates to the Financial Ombudsman Service (FOS), uphold rates internally and with the FOS, response rates from customer contact activity relating to previous sales, average redress payments and complaint handling costs.

The total amount provided for PPI represents management's best estimate of the likely future cost. However, there is some uncertainty around the impact of the proposed FCA media campaign on complaint volumes in the lead up to the proposed timebar. If the total volume of PPI complaints was 5% higher than currently estimated, the customer redress provision would increase by £19 million.

Other amounts that are provided as an estimate of the potential costs of remediation are subject to ongoing review of various matters, including consumer credit regulations. For these matters, the ultimate amount of redress that will be payable will depend upon a number of internal and external factors. These include the conclusion of legal interpretations and actions to be taken, the time periods to which any redress should apply, the level of complaints that the Group expects to receive from customers and the estimate of amounts of redress and associated costs that will be payable.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

9 Taxation

Tax charge in the income statement	2016 £m	2015 £m
Current tax:		
UK corporation tax	330	215
Corporation tax – adjustment in respect of prior years	(8)	(22)
Total current tax	322	193
Deferred tax:		
Current year (credit)/charge	(35)	13
Adjustment in respect of prior years	5	6
Effect of corporation tax rate change	-	(7)
Effect of banking surcharge on deferred tax balances	2	-
Total deferred taxation	(28)	12
Tax charge	**294**	205

The actual tax charge differs from the theoretical amount that would arise using the standard rate of corporation tax in the UK as follows:

Reconciliation of tax charge	2016 £m	2015 £m
Profit before tax	1,279	1,044
Tax calculated at a tax rate of 20% (2015: 21%)	256	219
Adjustments in respect of prior years	(3)	(16)
Banking surcharge	22	-
Expenses not deductible for tax purposes/(income not taxable):		
Depreciation on non-qualifying assets	1	2
Bank levy	8	6
Other	8	1
Effect of corporation tax rate change	-	(7)
Effect of banking surcharge on deferred tax balances	2	-
Tax charge	**294**	205

The Finance (No. 2) Act 2015 introduced legislation to impose a surcharge of 8% on the profits of banking companies after 1 January 2016. As a result, a banking surcharge of £22 million is included in the UK corporation tax charge shown above.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

10 Loans and advances to customers

	2016 £m	2015 £m
Prime residential mortgages	**129,948**	124,527
Specialist residential mortgages	**32,114**	28,248
Consumer banking	**3,588**	3,575
Commercial lending	**11,772**	12,890
Other lending	**19**	25
	177,441	169,265
Fair value adjustment for micro hedged risk	**1,366**	1,382
Total	**178,807**	170,647

Loans and advances to customers in the table above are shown net of impairment provisions held against them. The fair value adjustment for micro hedged risk relates to commercial lending.

Asset backed funding

Certain prime residential mortgages have been pledged to the Group's asset backed funding programmes or utilised as whole mortgage loan pools for the Bank of England's (BoE) Funding for Lending Scheme (FLS). The programmes have enabled the Group to obtain secured funding or to create additional collateral which could be used to source additional funding.

Mortgages pledged and the nominal values of the notes in issue are as follows:

2016	Mortgages pledged	Notes in issue			
		Held by third parties	Held by the Group		Total notes in issue
			Drawn	Undrawn	
	£m	£m	£m	£m	£m
Covered bond programme	**18,996**	**13,709**	**-**	**-**	**13,709**
Securitisation programme	**12,368**	**4,705**	**-**	**1,635**	**6,340**
Whole mortgage loan pools	**12,344**	**-**	**10,749**	**1,595**	**12,344**
Total	**43,708**	**18,414**	**10,749**	**3,230**	**32,393**

2015	Mortgages pledged	Notes in issue			
		Held by third parties	Held by the Group		Total notes in issue
			Drawn	Undrawn	
	£m	£m	£m	£m	£m
Covered bond programme	17,161	11,305	-	-	11,305
Securitisation programme	14,902	4,839	-	1,839	6,678
Whole mortgage loan pools	13,455	-	12,080	1,375	13,455
Total	45,518	16,144	12,080	3,214	31,438

The securitisation programme notes are issued by Silverstone Master Issuer plc. Silverstone Master Issuer plc is fully consolidated into the accounts of the Group.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

10 Loans and advances to customers (continued)

The whole mortgage loan pools are pledged at the BoE under the FLS. Notes are not issued when pledging the mortgage loan pools at the BoE. Instead, the whole loan pool is pledged to the BoE and drawings are made directly against the eligible collateral, subject to a haircut. Therefore, values shown under notes in issue are the whole mortgage loan pool notional balances.

