Annual Report and Accounts 2014

one
Savings Bank

Specialist Personal Flexible

Strategic report

Governance

Financial statements

OneSavings Bank is a specialist lender primarily focused on carefully selected sub-sectors of the mortgage market. Its specialist lending is supported by a stable retail savings franchise with 150 years of heritage.

I am delighted to welcome you to OneSavings Bank plc's first Annual Report following its listing on the main market of the London Stock Exchange in June 2014. During 2014, the Company comfortably met the financial objectives set out at IPO, with the delivery of strong loan book and earnings growth. The business remains well placed to take advantage of the continued demand in the market for our specialist lending capabilities and customer centric business model.

Mike Fairey, Non-Executive Chairman

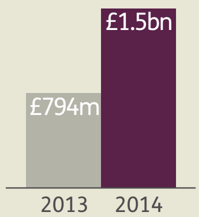
Go to Governance section P38 for the Chairman's letter to shareholders

Highlights

Gross new lending

up 84%

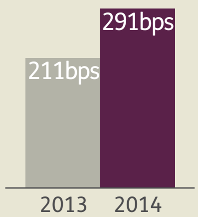
£1.5bn
(2013: £794m)



Net interest margin

up 80bps

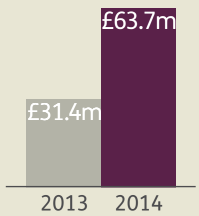
291bps
(2013: 211bps)



Profit before tax

up 103%

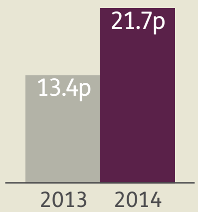
£63.7m
(2013: £31.4m)



Basic EPS

up 62%

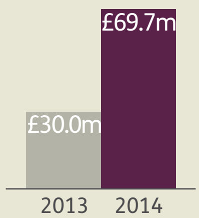
21.7p
(2013: 13.4p)[1]



Underlying profit before tax

up 133%

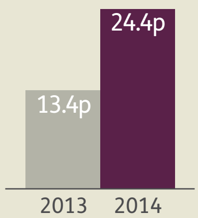
£69.7m
(2013: £30.0m)



Underlying basic EPS

up 82%

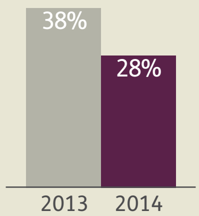
24.4p
(2013: 13.4p)



Cost:income ratio

improved 10% points

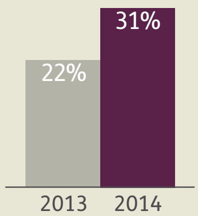
28%
(2013: 38%)



Underlying return on equity

up 9% points

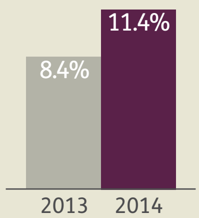
31%
(2013: 22%)



Fully-loaded common equity tier 1 ratio

strengthened

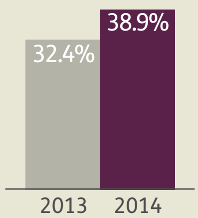
11.4%
(2013: 8.4%)[2]



Customer satisfaction (NPS)

up 6.5% points

38.9%
(2013: 32.4%)



Maiden dividend of

3.9p per share

1 Previously reported as 14.2p per share before deducting coupons on perpetual subordinated bonds classified as equity
2 Estimated as at 31 December 2013

For more information and definitions, go to the Key performance indicators P18

At a glance

Our business

Retail savings

- **High Street branches**
  Our Kent Reliance branded network operates nine branches in the South East of England and offers a variety of fixed, notice, easy access and regular savings products, including NISAs.
- **Direct**
  The direct channel sources savings products via the telephone and post.
- **Online**
  We source retail savings deposits via the internet.

Retail Savings balance by channel	2014	2013
Branches	**19%**	16%
Direct	**49%**	46%
Online	**32%**	38%

For more information go to Our strategy in action P12

Buy-to-Let/ SME lending

- **Buy-to-Let mortgages**
  We lend to individuals and limited companies secured on residential property held for investment purposes. Our target market is experienced and professional landlords or High Net Worth individuals with established and extensive property portfolios.
- **Commercial mortgages**
  We provide loans to limited companies and individuals secured on commercial and semi-commercial properties held for investment purposes or for owner occupation.
- **Residential development**
  We provide development loans to small and medium sized developers of residential property in the South of England. Loans are staged with independent chartered surveyors signing off each stage of the development before funds are released.

Buy-to-Let/SME	2014	2013
Loans & advances (£bn)	**2.1**	1.1
Gross new lending (£bn)	**1.2**	0.6
Average book LTV (%)	**68**	71

For more information go to the Operating and financial review P20

Residential mortgage lending

- **Bespoke first charge**
  We provide loans to individuals, secured by a first charge against their residential home. Our target market includes High Net Worth and Complex Income customers.
- **Second charge**
  We provide loans to individuals seeking to raise additional funds secured by a second charge against their residential home. We predominantly target good credit quality borrowers.
- **Shared ownership**
  We lend to first-time buyers and key workers buying a property in conjunction with a Housing Association.

Residential	2014	2013
Loans & advances (£bn)	**1.8**	1.8
Gross new lending (£m)	**286**	227
Average book LTV (%)	**54**	51

For more information go to the Operating and financial review P22

Personal loans

OneSavings Bank acquired the performing former Northern Rock consumer loan portfolio from UK Asset Resolution Limited in July 2013. This portfolio of high-margin, seasoned loans currently represents the Group's only unsecured lending and is serviced by a third party specialist servicer.

Our trading brands

OneSavings Bank is made up of a family of specialist financial services brands.

KentReliance

Largest lending business in the Group, offering Buy-to-Let and first charge residential loans.

Kent Reliance is also an established, stable and award winning savings franchise. Its strong customer focus delivers high levels of customer satisfaction, resulting in strong customer loyalty and customer retention.

InterBay Commercial

Specialist semi-commercial and commercial mortgage lender providing Buy-to-Let loans, alongside owner-occupied and investor commercial mortgages throughout England and Wales (acquired in August 2012).

Heritable Development Finance

Experienced team providing specialist residential development finance to small and medium sized developers with a proven track record (formed in December 2013).

Prestige Finance

Long standing second charge lender, which offers an award-winning range of specialist secured loans throughout the UK (acquired in September 2012).

Guernsey Home Loans

Specialist residential and Buy-to-Let mortgages for its local market since 2005.

Jersey Home Loans

Specialist residential and Buy-to-Let mortgages for its local market since 2002.

Easiprocess

Based in Bangalore, India, and a wholly-owned subsidiary of OneSavings Bank; provides primary processing for our Kent Reliance, Jersey and Guernsey brands.

Chief Executive Officer's statement

Andy Golding
Chief Executive Officer

2014 has been a successful year for OneSavings Bank. Having laid the foundations for the future with a well received listing on the main market of the London Stock Exchange, we have gone on to deliver on our promises with a strong business performance across all key metrics.

Underlying RoE

2014:

31%

2013: 22%

Overview

Whilst OneSavings Bank was formed as recently as February 2011, it can trace its roots back over 150 years and its management team has substantial experience in the financial services sector. We have a straightforward business model comprising secured lending brands that have expertise and good reputations in underserved markets that offer risk-adjusted high margin returns. Our business is funded by an award winning retail savings franchise that focuses on attracting new and retaining existing savers by offering good value for the long term with a transparent savings proposition. Our priorities are to respond to customer needs, be straightforward to deal with and be well understood by our customers. This clear focus on our customers has consolidated our position as a leading bank in our markets, which is borne out by the 2014 results.

Results

The rigorous process of the Initial Public Offering (IPO) has prepared the Group well for the demands of being a listed company and has demonstrated the capability of its management team. We have a clear strategy, coupled with strong internal capabilities and confidence in our markets. As a result we believe that we are well placed for future growth. I am pleased to say that, without exception, we have performed consistently against the strategy we set at the start of the year and have delivered a strong set of results that exceeded all of our stated financial objectives.

The Group's loan book grew by 29% to £3.9bn in 2014 (2013: £3.0bn), driven predominantly by £1.5bn in new business origination (2013: £794m). Underlying pre-tax profit increased by 133% to £69.7m (2013: £30.0m).

The Group's underlying return on equity improved by 9 percentage points to 31% (2013: 22%) and we have strengthened our fully-loaded common equity tier 1 capital ratio to 11.4% (2013: 8.4% estimated under CRD IV) including net IPO proceeds of £35.8m. The Board is recommending a final dividend of 3.9 pence per share in line with our stated dividend policy.

Key drivers

We have continued to differentiate ourselves from the competition by offering well defined propositions into high margin, underserved markets, where we have the experience, as well as the internal and intermediary infrastructure, to successfully develop and service those markets. Each of our mainstream lending brands, Kent Reliance, InterBay Commercial and Prestige Finance, have extended the scope of their lending during 2014, growing both overall market share and also their reputation amongst intermediaries. I am also pleased that Heritable Development Finance has grown from its formation in December 2013 into a vibrant, high quality residential development lender, further adding to the Group's capabilities.

In our retail savings business, we have grown retail deposits by 33% to £4.3bn, (2013: £3.3bn) maintaining a loan to deposit ratio below 100% and delivering on our strategy to be primarily retail funded. Our customer-centric strategy of offering consumers good value for the long term with a transparent savings proposition, has continued to deliver a dependable and loyal customer base, with 92% of maturing fixed rate bond and ISA balances in 2014 choosing to stay with Kent Reliance. We have welcomed 27,000 new savings customers to the Group during the year, demonstrating the improving brand recognition.

We have kept tight control on credit quality, as seen in our reportable arrears statistics: from more than 14,000 loans totalling £2.7bn of new organic originations since the bank's creation in February 2011, we only have 24 cases of arrears over three months in duration, with an aggregate balance of £4.5m and average LTV of 64%.

As the Group has grown, costs have been controlled in line with our stated targets. We have made planned investments in customer facing and back office infrastructure both in the UK and in our wholly-owned Indian operation, EasiProcess, which undertakes a range of primary processing services at a significantly lower cost than an equivalent UK-based operation. This, together with the positive "jaws" delivered between income and costs, has resulted in a significant improvement in the cost:income ratio to 28%, down from 38% in 2013, which is well within the Board's target of 35%.

I am particularly proud that we have achieved this while maintaining our focus on customers, borne out by a consistently high and increasing consumer Net Promoter Score (NPS) of 38.9% (2013: 32.4%). This is also demonstrated by our numerous awards, such as What Mortgage Best Buy-to-Let Lender 2014, and by Kent Reliance being named as the savings account provider with the Best Customer Service in the UK by Which? in 2014.

I would like to thank our staff for their contribution to the results. I am delighted that over half of them have chosen to add to their IPO equity share award by participating in the OneSavings Bank Sharesave scheme demonstrating their commitment and pride in what is being achieved, as well as their confidence in the future.

New Chairman and Board changes

During 2014 we welcomed our new Non-Executive Chairman Mike Fairey, who brings 40 years' experience as a senior retail banker, and three new, Independent Non-Executive Directors in Mary McNamara, Graham Allatt and Nathan Moss. They bring with them deep experience in strategy, commercial, risk and credit management leadership.

Market outlook

The recovery in the UK economy has led to an improvement in the housing market. Whilst there are some threats to growth, our view is that the UK economy will withstand the headwinds and that growth will continue. That said, these headwinds have pushed back expectations of interest rate rises and market expectations are for interest rates to increase from late 2015.

We lend on high quality assets with strong resale and rental potential and restrict lending on new build flats. The average loan-to-value on our new lending in 2014 was 70% and on the total mortgage book is 62%, giving us protection against any unforeseen dip in house prices.

The Buy-to-Let market continues to exhibit growth, underpinned by strong tenant demand due to social and demographic changes, government policy, House Price Inflation (HPI) and reduced availability of finance for first-time buyers. We expect the growth that has been seen in the private rented sector since 2000 to continue. This, as expected, has led to a modest level of increased competition, however we remain confident that we can continue writing highly profitable business within our chosen markets.

Residential mortgage lending is expected to strengthen further as the economy improves. Although the Mortgage Market Review (MMR) led to a modest level of disruption, we expect this to normalise as lenders, who initially reacted conservatively to the new regulations, adapt their criteria to a more appropriate level. We welcome moves to increase the level of regulation in the second charge mortgage market as a means of providing consumers with greater confidence that they will see good outcomes from the advice they receive. The inclusion of second charge lending within broader mortgage regulation will, we believe, support further growth in this market.

Dividend

2014:
3.9p
per share

Competition within prime owner occupied residential mortgage lending intensified during 2014 and that market saw further margin compression. We remain confident that our focus on specialist, underserved areas of the market will stand us in good stead and help mitigate competitive pressures in the wider market.

Focus for upcoming year

Over the coming year, OneSavings Bank will maintain its focus on delivering its stated strategy and objectives. Organic lending will remain the key driver of growth in the loan book and we anticipate loans growing at a rate in line with organic capital generation, whilst maintaining a strong capital position. We will, however, continue to evaluate inorganic opportunities as and when they arise. We will concentrate the expertise that we bring to our chosen market to deliver our target return on equity as we continue to focus on the quality of our new lending and enhance our customer reputation across our lending and savings brands.

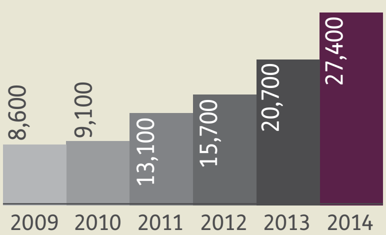
Andy Golding
Chief Executive Officer
16 March 2015

Market review

Economic overview

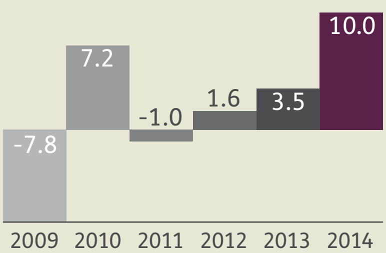
The UK economy continued its growth through 2014 with a GDP growth rate of 2.6%, with the Bank of England (BoE) forecasting GDP to remain above 2.5% through 2015. This has fed through to housing demand, with an increase in property transactions and increased lending volumes. Inflation, as measured by the Consumer Price Index (CPI), has remained below the BoE's target level of 2% (1.5%) and the BoE expects CPI inflation to remain below 2% in 2015. Given subdued inflation expectations and the global macroeconomic weakness, the first BoE rate rise is predicted in late 2015. The Monetary Policy Committee (MPC) has commented that interest rates, when they do rise, will do so gradually and will probably remain below average historical levels for some time.

UK Buy-to-Let Gross Advances 2009–2014 (£m)



Source: CML Research

UK House Price Inflation 2009–2014 (%)



Source: ONS, Survey of Mortgage Lenders

The housing market

The UK housing market experienced strong growth in the first half of the year with house prices (as measured by ONS House Price data) increasing by an average of 12% on an annualised basis, and mortgage activity stronger than the Council of Mortgage Lenders (CML) had anticipated. However, house prices have risen less strongly in the second half of 2014, partly reflecting the availability of mortgage credit and also an easing in demand for housing finance. The economic recovery, characterised by strong GDP growth, low inflation and falling unemployment, should mitigate any impact of rising interest rates on affordability and repossessions.

The mortgage market

The CML now expects a moderate increase in gross lending in 2015 to circa £220bn, with arrears expected to remain stable at current levels. OneSavings Bank ended 2014 with strong mortgage pipelines across its principal lending brands. It is well placed to take advantage of expected mortgage market growth and the improving economic backdrop and continue to grow its balance sheet through risk-adjusted high-margin lending in the year ahead.

The competitive landscape

The UK market for mass market lending and savings products is highly concentrated towards the High Street Banks. It is dominated by five major players, whose strategy is to use current accounts to cross sell a range of products, including savings and investments, mortgages, personal loans and credit cards.

The High Street Banks primarily target the traditional, high-volume consumer markets and rely upon economies of scale and process automation – specialist experience or processes are not required.

In recent years, High Street Banks have been subject to heightened and sustained regulatory, political and public scrutiny following several industry crises: the need for state aid during the financial crisis, alleged complicity in LIBOR rate fixing, mis-selling of payment protection insurance and interest rate swaps.

This has facilitated the entry of the 'Challenger Banks', a term applied to an emerging group of banks seeking to challenge the dominant market share of the High Street Banks. These Challenger Banks also offer current accounts as their core proposition, and use them to develop wider relationships. Much smaller than High Street Banks and without negative brand legacy, they develop propositions that appeal to customers where they have identified areas of competitive advantage such as service, accessibility and product features.

The newest entrants are 'Specialist Banks', a group which includes OneSavings Bank. They focus on specific UK lending niches underserved by the others and do not offer current accounts. A feature of these Specialist Banks is a growing presence in the retail savings sector as they seek to develop a range of funding sources.

OneSavings Bank's lending markets

UK Buy-to-Let/Specialist SME Market

Demand in the private rented housing sector (PRS) has increased consistently since 2000, underpinned by strong tenant demand as a result of social and demographic changes, government policy and the potential difficulties faced by first-time buyers in securing finance.

The PRS provides accommodation for more than 4.6m households in Great Britain, nearly 18% of the total. Sector growth is expected to continue – 20% of the UK housing stock will be PRS in 2020, increasing to 25% in 2025 **(Local Government forecasting)**. The total value of property in the PRS in Great Britain has now reached £931bn, and despite a recent slowdown in rapid house price growth, is expected to break through the £1 trillion barrier in Q2 2015. At the same time, social housing properties as a percentage of the entire housing sector have decreased, with renting viewed as the only major alternative to home ownership.

The Buy-to-Let mortgage market that serves the PRS has increased rapidly to match this growth, with the number of outstanding mortgages rising from 120,300 in 2000 to 1.6 million in 2014. Whilst it suffered during the financial crisis, the Buy-to-Let mortgage market has grown again in recent years, with the recovery forecast to continue as a result of an increase in the number of professional landlords and improving funding conditions.

The Buy-to-Let market continues to recover to its pre-crisis level. The drastic reduction in lender appetite that was seen in 2008 has yet to be fully restored however, and many portfolio landlords have had limited options to grow or refinance their portfolios for some years. Those options are returning to the market and this, coupled with the more positive economic outlook, is driving demand from landlords who often have substantial equity in their portfolios and are looking to make new purchases by increasing leverage on their existing assets.

This market is one that the Group is particularly focused upon. Whilst commentary on the Buy-to-Let market has recently widened to include terms such as 'dinner party' or 'accidental' landlords, these are not key audiences for the Group. Equally, whilst pension reforms may result in Buy-to-Let being seen as an option in retirement planning, these customers lack the experience to be an attractive sector for the Bank. They are also most likely to be caught up in regulatory changes, such as those proposed by the European Mortgage Credit Directive.

Residential development

Demand for new housing continues to be strong due to population growth and life style changes. The Commons Library estimates that around 232,000 new homes are required each year. This exceeds the number of homes added to the dwelling stock in recent years by a considerable margin – in the 12 months ending September 2014, 117,070 homes were completed.

Within the residential development segment, experienced small to medium sized developers are generally underserved by the High Street Banks who remain focused on lending to the national house builders.

In December 2013, the Group hired a team of specialist underwriters with an average of more than 15 years' experience in residential development lending and established Heritable Development Finance (HDF). HDF commenced lending in early 2014 providing financing for residential development projects undertaken by experienced developers with significant track records.

Specialist residential lending

The High Street Banks typically rely on a heavily automated, scorecard driven approach to lending, as this provides them with a cost effective means of servicing a high volume of residential mortgage loans. As effective as this model is in the high volume market, it is not effective in the specialist market, where OneSavings Bank's manual underwriting and individual case assessment model is more appropriate. Customers with complex asset or income structures and those seeking shared ownership mortgages are not well served by the commoditised and often inflexible decision processes of mainstream lenders and hence fall into the Bank's target market. This market has been enhanced by the regulatory changes imposed by the MMR and has seen a growth in demand for the personalised and manual approach to underwriting that OneSavings Bank offers. As a result, lending to these borrowers typically commands higher margins than mainstream lending. Specialist lenders that have developed experienced and skilled underwriting assessment and process management techniques can achieve these higher margins whilst maintaining low risk profiles.

There has been significant regulatory change in the residential market over the last decade, with new measures designed to ensure good lending practices and consumer outcomes. This has been enhanced by the MMR, which saw new qualification requirements for sales staff and tougher affordability tests for consumers. This has created opportunities for lenders such as OneSavings Bank, which invest time in assessing individual cases. The MMR brought a level of disruption to the residential mortgage market as lenders struggled to come to terms with new affordability based lending models. However, as a lender that had been using affordability based lending for some time, the impact on OneSavings Bank was insignificant.