Mortgages pledged include £7.4 billion (2015: £9.5 billion) in the covered bond and securitisation programmes that are in excess of the amount contractually required to support notes in issue.

Mortgages pledged are not derecognised from the Group balance sheet as the Group has retained substantially all the risks and rewards of ownership. The Group continues to be exposed to the liquidity risk, interest rate risk and credit risk of the mortgages. No gain or loss has been recognised on pledging the mortgages to the programmes.

Notes in issue, held by the Group and drawn are whole mortgage loan pools securing amounts drawn under the FLS. At 4 April 2016 the Group had outstanding FLS drawings of £8.5 billion (2015: £8.5 billion).

Notes in issue, held by the Group and undrawn, are debt securities issued by the programmes to the Group and mortgage loan pools that have been pledged to the BoE but not utilised.

In accordance with accounting standards, notes in issue and held by the Group are not recognised by the Group in its balance sheet.

The Group established the Nationwide Covered Bond programme in November 2005. Mortgages pledged provide security for issues of covered bonds made by the Group. During the year ended 4 April 2016 €3.3 billion (£2.4 billion sterling equivalent) of notes matured. During the year ended 4 April 2016 £0.8 billion and €4.3 billion (£3.9 billion sterling equivalent) of notes were issued.

The Group established the Silverstone Master Trust securitisation programme in July 2008. Notes are issued under the programme and the issuance proceeds are used to purchase, for the benefit of note holders, a share of the beneficial interest in the mortgages pledged by the Group. The remaining beneficial interest in the pledged mortgages of £6.3 billion (2015: £8.2 billion) stays with the Group and includes its required minimum seller share in accordance with the rules of the programme. The Group is under no obligation to support losses incurred by the programme or holders of the notes and does not intend to provide such further support. The entitlement of note holders is restricted to payment of principal and interest to the extent that the resources of the programme are sufficient to support such payment and the holders of the notes have agreed not to seek recourse in any other form. During the year ended 4 April 2016 £0.2 billion, €1.1 billion and $0.6 billion (total £1.4 billion sterling equivalent) of notes matured. During the year ended 4 April 2016 £0.3 billion, €0.7 billion and $0.3 billion (total £1.0 billion sterling equivalent) of notes were issued.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

11 Subordinated liabilities and subscribed capital

	2016 £m	2015 £m
Subordinated liabilities		
Subordinated notes	**1,750**	2,043
Fair value adjustment for micro hedged risk	**77**	89
Unamortised premiums and issue costs	**(10)**	(11)
Total	**1,817**	2,121
Subscribed capital		
Permanent interest bearing shares	**362**	362
Fair value adjustment for micro hedged risk	**68**	74
Unamortised premiums and issue costs	**(17)**	(21)
Total	**413**	415

All of the Society's subordinated notes and permanent interest bearing shares (PIBS) are unsecured. The Society may, with the prior consent of the Prudential Regulation Authority (PRA), repay the PIBS and redeem the subordinated notes early.

The subordinated notes rank pari passu with each other and behind claims against the Society of all depositors, creditors and investing members, other than the holders of PIBS, Additional Tier 1 (AT1) capital and core capital deferred shares (CCDS).

The PIBS rank pari passu with each other and the AT1 instruments, behind claims against the Society of the subordinated note holders but ahead of claims by the holders of CCDS.

12 Fair value hierarchy of financial assets and liabilities held at fair value

IFRS 13 requires an entity to classify assets and liabilities held at fair value and those not measured at fair value but for which the fair value is disclosed according to a hierarchy that reflects the significance of observable market inputs in calculating those fair values. The three levels of the fair value hierarchy are defined below:

Level 1 – Valuation using quoted market prices

Assets and liabilities are classified as Level 1 if their value is observable in an active market. Such instruments are valued by reference to unadjusted quoted prices for identical assets or liabilities in active markets where the quoted price is readily available, and the price reflects actual and regularly occurring market transactions on an arm's length basis. An active market is one in which transactions occur with sufficient volume and frequency to provide pricing information on an ongoing basis.

Level 2 – Valuation technique using observable inputs

Assets and liabilities classified as Level 2 have been valued using models whose inputs are observable in an active market. Valuations based on observable inputs include derivative financial instruments such as swaps and forwards which are valued using market standard pricing techniques, and options that are commonly traded in markets where all the inputs to the market standard pricing models are observable. They also include investment securities valued using consensus pricing or other observable market prices.

Level 3 – Valuation technique using significant unobservable inputs

Assets and liabilities are classified as Level 3 if their valuation incorporates significant inputs that are not based on observable market data ('unobservable inputs'). A valuation input is considered observable if it can be directly observed from transactions in an active market, or if there is compelling external evidence demonstrating an executable exit price. An input is deemed significant if it is shown to contribute more than 10% to the valuation of a financial instrument. Unobservable input levels are generally determined based on observable inputs of a similar nature, historical observations or other analytical techniques.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

12 Fair value hierarchy of financial assets and liabilities held at fair value (continued)

The following tables show the Group's financial assets and liabilities that are held at fair value by fair value hierarchy, balance sheet classification and product type:

2016	Fair values based on Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Government and supranational investments	6,843	-	-	6,843
Other debt investment securities	1,011	2,758	-	3,769
Available for sale investment securities	7,854	2,758	-	10,612
Investments in equity shares (note i)	-	-	125	125
Interest rate swaps	-	2,180	-	2,180
Cross currency interest rate swaps	-	1,238	-	1,238
Forward foreign exchange	-	44	-	44
Equity index swaps	-	-	436	436
Total derivative financial instruments	-	3,462	436	3,898
Other financial assets (note ii)	-	2	-	2
Total financial assets	7,854	6,222	561	14,637
Financial liabilities				
Interest rate swaps	-	(3,103)	(4)	(3,107)
Cross currency interest rate swaps	-	(338)	-	(338)
Forward foreign exchange	-	(4)	-	(4)
Swaptions	-	(8)	-	(8)
Equity index swaps	-	-	(1)	(1)
Index linked swaps	-	(5)	-	(5)
Total derivative financial instruments	-	(3,458)	(5)	(3,463)
Other deposits - PEBs (note iii)	-	-	(1,885)	(1,885)
Total financial liabilities	-	(3,458)	(1,890)	(5,348)

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

12 Fair value hierarchy of financial assets and liabilities held at fair value (continued)

	Fair values based on			
2015	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Government and supranational investments	6,726	-	-	6,726
Other debt investment securities (note iv)	1,033	3,266	12	4,311
Available for sale investment securities	7,759	3,266	12	11,037
Investments in equity shares (note i)	-	-	25	25
Interest rate swaps	-	2,022	-	2,022
Cross currency interest rate swaps	-	328	-	328
Forward foreign exchange	-	76	-	76
Equity index swaps	-	-	911	911
Total derivative financial instruments	-	2,426	911	3,337
Other financial assets (note ii)	-	12	-	12
Total financial assets	7,759	5,704	948	14,411
Financial liabilities				
Interest rate swaps	-	(3,044)	-	(3,044)
Cross currency interest rate swaps	-	(910)	-	(910)
Forward foreign exchange	-	(76)	-	(76)
Swaptions	-	(8)	-	(8)
Equity index swaps	-	-	(1)	(1)
Index linked swaps	-	(9)	-	(9)
Total derivative financial instruments	-	(4,047)	(1)	(4,048)
Other deposits - PEBs (note iii)	-	-	(3,332)	(3,332)
Total financial liabilities	-	(4,047)	(3,333)	(7,380)

Notes:
i. Investments in equity shares are held at fair value and exclude £1 million of investments in equity shares which are held at cost.
ii. Other financial assets represent the fair value of certain mortgage commitments included within other assets in the balance sheet.
iii. Other deposits comprise PEBs which are held at fair value through the income statement. The remaining other deposits are held at amortised cost and are included in note 14.
iv. The prior year fair value for covered bond investment securities has been reclassified to Level 1, to better reflect the valuation approach, consistent with the current year presentation.

The Group's Level 1 portfolio comprises liquid securities for which traded prices are readily available.

Asset valuations for Level 2 available for sale investment securities are sourced from consensus pricing or other observable market prices. None of the Level 2 available for sale assets are valued from models. Level 2 derivative assets and liabilities are valued from discounted cash flow models using yield curves based on observable market data.

More detail on the Level 3 portfolio is provided in note 13.

Transfers between fair value hierarchies

Instruments move between fair value hierarchies primarily due to increases or decreases in market activity or changes to the significance of unobservable inputs to valuation. There were no significant transfers between the Level 1 and Level 2 portfolios during the year.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

13 Fair value hierarchy of financial assets and liabilities held at fair value – Level 3 portfolio

The main constituents of the Level 3 portfolio are as follows:

Available for sale investment securities

The Group did not hold any Level 3 available for sale investment securities at 4 April 2016. During the period all investments were transferred from Level 3 to Level 2 due to changes in the availability of observable market prices. For the purpose of reporting movements between levels of the fair value hierarchy, transfers are recognised at the beginning of the reporting period in which they occur.

Investments in equity shares

The Level 3 investments in equity shares of £125 million at 4 April 2016 consist primarily of the investment in Visa Europe Limited and an interest in a fund which is supported by zero coupon bonds of an A rated bank. External valuations are used to obtain the fair value of this instrument.