Second charge lending

The second charge market saw an estimated £600m of gross new lending in 2014. OneSavings Bank targets good credit quality mortgage borrowers with an existing loan who wish to extend their borrowing but do not want to change their existing loan arrangements. Borrowers are typically seeking to fund a major purchase or home improvement or to consolidate and reschedule other consumer debt without refinancing their existing first charge mortgage, as it often carries a low interest rate.

On 1st April 2014, responsibility for the oversight of consumer credit shifted from the Office of Fair Trading (OFT) to the Financial Conduct Authority (FCA). The FCA has since proposed that from 21 March 2016, the regulation of second charge mortgages should move from its consumer credit regime and instead will be governed by mortgage regulation. Under the proposals, second charge firms would be required to comply with FCA mortgage regulation in areas such as affordable lending, advice, and dealing with payment difficulties.

Quite rightly the focus of the FCA is to safeguard the consumer and ensure the most appropriate customer outcome is achieved. By giving the secured lending sector its own oversight it is sending a very clear message that in many cases the appropriate outcome for a customer may well be a secured loan. As an established, regulated business with a strong compliance ethic and processes and procedures for managing conduct risk, OneSavings Bank is well-placed to benefit from these changes.

Our strategic framework

Our objective

To be a leading specialist lender in our chosen sub-sectors, supported by a strong retail savings franchise.

Our strategy

one specialist lender

- **Sub-sector market specialisation**
  Focus on underserved specialist sub-sectors that demonstrate potential for growth and the ability to generate attractive risk-adjusted returns.
- **Bespoke underwriting**
  Embrace personal underwriting, using our experienced teams to understand and work with individual circumstances, to assess risk accurately and to lend responsibly.
- **Intermediary relationships**
  Continue to develop trusted specialist intermediary relationships through effective and personalised service.
- **Inorganic growth**
  Continue to pursue selected inorganic growth opportunities to increase the size of our loan portfolio and to extend our lending franchise.

one fair place to save

- **Stable funding platform**
  Attract new and retain existing savers for the long term, developing our established savings franchise to provide a sustainable funding mechanism for balance sheet growth.
- **Transparent savings products**
  Provide a range of transparent retail savings products, giving our depositors long term value for money.
- **Customer focused philosophy**
  Provide a personal service and meet customer savings requirements.

one unique operating model

- **Integrated multi-brand approach**
  Capitalise on our strong family of brands and develop cross-referrals, adopting an integrated internal structure to maximise efficiency and output.
- **Cost-efficient operations**
  Leverage our operational structure to drive cost efficiencies, focusing on further development of our low cost operating platform in India.
- **Investment in infrastructure and systems**
  Continue to invest in internal systems, IT, infrastructure and processes, and maintain our robust risk management and control framework.

Reporting links

Performance: Our Key Performance Indicators (KPIs) measure our performance
For more information see P18

Risk: We look to understand and to mitigate the risks in achieving our strategic goals
For more information see P28

Directors' remuneration: We aim to align this with how we have performed against our strategic targets
For more information see P52

Our business model

Our strategy in action

one specialist lender

Sub-sector market specialisation

We focus on specialist mortgage lending to consumers, entrepreneurs and SMEs in sub-sectors of the UK market where we have identified opportunities for both risk-adjusted high returns and strong growth.

- Buy-to-Let
- Commercial and semi-commercial
- Residential development finance
- Bespoke first charge residential
- Second charge residential
- Shared ownership

OneSavings Bank also provides funding lines to other lenders secured against pools of loan collateral. The terms require the third party lender to abide by prescribed criteria for underwriting of the underlying loans. The advance rate varies depending on the quality of the underlying assets. These funding lines provide indirect access to certain high yielding, specialist sub-segments, such as residential bridge finance. As at the end of 2014, the Group had £71m of secured funding lines (2013: £37m).

Bespoke underwriting

Our highly skilled underwriting team has an average of 12 years' experience. We adopt a manual approach to underwriting specifically geared to each individual customer. We do not use automated or scorecard based processes for underwriting new loans.

Our Transactional Credit Committee meets twice weekly to assess new mortgage applications that exceed £1m of Group exposure, giving us the ability to respond quickly and flexibly to more complex requests, providing a service differential.

Our own brand residential arrears level is testament to the success of this underwriting approach – as at December 2014, out of more than 14,000 loans totalling £2.7bn originated since the Bank's creation in February 2011, we only have 24 cases of arrears over three months in duration, with an aggregate balance of £4.5m and average LTV of 64%.

Intermediary relationships

We originate almost all of our organic lending through a selected panel of specialist intermediaries, who have access to our senior team and can take advantage of our multi-brand approach. We meet regularly with all our intermediaries, ensuring a well established and personal relationship, and work closely with them to find bespoke solutions for their mortgage customers.

This regular intermediary engagement positions us as a key supplier for their customers. We continue to deepen our relationships with these intermediaries and conservatively expand the panel with whom we work. Our Intermediary NPS – a measure of how satisfied they are with our service – was over 50% in 2014.

Gross new organic lending

2014:

£1.5bn

2013: £794m

Best Buy-to-Let Mortgage Provider 2014

What Mortgage

Inorganic growth

Since the formation of OneSavings Bank the Group has diversified into new lending markets through business acquisitions, including InterBay Commercial, an SME lender, in August 2012 and Prestige Finance, a second charge lender, in September 2012. The Group also acquired the operating infrastructure, systems and staff of Heritable Partners Limited in December 2013 and commenced residential development financing in early 2014.

Between 2011 and 2013 the Group acquired 11 mortgage portfolios and 1 unsecured personal loan portfolio. These portfolios were acquired to dilute the impact of the low yielding back book inherited from KRBS, as in aggregate they were purchased at a significant discount and are therefore higher yielding. All of these portfolios are performing in line with or better than the base case financial expectations prepared prior to purchase.

The Group is focused on organic origination as its core growth strategy, however it will continue to actively consider inorganic opportunities as they arise. The Bank acquired a small portfolio of SME mortgages in the second half of 2014.

Lending to an experienced investor

Mr Viventi is an experienced investor with a mix of commercial and residential investment properties in his substantial portfolio. His aggregate borrowing with the Bank is approximately £10m, with loans under both the Kent Reliance and InterBay Commercial brands.

He was introduced to OneSavings Bank by his broker, Julian Ingall of Coreco, based in the City of London. In 2013, facilities were provided by Kent Reliance for the remortgage of residential investment property in Central London. Then in 2014 when Mr Viventi was seeking to remortgage and capital raise on two of his commercial properties, again in Central London, Julian recognised that OneSavings Bank was well placed to assist, this time through InterBay Commercial.

Working with senior management at the Bank, including the Group Real Estate Director, Julian arranged finance on the two properties. As part of the process of agreeing the loan, the Bank met with Mr Viventi and visited the proposed security properties.

Julian recognised that the breadth of proposition offered by OneSavings Bank was ideal for his client; 'the option to have a relationship with a lender capable of handling both the residential and commercial elements of Giorgio's portfolio is invaluable. The meeting with the Bank was hugely reassuring for both parties and we have an ongoing dialogue about further financing opportunities.'

Julian facilitated bespoke pricing on a facility that recognised Mr Viventi's expertise in his chosen markets and enabled him to release value from his existing portfolio, using the funds to acquire new property.

Our strategy in action continued

one fair place to save

Stable funding platform

By maintaining our strong focus on our savings customers we are rewarded with a loyal customer base; the average length of Kent Reliance's savings customer relationship is 8 years (12 years for branch-based savings customers) and the average balance per account is £20,000. Only 6,600 accounts have balances in excess of £85,000.

We measure customer satisfaction in several ways: NPS assesses customer advocacy – the likelihood of a customer recommending us to someone else. Our customer NPS is 38.9% and we intend to build on this each year. We also measure customer satisfaction through regular customer surveys.

Our high levels of customer satisfaction contribute to high retention rates on maturing fixed term deposits. In 2014, we retained on average 92% of maturing balances.

See NPS as one of our KPIs on page 18

Transparent savings products

We offer savings products that are easy to understand and to access, giving each customer detailed product information and avoiding confusing Terms & Conditions. Our customers are entitled to flexibility, such as the ability to add to NISAs throughout the year, and fixed rate bonds allowing withdrawals under certain conditions.

Our products are nationally recognised. Kent Reliance maintains a regular presence in the media's Best Buy tables; in 2014 OneSavings Bank Best Buy products included our fixed-rate NISAs, fixed rate bonds and our Branch Easy Access Account. We were also awarded **Moneyfacts** Best Cash ISA Provider in 2014 for the second year running.

Customer focused philosophy

Our customer centric strategy and performance metrics are aligned to our business strategy. We maintain regular contact with all our savings customers to ensure we are focused on meeting their needs. We offer them exclusive retention products to ensure high levels of customer retention. This year we established a savings customer panel to discuss specific customer issues at regular events throughout the year and we are planning to launch an online panel. The majority of our savings customers are Provident Society members, who are invited to several face-to-face events a year with the senior management team.

Our Brand Values:

- To communicate and deal with each customer on an individual basis
- To be consistent across all channels
- To have confident and friendly staff
- To be simple and easy to do business with
- To offer long term value for money products without the use of short-term bonus rates
- Not to offer rates to attract new customers that aren't available to existing ones
- To build on the traits of the brand existing customers told us about – heritage, trustworthy, traditional.

Maintain and build upon 150 year heritage in savings

New savings customers

2014:

27,000

2013: 17,000

Best Cash ISA Provider 2014

WINNER
Moneyfacts Awards 2014

Moneyfacts

A family of Kent Reliance savers

The Wilson-Sharp family, consisting of Mum, Dad and their three daughters live in the historic town of Fordwich near Canterbury, an idyllic community that is famous for being the smallest town in England. A family of savers, there are a number of things that they value alongside good interest rates and a safe place for their money. Just as important is the reliability of a partner that offers them long term value, especially when some banks seem to be offering high rates one day and then taking them away the next. Along with many savers they are keen to see traditional values being demonstrated, especially when it comes to banking.

Mr Wilson-Sharp says that it is in his nature to be loyal but he expects that to be reciprocated. Whether it is with banks or any other partnership, it takes time to earn his trust and once that is established he doesn't like to be 'mucked about'. In the past he has left Kent Reliance but returned when he realised that our accounts suited his needs better. The reason that he and his wife have been savings customers for more than 10 years, and that they have encouraged their three daughters to have their own accounts is down to the fact that Kent Reliance gives them exactly what they want. In his words, 'Good savings rates, a personal service and the sense that I am valued as a customer'.

Our strategy in action continued

one unique operating model

Integrated multi-brand approach

Our brands operate under a common operational framework in order to drive capabilities and to capitalise on our cross-company expertise.

Over 2014, we have remodelled our distribution, sales and risk processes for our key lending brands, which now operate to a simplified management structure. This gives us the ability to present our multiple lending brands with great efficiency.

We work to a single risk appetite and a single lending policy, incorporating lending across these brands and spanning all our borrower customers. All product pricing goes through the same analysis and is built according to the core principles set by our Group Pricing Committee, consisting of senior management.

Cost efficient operations

The majority of our administrative support functions are performed at our wholly-owned subsidiary EasiProcess, in India, with daily interaction with the UK. This provides a scalable, low-cost operating platform delivering high quality service, driving down our cost:income ratio.

Investment in infrastructure and systems

We have continued to invest in our systems infrastructure with a Group-wide programme of enhancements. In 2014 this included significant investment to upgrade our IT software, networks and security infrastructure.

We have invested in a new Internet capability for our savings customers and have updated our mortgage origination systems. There have been several other system deployments which have been installed on a group-wide basis including a complaint handling system.

We have also continued to invest in our risk management framework, including the establishment of an online risk management system to track and manage operational risk.

India-based back office provides a cost advantage

Head count of 170

Over

80%

of staff are graduates or hold higher degrees

Customer Satisfaction Score (NPS)

2014:

38.9%

2013: 32.4%

Easiprocess

Our wholly-owned, off-shore customer service centre in Bangalore, India, is pivotal in delivering our award winning customer service. It also makes a significant contribution to our low cost:income ratio (a KPI – see page 18) and high levels of operational efficiency. The centre undertakes our core processing services for our savings and mortgage products in addition to providing phone and e-mail based customer service.

Over the past three years, we have undertaken a number of initiatives to improve customer service and process efficiency including:

- consolidating two sites
- improving processes through automation
- investing in staff training and skill development.

This change programme transformed EasiProcess into a centre of excellence in customer service. This is borne out in the continued increase in customer net promoter score to 38.9% in 2014, from 32.4% in 2013 and 10.9% in 2012. The progress made has been recognised nationally and in 2014, Kent Reliance won the best customer service award for savings institutions from Which? Magazine, an award voted on by its members.

Operating and financial review

OneSavings Bank

Group overview

OneSavings Bank delivered strong loan book and earnings growth in 2014 and exceeded all of its stated financial objectives as set out at IPO.

This strong performance reflects the continued successful delivery of our strategy to:

- be a leading specialist lender in our chosen sub-sectors
- retain our focus on bespoke underwriting
- further deepen our relationships and reputation for delivery with the intermediaries who distribute our mortgage products
- leverage our efficient, scalable and cost effective operating model
- maintain and build on our stable retail savings franchise.

Business highlights

Gross new organic lending of £1.5bn in 2014 was up 84% compared to £794m in 2013. We have continued to see strong opportunities for growth at risk-adjusted high returns, particularly in Buy-to-Let. Buy-to-Let/SME is now the Group's largest segment comprising 52% of the gross loan book with Residential Mortgages at 45% and Personal Loans at 3% as at 31 December 2014.

For all our lending segments, we manually underwrite all risks, providing us with competitive advantage over more automated lenders as we are able to identify and understand complex cases that others cannot.

Loans and advances grew by 29% in 2014 to £3.9bn as a result of this strong new organic origination, net of redemptions on the back book and acquired portfolios in run-off. This growth was supported by internal capital generation and the use of some of the net proceeds raised in the Bank's IPO in June 2014. The Bank raised £41.5m of gross primary proceeds in the IPO, providing £35.8m of net primary proceeds after underwriting commissions and other IPO related costs. These net proceeds were used to increase Common Equity Tier 1 capital, support future loan book growth and for general corporate purposes.

The Group remains focused on organic origination as its core growth strategy, however, it continues to actively consider inorganic opportunities as they arise. To that end, the Group acquired one small portfolio of SME mortgages in the second half of 2014 for £20.4m with gross receivables of £25.6m (2013: total mortgage portfolio purchases of £133m with gross receivables of £182m and the purchase of a personal loan portfolio for £258m). The Group conducts extensive due diligence when considering any portfolio acquisitions. All of our acquired portfolios are performing in line with or better than the base case financial projections prepared prior to purchase.

The Group reported very strong profit growth in 2014 with underlying profit before taxation[1] increasing by 133% to £69.7m, reflecting the strong balance sheet growth, improved net interest margin and continued focus on cost discipline and efficiency. On a statutory basis, profit before taxation more than doubled to £63.7m. Net Interest Margin improved by 80bps to 291bps in 2014 reflecting the positive impact of high margin new lending and a continued reduction in cost of funds. Underlying return on equity[1] strengthened to 31% (2013: 22%) as a result of this improved profitability despite the higher level of capital post IPO, and underlying basic EPS strengthened to 24.4p (2013: 13.4p). On a statutory basis, basic EPS was 21.7p in 2014 (2013: 13.4p).

The Group remained predominantly retail funded during the year with a loan to deposit ratio of 90% as at 31 December 2014. Our customer-centric strategy of providing transparent savings products which offer long term value for money continues to deliver high levels of customer satisfaction and loyalty. We had a Net Promoter Score of 38.9% and a maturing fixed term bond and ISA balance retention rate of 92% in 2014 (2013: 32.4% and 88% respectively).

The Group joined the Bank of England's Funding for Lending (FLS) Scheme in January 2014 and was subsequently accepted as a mortgage collateral counterparty later in the year. The Group pre-positioned pools of mortgage collateral with the Bank of England in February 2015 and can now draw funding under the scheme to support growth in the loan book in 2015.

1 For more information see Key performance indicator table on P18.

Financial objectives

The table below sets out the Group's stated financial objectives and our performance against them during the year.

The Bank remains predominantly retail funded with a strong loan to deposit ratio of 90% as at 31 December 2014. The retail savings market has in the past demonstrated more stability across the economic cycle than wholesale funding markets providing a sustainable funding source to support the Group's growth.

Our focus on cost discipline and efficiency as we grow continued throughout 2014, helping to deliver a very strong cost:income ratio of 28% for the year, comfortably below our financial objective of 35% despite including further investment in the Bank's IT infrastructure, software and operations during the year.

The Bank ended the year with a fully-loaded CET1 Capital ratio of 11.4% having strengthened its capital position at IPO, raising net primary proceeds of £35.8.

At this higher level of capital the Group delivered a very strong underlying RoE of 31% or 29% on a pro forma basis, assuming that the net IPO proceeds were in place at the start of the year.

The Board is recommending a dividend of 3.9 pence per share in line with the Bank's dividend pay-out policy, representing a two-thirds final dividend on 25% of underlying profit after taxation.

Financial objectives 2014-2016[1]

		2014 Result
Funding/liquidity strength	Maintain loan to deposit ratio of <100%[2]	90%
Cost discipline	Cost:income ratio of <35%	28%
Capital strength	CRD IV CET1 ratio >10%	11.4%
Shareholder returns	RoE of >25%	31%[3]
Dividend policy	Pay-out ratio of ≥25%[4]	25%

1 Objectives relate to the current financial planning cycle that lasts until the end of 2016. This does not represent any forecast, target or expectation as to future results or performance and there can be no assurance that the objective will be met.
2 Excluding the impact of any drawdown under the Funding for Lending Scheme (FLS).
3 For more information see Key performance indicator table P18.
4 Pay-out ratio of at least 25 per cent of underlying profit after taxation.

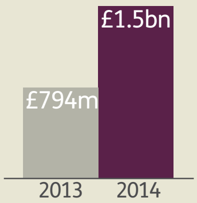
Operating and financial review continued

Key performance indicator table

Gross new lending

Performance

up 84%



Definition

This is defined as gross new organic lending before redemptions.

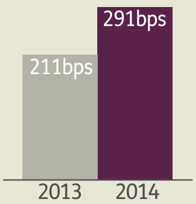
2014 performance

Gross new lending in 2014 reflects strong growth in new origination in both the Buy-to-Let/SME and Residential Mortgage segments.

Net interest margin

Performance

up 80bps



Definition

This is defined as net interest income less coupons on perpetual subordinated bonds (PSBs) classified as equity, as a percentage of average interest bearing assets. It represents the margin earned on loans and advances and liquid assets after swap expense/income and cost of funds.

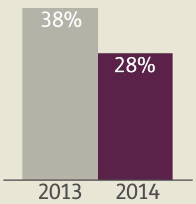
2014 performance

The improvement in net interest margin reflects the positive impact of high margin organic origination and portfolio purchases and a continued reduction in the Bank's cost of retail funds.

Cost:income ratio

Performance

improved 10% points



Definition

This is defined as administrative expenses including depreciation and amortisation as a percentage of total income after deducting coupons on equity PSBs. It is a measure of operational efficiency.

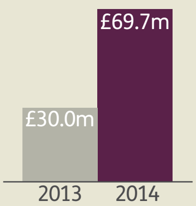
2014 performance

The improvement in this ratio reflects the Bank's continued focus on lending in risk-adjusted high-margin sub-segments of the market and on cost control as it grows. The ratio continues to reflect the benefit of the Bank's efficient and scalable low cost back office based in Bangalore, India. The Bank targets a cost:income ratio of less than 35%.

Underlying profit before taxation

Performance

up 133%



Definition

This is defined as profit before taxation and before exceptional Initial Public Offering (IPO) expenses of £7.4m in 2014 and after deduction of coupons on equity PSBs of £1.5m in each period. It reflects the underlying profitability of the business.

2014 performance

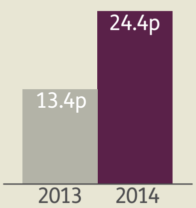
The more than two-fold increase reflects strong balance sheet growth, improved net interest margin and continued focus on cost discipline and efficiency.

Statutory profit before taxation of £63.7m in 2014 more than doubled compared to £31.4m in 2013.

Underlying basic EPS, pence per share

Performance

up 82%



Definition

This is defined as underlying profit after taxation (before exceptional IPO costs, including the tax effect, of £6.4m and after deducting, including the tax effect, coupons on equity PSBs including the tax effect of £1.1m) divided by the weighted average number of ordinary shares in issue. It is a measure of shareholder value.