Derivative financial instruments

Level 3 assets and liabilities in this category are primarily equity linked derivatives with external counterparties which economically match the investment return payable by the Group to investors in the PEBs product. The derivatives are linked to the performance of specified stock market indices and have been valued by an external third party. Fair value changes are recognised within gains/losses from derivatives and hedge accounting. Upon maturity the gain/loss is transferred to interest expense and similar charges.

Other deposits – PEBs

This category relates to deposit accounts with the potential for stock market correlated growth linked to the performance of specified stock market indices. The PEBs liability of £1,885 million (2015: £3,332 million) is valued at a discount to reflect the time value of money, overlaid by a fair value adjustment representing the expected return payable to the customer. The fair value adjustment has been constructed from the valuation of the associated derivatives as valued by an external third party. Fair value changes are recognised within gains/losses from derivatives and hedge accounting. Upon maturity the gain/loss is transferred to interest expense and similar charges.

The minimum amount on an undiscounted basis that the Group is contractually required to pay at maturity for the PEBs is £1,551 million (2015: £2,585 million). The maximum additional amount which would also be payable at maturity in respect of additional investment returns is £636 million (2015: £1,080 million). The payment of additional investment returns is dependent upon performance of certain specified stock indices during the period of the PEBs. As noted above, the Group has entered into equity-linked derivatives with external counterparties which economically match the investment returns on the PEBs.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

13 Fair value hierarchy of financial assets and liabilities held at fair value – Level 3 portfolio (continued)

The tables below set out movements in the Level 3 portfolio, including transfers in and out of Level 3.

Movements in Level 3 portfolio	**Available for sale investment securities £m**	**Investments in equity shares £m**	**Net derivative financial instruments £m**	**Other deposits - PEBs £m**
At 5 April 2015	12	25	910	(3,332)
Gains/(losses) recognised in the income statement:				
Net interest income/(expense)	**-**	**-**	**398**	**(439)**
(Losses)/gains from derivatives and hedge accounting	**-**	**-**	**(476)**	**465**
Gains/(losses) recognised in other comprehensive income:				
Fair value movement taken to members' interests and equity	**-**	**100**	**-**	**-**
Settlements	**-**	**-**	**(401)**	**1,421**
Transfers out of Level 3 portfolio	**(12)**	**-**	**-**	**-**
At 4 April 2016	**-**	**125**	**431**	**(1,885)**

Movements in Level 3 portfolio	Available for sale investment securities £m	Investments in equity shares £m	Net derivative financial instruments £m	Other deposits - PEBs £m
At 5 April 2014	71	28	669	(3,222)
Gains/(losses) recognised in the income statement:				
Net interest income/(expense)	-	-	1	(50)
Gains/(losses) from derivatives and hedge accounting	-	-	241	(245)
Net impairment losses on investment securities	(5)	-	-	-
Gains/(losses) recognised in other comprehensive income:				
Fair value movement taken to members' interests and equity	1	(3)	-	-
Settlements	(55)	-	(1)	185
At 4 April 2015	12	25	910	(3,332)

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

13 Fair value hierarchy of financial assets and liabilities held at fair value – Level 3 portfolio (continued)

Level 3 portfolio sensitivity analysis of valuations using unobservable inputs

The fair value of financial instruments is, in certain circumstances, measured using valuation techniques based on market prices that are not observable in an active market or significant unobservable market inputs.

Reasonable alternative assumptions can be applied for sensitivity analysis, taking account of the nature of valuation techniques used, as well as the availability and reliability of observable proxy and historic data. The following table shows the sensitivity of the Level 3 fair values to reasonable alternative assumptions (as set out in the table of significant unobservable inputs on the following page) and the resultant impact of such changes in fair value on the income statement or members' interests and equity:

2016		**Members' interests and equity**	
Sensitivity of Level 3 fair values	**Fair value £m**	**Favourable changes £m**	**Unfavourable changes £m**
Investments in equity shares	**125**	**41**	**(32)**
Net derivative financial instruments (note i)	**431**	**-**	**-**
Other deposits – PEBs (note i)	**(1,885)**	**-**	**-**
Total	**(1,329)**	**41**	**(32)**

2015		Members' interests and equity	
Sensitivity of Level 3 fair values	Fair value £m	Favourable changes £m	Unfavourable changes £m
Available for sale investment securities:			
Collateralised debt obligations	12	1	(1)
Investments in equity shares	25	2	(1)
Net derivative financial instruments (note i)	910	-	-
Other deposits – PEBs (note i)	(3,332)	-	-
Total	(2,385)	3	(2)

Note:
i. Changes in fair values of the equity index swaps included in net derivative financial instruments will be largely offset by the change in fair value of the PEBs deposits. Any resultant impact is deemed by the Group to be insignificant; therefore these sensitivities have been excluded from the table above.

The Level 3 portfolio at 4 April 2016 did not include any impaired assets (2015: £nil). The sensitivity analysis on fair values in the tables above therefore does not impact on the income statement.

Alternative assumptions are considered for each product and varied according to the quality of the data and variability of the underlying market.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

13 Fair value hierarchy of financial assets and liabilities held at fair value – Level 3 portfolio (continued)

The following table discloses the significant unobservable inputs underlying the above alternative assumptions for assets and liabilities recognised at fair value and classified as Level 3 along with the range of values for those significant unobservable inputs. Where sensitivities are described the inverse relationship will also generally apply.

2016	**Total assets £m**	**Total liabilities £m**	**Valuation technique**	**Significant unobservable inputs**	**Range (note ii)**		**Weighted average (note iii)**	**Units (note iv)**
Investments in equity shares	**18**		**Mark to market**	**Price**	**93.30**	**107.00**	**98.00**	**Points**
	107		**Discounted cash flows**	**Discount rate**	**10.00**	**12.00**	**11.00**	**%**
				Share conversion	**-**	**100.00**	**77.30**	**%**
				Execution risk	**-**	**30.00**	**12.41**	**%**
	125							
Net derivative financial instruments (note i)	**431**							
Other deposits – PEBs (note i)		**(1,885)**						

2015	Total assets £m	Total liabilities £m	Valuation technique	Significant unobservable inputs	Range (note ii)		Weighted average (note iii)	Units (note iv)
Available for sale investment securities:								
Collateralised debt obligations	12		Mark to market	Price	66.00	75.00	69.00	Points
Investments in equity shares	25		Mark to market	Price	99.00	114.00	104.00	Points
Net derivative financial instruments (note i)	910							
Other deposits – PEBs (note i)		(3,332)						

Notes:

i. Changes in fair values of the equity index swaps included in net derivative financial instruments will be largely offset by the change in fair value of the PEBs deposits. Any resultant impact is deemed by the Group to be insignificant; therefore these sensitivities have been excluded from the table above.

ii. The range represents the values of the highest and lowest levels used in the calculation of favourable and unfavourable changes as presented in the previous table.

iii. Weighted average represents the input values used in calculating the fair values for the above financial instruments.

iv. Points are a percentage of par; for example 100 points equals 100% of par. One basis point (bps) equals 0.01%; for example, 125 basis points (bps) equals 1.25%.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

13 Fair value hierarchy of financial assets and liabilities held at fair value – Level 3 portfolio (continued)

Some of the significant unobservable inputs used in fair value measurement are interdependent. Where this is the case, a description of those interrelationships is included below.

Price

Prices for securities that are marked to market, where the market is illiquid, and supporting price information is scarce, are typically subject to significant uncertainty. An increase in the price will directly cause an increase in fair value and vice versa.

Discount rate

The discount rate is used to determine the present value of future cash flows. The level of the discount rate takes into account the time value of money, but also the risk or uncertainty of future cash flows. Typically, the greater the uncertainty, the higher the discount rate. A higher discount rate leads to a lower valuation and vice versa.

Share conversion

Where the conversion of a security into an underlying instrument is subject to underlying security market pricing and contingent litigation risk, share conversion is factored in to the fair value. The higher the share conversion, the higher the valuation and vice versa.

Execution risk

Where a security is dependent on a future transaction taking place, and the occurrence of this is not certain, execution risk is factored into the security’s valuation. The greater the execution risk, the lower the valuation and vice versa.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

14 Fair value of financial assets and liabilities measured at amortised cost

The following table summarises the carrying value and fair value of financial assets and liabilities measured at amortised cost on the Group's balance sheet:

2016	**Carrying value £m**	**Fair values based on Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total fair value £m**
Financial assets					
Loans and advances to banks	**3,591**	**3,591**	**-**	**-**	**3,591**
Loans and advances to customers:					
Residential mortgages	**162,062**	**-**	**-**	**161,766**	**161,766**
Consumer banking	**3,588**	**-**	**-**	**3,458**	**3,458**
Commercial lending	**13,138**	**-**	**-**	**13,077**	**13,077**
Other lending	**19**	**-**	**-**	**19**	**19**
Total	**182,398**	**3,591**	**-**	**178,320**	**181,911**
Financial liabilities					
Shares	**138,715**	**-**	**138,896**	**-**	**138,896**
Deposits from banks	**2,095**	**-**	**2,096**	**-**	**2,096**
Other deposits (note i)	**5,750**	**-**	**5,752**	**-**	**5,752**
Due to customers	**6,201**	**-**	**-**	**6,204**	**6,204**
Debt securities in issue	**36,085**	**13,582**	**23,195**	**-**	**36,777**
Subordinated liabilities	**1,817**	**-**	**1,949**	**-**	**1,949**
Subscribed capital	**413**	**-**	**381**	**-**	**381**
Total	**191,076**	**13,582**	**172,269**	**6,204**	**192,055**