2014 performance

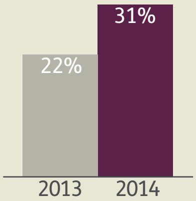
The strong growth reflects the significant increase in underlying profitability of the Bank.

On a statutory basis basic EPS improved to 21.7 pence per share in 2014 from 13.4 pence per share in 2013.

Underlying return on equity

Performance

up 9% points



Definition

This is defined as underlying profit after taxation as a percentage of average shareholders' equity (excluding equity PSBs of £22m).

2014 performance

The underlying return on equity for 2014 of 31% (29% on a pro-forma basis, assuming that the net IPO proceeds were received at the start of the year) is ahead of the Bank's target of at least 25%.

Dividend per share

Performance

3.9p

Definition

This is defined as the recommended final dividend for 2014 of £9.5m divided by the number of ordinary shares in issue at 31 December 2014.

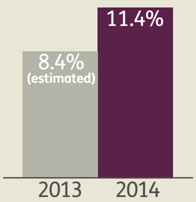
2014 performance

The Board will recommend a final dividend of 3.9p per share in respect of 2014 at the Bank's AGM on 2 June 2015. This represents two-thirds of 25% of underlying profit after tax for 2014, in line with the Bank's target dividend pay-out ratio.

CRD IV fully-loaded Common equity tier 1 ratio

Performance

Strengthened



Definition

This is defined as common equity tier 1 capital as a percentage of risk-weighted assets (calculated on a standardised basis) and is a measure of the capital strength of the Bank.

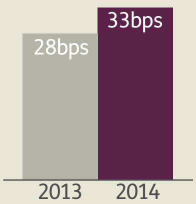
2014 performance

The strengthened capital ratio reflects the positive impact of the net primary proceeds of £35.8m at IPO and profits for 2014.

Loan loss ratio

Performance

Increased by 5bps



Definition

This is defined as impairment losses expressed as a percentage of average gross loans and advances. It is a measure of the credit performance of the loan book.

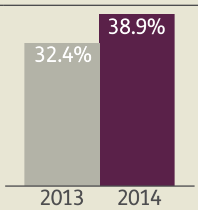
2014 performance

The ratio of 33bps for 2014 (2013: 28bps) includes a full year's impact of the personal loan portfolio purchased as a performing book in July 2013 and remains in line with management expectations.

Customer satisfaction – Net Promoter Score

Performance

up 6.5% points



Definition

The net promoter score measures our customers' satisfaction with our service and products. It is based on customer responses to the question of whether they would recommend us to a friend. The question scale is 0 for absolutely not to 10 for definitely yes. Based on the score a customer is defined as a detractor between 0 and 6, a passive between 7 and 8 and a promoter between 9 and 10. Subtracting the percentage of detractors from the percentage of promoters gives a net promoter score of between -100 and +100%.

2014 performance

The Bank's customer NPS for 2014 improved to 38.9% compared to 32.4% in 2013.

Operating and financial review continued

Buy-to-Let/SME

We provide Buy-to-Let mortgages secured on residential property held for investment purposes by experienced and professional landlords and commercial mortgages secured on commercial and semi-commercial properties held for investment purposes or for owner occupation. We also provide residential development finance to small and medium sized developers and secured funding lines to other lenders.

The Group increased its volume of new organic lending in this segment to £1.2bn, an increase of 108% on 2013 new lending of £567m. This included strong growth in Buy-to-Let particularly in London and the South East where we saw strong growth opportunities at risk-adjusted high returns.

The Group was focused on organic origination as its core growth strategy during the year, however, we also purchased a small portfolio of SME loans in October 2014 and we will continue to actively consider inorganic opportunities in this segment as they arise. This portfolio was migrated onto the InterBay platform.

The total Buy-to-Let/SME net loan book grew by 90% in 2014 to £2.0bn (2013: £1.1bn) due to the gross new lending in the year, partially offset by back book redemptions, and is now the Group's largest segment. Buy-to-Let/SME made a contribution to profit of £44.6m in 2014, up 272% compared to £12.0m in 2013, reflecting the positive impact of high margin organic origination since the start of 2013 and a continued reduction in the Bank's cost of retail funds.

The Buy-to-Let/SME segment's contribution to profit was £45.4m in 2014 (2013: £15.1m) on an adjusted basis, excluding impairment losses of £0.8m in 2014 (2013: £3.1m) on the ring-fenced legacy problem portion of the loan book inherited from KRBS. Loan losses on this book in 2013 reflected the accelerated workout of the legacy problem book.

The Group continued to see good opportunities in 2014 for risk-adjusted high return lending in each of its Buy-to-Let/SME sub-segments: Buy-to-Let, Commercial and Residential Development Finance.

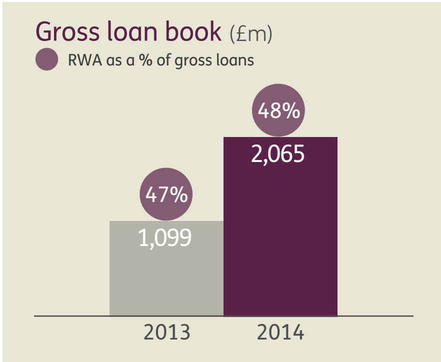
The largest growth opportunity in 2014 was in Buy-to-Let lending to experienced and professional portfolio landlords through the Kent Reliance and InterBay brands. We distribute via a tightly controlled and limited panel of intermediaries throughout England and Wales with a bias on properties in London and the South-East where the demand supply gap is widest and most sustainable. The overall Buy-to-Let market grew in 2014 and capacity withdrawn by lenders no longer active in this segment provided consistently strong opportunities to refinance portfolio landlords during the year.

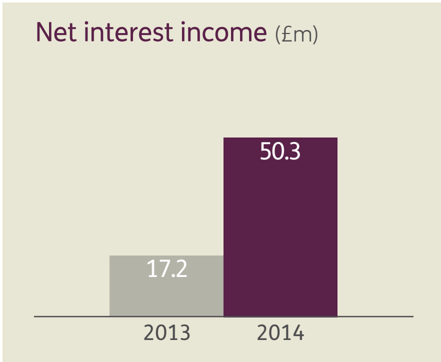
The Group also grew its commercial and semi-commercial lending through the InterBay brand in 2014. Through this brand we provide mortgages to limited companies and individuals secured on commercial and semi-commercial properties held for investment purposes or for owner occupation. InterBay's customers include professional landlords with investment portfolios holding both Buy-to-Let and commercial properties.

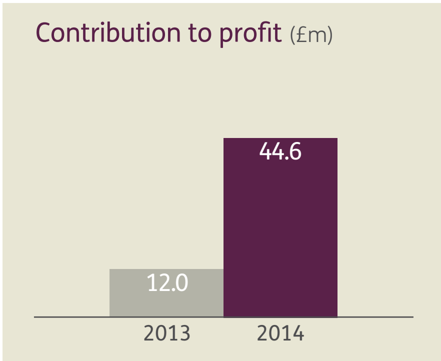
In December 2013, the Group hired a team of specialist underwriters with an average of more than 15 years' experience in the residential development sector and established Heritable Development Finance (HDF), which commenced lending in early 2014. HDF provides financing for residential development projects undertaken by experienced small to medium sized developers with strong track records, who value our levels of service and expertise.

The Group initiated secured funding lines to other lenders in this segment in 2014, including providing funding for development finance.

The Group remains highly focused on the credit quality of new lending as demonstrated by the average LTV in the Buy-to-Let/SME segment as at 31 December 2014 of 68% (31 December 2013: 71%) with 2% of loans exceeding 90% LTV (31 December 2013: 5%).







Large portfolio landlord

Al Kerr is an experienced, professional landlord who owns a substantial portfolio of properties in West London. His involvement in the Buy-to-Let market extends back to the mid 1990s, when he purchased his first investment property in Shepherd's Bush, London. As his portfolio grew over the years, he realised that managing a successful property portfolio required his full attention and he left his career in banking to focus solely on his property interests.

Naturally risk averse, he has judiciously added to his portfolio over the years, adopting a strategy of acquiring property in good areas where the potential for high returns from both capital and rental growth, has been strong. He has focused on maintaining his portfolio in the Hammersmith, Chiswick and Acton areas of London, where demand from professional tenants is high. A clear focus on his target audience ensures that he has very high occupancy rates across his portfolio.

Such is the scale of his property business now that he employs a dozen people directly and several more indirectly, as his maintenance and renovation programmes ensure a steady flow of work for local building firms.

His portfolio is financed by a number of lenders, however, many have now scaled back their appetite for the BTL market, with some not lending at all. The absence of choice mystifies Mr Kerr, whose commercial acumen has seen his business thrive despite the economic turmoil that followed the financial crisis. He welcomed the personalised approach that Kent Reliance offered; 'as a successful landlord with relatively low levels of debt on my portfolio, I would have thought I was a safe bet for most lenders, however my experience is that the centralised, policy driven models of larger lenders don't help professionals like me. It has been refreshing to work with a lender that takes the time to understand my business and reassuring to know that they are willing to support its future growth.'

Through its Kent Reliance brand, OneSavings Bank has lent Mr Kerr a total of approximately £9m to help him extend his portfolio through a combination of new purchases and remortgaging of existing properties. Recognising the scale of his business, the Bank has developed two bespoke mortgage products to meet Mr Kerr's needs and has offered him further financing to assist in future acquisitions.

Operating and financial review continued

Residential mortgages

We lend to owner-occupiers with a geographical bias towards London and the South East. OneSavings Bank offers bespoke residential first charge, second charge and shared-ownership mortgages through specialist brokers. We also provide secured funding lines to other lenders.

During the year the Group increased its volume of gross organic residential lending to £286m (2013: £227m) as it saw opportunities to lend at risk-adjusted high returns.

Between 2011 and 2013, the Group purchased a number of residential mortgage portfolios. These were purchased at significant discounts and have generated high yields that have diluted the impact of the low yielding book inherited from KRBS. These purchases included a number of residential mortgage portfolios acquired in 2013 for a total of £133m with gross receivables of £182m. All of the acquired mortgage portfolios are performing in line with or better than the base case financial expectations prepared prior to purchase. In 2014, the Group was focused on organic origination as its core growth strategy in this segment and made no residential portfolio purchases during the year. We will however continue to actively consider inorganic opportunities as they arise.

The total net residential loan book remained flat at £1.8bn as at 31 December 2014 as gross new origination was offset fully by redemptions on the back book and acquired mortgage books in run-off.

Residential Mortgages made a contribution to Group profit of £49.9m in 2014 up 32% compared to £37.8m in 2013, reflecting the positive impact of high margin organic origination and portfolio purchases since the start of 2013 and a continued reduction in the Bank's cost of retail funds. The Residential Mortgages segment's contribution to profit was £50.3m in 2014 (2013: £38.8m) on an adjusted basis, excluding impairment losses of £0.4m (2013: £1.0m) on the ring-fenced legacy problem portion of the loan book inherited from KRBS. Loan losses on this book in 2013 reflected the accelerated workout of the legacy problem book.

The Group continued to see good opportunities in 2014 for risk-adjusted high return lending in each of its Residential Mortgages sub-segments: bespoke first charge, second charge and shared-ownership.

Our Kent Reliance brand provides bespoke first charge mortgages, typically to prime credit quality borrowers with more complex circumstances, for example high net worth borrowers with multiple income sources and self-employed borrowers. These circumstances often preclude them from the mainstream market, where most lenders favour automated decision-making over manual underwriting.

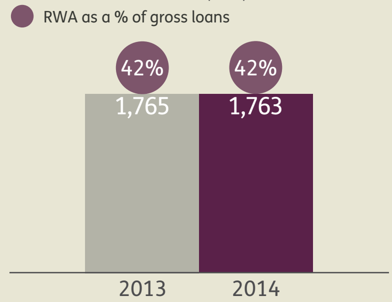
Kent Reliance also operates in the shared ownership market, where borrowers buy a property in conjunction with a housing association. In the second half of the year we significantly enhanced our proposition in this market.

Our second charge mortgage brand, Prestige Finance, provides secured finance to good credit quality borrowers who are seeking a loan to raise funds rather than refinancing their first charge mortgage. During 2014, Prestige Finance enhanced its position as a market leader in the second charge market.

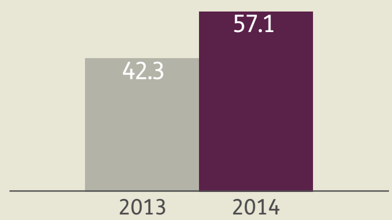
The Group also increased its secured funding to other lenders in the year, including additional advances and lines to bridge finance lenders.

The LTV of mortgages in this segment remained low at 54% as at 31 December 2014 (31 December 2013: 51%) with only 1% of loans exceeding 90% LTV (31 December 2013: 3%).

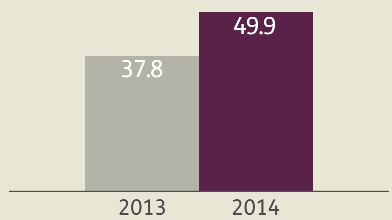
Gross loan book (£m)



Net interest income (£m)



Contribution to profit (£m)



The Mortgage Market Review (MMR), which came into effect in April 2014, represented the most significant regulatory change in the residential mortgage market since October 2004, and introduced a range of measures designed to ensure good lending practices and consumer outcomes. Principal amongst the changes was the need to have better qualified staff to deliver advice and a more robust assessment of affordability. The effect was market disruptive for direct lenders who incurred costs in retraining staff and in introducing a wide range of new approaches to affordability assessment, resulting in delays and difficulties in obtaining a mortgage for some consumers.

OneSavings Bank was not significantly impacted by the MMR given its intermediary-only residential lending model and manual affordability driven underwriting process. We were well placed to take advantage of the disruption in the direct lending portion of the residential mortgage market following the MMR.

Specialist residential lending

Paul Louis is a residential mortgage customer with Kent Reliance. He was introduced by his broker at John Charcol, a large mortgage introducer based in London. Mr Louis, already a homeowner, was looking to move to a larger property whilst retaining his current home as a Buy-to-Let. He sought a mortgage of £340,000 against a purchase price of £465,000.

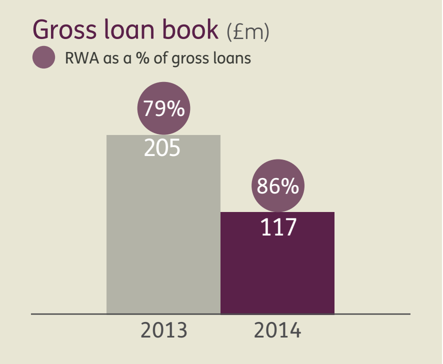
A successful entrepreneur, Mr Louis is the co-founder of a consultancy firm, Vandal, that provides research services to the beverage industry around the world. He was viewed by most lenders as self-employed, with an income therefore more complex to interpret than most applicants'. As a result, and despite his ability to afford the mortgage loan he was after, he didn't fit the mould and hence finding a lender was not straightforward. His situation was not helped by the nature of the property he wished to buy, a unique house built in the 1960s by a Buddhist monk, comprising two separate structures joined by a bridge over a pond and set in three acres of land near Deal, in Kent.

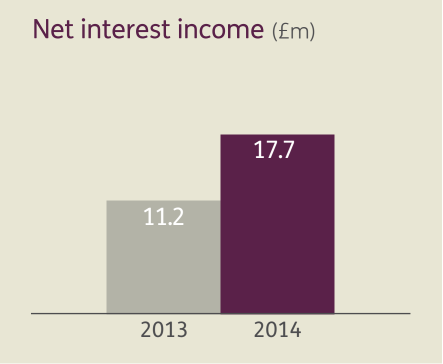
Charcol has a strong relationship with Kent Reliance, and his broker, Steve Friend, recognised that our underwriting team had both the skills and approach necessary to assess his circumstances and to also undertake a proper evaluation of the suitability of the unusual property as security for mortgage purposes. Steve's view is that 'lending to self-employed people has never been straightforward, and the advent of the MMR made the process of affordability assessment even more complex, with many lenders becoming even more inflexible with their interpretation of the rules. It was important to me to find my client a lender with the expertise to review Paul's situation and see it as the strong lending proposition that it is.'

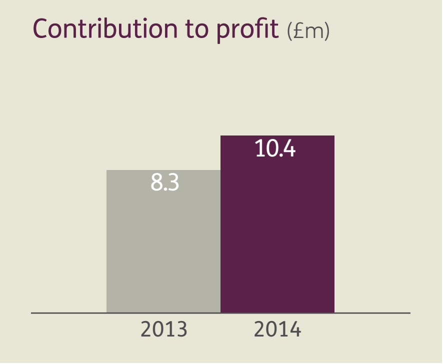
Personal loans

OneSavings Bank acquired the performing former Northern Rock consumer loan portfolio from UKAR in July 2013 for £258m. This portfolio of high margin, seasoned, performing loans currently represents our only unsecured lending.

The book is in run-off with a short remaining weighted average life. The portfolio has a net carrying value of £109m, after collective provisions, as at 31 December 2014 (31 December 2013: £203m). The portfolio made a contribution to profit of £10.4m in 2014 (2013: £8.3m) after impairment losses of £5.9m (2013: £2.1m). Impairment losses include a full year's worth of provisioning following its purchase in July 2013 as a performing book as well as the impact of a change in methodology to recognise losses earlier as arrears emerge. Arrears on the portfolio are running significantly below expectations at the time of purchase.







Financial review

Strong growth in gross new organic lending up

84%

to

£1.5bn

2013: £794m

	Group 31/12/2014	Group 31/12/2013
Summary Profit or Loss	**£m**	£m
Net interest income	**125.2**	70.8
Gains/(losses) on financial instruments	**(2.1)**	(0.9)
Net fees and commissions	**0.4**	(1.0)
External servicing fees	**(4.6)**	(3.5)
Administrative expenses[1]	**(33.3)**	(24.5)
FSCS and other provisions	**(2.8)**	(2.2)
Impairment losses	**(11.7)**	(7.3)
Exceptional IPO expenses	**(7.4)**	–
Profit before taxation	**63.7**	31.4
Profit after taxation	**51.5**	26.8
Underlying profit before taxation[2]	**69.7**	30.0
Underlying profit after taxation[3]	**56.8**	25.3
Key ratios		
Net interest margin[2]	**291bps**	211bps
Cost:income ratio[2]	**28%**	38%
Management expense ratio[4]	**0.77%**	0.72%
Loan loss ratio	**0.33%**	0.28%
Basic EPS[2], pence per share	**21.7**	13.4
Underlying basic EPS[2], pence per share	**24.4**	13.4
Underlying return on equity[2]	**31%**	22%
Dividend per share, pence per share	**3.9**	–
Extracts from the Statement of Financial Position	**£m**	£m
Loans and advances	**3,919.4**	3,041.2
Retail deposits	**4,331.6**	3,251.6
Total assets	**4,936.1**	3,763.9
Key ratios		
Liquidity ratio[5]	**20.1%**	17.9%
Common equity tier 1 ratio[6]	**11.4%**	9.2%
Total capital ratio[7]	**14.8%**	13.5%

1 Including depreciation and amortisation.
2 See definition in Key performance indicator table on P18.
3 Underlying profit after taxation (before exceptional IPO costs, including the tax effect, of £6.4m and after deducting, including the tax effect, coupons on equity PSBs including the tax effect of £1.1m).
4 Administrative expenses including depreciation and amortisation as a percentage of average total assets.
5 Liquid assets as a percentage of funding liabilities.
6 Fully-loaded under Basel III/CRD IV as at 31 December 2014 and under Basel II as at 31 December 2013.
7 Under Basel III/CRD IV as at 31 December 2014 and Basel II as at 31 December 2013.

Operating and financial review continued

Financial review continued

Continued strong loan to deposit ratio of

90%

with growth in loans and advances funded by retail deposits

2013: 93%

Strong income growth and continued focus on cost further reduction in cost: income ratio to

28%

2013: 38%

Strong profit growth

The Group reported very strong profit growth in 2014 with underlying profit before taxation (before exceptional IPO costs of £7.4m and after deducting coupons on equity PSBs of £1.5m) more than doubling to £69.7m, reflecting strong balance sheet growth, improved net interest margin and continued focus on cost discipline and efficiency.

Underlying profit after taxation (before exceptional IPO costs, including the tax effect, of £6.4m and after deducting, coupons on equity PSBs, including the tax effect, of £1.1m) was £56.8m. The underlying profit after taxation in 2013 of £25.3m (after deducting coupons on equity PSBs of £1.5m) included the benefit of the recognition of a deferred tax asset of £4.7m in respect of trading losses in the InterBay Group, which resumed lending in late 2012 after its acquisition by the Bank.