2015	Carrying value £m	Fair values based on Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
Financial assets					
Loans and advances to banks	3,392	3,392	-	-	3,392
Loans and advances to customers:					
Residential mortgages	152,775	-	-	149,778	149,778
Consumer banking	3,575	-	-	3,456	3,456
Commercial lending	14,272	-	-	13,145	13,145
Other lending	25	-	-	25	25
Total	174,039	3,392	-	166,404	169,796
Financial liabilities					
Shares	132,373	-	132,505	-	132,505
Deposits from banks	1,974	-	1,976	-	1,976
Other deposits (note i)	5,744	-	5,745	-	5,745
Due to customers	6,119	-	-	6,122	6,122
Debt securities in issue (note ii)	28,105	11,539	17,194	-	28,733
Subordinated liabilities	2,121	-	2,295	-	2,295
Subscribed capital	415	-	387	-	387
Total	176,851	11,539	160,102	6,122	177,763

Note:

i. Other deposits exclude PEBs which are held at fair value through the income statement and which are included in note 12.

ii. The prior year fair value for covered bond debt securities in issue has been reclassified to Level 1, to better reflect the valuation approach, consistent with the current year presentation.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

14 Fair value of financial assets and liabilities measured at amortised cost (continued)

Loans and advances to customers

The Group estimates the fair value of loans and advances to customers using consistent modelling techniques across the different loan books. The estimates take into account expected future cash flows and future lifetime expected losses, based on historic trends and discount rates appropriate to the loans, to reflect a hypothetical exit price value on an asset by asset basis. Variable rate loans are modelled on estimated future cash flows, discounted at current market interest rates. Variable rate retail mortgages are discounted at the currently available market standard variable interest rate (SVR) which, for example, in the case of the Group's residential base mortgage rate (BMR) mortgage book generates a fair value lower than the amortised cost value as those mortgages are priced below the SVR.

For fixed rate loans, discount rates have been based on the expected funding and capital cost applicable to the book. When calculating fair values on fixed rate loans, no adjustment has been made to reflect interest rate risk management through internal natural hedges or external hedging via derivatives.

Shares, deposits and borrowings

The estimated fair value of shares and deposits with no stated maturity, including non-interest bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest rate shares, deposits and other borrowings without quoted market prices represents the discounted amount of estimated future cash flows based on expectations of future interest rates, customer withdrawals and interest capitalisation. For variable interest rate deposits, estimated future cash flows are discounted using current market interest rates for new debt with similar remaining maturity. For fixed rate shares and deposits, the estimated future cash flows are discounted based on market offer rates currently available for equivalent deposits.

Debt securities in issue

The estimated fair values of longer dated liabilities are calculated based on quoted market prices where available or using similar instruments as a proxy for those liabilities that are not of sufficient size or liquidity to have an active market quote. For those notes for which quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity.

15 Offsetting financial assets and financial liabilities

The Group has financial assets and liabilities for which there is a legally enforceable right to set off the recognised amounts, and 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.

In accordance with IFRS 7 Financial Instruments: Disclosures, the following table shows the impact on derivative financial instruments and total return swaps 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 ISDA Master Agreement, global master repurchase agreements and global master securities lending agreements, whereby outstanding transactions with the same counterparty can be offset and settled net following a default or other predetermined event.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

15 Offsetting financial assets and financial liabilities (continued)

Financial collateral on derivative financial instruments consists of cash and securities settled, typically daily or weekly, to mitigate the mark to market exposures. Financial collateral on total return swaps typically comprises highly liquid securities which are legally transferred and can be liquidated in the event of counterparty default.

The net amounts after offsetting under IFRS 7 presented below show the exposure to counterparty credit risk for derivative contracts after netting benefits and collateral, and are not intended to represent the Group's actual exposure to credit risk. This is due to a variety of credit mitigation strategies which are employed in addition to netting and collateral arrangements.