Net interest margin

The Group showed strong growth in net interest income up 77% to £125.2m in 2014, due to loan book growth and an improved net interest margin (NIM) which was up 80bps to 291bps. The improvement in NIM reflects the positive impact of high margin organic origination and portfolio purchases, and a continued reduction in the Bank's cost of retail funds.

While retail deposits are still expensive relative to LIBOR by long term historical standards, they have become cheaper over the past couple of years, as the unprecedented deposit price competition between banks during the financial crisis eased once wholesale funding markets improved and UK banks could access cheap marginal liquidity through the FLS.

The reduction in retail deposit pricing seen since the start of 2013 is not yet fully reflected in the Bank's results for 2014, as a significant portion of the Bank's retail deposits are one and two year fixed-term deposits with a commensurate lag in re-pricing expected through 2015. The consequential improvement in NIM is expected to be largely offset by the impact of the roll-off of the higher-margin personal loan portfolio net of new mortgage lending.

The Bank pre-positioned pools of mortgage collateral with the Bank of England in February 2015 and can now draw funding under the scheme to support growth in the loan book in 2015. Funding can be drawn until the end of January 2016 and is available for four years.

Gains/(losses) on financial instruments

Losses on financial instruments in 2014 of £2.1m (2013: £0.9m) includes cancelled swap amortisation costs of £3.2m (2013: £2.8m), which increased following additional swap cancellations during 2013, and losses on unmatched or ineffective hedges of £1.2m (2013: a gain of £1.8m), net of a £2.3m gain from the sale of the Bank's RMBS portfolio on 31 January 2014.

Net fees and commission

Net fees and commission income of £0.4m (2013: expense of £1.0m) comprises fees and commission receivable of £0.9m (2013: £0.7m) including servicing fee income in the Prestige Group and fees and commission payable of £0.5m (2013: £1.7m). Fees and commission payable in 2013 included commission payable to Kent Reliance Provident Society to run a number of branches for the Bank. The Bank bought out the agency agreement in late 2013 for £0.7m and the branches are now directly managed by the Bank.

External servicing fees

External servicing fees increased by £1.1m to £4.6m in 2014 due to the inclusion of a full year's cost of servicing for the additional portfolio purchases and mortgages originated under forward flow agreements in 2013.

Efficient and scalable operating platform

Administrative expenses including depreciation were up 36% to £33.3m in 2014 (2013: £24.5m) reflecting the build out of the operations to support growth in the business, the demands of new regulations, enhancements to the resilience of the Bank's IT infrastructure and upgrades to the Bank's savings and mortgage technology to provide enhanced functionality for savings and mortgage customers as well as operational efficiencies.

The Group's cost:income ratio fell 10 percentage points to 28% in 2014 (2013: 38%) reflecting the Bank's continued focus on lending in risk-adjusted high margin sub segments of the market and on cost control as it grows. The management expense ratio was 0.77% for 2014 reflecting the further build out of operations described above (2013: 0.72%). Both ratios reflect the benefit of the Bank's efficient and scalable low cost back office based in Bangalore, India.

FSCS and other provisions

These are primarily in respect of FSCS levies, which increased to £2.8m in 2014 (2013: £2.2m). This represents the full annual charge recognised on 1 April in each year, based on retail savings balances as at the previous 31 December. The increase was due primarily to the growth in retail savings balances during 2013.

Impairment losses

Impairment losses increased to £11.7m in 2014 (2013: £7.3m) representing 33bps on average gross loans and advances (2013: 28bps) and included £5.9m (2013: £2.1m) in relation to the personal loan portfolio and £1.2m (2013: £4.1m) relating to the ring-fenced legacy problem loan book inherited from KRBS, which reduced following the accelerated workout programme carried out in 2013. The loan losses in respect of the personal loan portfolio include a full year's worth of provisioning following its purchase as a performing loan book in July 2013 as well as the impact of a change in methodology to recognise losses earlier as arrears emerge in the portfolio. Arrears in the personal loan book continue to run significantly below the initial forecasts used to price the purchase.

Impairment losses on acquired mortgage portfolios increased to £2.8m in 2014 (2013: £1.8m) in part due to new portfolios purchased in 2013, but remained well below levels forecast at the time of acquisition.

The performance of the front book of mortgages, organically originated since the creation of the Bank in February 2011, remains extremely strong with only 24 accounts three months or more in arrears as at 31 December 2014, totalling £4.5m with an average LTV of 64%, reflecting the strength of the Bank's underwriting and lending criteria.

Exceptional IPO expenses

IPO related costs were £6.0m of which £2.4m attributable to the primary issuance was taken directly to equity. The remaining £3.6m was taken to exceptional IPO expenses in the profit and loss.

Exceptional IPO expenses of £7.4m in the profit and loss also include an expense of £3.8m in respect of nil price options over OneSavings Bank shares granted to certain Directors, senior managers and other employees of the Bank at admission. This comprises £2.3m representing the fair value at grant date of options which vested on admission and a further £1.5m expensed after admission in respect of options with future vesting provisions. These options were granted by OSB Holdco Ltd, the Bank's major shareholder and as such the expense is offset fully by an additional capital contribution.

Dividend

The Board recommends a final dividend of 3.9p per share in respect of 2014 representing two-thirds of 25% of underlying profit after taxation for 2014 of £56.8m, in line with the Bank's target dividend pay-out ratio. The proposed final dividend will be paid on 5 June 2015, subject to approval at the Annual General Meeting on 2 June 2015, with a record date of 15 May 2015.

Balance Sheet growth

Loans and advances grew by 29% in 2014 to £3.9bn (31 December 2013: £3.0bn) with a slightly higher growth rate of 33% and 31% respectively for retail deposits and total assets due to higher levels of liquidity (see further details on liquidity below). The growth in loans and advances was due primarily to a significant increase in new lending in the Buy-to-Let/SME and Residential Mortgages segments, partly offset by redemptions in the organic back book and acquired mortgage portfolios in run-off.

Liquidity

OneSavings Bank operates under the PRA's Individual Liquidity Adequacy Assessment (ILAA) regime. The Bank operates within a target range in excess of the minimum regulatory requirement. The Bank continued to manage its liquidity efficiently in 2014 having successfully spread savings maturities more evenly throughout the year and demonstrated a strong retention track record on fixed term bond and ISA and NISA maturities. The Group's liquidity ratio as at 31 December 2014 was 20.1% (31 December 2013: 17.9%) as the Bank built up additional liquidity in December in advance of pensioner bonds expected to launch at higher than market rates in January 2015.

The Bank pre-positioned pools of mortgage collateral with the Bank of England in February 2015 which allows it to draw down funding under FLS and the liquidity insurance facilities.

Capital

The PRA issued Policy Statement PS7/13 in December 2013 containing the final rules and supervisory statements implementing the Capital Requirements Directive (2013/36/EU) (CRD) and the Capital Requirements Regulation (575/2013) (CRR), jointly CRD IV, effective from 1 January 2014.

A summary of the impact of CRD IV on the Bank can be found on page 20 of the 2013 Annual Report.

The Bank's fully-loaded Common Equity Tier 1 Capital ratio (CET1 ratio) under CRD IV increased to 11.4% as at 31 December 2014 (31 December 2013: estimated at 8.4% under CRD IV and 9.2% under Basel II) reflecting the positive impact of the net primary proceeds of £35.8m at IPO and profits for 2014, partially offset by the recommended dividend of £9.5m following the issuance of the European Banking Authority's (EBA) final technical standard on own funds.

The Bank had a Total Capital Ratio of 14.8% and a leverage ratio of 4.2% as at 31 December 2014.

Chief Risk Officer's report

Throughout 2014, OneSavings Bank has taken an active approach to risk management and has continued to build on a best-in-class capability, ensuring that risks are appropriately rewarded where strategic, mitigated where appropriate, and well understood in all cases.

Risk management framework

To support this strategic risk management, the Group has put in place a risk management framework, which consists of four key components.

- Strategy and risk appetite: The Board establishes a strategy for the Group and articulates a Statement of Risk Appetite that is consistent with that strategy.
  - The Group has an appetite to take credit risk in the pursuit of risk-adjusted high returns, but its absolute appetite for credit risk is nevertheless low, a balance which it strikes through a strategic focus on specialist lending.
  - The Group has a low appetite for market risk and does not seek to take a significant interest rate position or a directional view on rates.
  - The Group has a low appetite for liquidity risk, with a strategic focus on highly stable retail deposits covered by the FSCS.
  - The Group has a moderate appetite for operational risk. The specialist nature of much of the Group's business often requires manual processes, which bring with them an increased exposure to operational risk and need careful management.
  - The Group has a low appetite for conduct risk and maintains a strategic focus on simple, customer-friendly products.
  - The Group has a moderate appetite for regulatory risk. Group culture focuses on full compliance with all relevant regulation, including any changes in regulation, and is supported by robust assurance from the Compliance team. However, the Group's interpretation of regulation may differ from that of the wider market, particularly in the interest of an improved customer experience, and it accepts that regulators' interpretation may subsequently prove more restrictive than its own.
- Governance: The role of the Board, Board Committees, and management committees in this framework is summarised in the diagram below[1]. The Board has overall responsibility for ensuring effective risk management within the Group. Credit, market, liquidity, and operational risk – generally those matters regulated by the PRA – are monitored by the Risk Committee and led at the Executive level by the Chief Risk Officer. Conduct and regulatory risk – generally those matters regulated by the FCA – are monitored by the Audit Committee and led at the Executive level by the Group General Counsel. Management committees have been established to ensure detailed governance of each risk type. Additional sub-committees are responsible for certain finer aspects of risk management. In particular, the Transactional Credit Committee, a sub-committee of the Credit Committee, meets twice a week to sanction individual lending cases that fall outside the mandates of the Underwriting team.
- Policies: Policies have been established for the management of each risk type and are subject to annual Board review and approval. They specify responsibility for managing each risk and requirements for measurement and reporting.
- Management Information (MI): MI is produced so that each risk type can be monitored. The MI is produced on a range of frequencies and levels of detail, as appropriate for each risk and level of monitoring, from daily monitoring of liquidity by management to quarterly updates on regulatory risk for the Board. Effective MI relies on robust IT systems and high quality data.

Within this risk management framework, the principal risks to which the Group is exposed have been identified (see P30). In addition, the Group carries out two major risk-focused annual planning exercises, the Internal Capital Adequacy Assessment Process (ICAAP) and the Individual Liquidity Adequacy Assessment (ILAA). The ICAAP establishes the Board's view on the Group's capital requirements, both under a base case forecast and under stress. This is an input to the PRA's SREP process, which leads to regulatory capital guidance. The ILAA establishes the Board's view on the Group's liquidity management and requirements. It is an input to the PRA's SLRP process, which leads to regulatory liquidity guidance.

2014 highlights

As a mortgage lender, OneSavings Bank is exposed to the macroeconomic environment in general and house prices in particular. Throughout 2014, house prices have increased in our core geographic markets of London 16.3% and the South-East 10.8%, and we have maintained a prudent approach to lending. (See Market review, P06).

We continue to find low-risk opportunities in areas of the market traditionally thought of as higher-risk, including originating second-charge loans to prime borrowers at conservative LTV levels, commercial loans against highly saleable properties, and niche residential development lending to borrowers with a strong track record and solid projects. We offer secured funding lines to finance companies, maintaining substantial over-collateralisation and cross-collateralisation.

We carefully underwrite each lending case, maintain sensible LTVs, assess affordability on each loan and avoid lending on property where we believe current valuations are unsustainable. We also operate portfolio limits and stress tests to ensure sufficient capital is in place to withstand a market downturn.

Metrics illustrating ongoing improvement in the Group's lending risk profile include:

- portfolio[2] arrears rate decreased from 2.9% to 2.3%;
- legacy problem loans reduced from £43.9m to £31.1m; and
- arrears balances on acquired portfolios reduced from £59.8m to £54.4m. These were in aggregate acquired at a significant discount to par leading to an average LTV of 60% as at 31 December 2014 providing good credit protection.

Our liquidity forecasting and controls have continued to improve, enhancing our ability to achieve financial efficiency while maintaining sufficient liquidity. We gained access to the FLS in 2014 and prepositioned mortgage collateral with the Bank of England in February 2015 in order to fully utilise the scheme for funding and to access liquidity insurance facilities, should that become necessary.

We continue to focus on operational risk management. With our bespoke underwriting approach, the Group relies on manual processes; a strong control framework and rigorous root cause analysis of any incidents ensuring that this operational risk is well managed.

1 More information on the broader roles of these bodies in Group governance is included in the Corporate governance report (see P38).
2 Excluding legacy problem loans.

We continually review operations, and have made a number of changes to improve quality and reduce cost, including outsourcing of mailings to a specialist provider, consolidation of our third-party servicing relationships, and implementation of an industry-leading system for managing customer complaints. Our ongoing IT investment included this year the launch of a new internet savings platform, providing more efficient, reliable and automated processing along with an enhanced customer offering. (See Our strategy, P08).

Our business model is low transaction volume, which leads to low exposure to the risk of financial crime relative to the industry; nevertheless, we maintain best practice controls to mitigate that risk.

Outlook for 2015

Looking forward, consensus economic forecasts see steady improvements in incomes and property prices with reductions in unemployment. Interest rates are expected to rise, leading to increased payments for many borrowers. But in the context of broad economic improvement, we expect this to be manageable for most customers and the Group. Nevertheless, we are working to identify those borrowers most exposed to a rate rise, so we can engage early. Simple, customer-friendly savings products should remain a reliable source of funding, and our ability to forecast our liquidity needs continues to improve. We have enhanced both operations and operational risk management, which will enable continued improvements in quality and efficiency.

Risk Governance structure

Risk	Credit	Market	Liquidity	Operational	Regulatory	Conduct
Board governance	Board					
	Risk Committee				Audit Committee	
Management governance	Executive committee					
	Credit committee	ALCO		Regulatory, Operational, and Conduct Risk Committee (ROCC)		
	Chief Risk Officer				Group General Counsel and Company Secretary	
Key policies	Lending Policy Arrears, Repossession and Forbearance Policy	Interest Rate and Basis Risk Policy	Treasury Policy, ILAA	Operational Risk Policy		Conduct Risk Policy
Management information	Credit MI pack	ALCO MI pack		Operational Risk MI pack	Regulatory/ Compliance MI	Conduct Risk MI

Forbearance measures undertaken during the financial year:

Forbearance type	2012	2013	2014
Capitalisation	69	3	**0**
Temporary switch to interest only	117	80	**41**
Interest rate reduction	0	0	**1**
Loan term extension	3	30	**15**
Full or partial debt forgiveness	0	0	**0**
Payment holiday	0	18	**16**
Assistance with voluntary sale of property	18	6	**1**
Reduced monthly payments	19	17	**37**
Total	226	154	**111**

Note: Forbearance figures include Kent Reliance and subsidiary figures only.

Principal Risks and Uncertainties

Risk type and definition	Risk	Mitigation	Direction
Credit risk			
Potential for loss due to the failure of a counterparty to meet its contractual obligation to repay a debt in accordance with the agreed terms.	**Individual borrower defaults** Borrowers may encounter idiosyncratic problems in repaying their loans, for example due to the loss of a job or execution problems with a development project. While most of the Bank's lending is secured, some borrowers fail to maintain the value of the security.	All loans are extended only after thorough bespoke and expert underwriting to ensure ability and propensity of borrowers to repay and sufficient security in case of default. Should there be problems with a loan, the collections and recoveries team works with customers unable to meet their loan service obligations to reach a satisfactory conclusion while adhering to the principle of treating customers fairly. A summary of forbearance measures undertaken is presented on P29. While information on arrangements to pay is not included in the forbearance data, the Bank typically finds that over 80% of arrangements made by the team meet the payment plan agreed. Our strategic focus on lending to professional landlords means that properties are likely to be well managed, with income from a diversified portfolio mitigating the impact of rental voids or maintenance costs. Lending to owner-occupiers is subject to a detailed affordability assessment, including the borrower's ability to continue payments when interest rates increase. Lending on commercial property is more based on security, and is scrutinised by the Group's independent Real Estate team as well as by external valuers. Development lending is extended only after a deep investigation of the borrower's track record and the specific project and requires approval by a dedicated Development Finance Transactional Credit Committee.	**Unchanged** The Group's Lending Policy, underwriting standards, and approach to collections and recoveries have seen no material change in the past year.
	Macroeconomic downturn A broad deterioration in the economy would adversely impact both the ability of borrowers to repay loans and the value of the Group's security. Credit losses would impact across the lending portfolio, so even if individual impacts were to be small, the aggregate impact on the Group could be significant.	The Group works within portfolio limits on LTV and name, sector, or geographic concentration that are approved by Risk Committee and the Board and reviewed at least annually. In addition, stress testing is performed as part of the ICAAP to ensure the Group maintains sufficient capital to absorb losses in an economic downturn and still meet its regulatory requirements.	**Decreased** While the economic outlook remains uncertain, and particular concerns remain regarding contagion from Europe and geopolitical instability, the economic outlook for the UK has improved over the past year.
	Wholesale credit risk The Bank has wholesale exposures both through call accounts used for transactional and liquidity purposes and through derivative exposures used for hedging.	The Group transacts only with high quality wholesale counterparties. Derivative exposures include collateral agreements to mitigate credit exposures.	**Decreased** The Group established a reserve account with the Bank of England, enabling it to eliminate credit risk on most of its liquidity portfolio.

Risk type and definition	Risk	Mitigation	Direction
Market risk			
Potential loss due to changes in market prices or values.	Interest rate risk An adverse movement in the overall level of interest rates could lead to a loss in value due to mismatches in the duration of assets and liabilities.	The Group's Treasury department actively hedges to match the timing of cash flows from assets and liabilities.	Decreased The Group has become more sophisticated in its assessment of interest rate risk, developing a better understanding of the potential impact of more complex movements in rates and enabling better hedging.
	Basis risk A divergence in market rates could lead to a loss in value, as assets and liabilities are linked to different rates.	The Group strategically focuses on products linked to administered rates to keep control of yield. Where there is a mismatch of market rates in the portfolio (e.g. Base Rate vs. LIBOR), the Treasury department hedges the exposure.	Unchanged Product design and hedging has enabled the Group to maintain the overall level of basis risk through the year.
Liquidity risk			
The risk that the Group will be unable to meet its financial obligations as they fall due.	Retail funding stress As the Group is primarily funded by retail deposits, a retail run could put it in a position where it could not meet its financial obligations.	The Group's funding strategy is focused on a highly stable retail deposit franchise. The large number of depositors provides diversification, and c. 95% of balances are covered by the FSCS and so at no material risk of a retail run. In addition, the Group performs in depth liquidity stress testing as part of its ILAA and maintains a liquid asset portfolio sufficient to meet obligations under stress. Finally, the Group has prepositioned mortgage collateral with the Bank of England, so that its liquidity insurance facilities can be accessed in the unlikely event that should become necessary.	Decreased The Group has made continual improvements in both its regular liquidity forecasting and stress testing framework. In addition, it has gained access to the Bank of England liquidity insurance facilities.

Principal Risks and Uncertainties continued

Risk type and definition	Risk	Mitigation	Direction
Operational risk			
The risk of loss or negative impact to the Group resulting from inadequate or failed internal processes, people, or systems or from external events.	**Mortgage fraud** Applicants may provide false information or documentation to obtain a mortgage they might not otherwise be offered. In extreme cases, funds could be borrowed against an inflated valuation or even a non-existent property.	Experienced underwriters perform thorough checks on application information, including credit checks, ID checks, address checks, and Land Registry checks and checks against the National Hunter anti-fraud data sharing system. Brokers, valuers, and solicitors are managed through panels and are subject to regular review.	**Unchanged** There has been no material change to the Group's approach to mortgage fraud risk.
	Network/system intrusion If hackers were to penetrate the Group's IT system, consequences could range from the diversion of funds to the theft of customer data.	An outsourced agency monitors the Bank's infrastructure for known threats and reports when they are being executed. This is being extended to subsidiaries in 2015. Third-party tools are used regularly for penetration testing on the Bank's systems. Anti-virus software is installed to detect viruses and malware. An IT security governance forum regularly reviews activity.	**Unchanged** As the Group has increased its profile and developed its online offering, it has likely become more of a target for hackers. At the same time, its security measures have continued to improve and have performed very well under testing.
	Model risk A small error in a model could be missed and lead the Group to overpay for a purchase or undercharge for a loan. If this were to happen on a large transaction, the absolute impact could be significant.	Models are subject to independent review and robust controls. Developers and users of the models have extensive industry experience and provide 'sanity checking' that will prevent any large errors.	**Unchanged** More models have been established in the business, meaning less new development and fewer chances to introduce errors. At the same time, the Group continues to pursue some relatively large transactions, particularly portfolio acquisitions, where a small model error could have a large absolute impact. The net impact of these changes is a broadly unchanged exposure.
	Gaps in due diligence scope Transactions undertaken by the Commercial Team are bespoke, with each requiring well specified due diligence. Gaps in scope could mean that significant issues in a pool acquisition or funding line are not picked up in time, resulting in assets that are significantly lower value than assumed and/or significant cost to remedy issues.	Key stakeholders from Risk, Credit, Compliance, and Legal review transactions at early stages and before they are finalised. External specialists are used to conduct due diligence where appropriate.	**Unchanged** The business has grown and these transactions have become more 'business-as-usual', with a consistent team and approach mitigating the bespoke nature of each transaction. At the same time, the Group continues to pursue some relatively large transactions, where a gap in due diligence could have a bigger impact. The net impact of these changes is a broadly unchanged exposure.

Risk type and definition	Risk	Mitigation	Direction
Conduct risk			
The risk that the Group's culture, organisation, behaviours, and actions result in unfair, unreasonable, or unexpected customer outcomes and detriment.	**Lending products** While the Group's products are simple, the size of a mortgage loan for a typical customer and the general lack of experience with such transactions means that customers may find themselves exposed to unfavourable outcomes.	The Group has a strategic dedication to simple, customer-friendly products. In addition, distribution is through intermediaries, who take on the role of advising customers, though the Group does review their performance. Finally, a robust conduct risk framework and product assessment tool is in place.	**Decreased** There has been little change in the Group's product offering from a conduct standpoint over the past year. A conduct risk framework and product risk tool have been introduced. A review of the product suite has confirmed that risk is low, and any risk in new product development has been further reduced.
	Back book The Group has a substantial back book of loans that were originated in a different conduct risk environment. The back book has not yet been reviewed in its entirety, and it is possible that there are some product features that could lead to customer detriment.	A thorough review of the back book is underway to identify conduct risk issues and remediate as appropriate.	**Unchanged** The issues highlighted through the back book review have so far been limited to a small number of cases, and, after investigation, the impact has proven to be limited.
Regulatory risk			
The risk that a change in legislation or regulation or an interpretation that differs from the Group's will adversely impact the Group.	**Capital requirements** The regulatory capital regime is subject to change and could lead to increases in the level and quality of capital that the Group needs to hold to meet regulatory requirements.	The Group engages actively with regulators, industry bodies, and advisors to keep in front of potential changes and provide feedback through the consultation process.	**Increased** Recent changes implemented as part of CRD IV have resulted in requirements for more and higher quality capital, though elements of these requirements are being phased in. Further proposals currently under discussion could lead to significant increases in the Group's capital requirements.
	Conduct regulation Regulatory changes focused on the conduct of business could force changes in the way the Group carries out business and impose substantial compliance costs.	The Group has a programme of regulatory horizon scanning linking into a formal regulatory change management programme. In addition, the focus on simple products and customer-oriented culture means that current practice may not have to change significantly to meet new conduct regulations.	**Increased** The regulatory environment has tightened and this is likely to continue, exposing the Group to increased risk.

Corporate responsibility

‘Great Ormond Street Hospital very much values the continued support of Kent Reliance and OneSavings Bank, and it is only through the generous support of companies like yours that the hospital can continue providing the very best care for children.’

Our corporate commitment to the community

To be responsible

Through the retail savings brand Kent Reliance, OneSavings Bank maintains its heritage within the county of Kent by being an actively engaged member of the local community. As the company grows we are responsible for sharing our success not just in the form of donations and fundraising but also with volunteering opportunities.

To be inclusive

We support a wide range of groups in the community ranging from sponsorship of the Kent Football Association disability team to supporting the Demelza Children’s Hospice and Business Awards for regional and local organisations.

Great Ormond Street Hospital

OneSavings Bank supports Great Ormond Street Hospital (GOSH) through an affinity programme. The exclusive childrens ‘Peter Pan’ savings account and GOSH long term savings bond provide a percentage of balances each year to the hospital. Now in its fourth year, this has been used by the hospital to support a range of activities including providing accommodation for parents who need to stay close to their sick children whilst they are being treated.

Grassroots sport

The Kent Football Association supports 4,500 teams and 45,000 players across the county each week. OneSavings Bank supports their grassroots programmes that target building stronger communities, reducing crime, improving health and tackling obesity. Grassroots sport relies on volunteers to run teams and leagues, coach and develop players and keep local sport alive. In 2014 we have extended our support to girl player development and to fund disability Player Development Centres.

The Kent FA services the needs of the football community by putting in place a new generation of modern football facilities, increasing and widening participation levels, establishing strong sustainable links between schools and clubs and investing in the football workforce (Referees and Coaches) by providing quality training courses.

The impact can be felt by clubs such as Anchorian’s sports club, a family oriented sports club that prides itself on the players enjoying the game and having fun. The club welcomes all abilities, including people with physical and mental disability, and all ages, measuring its success by increasing player participation, and by the development of all its players. Through Kent Reliance, OneSavings Bank sponsors the Anchorian’s Teams, supporting five disability teams to compete throughout the county.

Demelza Children's Hospice

Demelza provides a ten bedded hospice combined with a large range of hospice and care services to children, young people and their families during an unimaginably difficult time. Life-limited or life threatened children or young people and their families benefit from a wide range of facilities that include a Multi-Sensory room, Soft Play, a Hydrotherapy Pool and The Inclusion Zone for young people.

Kent Reliance supports Demelza through ongoing fundraising, with its 'Go-Dotty' annual week of activities and via staff members who have helped by running marathons, volunteering at the Hospice and even performing sponsored sky dives.

Kent Charity Awards

We are a founder sponsor of the Kent Charity Awards. In its inaugural year, it is a unique event in the charitable calendar to showcase the hard work and perseverance that charities and their staff undertake to make the lives of others better and recognise their achievements.

In the business community

OneSavings Bank is a sponsor of the Medway Business Awards. These awards were originally aimed at giving the area back some of the self-esteem lost at the closure of the naval dockyard and other manufacturing industries. Today the awards are a celebration of what regeneration means and the role that small and medium enterprises (SMEs) can play. Today, across the region, business parks are thriving with many SMEs thriving and trading in the global market.

Kent Excellence in Business Awards

Kent Excellence in Business Awards (KEiBA) is an established scheme to challenge regional SMEs to demonstrate excellence and share best practice amongst their peers. Involved since 2011, the Bank has sponsored several categories covering best practice in areas such as employment and community engagement.

Board of Directors (biogs)

					
Name and title	**Mike Fairey** Non-Executive Chairman	**Andy Golding** Chief Executive Officer	**April Talintyre** Chief Financial Officer	**Malcolm McCaig** Non-Executive Director	**Tim Hanford** Non-Executive Director
Appointment	Mike was appointed to the Board of OneSavings Bank as Chairman in April 2014.	Andy was appointed to the Board of OneSavings Bank as Chief Executive Officer in December 2011.	April was appointed to the Board of OneSavings Bank as Chief Financial Officer in May 2012.	Malcolm joined Kent Reliance Building Society in 2009 and was appointed to the Board of OneSavings Bank in August 2010.	Tim was appointed to the Board of OneSavings Bank in February 2011.
Committee membership	Chairman of the Nomination Committee.	None.	Member of the Risk Committee.	Member of the Remuneration and Audit Committees.	None.
Key strengths	Mike is an extremely experienced banking executive. In a career spanning more than 40 years, he has held a range of senior positions.	Andy has over 29 years' experience in financial services.	April has broad financial services experience.	Malcolm has experience in finance and has worked extensively in the financial services sector.	Tim has over 25 years' experience in banking and investment, including in credit strategies, risk management, mergers and acquisitions.
Experience, skills & qualifications	Mike was Deputy Chief Executive of Lloyds Banking Group for 10 years, until 2008. Currently, he holds a number of non-executive positions. He is also the Chairman of the Trustees of the Lloyds TSB Pension Funds.	Prior to joining OneSavings Bank he was the CEO of Saffron Building Society, where he had been since 2004. In the past he held senior positions at NatWest, John Charcol and Bradford & Bingley. He currently holds a number of posts with industry institutions including membership of the Council of Mortgage Lenders Executive Committee. He is also a Director of the Building Societies Trust and has also served as a Non-Executive Director for Northamptonshire NHS.	Prior to joining OneSavings Bank, April worked for Goldman Sachs International for over 16 years, most recently as an Executive Director in the Rothesay Life pensions insurance business and prior to that as an Executive Director in the Controllers division in London and New York. April began her career at KPMG in a general audit department. She has been a member of the Institute of Chartered Accountants in England and Wales since 1992.	Malcolm joined Kent Reliance Building Society in 2009. He was Chairman of the Kent Reliance Building Society and later Kent Reliance Provident Society. He was a Partner at both Ernst & Young and Deloitte, and has held senior management positions at Prudential, National Australia Bank and CIGNA. His Non-Executive Director portfolio includes Unum, Punjab National Bank (International) Ltd, Tradition (UK) and QBE Europe.	Tim is Managing Director of J.C. Flowers & Co. UK Ltd. Prior to his role at JCF, he was Head of Private Equity at Dresdner Bank and a member of the Institutional Restructuring Unit's Executive Committee. Tim has also served as a Board Director of Schroders, based in Hong Kong and Tokyo, where he was responsible for structured finance.

Dr David Morgan
Non-Executive Director

Dr Morgan was appointed to the Board of OneSavings Bank in February 2011.

Member of Nomination Committee.

Dr Morgan has extensive experience in corporate finance, particularly in the banking sector.

Dr Morgan became the Managing Director in charge of J.C. Flowers & Co for Europe and Asia Pacific in December 2009. From 1999 to 2008, he served as Chief Executive Officer of Westpac Banking Corporation, a global top 20 bank. Prior to joining Westpac, Dr Morgan was the Senior Deputy Secretary of the Australian Federal Treasury. Dr Morgan was Chairman of the Australian Bankers Association from 2006 to 2007. In 2009, Dr Morgan was awarded an Order of Australia in the Australia Day Honours by the Federal Government for his service to the finance sector.

Rod Duke
Senior Independent Director

Rod was appointed to the Board of OneSavings Bank in July 2012 and was appointed Senior Independent Director in 2014.

Chairman of the Risk and member of the Audit and Nomination Committees.

Rod has extensive experience across retail and commercial banking.

Rod was formerly Group General Manager, HSBC with responsibility for UK distribution – branches, call centres and internet banking – for both personal and commercial customers. Rod was with HSBC for 33 years. Previous directorships include VISA (UK), HFC Bank plc and HSBC Life. He also served on the Board of Alliance & Leicester plc until its takeover by Santander. Rod is a Fellow of the Institute of Financial Services.

Stephan Wilcke
Non-Executive Director

Stephan was appointed to the Board of OneSavings Bank in February 2011.

Member of the Risk Committee.

Extensive operating, investing, risk management and corporate finance experience particularly in financial services.

Stephan joined the Bank in 2011 as a Non-Executive Director and Chairman of the Risk Committee. He was Executive Chairman from early 2012 and became a Non-Executive Director in 2014. Previously, Stephan was the Chief Executive Officer of the Asset Protection Agency, an executive arm of HM Treasury and a Partner and the Head of European Financial Services at Apax Partners. Stephan is on the general council of the Hellenic Financial Stability Fund, a Member of the Financial Services Commission of Jersey and a Member of the Board and Investment Committee of EMF Capital Partners Ltd and a Non-Executive Director and Chairman of the Audit Committee of Milvik AB.

Mary McNamara
Non-Executive Director

Mary was appointed to the Board of OneSavings Bank in May 2014.

Chairman of Remuneration and member of Risk Committees.

Mary has broad experience in the Banking and finance sectors.

Mary was CEO of the Commercial Division and Board Director of the Banking Division at Close Brothers Group PLC, responsible for the Asset, Invoice and Leasing businesses in the UK and overseas from 2010 to 2013. Mary spent a year as COO of Skandia, the European arm of Old Mutual Group and prior to that, 17 years at GE Capital, running a number of businesses including GE Fleet Services Europe and GE Equipment Finance. Mary is Chair of Governors of the Leasing Foundation.

Graham Allatt
Non-Executive Director

Graham was appointed to the Board of OneSavings Bank in May 2014.

Chairman of Audit and member of Risk Committees.

Graham has significant banking and credit risk experience and financial experience.

Graham is a senior commercial and retail banker who worked in credit and risk roles at a number of the UK's major banks for 30 years including being Acting Group Credit Director at Lloyds TSB and Chief Credit Officer at Abbey National. Prior to this he spent 18 years in the NatWest Group culminating in the role of Managing Director, Credit Risk at NatWest Markets. A Fellow of the Institute of Chartered Accountants, Graham is on the finance committee of the Friends of the British Library and was involved in housing associations for nearly 30 years as Treasurer and Board member in the North of England and in London.

Nathan Moss
Non-Executive Director

Nathan was appointed to the Board of OneSavings Bank in May 2014.

Member of Remuneration and Nomination Committees.

Nathan is a business development and marketing specialist and has worked extensively in the banking sector.

Nathan was Group Strategy Director at Friends Life from 2010 to 2013 and responsible for group strategy, business development and innovation. Nathan joined Scottish Widows in 2002 as Managing Director, Marketing & Distribution before becoming Managing Director of Wealth Management at Lloyds TSB Group in 2007, responsible for strategy and business performance. Prior to this he spent 18 years with HSBC Group including four years as General Manager, Personal Financial Services and culminating as COO of Merrill Lynch HSBC. Nathan is a Non-Executive Director of Homeserve Membership Ltd.

Corporate governance report

UK Corporate Governance Code 2012 – Compliance Statement

The Company adopted the UK Corporate Governance Code 2012 on 10 June 2014 on admission of its shares to the UKLA's Official List and listing on the Main Market of the London Stock Exchange.

From the date of listing to the end of 2014, the Company has applied all of the main principles of the Code and has complied with all Code provisions, except provision A.4.2 which requires that the Chairman should hold meetings with the Non-Executive Directors without the executives present. An explanation for non-compliance with this provision is set out on page 40.

Prior to 10 June 2014, the Company complied with all Code provisions except provision A.3.1 which requires that the Chairman should, on appointment, meet the independence criteria in provision B.1.1. The Company did not comply with provision A.3.1 for the period from 1 January to 1 April 2014 as Stephan Wilcke is not considered to be independent. Mike Fairey was considered to be independent on his appointment, and the Company has therefore complied with provision A.3.1 since 2 April 2014.

Dear Shareholder,

I am pleased to present to you the Company's Corporate Governance report.

OneSavings Bank listed its Ordinary Shares on the main market of the London Stock Exchange on 10 June 2014. The Listing Rules of the Financial Conduct Authority, and the UK Corporate Governance Code (the 'Code'), have therefore only applied to the Company since that date.

The Board is committed to the highest standards of corporate governance as it considers that good corporate governance is essential to provide the executive team with the environment and culture in which to drive the success of the business. Sound governance structures were in place prior to the IPO, and I believe our positive approach to governance is borne out in both the success of the Company in meeting all of its post IPO financial objectives, and in the fact that we are able to report near full compliance with the Code for the period since we became a listed Company.

In the lead up to the IPO, in addition to my own appointment as Chairman, we also appointed three new Independent Non-Executive Directors, all of whom bring a wealth of knowledge and experience to the Board. Such significant structural change obviously requires a 'bedding in' period, but I am happy to report that the Board and its Committees are already operating effectively. We intend to keep Board and Committee performance under close review moving forward, and will conduct a formal performance review exercise at an appropriate point during 2015.

I would like to thank Sir Callum McCarthy and David Mills, who stepped down from the Board in May, for their instrumental roles in developing the business at a time of rapid change. I would also like to thank Stephan Wilcke who stepped down in April as Chairman and Executive lead on mergers and acquisitions after two years. Stephan remains on the Board as a Non-Executive Director.

It may be stating the obvious, but the IPO has also introduced the Company to a new and wide shareholder base with whom it is vital we communicate. An Investor Relations function has been established (further detail is set out on page 43) to assist the Board in developing a programme of meetings and presentations to both institutional and private shareholders, and we look forward to welcoming our shareholders to the Company's first Annual General Meeting as a listed entity which will be held at The Lincoln Centre, 18 Lincoln's Inn Fields, London on 2 June 2015.

Mike Fairey
Non-Executive Chairman

Leadership – Governance structure

The Board
Leadership, Strategic Aims, Risk, Values and Standards

Audit Committee[1]
Chairman
Graham Allatt

Members
Malcolm McCaig
Rod Duke

Key responsibilities
Monitoring the integrity of financial statements. Ensuring that an effective system of internal controls is maintained and monitoring accounting policies.

More information
Audit Committee report – pages 46-50

Remuneration Committee[1]
Chairman
Mary McNamara

Members
Malcolm McCaig
Nathan Moss

Key responsibilities
Determination of specific remuneration packages for all Executive Directors and certain senior executives of the Group.

More information
Directors' remuneration report – pages 52-66

Nomination Committee[1]
Chairman
Mike Fairey

Members
Rod Duke
Dr David Morgan
Nathan Moss

Key responsibilities
Consider and make recommendations to the Board in respect of appointments and ensuring that the structure, size and composition of the Board is kept under review.

More information
Nomination Committee report – pages 44-45

Risk Committee[1]
Chairman
Rod Duke

Members
Graham Allatt
Mary McNamara
April Talintyre
Stephan Wilcke

Key responsibilities
Oversight of the Group's risk appetite, risk monitoring and capital management.

Oversight and advice to the Board on current risk exposures and future risk strategy

Executive Committee
Members
Chief Executive, Chief Financial Officer, Chief Operating Officer, Chief Risk Officer General Counsel & Company Secretary, Chief Credit Officer , Sales & Marketing Director, Commercial Director and the Chief Technology Officer

Key responsibilities
Assist the Chief Executive in the performance of his duties, including development & implementation of the strategic plan, strong operating model to support the strategic plan and systems and controls to support the strategic plan.

Operations Committee
Key responsibilities
Oversee operational management of the business and provide operational inputs into larger projects.

Change Control Committee

Regulatory, Operational & Conduct Risk Committee
Key responsibilities
Monitors the Regulatory, Operational and Conduct Risk within the Group, ensures there are appropriate control frameworks in place and effective mitigants to ensure the Group remains within the Board approved Risk Appetite.

Executive M & A Committee
Key responsibilities
Ensures due diligence covers all relevant aspects.

Credit Committee
Key responsibilities
Review, assess and recommend to the Risk Committee proposed changes to Lending Policy, Arrears and possession Policy and Forbearance Policy.

Transactional Credit Committee

Asset and Liabilities Committee
Key responsibilities
To ensure the Treasury is operating effectively & assess the exposure of the Group to movements in interest rates.

Pricing Committee

1 Terms of reference of the Audit, Remuneration, Nomination and Risk Committees are available at osb.co.uk.

The role and structure of the Board

The Board is responsible for the long term success of the Company and provides entrepreneurial leadership to the Group. The Board focuses on setting strategy and monitoring performance, and ensures that the necessary financial and human resources are in place to enable the Company to meet its objectives. In addition, it ensures the appropriate financial and business systems and controls are in place to safeguard shareholders' interests and maintain effective corporate governance.

The Board is also responsible for ensuring the Company's continuing commitment to carrying on its business fairly, honestly and openly, with a commitment to zero tolerance towards bribery.

The Board operates in accordance with the Company's articles of association and its own written terms of reference. The Board has established a number of Committees as indicated in the chart on page 38. Each Committee has its own terms of reference which are reviewed at least annually.

The Board retains specific powers in relation to the approval of the Bank's strategic aims and policies and other matters which must be approved by it under legislation or the Company's articles of association. These powers are set out in the Board's written 'Terms of Reference' and 'Matters Reserved for the Board' which were approved by the Board in May 2014. A summary of the matters reserved for decision by the Board is set out below:

Strategy and management

- Overall strategy of the Group
- Approval of long term objectives
- Approval of annual operating and CAPEX budgets
- Review of performance against strategy & objectives

Structure and capital

- Changes to the Group's capital or corporate structure
- Changes to the Group's management and control structure

Financial reporting and controls

- Approval of financial statements
- Approval of dividend policy
- Approval of treasury policies
- Approval of significant changes in accounting policies
- Ensuring maintenance of a sound system of internal control and risk management

Remuneration

- Determining the Remuneration Policy for the Directors, Company Secretary and other senior executives
- Determining the remuneration of the Non-Executive Directors
- Introduction of new share incentive plans or major changes to existing plans

Corporate governance

- Review of the Group's overall governance structure
- Determining the independence of Directors

Other

- The making of political donations
- Approval of the overall levels of insurance for the Group

Board members

- Changes to the structure, size and composition of the Board
- Appointment or removal of the Chairman, CEO, SID and Company Secretary

The Board currently consists of the Chairman, two Executive Directors and eight Non-Executive Directors.