2016	**Gross and net amounts reported on the balance sheet**	**Master netting arrangements**	**Financial collateral**	**Net amounts after offsetting under IFRS 7**
	£m	**£m**	**£m**	**£m**
Financial assets				
Derivative financial instruments	**3,898**	**(2,020)**	**(1,804)**	**74**
Total return swaps	**87**	**-**	**(87)**	**-**
Reverse repurchase agreements	**450**	**-**	**(450)**	**-**
Total financial assets	**4,435**	**(2,020)**	**(2,341)**	**74**
Financial liabilities				
Derivative financial liabilities	**3,463**	**(2,020)**	**(1,391)**	**52**
Repurchase agreements	**127**	**-**	**(127)**	**-**
Total financial liabilities	**3,590**	**(2,020)**	**(1,518)**	**52**

2015	Gross and net amounts reported on the balance sheet	Master netting arrangements	Financial collateral	Net amounts after offsetting under IFRS 7
	£m	£m	£m	£m
Financial assets				
Derivative financial instruments	3,337	(1,900)	(1,386)	51
Total return swaps	149	-	(149)	-
Total financial assets	3,486	(1,900)	(1,535)	51
Financial liabilities				
Derivative financial liabilities	4,048	(1,900)	(2,129)	19
Total financial liabilities	4,048	(1,900)	(2,129)	19

The fair value of the financial collateral is the same as the values shown in the table above, except for the total return swaps collateral which has a fair value of £127 million (2015: £210 million) and the repurchase agreements collateral which has a fair value of £128 million (2015: £nil).

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

16 Core capital deferred shares (CCDS)

	Number of shares	CCDS £m	Share premium £m	Total £m
At 4 April 2016	**5,500,000**	**6**	**525**	**531**
At 4 April 2015	5,500,000	6	525	531

CCDS are a form of Common Equity Tier 1 (CET1) capital which have been developed to enable the Group to raise capital from the capital markets. Previously issued Tier 1 capital instruments, PIBS, no longer meet the regulatory capital requirements of CRD IV and are being gradually phased out of the calculation of capital resources under transitional rules.

CCDS are perpetual instruments. They rank pari passu to each other and are junior to claims against the Society of all depositors, creditors and investing members. Each holder of CCDS has one vote, regardless of the number of CCDS held.

In the event of a winding up or dissolution of the Society and if there was surplus available, the amount that the investor would receive for each CCDS held is limited to the average principal amount in issue, which is currently £100 per share.

There is a cap placed on the amount of distributions that can be paid to holders of CCDS in any financial year. The cap is currently set at £15.32 per share and is adjusted annually in line with CPI.

A final distribution of £28 million (£5.125 per share) for the financial year ended 4 April 2015 was paid on 22 June 2015 and an interim distribution of £28 million (£5.125 per share) in respect of the period to 30 September 2015 was paid on 21 December 2015. These distributions have been recognised in the statement of movements in members' interests and equity.

The directors have declared an unconditional final distribution of £5.125 per share in respect of the financial year ended 4 April 2016, amounting in aggregate to £28 million. The distribution will be recognised in the statement of movements in members' interests and equity in the financial year ended 4 April 2017.

17 Other equity instruments

	Total £m
At 4 April 2016	**992**
At 4 April 2015	992

AT1 instruments rank pari passu to each other and to PIBS. They are junior to claims against the Society of all depositors, creditors and investing members, other than the holders of CCDS.

AT1 instruments pay a fully discretionary, non-cumulative fixed coupon at an initial rate of 6.875% per annum. The rate will reset on 20 June 2019 and every five years thereafter to the five year mid swap rate plus 4.88%. Coupons are paid semi-annually in June and December.

A coupon of £34 million, covering the period to 19 June 2015, was paid on 22 June 2015 and a coupon of £34 million, covering the period to 20 December 2015, was paid on 21 December 2015. These payments have been recognised in the statement of movements in members' interests and equity.

A coupon payment of £34 million, covering the period to 20 June 2016, is expected to be paid on 20 June 2016 and will be recognised in the statement of movements in members' interests and equity in the financial year ended 4 April 2017.

The coupons paid and declared represent the maximum non-cumulative fixed coupon of 6.875%.

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

17 Other equity instruments (continued)

AT1 instruments have no maturity date. They are repayable at the option of the Society on 20 June 2019 and on every fifth anniversary thereafter. AT1 instruments are only repayable with the consent of the PRA.

If the fully-loaded CET1 ratio for the Society, on either a consolidated or unconsolidated basis, falls below 7% the AT1 instruments convert to CCDS instruments at the rate of one CCDS share for every £80 of AT1 holding.

18 Contingent liabilities

During the ordinary course of business the Group is subject to complaints and threatened or actual legal proceedings, as well as regulatory reviews, challenges and investigations. All such material matters are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of incurring a liability. Where it is concluded that it is more likely than not that a payment will be made a provision is recognised based on management's best estimate of the amount that will be payable. For other matters no provision is recognised but disclosure is made of items which are potentially material, either individually or in aggregate, except in cases where the likelihood of a liability crystallising is considered to be remote. Currently the Group does not expect the ultimate resolution of any such matters to have a material adverse impact on its financial position.