The Board meets formally at least ten times a year, with ad hoc meetings called as and when circumstances require. There is an annual calendar of agenda items to ensure that all matters are given due consideration and are reviewed at the appropriate point in the regulatory and financial cycle. During 2014 there were 11 scheduled Board meetings (there was no meeting in January but meetings were held monthly thereafter) and three ad-hoc Board meetings the majority of which were in connection with the IPO in June 2014. There were also three further Board Committees again in connection with the IPO. The table below shows the Directors' attendance at the Board and Committee meetings they were eligible to attend in 2014:

Director	Board scheduled meetings	Board ad hoc meetings	Audit	Remuneration	Nomination	Risk
Chairman						
Mike Fairey (appointed 2 April 2014)	8/8	2/2	–	–	2/2	–
Stephan Wilcke (as Chairman)	3/3	1/1	–	–	2/2	2/2
Stephan Wilcke (as NED)[1]	7/8	2/2	–	–	–	7/9
Executive Directors						
Andy Golding[2]	10/11	3/3	–	–	–	–
April Talintyre[2]	10/11	3/3	–	–	–	9/11
Non-Executive Directors						
Graham Allatt (appointed 6 May 2014)	7/7	2/2	2/2	–	–	8/8
Rod Duke	11/11	3/3	4/4	–	2/2	11/11
Tim Hanford[3]	10/11	3/3	–	3/3	–	1/1
Malcolm McCaig	11/11	3/3	4/4	9/9	2/2	–
Mary McNamara (6 May 2014)	7/7	2/2	–	6/6	–	7/8
Dr David Morgan[3]	7/11	2/3	–	–	4/4	–
Nathan Moss (14 May 2014)[3]	6/7	2/2	–	6/6	2/2	–
Past Directors						
Sir Callum McCarthy (retired 2 May 2014)	2/4	1/1	1/1	–	–	–
David Mills (retired 2 May 2014)	4/4	1/1	–	3/3	2/2	–

1 Unable to attend the Board meeting due to illness
2 Unable to attend the Board meeting due to the IPO roadshow
3 Unable to attend meetings due to scheduling clashes

Corporate governance report continued

At least once a year, the Board undertakes a full strategic review of the business operations, usually over the course of a day.

All Directors are expected to attend all meetings of the Board and any Committees of which they are members, and to devote sufficient time to the Company's affairs to fulfil their duties as Directors. Where Directors are unable to attend a meeting, they are encouraged to submit any comments on papers to be considered at the meeting to the Chairman in advance to ensure that their views are recorded and taken into account during the meeting.

Between the IPO in June 2014 and the financial year end, the Board's time has been focused on strategy and ensuring the Company's successful transition into the new listed environment. As such, there has not been adequate opportunity to arrange formal meetings between the Chairman and Non-Executive Directors without the Executive Directors present since listing. The importance of these meetings in terms of the ability of Non-Executives to fully perform their role is recognised, and it is intended that such meetings will be held at least three times a year from 2015.

Key Board activities during the year

- Strategy
- IPO Project
- Risk monitoring and review
- Governance and compliance
- External affairs and competitor analysis

Key Board roles and responsibilities

There is a clear division of responsibilities between the Chairman and Chief Executive which has been agreed by the Board. The roles of the Chairman and Chief Executive are held by different people and the purpose of each role is clear and distinct and set out in respective job descriptions. The Chairman is responsible for leading the Board and ensuring it acts effectively; the Chief Executive has overall responsibility for managing the Group and implementing the strategies and policies agreed by the Board. A summary of the key areas of responsibility of the Chairman and Chief Executive are set out below:

Role of the Chairman

- Chairing the Board and general meetings of the Company
- Setting Board agenda and ensuring that adequate time is available for discussion of all agenda items
- Promote the highest standards of integrity, probity and corporate governance throughout the Company
- Ensure that the Board receives accurate, timely and clear information in advance of meetings
- Promote a culture of openness and debate by facilitating the effective contribution of all Non-Executive Directors
- Ensure constructive relations between Executive and Non-Executive Directors and the Chief Executive in particular
- Regularly consider succession planning and the composition of the Board
- Ensure training and development needs of all Directors are met, and that all new Directors receive a full induction
- Ensure effective communication with shareholders and stakeholders

Role of the Chief Executive

- Ensure that the Company operates effectively at strategic, operational and administrative levels
- Responsible for all Bank activities
- Provide leadership and direction to encourage others to effect strategies agreed by the Board
- Channels expertise, energy and enthusiasm
- Build capability within the team, for individuals to develop within their role
- Develop and encourage talent within the business
- Identify commercial and business opportunities for the Company, building on strengths in key areas
- Responsible for all commercial activities of the Company, liaising with regulatory authorities where appropriate
- Responsible for quality and financial wellbeing of the Bank
- Represent the Company to external organisations and build awareness of the Company externally

Senior Independent Director

David Mills was the Senior Independent Director (SID) until his retirement from the Board on 2 May 2014. Rod Duke was appointed as the SID in his place. The SID's role is to act as a sounding board for the Chairman and to support him in the delivery of his objectives. This includes ensuring that the views of all other Directors are communicated to, and given due consideration by, the Chairman. In addition, the SID is responsible for leading the annual appraisal of the Chairman's performance.

The SID is also available to shareholders should they wish to discuss concerns about the Company other than through the Chairman and CEO, and the SID therefore attends a number of meetings with shareholders as part of the normal shareholder relations programme.

Company Secretary

The Company Secretary plays a key role within the Company, not only assisting the Directors with their pursuit of profit and growth, but also acting with integrity and independence to protect the interests of the Company, its shareholders and employees, and ensuring that the Company complies with all statutory and regulatory requirements. The Company Secretary works closely with the Chairman, Chief Executive and Chairmen of the Board Committees to ensure that Board procedures (including setting agendas and the timely distribution of papers) are complied with, and that there are good communication flows between the Board and its Committees, and between senior management and Non-Executive Directors. The Company Secretary is also available to all Directors to provide advice and support, including facilitating induction programmes and training.

Executive Committees

The Chief Executive, the Chief Financial Officer, the Chief Operating Officer, Chief Risk Officer, General Counsel and Company Secretary, Commercial Director, Chief Technology Officer, Chief Credit Officer and Sales and Marketing Director constitute the Bank's Executive Committee (Exco) and there are also five other committees reporting to the Executive Committee (See the Governance Structure Chart on page 38). The Purpose of the Exco is to assist the Chief Executive in the performance of his duties, including:

- the development and implementation of the strategic plan
- the development and implementation of a strong operating model that supports the strategic plan
- the development and implementation of systems and controls to support the strategic plan
- the monitoring of operating and financial performance
- the assessment and control of risk
- the prioritisation and allocation of resources
- the development of a high performing senior management team
- monitoring customer proposition and experience.

Effectiveness

Balance and independence

The effectiveness of the Board and its Committees in discharging their duties is essential for the success of the Company. In order to operate effectively, the Board and its Committees should comprise of an appropriate balance of skills, experience, independence and knowledge to encourage constructive debate and challenge to the decision making process. The size and composition of the Company's Board is kept under review by the Nomination Committee and the Board to ensure an appropriate balance of skills and experience is represented.

The Board currently comprises the Chairman (who was considered independent on appointment), two Executive Directors and eight Non-Executive Directors. Five of the Non-Executive Directors are considered by the Board to be independent. Tim Hanford and Dr David Morgan are not considered to be independent due to their position as representatives of the Group's major shareholders. Stephan Wilcke was, until 2 April 2014, the Executive Chairman of the Group and is therefore not considered to be independent in his current role as a Non-Executive Director.

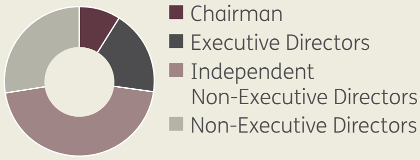
The Code recommends, in the case of a FTSE 350 company, that at least half the Board of Directors (excluding the Chairman) should comprise 'independent' Non-Executive Directors, being individuals determined by the Board to be independent in character and judgement and free from relationships or circumstances which may affect, or could appear to affect, the relevant individual's judgement. Where a company is outside the FTSE 350, the Code recommends that the Board of Directors comprises at least two 'independent' Non-Executive Directors. As at the date of this report, the Company (being outside the FTSE 350) complies with the recommendations of the Code concerning the number of independent Non-Executive Directors the Company should have.

The composition of the Board, and the balance of Independent Directors are indicated by the charts below:

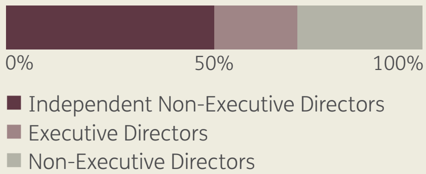
Chairman: Mike Fairey (considered Independent on appointment)

Not Independent	Independent
Andy Golding (CEO)	Graham Allatt
April Talintyre (CFO)	Rod Duke
Stephan Wilcke	Malcolm McCaig
Tim Hanford	Mary McNamara
Dr David Morgan	Nathan Moss

Board composition



Independence



Brief biographies of each Director can be found on pages 36 to 37.

The Board is satisfied that its current composition allows it to operate effectively and that all Directors are able to bring specific insights and make valuable contributions to the Board due to their varied commercial backgrounds. The Non-Executive Directors, and in particular the Independent Non-Executive Directors, provide constructive challenge to the executive management and the Chairman ensures that the views of all Directors are taken into consideration in the Board's deliberations.

Non-Executive Directors are appointed for terms of three years which may be renewed, subject to the particular Director being re-elected by shareholders, for up to a normal maximum of three terms (nine years). The continuing independence of the Non-Executive Directors is reviewed annually.

Commitment

The terms of appointment of the Non-Executive Directors specify the amount of time they are expected to devote to the Company's business. They are currently required to commit to a minimum of five days per month which is calculated based on the time required to prepare for and attend Board and Committee meetings, the AGM, meetings with shareholders and training. Their commitment also extends to working such additional hours as may be required in exceptional circumstances. Non-Executive Directors are required to confirm annually that they continue to have sufficient time to devote to the role.

In respect of the appointment of Mike Fairey as Chairman of the Company, the Nomination Committee considered whether his other commitments, notably his Chairmanship of APR Energy plc (from which he stepped down in August 2014) were likely to adversely impact his ability to carry out the role of Chairman of the Company, concluding that he would be able to devote sufficient time to the role.

Relationship Agreement

On admission of its shares following the IPO in June 2014, the Company entered into a relationship agreement (the 'Relationship Agreement') with its major shareholder OSB Holdco Limited (the Major Shareholder). Pursuant to the Relationship Agreement, the Major Shareholder has been granted the right to appoint one Non-Executive Director to the Board for so long as it holds at least ten per cent of the Company's ordinary shares and a further Non-Executive Director for so long as it holds at least 30 per cent of the Company's ordinary shares. Dr David Morgan and Tim Hanford are the representatives of the major shareholder appointed to the Board as Non-Executive Directors. The Directors believe that the terms of the Relationship Agreement enable the Group to carry on its business independently of the Major Shareholder and ensure that all agreements and transactions between the Group, on the one hand, and the Major Shareholder and its associates and/or persons acting in concert with the Major Shareholder or its associates, on the other hand, are at arm's length and on a normal commercial basis.

Conflicts of interest

The Company's Articles of Association set out the policy for dealing with Directors' conflicts of interest and are in line with the Companies Act 2006. The Articles permit the Board to authorise conflicts and potential conflicts, as long as the potentially conflicted Director is not counted in the quorum and does not vote on the resolution to authorise. Directors are required to complete an annual return and an annual fitness and propriety questionnaire, which requires declarations of external interests and potential conflicts. In addition, all Directors are required to declare their interests in the business to be discussed at each Board meeting.

The Board has also adopted an Ethics Policy which includes a procedure for identifying potential conflicts of interest at all levels of the business. Under this procedure, all potential conflicts of interest must be disclosed to the Company Secretary, who advises on proportionate controls to address the ethical conduct risks associated with them and who maintains and reviews a Group wide register of potential conflicts of interest.

Corporate governance report continued

Training and development

The Chairman ensures that all Directors receive a tailored induction on joining the Board with the aim of providing a new Director with the information required to allow him or her to contribute to the running of the Company as soon as possible. The induction programme is monitored by the Company Secretary to ensure that all information provided is fully understood by the new Director and that any queries are dealt with. Typically, the induction programme will include a combination of the provision of information in respect of the Company and face to face sessions as illustrated below:

Typical induction programme:

Materials include:
- Group & organisational structure charts
- Details of Board Committees, including terms of reference and copies of minutes
- Contact details for all Directors, Secretary and key staff
- Current business plan
- Articles of Association
- Minutes of recent Board meetings and dates of future meetings
- Guide for approved persons
- Current budget and last annual accounts
- Current ICAAP and ILAA

Face to face meetings & visits:
Meetings with:
- Chairman
- Other Directors
- Company Secretary
- Executive team
- Senior management

Visits to:
- Head Office
- Agencies/Branches
- Indian subsidiary sites (if appropriate)

As approved persons, under the approved persons regime operated by the PRA and FCA under the FSMA, all Directors must maintain the competence and skills required to meet the demands of their positions of 'significant influence' with the Bank. As part of the Annual Fitness and Propriety Questionnaire, Directors are required to complete a self-certification that they have undertaken sufficient training during the year to maintain their skills, knowledge and experience. The Company Secretary supports the Directors to identify relevant internal and external courses to ensure Directors are kept up to date with key regulatory changes, their responsibilities as approved persons and company Directors and other matters impacting on the business.

Information and support

The Company Secretary circulates an agenda and accompanying detailed papers to the Board well in advance of Board meetings. These include reports from Executive Directors and other members of senior management, and all Directors have direct access to senior management should they require additional information on any of the items to be discussed. A calendar of matters to be discussed at each meeting is prepared to ensure that all key issues are captured. The Board and Audit Committee also receive further regular and specific reports to allow the monitoring of the adequacy of the Company's systems and controls.

The information supplied to the Board and its Committees is kept under review and formally assessed on an annual basis as part of the Board evaluation exercise to ensure it is fit and proper for purpose and that it enables sound decision making.

The Company has adopted a formal procedure through which Directors may obtain independent professional advice at the Company's expense. The Directors also have access to the services of the Company Secretary as described above.

Performance evaluation

Given that there were significant changes to the composition of the Board, and in particular the appointment of a new Chairman, during 2014, the Board believes that a meaningful evaluation of the Board can only take place after it has been working together for a reasonable time. The Board will undertake an evaluation annually, with such evaluation process being externally facilitated at least every three years. A formal, externally facilitated evaluation will be carried out in 2015.

The Board undertook a self-evaluation at the end of 2014 and the results of this were discussed early in 2015. The main points arising were the need for succession planning and more formal training arrangements. The Nomination Committee was tasked with continuing its work on succession planning and to report back to the Board. The Company Secretary was tasked with formulating more formal and regular training arrangements.

Accountability

Financial and business reporting

The Board is committed to ensuring that all external financial reporting presents a fair, balanced and understandable assessment of the Group's position and prospects. Matters considered in establishing this include whether; there is a consistency between the front and back ends of the accounts, there was a balanced review of the competitive landscape, language used is sufficiently simple, there is an appropriate analysis of risks facing the business and equal prominence given to actual and overall profit.

Under the Schedule of Reserved Matters, the Board has responsibility for the approval of all externally published information including, but not limited to, annual and half-yearly financial statements, regulatory news announcements and publications required by regulators or to satisfy statutory requirements.

The Company has established a Disclosure and Communications Policy to assist the Board in ensuring the quality of its reporting. The Policy applies to all communications made by and relating to the Group including written statements in periodic financial reports, news releases, letters and circulars to shareholders and speeches and presentations given by Executive and senior management.

Review of effectiveness of financial controls

The Directors confirm that they have reviewed the effectiveness of the system of internal controls for the year under review and to the date of approval of the Annual Report and Accounts. The Board receives regular reports from the Audit Committee on its activities, including the Audit Committee's review of reports prepared by Internal Audit on the operation and efficacy of internal controls systems.

Treasury operations

The Board has approved a Board Treasury Policy which sets the Group's approach to the management of risks from treasury operations. Day-to-day responsibility for management of the Group's Treasury function is delegated to the Assets and Liabilities Committee which reports to the Risk Committee.

Risk management and internal control

The Board retains ultimate responsibility for setting the Bank's risk appetite and ensuring that there is an effective risk management framework to maintain levels of risk within the risk appetite. The Board regularly reviews its procedures for identifying, evaluating and managing risk, acknowledging that a sound system of internal control should be designed to manage rather than eliminate the risk of failure to achieve business objectives.

The Board has established a Risk Committee to which it has delegated responsibility for oversight of the Group's risk appetite, risk monitoring and capital management. The Risk Committee provides oversight and advice to the Board on current risk exposures and future risk strategy and assists the Board in fostering a culture within the Group which emphasises and demonstrates the benefits of a risk-based approach to internal control and management. Further details of the Group's risk management approach, structure and principal risks are set out in the risk management report on pages 28 to 33.

The Board has delegated to the Audit Committee responsibility for reviewing the effectiveness of the Company's internal control systems. The Audit Committee is supported by the internal audit function in discharging this responsibility, and receives regular reports from internal audit as to the overall effectiveness of the control system within the Group.

Control environment

The Company is organised along the 'three lines of protection' model which aims to ensure at least three stages of independent oversight to protect the customer and the Company from undue influence, conflict of interest and poor controls.

The first line of protection is provided by the operational business lines which measure, assess and control risks through the day-to-day activities of the business within the frameworks set by the second line of protection. The second line of protection is provided by the Risk, Compliance and Governance functions which include the Board and Executive Committee. As noted above, the Board sets the Company's risk appetite and is ultimately responsible for ensuring an effective risk management framework is in place. The Compliance function maintains the 'Key Controls Framework' which tracks and reports on key controls within the business to ensure compliance with the main provisions of the FCA and PRA handbooks. Policy documents also include key controls that map back to the Key Controls Framework.

The third line of protection is the internal audit function.

The Board is committed to consistent application of appropriate ethical standards and has established an Ethics Policy which sets out the basic principles to be followed to ensure ethical considerations are embedded in all business processes and decision making forums. Under the umbrella of the Ethics Policy, the Group has also established and maintains detailed policies and procedures in relation to the prevention of bribery and corruption, and a Whistleblowing Policy (see below).

Whistleblowing

The Company has well established procedures by which employees may, in confidence, raise concerns relating to possible improprieties in matters of financial reporting, financial control or any other matter. The Whistleblowing Policy and procedure applies to all employees of the Group. The Audit Committee is responsible for monitoring the Group's whistleblowing arrangements and the policy is reviewed periodically by the Board.

The Group is confident that the arrangements are effective, facilitate the proportionate and independent investigation of reported matters, and allow appropriate follow up action to be taken.

Relations with shareholders

Dialogue with shareholders

Prior to the IPO, the Company's shareholders comprised of funds managed by J.C. Flowers III (JCF), Kent Reliance Provident Society and a number of management and staff of the Company. As a result of the IPO, a much wider shareholder base has developed and the Group has therefore established a dedicated Investor Relations function to liaise with institutional investors and analysts. Investor relations activity and a review of the share register are regular items in the Board information pack.

As part of the IPO 'roadshow' in 2014, the Board met a large number of investors in the United Kingdom. The meetings involved the Chief Executive Officer and Chief Financial Officer. Since the IPO, the Group has engaged in active discussion with shareholders and investors, both on an individual basis and through attendance at investor conferences and roadshow events, and it is intended that the Company's investor communication programme will be developed further in the future.

As part of its future investor relations programme, the Group will aim to maintain an active dialogue with its key stakeholders, including institutional investors, to discuss issues relating to the performance of the Group including strategy and new developments. The Non-Executive Directors are available to discuss any matter stakeholders might wish to raise, and the Chairman and Independent Non-Executive Directors attend meetings with investors and analysts as required.

The Company has an investor website, which is publicly available and provides relevant information to both institutional and private shareholders, including performance updates and the presentations made to analysts and investors. In addition, private shareholders are able to question the Company through the Investor Relations function or the Company Secretarial function.

Relationship with major shareholder

As explained earlier in the report, on admission of its shares following the IPO in June 2014, the Company entered into a relationship agreement (the Relationship Agreement) with its major shareholder OSB Holdco Limited (the Major Shareholder).

Annual General Meeting

The Company's first Annual General Meeting since listing will take place on 2 June 2015 at The Lincoln Centre, 18 Lincoln's Inn Fields, London and the Chairmen of each of the Board's committees will be present to answer questions put to them by shareholders. The Annual Report and Accounts and notice of the Annual General Meeting will be sent to shareholders at least 20 working days prior to the date of the meeting.

Shareholders are encouraged to participate in the AGM process, and all resolutions will be proposed and voted on at the meeting on an individual basis by shareholders or their proxies. Voting results will be announced through the Regulatory News Service and made available on the Company's website.

Nomination Committee report

Dear Shareholder,

I am pleased to present the report of the Nomination Committee, my first as Chairman of both the Company and the Nomination Committee.

During the early part of 2014, our focus was on establishing the appropriate Board composition to take the Company forward in a listed environment following the IPO. This activity led to my own appointment as Chairman, and the appointments of three new Independent Non-Executive Directors, Graham Allatt, Mary McNamara and Nathan Moss, in May 2014. More information about the appointment process is set out in the report below.

We also reviewed the composition of the Board's Committees in the context of both the UK Corporate Governance Code requirements around independence, and the skills and experience needed to ensure the Committees can discharge their duties effectively.

We are satisfied that the composition structures we have established are operating well, and we will continue to monitor Board and Committee membership in 2015.

Mike Fairey
Non-Executive Chairman

Membership and meetings

Director	Number of meetings
Chairman	
Mike Fairey (Committee Chairman from 3 April 2014)	2/2
David Mills (resigned as Committee Chairman on 3 April 2014)	2/2
Current members	
Rod Duke (Member of the Committee from 3 April 2014)	2/2
Dr David Morgan	4/4
Nathan Moss (Member of the Committee from 15 May 2014)	2/2
Former members	
Malcolm McCaig (resigned as member of the Committee on 3 April 2014)	2/2
Stephan Wilcke (resigned as member of the Committee on 3 April 2014)	2/2

The Nomination Committee meets at least once annually and at such other times during the year as is necessary to discharge its duties. Only members of the Committee have the right to attend meetings, however other individuals, such as the Chief Executive and external advisers, may be invited to attend for all or part of any meeting.

Membership of the Committee was reviewed during the year in the context of the appointment of the new Chairman and Independent Non-Executive Directors to the Board, and several changes were made to the composition of the Committee.
All Committee members are Independent Non-Executive Directors.

Role of the Nomination Committee

The Committee leads the process for appointments to the Board and ensures that the Board, its Committees, and the boards of the Company's subsidiaries, are appropriately balanced in terms of skills, experience, independence and knowledge of the Company. The specific responsibilities and duties of the Committee are set out in its terms of reference which were updated in May 2014 and are available to download from the Company's website. The key responsibilities of the Committee are as follows:

Nomination Committee – Key Responsibilities

Board & Committee composition
- Regularly review structure, size and composition of the Board
- Recommend changes to membership of Audit, Risk and Remuneration Committees
- Recommend suitable candidates for the role of the Senior Independent Director

Appointments
- Prepare role description for Board appointments following an evaluation of the balance of skills, knowledge and experience on the Board
- Identify and nominate to the Board candidates to fill Board vacancies
- Make recommendations to the Board regarding the reappointment of NEDs at the end of their term of office
- Make recommendations to the Board regarding the annual re-election of Directors by shareholders

Effectiveness
- Review annually whether Directors continue to meet independence criteria
- Review the results of the Board performance evaluation process that relate to the composition of the Board
- Review annually the time required from NEDs

Succession planning
- Keep under review the leadership needs of the organisation
- Give full consideration to succession planning for Directors and other senior executives
- Formulate succession plans for both Executive and Non-Executive Directors and in particular the Chairman and Chief Executive

Activity during 2014
The main activities of the Committee during 2014 were as follows:
- Review of the composition of the Board in the context of the impending listing
- Recruitment process and recommendation of the appointment of the new Chairman of the Board
- Consideration and recommendation to the Board of the appointment of three new Independent Non-Executive Directors
- Review and changes to the composition (membership and Chairmen) of the Board Committees.

Chairman's appointment
Recognising the need to appoint an Independent Non-Executive Chairman in advance of the listing of the Company's shares on the London Stock Exchange, in late 2013 the Committee commenced a process to identify a successor to Stephan Wilcke. The Committee appointed Odgers Berndtson, an executive search agency with no other connection to the Group apart from the provision of executive recruitment services, to assist with the identification of appropriate candidates. The Committee prepared a job description for the role which included an assessment of the time commitment expected.

In February 2014, the Committee considered a long list of potential candidates prepared by Odgers Berndtson. The Committee discussed in detail the skills, experience and other commitments of each candidate and agreed a shortlist of three. Interviews between the shortlisted individuals and the Committee and Executive Directors were then arranged. Having received interview feedback from all parties, the Committee unanimously recommended to the Board that Mike Fairey should be appointed as the new Chairman of the Company.

Appointment of Non-Executive Directors
Having identified the need to strengthen the independence of the Board's Non-Executive Directors, the Committee reviewed the skills, experience and diversity of the Board and prepared candidate specifications before instructing Odgers Berndtson to prepare a long list of potential candidates. In specifying the requirements, the Committee indicated a desire to appoint a further female Director subject to merit.

Having identified and interviewed its preferred candidates, the Committee recommended to the Board the appointments of Graham Allatt, Mary McNamara and Nathan Moss as Non-Executive Directors with those appointments being formally approved and announced in May 2014.

Committee composition
The Committee conducted a rigorous review of the composition of the Audit, Remuneration, Risk and its own composition during 2014. The review, which included consideration of the role of the Chairman of each of the Committees, was framed in the context of the impending listing and the relevant requirements of the UK Corporate Governance Code and the Walker review, as well as the impact of the retirement of Sir Callum McCarthy and David Mills from the Board.

Following the review, the Committee recommended a number of changes to the composition of the Committees which are illustrated in the attendance schedules at the start of each Committee's annual report. The Committee is satisfied that the implemented structure will allow the effective discharge of duties by each Committee, and will continue to monitor Board and Committee performance and structure going forward.

Diversity
The Board recognises the benefits of diversity, including gender diversity, on the Board, although it believes that all appointments should be made on merit, whilst ensuring that there is an appropriate balance of skills and experience within the Board.

As such, while the Board notes the recommendations of the Davies Review, it does not believe it to be appropriate to set any measurable objectives in relation to the proportion of women on the Board at this time

The Nomination Committee is responsible for reviewing on an annual basis the Company's Board Diversity Policy; in particular whether introducing measurable objectives is appropriate for the Company.

Priorities for 2015
The Nomination Committee's priorities for 2015 are:
- Continued evaluation of the skills, knowledge and experience required for a balanced Board
- Consider succession planning for Directors and other senior executives
- Review the structure, size, composition and diversity of the Board, including potential recruitment of an additional Independent Non-Executive Director
- Consider the composition of the Board Committees.

Mike Fairey
16 March 2015

Audit Committee report

Dear Shareholder,

I am pleased to have assumed the role of Chairman of the Audit Committee on 14 August 2014 having joined the Committee and the Company as an Independent Non-Executive Director on 6 May 2014.

The Committee saw increased activity during the year in light of the Company's IPO in June 2014. Significant additional time at meetings was allocated to review and consider various reports required under the IPO regulatory framework, including the Financial Position and Prospects Report, Working Capital Report and the financial statements included in the IPO prospectus. The Committee reviewed and commented on the various reports, where necessary providing comfort or recommendations to the Board for their approval.

Further details on the activities of the Committee during the year and how it discharged its responsibilities are provided in the report below.

I would like to take this opportunity to thank Malcolm McCaig for his help and advice during my transition to the Committee Chairmanship and for his continued valuable contribution as a Committee member.

Graham Allatt
Audit Committee Chairman

Membership and meetings

The Audit Committee currently comprises three Independent Non-Executive Directors.

Director	Number of meetings attended
Chairman	
Malcolm McCaig (Chairman until 14 August 2014, then member)	4/4
Graham Allatt (Chairman from 14 August 2014)	2/2
Current members	
Rod Duke	4/4
Former members	
Sir Callum McCarthy (resigned as member of the Committee on 2 May 2014)	1/1

The Audit Committee is required to meet at least three times a year, with meetings scheduled at appropriate intervals in the reporting and audit cycle. Additional meetings are held as required. In 2014 there were a total of four meetings, reflecting the additional demands placed on the Audit Committee as a result of the Bank's IPO in June 2014.

Only members of the Committee have the right to attend meetings, however standing invitations are extended to the Executive Directors, Chief Risk Officer and Head of Compliance, all of whom attend meetings as a matter of practice. Other non-members may be invited to attend all or part of any meeting as and when appropriate. The Company Secretary acts as secretary to the Committee. The internal and external auditors attend all meetings and also meet in private with the Committee on each occasion. In addition the Chairman of the Audit Committee has regular contact with the external and internal auditors throughout the year. The Chairman meets with the Chief Financial Officer, Head of Compliance and Company Secretary in advance of each meeting to agree the agenda and receive a full briefing on the key agenda items.

Membership of the Committee was reviewed by the Nomination Committee in early 2014 in the context of the impending IPO, the resignation of Sir Callum McCarthy as a Non-Executive Director of the Group on 2 May 2014 and Malcolm McCaig's request to step down as Chairman of the Committee. The review identified Graham Allatt as the appropriate ongoing Chairman of the Committee and he was appointed as a member of the Committee when he joined the Board as a Non-Executive Director on 6 May 2014. Malcolm McCaig remained as Chairman of the Committee until 14 August 2014, allowing Graham Allatt a period of time to become familiar with the business before taking on the responsibilities of Committee Chairman. Graham has financial experience, as a senior banker and has worked with several of the UK's major banks, including in Chief Credit Officer and Chief Risk Officer roles. He has chaired a number of risk management and Audit Committees in both the private and voluntary sectors, and was a member of the Disclosure Committee at Lloyds. Malcolm continues to serve as a member of the Committee. Taken as a whole, the Committee has an appropriate balance of skills including recent and relevant financial experience.

Role of the Audit Committee

The primary role of the Audit Committee is to assist the Board in overseeing the systems of internal control and external financial reporting across the Group. The Committee's specific responsibilities are set out in its terms of reference which were updated in May 2014. These are available on the Company's website and cover external and internal audit, financial and narrative reporting, compliance, whistleblowing and fraud and internal controls and risk management.

Audit Committee – Key Responsibilities

External Audit
- Recommend the appointment, reappointment or removal
- Oversee the relationship, approve terms of engagement and review independence and objectivity
- Meet regularly without management present
- Develop policy on the supply of non-audit services
- Ensure the audit contract is tendered at least every ten years

Internal Audit
- Approve appointment or termination of the head of internal audit/ internal audit function
- Monitor and review effectiveness
- Review and approve the internal audit charter
- Review and assess the internal audit plan
- Ensure access to the Board and Committee Chairmen
- Review management's responsiveness to findings

Financial and narrative reporting
- Monitor the integrity of the financial statements
- Review and report to the Board on significant financial issues and judgements
- Review and challenge accounting policies, methods used to account for significant or unusual transactions, clarity and completeness of disclosure
- Where requested by the Board, advise whether the annual report is fair, balanced and understandable

Compliance, whistleblowing and fraud
- Review the adequacy and security of whistleblowing arrangements
- Review procedures for detecting fraud and preventing bribery
- Review regular reports from the Money Laundering Reporting Officer and the adequacy and effectiveness of anti-money laundering systems and controls
- Review the adequacy and effectiveness of the compliance function and Conduct Risk Framework

Internal controls and risk management
- Monitor and review the adequacy and effectiveness of the company's internal financial controls and risk management systems
- Review and approve the statements in the Annual Report concerning internal controls and risk management

Activity during 2014
The principal activities undertaken by the Committee during the year are described below.

Significant issues and areas of judgement considered by the Committee

The following significant issues and accounting judgements were considered by the Committee in relation to the 2014 Annual Report and financial statements. In its assessment, the Committee considered and challenged reports from management prior to both the interim and full year results explaining each area of judgement and management's recommended approach. The Committee also received reports from the external auditor setting out its views on the accounting treatment and judgements underpinning the financial statements.

Loan book impairments
Specific provision assessments for individually significant loans or portfolios of loans involve significant judgement in relation to estimating future cash flows, including the cost of obtaining and selling collateral, the likely sale proceeds and any rental income prior to sale.

All assets without a specific provision are assessed collectively. Collective provisions are calculated using 12 month delinquency roll rates and one year probability of defaults on different segments of the loan book. These rates along with forced sale discounts and the level of house prices are applied to calculate expected losses. Judgement needs to be exercised in deciding how to apply historic experience to current market conditions.

The Committee received and challenged reports from management prior to each reporting date explaining the approach taken to provisioning and the resulting changes in provision levels during the period. The Committee requested additional information by loan book during the year including provision coverage ratios, assumed probability of default, loss given default and loan to value ratios for loans 3 months or more in arrears to help with their assessment of the reasonableness of provisions. In addition, the Committee asked the Risk Committee to review the specific provisions for the top 20 impaired loans. Two of the three current members of the Committee are also members of the Risk Committee and as such were privy to additional detailed credit information on the loan book throughout the year.

The Committee is satisfied that the approach taken and judgements made were reasonable.

Loan book acquisition accounting and income recognition
Acquired loan books are initially recognised at cost. Significant judgement is required in calculating their effective interest rate (EIR) using cash flow models which include assumptions on the likely macroeconomic environment, including HPI, unemployment levels and interest rates, as well as loan level and portfolio attributes and history used to derive prepayment rates, the probability and timing of defaults and the amount of incurred losses. The Committee reviewed and challenged reports from management before each reporting date on the approach taken. Particular focus was given to loan books purchased at deep discounts including sensitivity analysis on the impact of estimated future prepayment rates and other assumptions on carrying value and the timing of the release of discounts to profit and loss. The Committee requested a comparison of actual cash flows to those assumed in the cash flow models by book to challenge management's assessment of the need to update cash flow projections and adjust carrying values accordingly. Based on this work the Committee is satisfied that the approach taken and judgements made were reasonable.

Effective interest rate
A number of assumptions are made when calculating the effective interest rate for newly originated loan assets. These include their expected lives, likely redemption profiles and the anticipated level of any early redemption charges. Net fee income is a significant element of the effective interest rate of the Company's Buy-to-Let products and is recognised in profit and loss over the expected life of the loans. Judgement is required in assessing the expected life of products with an initial discounted or fixed period which then revert to the Company's standard variable rate. The Committee reviewed and challenged the assumptions used in EIR calculations, in particular the period over which net fee income is spread and also received sensitivity analysis for different useful lives. Based on this work the Committee is satisfied that the approach taken and judgements made were reasonable.

Fair, balanced and understandable

The Committee considered on behalf of the Board whether the 2014 Annual Report and financial statements taken as a whole are fair, balanced and understandable, and whether the disclosures are appropriate. The Committee reviewed the Group's procedures around the preparation, review and challenge of the Report and the consistency of the narrative sections with the financial statements.

Audit Committee report continued

Following its review, the Committee is satisfied that the Annual Report is fair, balanced and understandable, and provides the information necessary for shareholders and other stakeholders to assess the Company's position and performance, and has advised the Board accordingly.

Internal audit

The Company outsources the internal audit function. Grant Thornton LLP was appointed as internal auditor effective 1 January 2014 after a robust tender process. The role of the internal audit function is to determine whether the Group's network of risk management, control and governance processes is adequate and functioning appropriately.

The terms of the internal audit function's appointment are set out in the Internal Audit Charter which was approved by the Audit Committee in March 2014. The Committee also approved the annual Internal Audit plan which identified areas of focus for the year. Outcomes of the work of internal audit are reported to the Audit Committee and the Group's management with responsibility for any improvement or remedial action allocated appropriately. The internal audit function carries out follow up reviews to ensure that any control weaknesses are addressed.

The Committee also monitored the relationship between the internal audit function and the Group's management throughout the year.

The Committee carries out an annual review of the effectiveness of the internal audit function. This was facilitated in 2014 by a survey completed by Committee members, the Executive Directors other executives and senior managers who had interacted with the internal audit function during the year. Following the review the Committee was satisfied that the internal audit function operated effectively during the year. The review identified a few areas for possible improvement, which in general were already being addressed. These included gaining more knowledge of issues facing the business following their appointment as internal auditors in 2014, and improving communication with management about the Bank's progress with resolving audit recommendations.

Systems of internal control and risk management

The Audit Committee received regular reports from the internal audit function during 2014 which included progress updates against the Internal Audit Plan, the results of audits undertaken and any outstanding audit action points. The Committee used these reports and the results of reviews carried out by the Group's compliance function as the basis for its assessment of the effectiveness of the Group's system of internal controls and risk management. The Committee also received a report on the effectiveness of the Group's system of controls from the Chief Executive.

The Group has continued to develop its governance arrangements during the year which has included the enhancement of various policies and procedures to support the systems of internal control and risk management. The Audit Committee has been central to this process, in particular in the drafting, review and approval of a number of updated or new policies covering anti-bribery and corruption, data retention, approved persons, fraud prevention and arrangements, data protection and conduct risk.

External auditor

The Committee is responsible for overseeing the Group's relationship with its external auditor, KPMG LLP (KPMG). This includes the ongoing assessment of the auditor's independence and the effectiveness of the external audit process, the results of which inform the Committee's recommendation to the Board as to the auditor's appointment (subject to shareholder approval) or otherwise.

Appointment and tenure

KPMG was appointed as the first external auditor of the Bank for the period ended 31 December 2011. Prior to that date it fulfilled the external audit function for the KRBS whereby following a tender process it was first appointed for the 31 December 2010 period-end. The current lead audit partner, Richard Gabbertas, has been in place during this time and 2014, therefore, represents his fifth year in that role.

KPMG generally require the rotation of the lead audit partner every five years for a listed client. In light of the Bank's IPO and the resulting degree of change and demands facing the Group, the Committee has requested to extend Richard's tenure for an additional year. KPMG has considered this arrangement in line with its risk and independence policies and has agreed, recognising the guidance published by the FRC in 'APB Ethical Standard for Auditors ES 3 (Revised) – 'Long Association with the Audit Engagement''. Therefore, a new lead audit partner is expected to be selected for the 2016 audit. The Code requires that FTSE 350 companies should put the external audit contract out to tender at least every ten years. Although it is not a FTSE 350 company, the Bank intends to put the external audit out to tender at least every 10 years.

The Committee has noted the adoption during 2014 of new EU legislation relating to the statutory audit market, and will monitor the development of legislation in the UK to implement the new regime. The new legislation requires auditor rotation every 10 years, with member state discretion to extend this to 20 years if there is a public tender every 10 years. Transitional arrangements are also available. In light of this, the Committee intends to put the external audit out to tender no later than for the 2019 year end.

Effectiveness

The Committee assesses the effectiveness of the external audit function on an annual basis. The review was facilitated in 2014 through a survey completed by members of the Committee, the Executive Directors, other executives and other key staff who had significant interaction with the external audit team during the year. The survey assessed the effectiveness of the lead partner and audit team, the audit approach and execution, the role of management in the audit process, communication, reporting and support to the Committee as well as the independence and objectivity of the external auditor. The assessment concluded that the external audit process was effective with no material areas requiring significant improvement.

Non-audit services

The engagement of the external auditor to provide non-audit services to the Group could impact the assessment of its independence and objectivity. The Group has therefore established a policy governing the use of the external auditor for non-audit services. The policy specifies prohibited and permitted services (as detailed in the table opposite) and sets the framework within which permitted non-audit services may be provided. Prohibited services comprise activities that are generally perceived to involve the auditor making judgements or decisions that are the responsibility of management.

The Group maintains active relationships with several other large firms and any decision to appoint the external auditor is taken in the context of whether their understanding of the Group places them in a better position than other firms to undertake the work and includes an assessment of the cost effectiveness and practicality of using an alternative firm.

Prohibited Services	Permitted Services
Book-keeping or other services related to the accounting records or financial statements	General accounting advice on the application of IFRS and training support
Financial information systems design and implementation	Tax compliance and advice
Appraisal or valuation services, fairness opinions or contribution-in-kind reports	Transaction related services, including acquisition due diligence and tax and accounting advice
Actuarial services	Other audit-related services; interim profit verification; half year review, comfort letters
Management functions or human resources	Such other activities as may be agreed by the Committee from time to time
Broker, dealer, investment adviser or investment banking services	
Legal services and expert services unrelated to the audit	
Executive selection and recruitment	
Seconding employees to key management positions	
Tax assignments where fees are contingent and material and/or dependent on uncertain tax law and audit judgement	

The Committee pre-approved a number of permitted services in 2014; interim profit verifications, the half year review and tax compliance for the Group. The Committee also pre-approved other permitted non-audit services below an overall threshold of 100% of the cost of 2013 Group annual audit services and subject to any single item above £100,000 being pre-agreed with the Committee Chairman. The Committee reviews a schedule of year to date non-audit services at each meeting.