19 Related party transactions

Related party transactions in the year ended 4 April 2016 are similar in nature to those included in the Annual Report and Accounts 2015. Loans to key management personnel, undertaken on normal commercial terms, were £1.4 million (4 April 2015: £0.9 million).

NOTES TO THE PRELIMINARY RESULTS ANNOUNCEMENT

20 Notes to the cash flow statement

	2016 £m	2015 £m
Non-cash items included in profit before tax		
Net decrease in impairment provisions	**(209)**	(636)
Net increase/(decrease) in provisions for liabilities and charges	**48**	(15)
Impairment (recoveries)/losses on investment securities	**(8)**	18
Depreciation, amortisation and impairment	**325**	294
Profit on sale of property, plant and equipment	**(5)**	(2)
Loss on the revaluation of land and buildings	**3**	-
Interest on subordinated liabilities	**99**	115
Interest on subscribed capital	**26**	42
(Gains)/losses from derivatives and hedge accounting (note i)	**(39)**	20
Total	**240**	(164)
Changes in operating assets and liabilities		
Loans and advances to banks	**142**	(4)
Net derivative financial instruments and fair value adjustment for portfolio hedged risk (note ii)	**(971)**	1,059
Loans and advances to customers	**(7,951)**	(3,470)
Other operating assets	**(420)**	(198)
Shares	**6,342**	1,905
Deposits from banks, customers and others	**(1,238)**	1,842
Debt securities in issue	**1,613**	(582)
Deferred taxation (note ii)	**136**	23
Retirement benefit obligations	**(73)**	51
Other operating liabilities	**7**	(199)
Total (note ii)	**(2,413)**	427
Cash and cash equivalents		
Cash	**8,797**	4,325
Loans and advances to banks repayable in 3 months or less	**3,266**	2,925
Total	**12,063**	7,250

Notes:
i. Comparatives have been restated as detailed in note 2.
ii. Amounts in relation to derivative financial instruments and fair value adjustment for portfolio hedged risk and deferred taxation are presented on a net basis; comparative information has been reclassified to conform to the current year presentation. Accordingly, changes in operating assets and liabilities are presented on a net basis, whereas in the prior year operating assets and liabilities were presented separately.

The Group is required to maintain balances with the Bank of England and certain other central banks which, at 4 April 2016, amounted to £325 million (2015: £319 million). These balances are included within loans and advances to banks on the balance sheet and are not included in the cash and cash equivalents in the cash flow statement as they are not liquid in nature.

21 Other matters

On 2 November 2015, Visa Inc. announced the proposed acquisition of Visa Europe Limited. The Group is a principal member and shareholder of Visa Europe Limited and in exchange for its share will receive a combination of cash and preferred stock. The Group's share of the consideration payable on completion is approximately 1% of the total proceeds. The preferred stock will be convertible into Visa Inc. common stock at a future date provided conditions to the transaction closing are met. The conversion of the preferred stock remains subject to potential reduction for certain litigation losses that may be incurred by Visa Europe Limited. On completion of the transaction, the Group expects to recognise a gain in the income statement.

RESPONSIBILITY STATEMENT

The Directors confirm that the financial statements, prepared in accordance with International Financial Reporting Standards as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and income and expenditure of the Group as required by the Disclosure and Transparency rules (DTR 4.1.12). The Chief Executive's Review and the Financial Review together include a fair review of the development and performance of the business and the Group, and taken together with the primary financial statements, supporting notes and the Business and Risk Report provide a description of the principal risks and uncertainties faced.

A full list of the board of directors will be disclosed in the Annual Report and Accounts 2016.

Signed on behalf of the Board by

Mark Rennison
Group Finance Director

23 May 2016

OTHER INFORMATION

The financial information set out in this announcement which was approved by the Board on 23 May 2016 does not constitute accounts within the meaning of section 73 of the Building Societies Act 1986.

The Annual Report and Accounts 2015 have been filed with the Financial Conduct Authority and the Prudential Regulation Authority. The Independent Auditors' Report on the Annual Report and Accounts 2015 was unqualified. The Annual Report and Accounts 2016 will be lodged with the Financial Conduct Authority and the Prudential Regulation Authority following publication.

A copy of this Preliminary report is placed on the website of Nationwide Building Society, nationwide.co.uk, from 24 May 2016. The Directors are responsible for the maintenance and integrity of information on the Society's website. Information published on the internet is accessible in many countries with different legal requirements. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

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