During 2014, the external auditor was engaged, with the approval of the Audit Committee, to provide certain non-audit services in respect of the Company's IPO. These included the preparation of reports on the Company's financial position and prospects, working capital and a report to the Company's sponsors regarding the Company's business and operations. In approving the use of KPMG to provide these services, the Committee took the view that its knowledge of the Company and its operations meant that it was best placed to provide the services, and was comfortable that its independence would not be compromised. The fees paid to the external auditor in respect of non-audit services during the year totalled £1,050k, representing 313% of 2014 Group audit services of £335,000 (£195k and 58% excluding IPO related services) and are detailed in the following table:

Nature of service	£'000
IPO related services	855
Audit-related assurance services including interim profit verifications	53
Tax compliance and advice	44
Regulatory advice and support	41
Other	57
Total non-audit services	1,050

Under the new EU statutory audit market legislation, certain non-audit service prohibitions and fee caps are introduced and are expected to be effective from 17 June 2016. The new prohibitions include tax advice and compliance and cap non-audit services to 70% of the average of audit services paid in the preceding three years. The cap is subject to transitional arrangements and is expected to apply to the Company from 17 June 2019.

The Committee's assessment of the external auditor's independence in 2014 took into account the non-audit services provided during the year, and confirmations given by KPMG as to its continued independence at various stages in the year.

Training

The Committee undertook a significant amount of training during the year, including making extensive use of the Audit Committee Institute and training programmes run by the major accountancy firms. In addition Committee members attended a number of executive level Committee meetings and met with key staff, brokers and customers during the year to increase their knowledge and understanding of the business.

Effectiveness

The Committee formally considers its effectiveness annually. The assessment was facilitated in 2014 using a survey completed by members of the Committee, the Executive Directors, and other executives and senior managers that had significant interaction with the Committee during the year. The review concluded that the Committee was operating effectively and efficiently, but identified the need for more formalised liaison with other Board Committees which was put in place by end of year.

Risk Committee report

Dear Shareholder,

I am pleased to present the report of the Risk Committee – our first as a listed Company.

2014 saw the appointment of new Independent Non-Executive Directors, as a pre-cursor to our IPO in June. Two of whom, Graham Allatt and Mary McNamara, were appointed to Risk Committee in view of their experience and skill sets.

The preparation for the IPO saw substantially increased activity across our Bank, including a full review of our risk environment. The Committee also reviewed and commented on various reports, including the ICAAP and ILAA, before recommending the documents to the Board for approval or noting. The Committee spent an appropriate proportion of its time reviewing a number of inorganic transactions, as well as its other advisory and oversight responsibilities.

Further information on the wide range of the role and activities of the Committee is provided in the following report.

Rod Duke
Risk Committee Chairman

Membership and meetings

Director	Number of meetings attended
Chairman	
Rod Duke	11/11
Current members	
Graham Allatt	8/8
Mary McNamara	7/8
April Talintyre	9/11
Stephan Wilcke	9/11
Former members	
Tim Hanford (stepped down as member of the Committee on 19 May 2014)	0/3

The Risk Committee meets at least six times a year, with additional meetings scheduled as required depending on the activity of the Group.

Only members of the Committee are entitled to attend meetings, however the Chief Risk Officer (CRO), Chief Executive Officer (CEO) and Chief Credit Officer (CCO) have standing invitations to the Committee unless the Chairman of the Committee informs any that they should not attend a particular meeting or discussion.

Graham Allatt and Mary McNamara joined the Committee during the year following their appointment as Independent Non-Executive Directors of the Company. Tim Hanford stepped down from the Committee on 19 May 2014.

Graham Allatt has recent and relevant financial services risk issues experience having worked with several of the UK's major banks, including in Chief Credit Officer and Chief Risk Officer roles. He has also chaired a number of risk management and audit committees in both the private and voluntary sectors, and was a member of the Disclosure Committee at Lloyds.

Role of the Committee

The Board has delegated to the Committee the responsibility for oversight of the Group's risk appetite, risk monitoring and capital management. The Committee's primary objectives are therefore to provide oversight and advice to the Board on current risk exposures and future risk strategy, and to assist the Board to foster a culture within the Group that emphasises and demonstrates the benefits of a risk-based approach to internal control and management of the Group.

The Committee's specific responsibilities are set out in its terms of reference which are available on the Company's website, and are summarised opposite:

Risk Committee – Key Responsibilities

Risk appetite and assessment
- Advise the Board on overall risk appetite, tolerance and strategy
- Review risk assessment processes that inform the Board's decision making
- Review the Group's capability to identify and manage new risks
- Advise the Board on proposed strategic transactions, including acquisitions or disposals, ensuring risk aspects and implications for risk appetite and tolerance are considered

Risk monitoring and framework
- Review credit risk, interest rate risk, liquidity risk, legal and regulatory risks and operation risk exposures by reference to risk appetite and capital adequacy
- Review ICAAP framework
- Monitor actual and forecast risk and regulatory capital positions
- Recommend changes to capital utilisation
- Review ILAA framework
- Monitor actual and forecast liquidity position
- Review reports on material breaches of risk limits and the adequacy of proposed action

CRO and risk governance structure
- Consider and approve the remit of the risk management function
- Recommend to the Board the appointment and removal of the CRO
- Review promptly all reports of the CRO
- Review and monitor management's responsiveness to the findings of the CRO
- Receive reports from the Credit Committee, Assets & Liabilities Committee and Regulatory, Conduct and Operational risk committee

Activity during 2014

The risk management framework of the Group is set out in detail on page 29. In order to discharge its duties and responsibilities, the Committee receives reports from those responsible for specific areas of risk within that framework. The Group's compliance function reports on conduct risk and regulatory risk and the CRO on all other risks.

Examples of how the Committee has discharged its responsibilities during the year are as follows:

Credit risk

The Committee received and reviewed regular detailed credit reports during the year identifying large exposures and arrears within various categories (e.g. residential loans, Buy-to-Let, consumer lending etc). The reports also highlight early warning indicators which allow the Committee and the risk function to address potential credit issues before they develop into significant risk areas.

Market risk and liquidity risk

Market risk and liquidity risk are continually monitored by the Assets and Liability Committee (ALCO) which reports to the Risk Committee. The Committee reviewed ALCO's regular assessments of the UK macroeconomic environment and potential impacts on the Group's assets and liquidity. It also considered and approved (within its own delegated authority) recommendations from ALCO for the disposal of certain assets during the year, including the Group's RMBS portfolio which was sold on 31 January 2014 to free capital for investment in more profitable lending.

Operational risks

The Committee received reports on operational risks at each of its meetings. The reports cover issues that have arisen to allow the Committee to assess management's response and remedial action proposed. Although there were several incidents during the course of 2014, the Committee was satisfied that the action taken was appropriate and that the control of operational incidents continued to improve. The operational risk update reports were also developed in the year to include a focus on forward looking risk which permits a more strategic discussion at the Risk Committee level.

The Committee also considered in detail the Group's ability to apply a global interest rate change across all of its products. A Global Rate Change (GRC) assessment was presented to the Committee which highlighted potential issues, with the most significant being a compliance issue around the potential need to reoffer mortgages that had not completed at the time of any rate change. The Committee took comfort from the assessment that a GRC would not cause significant problems.

ICAAP and ILAA

The Committee reviewed and commented on the proposed Internal Capital Adequacy Assessment Process and the Individual Liquidity Adequacy Assessment prior to their submission to the Board for approval.

In addition to the specific examples given above, the Committee reviewed various transaction proposals, assessing their potential impact on the risk profile of the Group. It also approved the Group's pillar III disclosure and various policies and policy updates, including the Interest Rate & Basis Risk Policy, the Treasury Policy, the Loan Loss Provisioning Policy and amendments to the OneSavings Bank Lending Policy.

Annual statement by the Chairman of the Remuneration Committee

Dear Shareholder,

As Chairman of the Remuneration Committee I am pleased to introduce our Directors' Remuneration Report. The Remuneration Committee has performed a major role during the year in carrying out a detailed review of remuneration policy and restructuring of executive pay arrangements in preparation for the Company's life as a listed company. We also underwent a change in governance of the Committee during the year due to the IPO which meant in many respects for the Committee it was a year split pre and post IPO. Changes in membership of the Committee and details of matters considered during the year are set out in the annual remuneration report on pages 59 to 66.

Our approach to remuneration policy

The Remuneration Committee has approved a set of over-riding principles for the design of the remuneration policy for employees in general and in respect of senior management. These are to:

- Attract, motivate and retain high performing employees
- Adhere to and respond to the regulatory framework for the financial services sector and UK Listed companies more generally
- Strike an appropriate balance between risk taking and reward
- Encourage and support a strong sales and service culture
- Reward the achievement of the overall business objectives of the Group
- Align employees' interests with those of shareholders and customers
- Be consistent with the Group's risk policies and systems to guard against inappropriate risk taking.

These principles are designed to incentivise Executive Directors to deliver growth in long term shareholder value whilst supporting appropriate behaviours.

It is intended that the principles will be delivered via a remuneration framework with the flexibility of being able to combine base salary, benefits, annual bonuses and employee share plans. It is also our intention that remuneration practices are consistent with best practice and our reporting is transparent and clear. The aim is that our remuneration policy may be understood by shareholders, employees and other stakeholders.

Performance orientated

As a consequence of our review we have introduced new features into the remuneration package for senior executives including the Executive Directors. These are:

Annual bonus plan (Deferred Share Bonus Plan)

Whilst deferral of the bonus is not an entirely new feature for OneSavings Bank, this has been extended to include other layers of management alongside the Executive Directors. The annual bonus for Executive Directors for 2015 includes the following elements:

- Maximum bonus potential of 100% of salary
- One half of any bonus payable is to be deferred into shares for three years.

In respect of the 2014 annual bonus the metrics have remained unchanged for the year regardless of the Company's listing. Further information is given in the annual report on remuneration.

Performance Share Plan (PSP)

Executive Directors will receive regular awards of shares under the PSP, the first of which will be made in March 2015. Vesting of these shares is subject to achievement of challenging performance conditions.

The Remuneration Committee has various discretions under these schemes and there are also provisions included in the rules to operate malus and clawback.

Shareholding guidelines

A requirement for Executive Directors to build up and retain a significant holding of OneSavings Bank shares has been introduced.

Further details on these key elements of remuneration policy may be found in the Policy Report.

Context for decisions on remuneration

The rigorous process of an Initial Public Offering (IPO), which is regarded by many as one of the most successful IPO's of 2014, has prepared the Group well for the demands of being a listed company.

It has also clearly demonstrated the capability of the Bank's management team, particularly when coupled with such strong results. During 2014, the Company comfortably met all the financial objectives set out at IPO, delivering significant loan book and earning growth, robust cost control and a very strong return on equity.

The business remains well placed to take advantage of continued demand in its markets and it is against this background that the Remuneration Committee approved bonus payments and LTIP awards under existing remuneration arrangements to the Executive Directors.

The Remuneration Committee has recently carried out a full year review of base salaries for the Executive Directors, which is the first salary review since our Admission to the London Stock Exchange in June 2014. Our review took into account pay positioning and practice in other publicly quoted companies of a similar size to OneSavings Bank, both within the Financial Services sector and within the wider market. As a result of this review, the Committee determined that the base salaries should be increased to £410,000 for the Chief Executive and £290,000 for the Finance Director in order to align with market rates within comparable UK listed companies.

As a Level 3 PRA regulated firm, we take seriously the requirements of the Remuneration Code. The European Banking Authority (EBA) is currently consulting on a proposal to extend the cap on variable remuneration ratios to Level 3 firms. As a result, the Remuneration Committee has decided to seek shareholder approval to operate within a variable:fixed ratio of 2:1, rather than the 1:1 which firms are restricted to if shareholder approval is not sought for a higher variable pay limit. Our policy is currently designed to operate within the 2:1 ratio, so the Committee considers it important to ensure that our policy can be operated freely in the event that the EBA's proposals come into force.

Employee share ownership

We also wish to encourage share ownership amongst employees to enable them to share in the success of the business. To this end, during the year, the Remuneration Committee also approved the introduction of an all employee UK Sharesave plan.

Shareholder engagement

We are committed to active engagement with our shareholders on remuneration issues. We ensured that major shareholders were kept informed in respect of remuneration prior to the IPO and remuneration proposals disclosed in the IPO prospectus and at roadshows. We also recently sought feedback from our major shareholders in advance of the publication of our Remuneration Policy report, to explain our approach to addressing the salaries of the Executive Directors and the AGM resolution to seek approval for operating within a 2:1 variable:fixed pay ratio should this become applicable.

I welcome any comments from shareholders on remuneration and will be present at the Annual General Meeting of the Company to answer any questions on our Remuneration Policy.

The remainder of the remuneration report is split into two parts, in line with legislative reporting requirements:

- Remuneration Policy report. This sets out remuneration policy for the Directors. The policy report is subject to a binding vote of the shareholders at the Annual General Meeting. If approved by shareholders the policy as outlined in the Policy Report will come into effect on the date of the Annual General Meeting. If there is any change to remuneration policy, the new policy will be re-submitted to shareholders for approval.
- The Annual Report on remuneration sets out how the Remuneration Policy has been implemented during the year. This is subject to an annual advisory vote of shareholders.

Mary McNamara
Chairman of the Remuneration Committee
16 March 2015

Remuneration Policy report

Policy overview

This part of the Directors' remuneration report sets out the Remuneration Policy for the Company and has been prepared in accordance with the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, as amended. The Policy has been developed taking into account a number of regulatory and governance principles, including:

- The UK Corporate Governance Code 2014
- The Listing Rules
- The regulatory framework applying to the Financial Services Sector (including the PRA Remuneration Code and provisions of CRD IV)
- The executive remuneration guidelines of the main institutional investors and their representative bodies.

The policy report will be put to a binding shareholder vote at the 2015 AGM and the Policy will take formal effect from the date of approval. It is currently intended that the Policy will apply for the three-year period following approval, subject to any change which may occur in the external regulatory framework within the sector in which the Company operates.

Objectives of the Remuneration Policy

The over-riding principles of the Remuneration Policy for employees across the Group are as follows:

- Attract, motivate and retain high performing employees
- Adhere to and respond to the regulatory framework for the financial services sector and UK Listed companies more generally
- Strike an appropriate balance between risk taking and reward
- Encourage and support a strong sales and service culture
- Reward the achievement of the overall business objectives of the Group
- Align employees' interests with those of shareholders and customers
- Be consistent with the Group's risk policies and systems to guard against inappropriate risk taking.

In respect of the Executive Directors and senior management, performance-related pay will form a significant but appropriate part of remuneration packages and there will be an appropriate balance between short and longer-term performance targets linked to the delivery of the Group's objectives. The policy is intended to be delivered via a remuneration framework with the flexibility of being able to combine base salary, benefits, commission, annual bonuses and employee share plans.
The specific policy applying to Executive Directors is set out in the table and accompanying notes on page 55.

How we take account of risk in the Remuneration Policy

Risk management is at the heart of our business, and underpins all our business decisions. In the context of remuneration, the Committee takes account of risk in a number of ways, including:

- Ensuring that the balance of remuneration (i.e. absolute pay levels and the balance between fixed and performance-related pay) is appropriate to our business and risk appetite
- In the choice of performance metrics and time horizons applying to incentives, whereby a broad balance of measures is used across our plans
- The use of appropriate underpins and discretions to our incentive plans, allowing the Committee to take account of the wider risk management framework when judging the out-turn under incentive plans
- Having a significant proportion of performance-related pay deferred and paid in shares
- The inclusion of clawback and malus provisions on incentive pay, which may apply for a period of up to seven years following the end of the performance period.

As a Level 3 PRA regulated firm, we also take seriously the requirements of the Remuneration Code. In the design of our Remuneration Policy, we have therefore responded to the evolving regulation in this area, and considered the way in which the EBA cap on variable remuneration may apply to Level 3 Code firms. As a result, we are seeking shareholder approval to increase the cap on our variable pay to up 200% of fixed pay (i.e. a 2:1 ratio), and our Remuneration Policy is designed to operate within this cap.

How the views of shareholders and employees are taken into account

The Committee does not formally consult directly with employees on executive pay but receives periodic updates from the General Manager, Human Resources in relation to salary and bonus reviews across the Company. As set out in the policy table overleaf, in setting remuneration for the Executive Directors, the Committee takes note of the overall approach to reward for employees in the Company and salary increases will ordinarily be (in percentage of salary terms) in line with those of the wider workforce. Thus, the Committee is satisfied that the decisions made in relation to Executive Directors' pay are made with an appropriate understanding of the wider workforce.

The Committee will seek to engage with shareholders and their representative bodies when it is proposed that any material changes are to be made to the Remuneration Policy. In addition, we will consider any shareholder feedback received in relation to the AGM.

This, plus any additional feedback received from time to time, will be considered as part of the Committee's annual review of Remuneration Policy.

As this is the Company's first AGM since listing, no previous voting outcomes are available; we will publish details of remuneration related voting outcomes from the 2015 AGM in next year's report and these will be available on the Company's website following the meeting.

The Remuneration Policy for Executive Directors

The table below and accompanying notes summarise the key aspects of the Company's Remuneration Policy for Executive Directors.

Element	Purpose and link to strategy	Operation and performance conditions	Maximum
Salary	To recruit and reward executives of a suitable calibre for the role and duties required. Recognises individual's experience, responsibility and performance.	Paid monthly. Base salaries are reviewed annually, with any changes effective from 1 April. No performance conditions apply to the payment of salary. However, when setting salaries, account is taken of an individual's specific role, duties, experience and contribution to the organisation. As part of the salary review process, the Committee takes account of the external market for UK listed companies both in the Financial Services sector and across all sectors, in order to ensure that salary positioning is appropriate. Whilst this is not the key driver of salary increases, it provides important background context.	Average annual increases will generally be broadly in line with the average of the workforce. Higher increases may be awarded in response to acute retention issues, an increase in the scope of the role, following the appointment of a new executive (which could also include internal promotions) to bring that executive's package in line with market over a number of years or in response to market factors.
Benefits	To provide market competitive benefits to ensure the well being of employees.	The Company provides: • car allowance (£12,000 and £8,000 for the CEO and CFO respectively) • life assurance • income protection • private medical insurance.	There is no maximum cap on benefits, as the cost of benefits may vary according to the external market but the nature of the benefits themselves will not change.
Pension	To provide retirement planning to employees.	Directors may participate in a defined contribution plan, or, if they are in excess of the HMRC annual or lifetime allowances for contributions, may elect to receive cash in lieu of all or some of such benefit.	Up to 13% of salary, subject to employee matching.
Annual bonus	To incentivise and reward individuals for the achievement of pre-defined, Committee approved, annual financial and operational objectives which are closely linked to the corporate strategy.	The annual bonus targets will have at least a 75% weighting based on performance under an agreed balanced scorecard which includes an element of risk appraisal. The remaining balance will be based on personal performance targets. The objectives in the scorecard, and the weightings on each element will be set annually, and may be flexed according to role. Each element will be assessed independently, but with Committee discretion to reduce the resulting outcome. Details of the performance targets set for the year under review and a summary of performance against them will normally be provided in the annual report on remuneration. 50% of any bonus paid will be made in shares under the OneSavings Bank Deferred Share Bonus Plan 2014 (the DSBP). These deferred shares will vest after three years, provided that the executive remains in employment at the end of the three year period. Clawback/malus provisions apply, as described in note 1 below.	The maximum bonus opportunity is 100% of salary.
Performance Share Plan (PSP)	To incentivise and recognise execution of the business strategy over the longer term. Rewards strong financial performance over a sustained period.	PSP Awards will be made annually at the discretion of the Committee, usually following the announcement of full-year results. Normally, policy awards will be made to Executive Directors and the senior leadership team, based on a mixture of internal financial performance targets and relative total shareholder return. Any vesting will be subject to an underpin, whereby the Remuneration Committee must be satisfied that the business has operated within the Board's risk appetite framework. This takes into account capital adequacy, liquidity, credit risk, operational risk and conduct & compliance risk. The performance targets will be measured over three financial years. Clawback and malus provisions apply and are structured as for the annual bonus.	The PSP has a grant limit of 200% of salary. Actual awards may be lower than this, and will comply with any overall regulation over the permitted level of variable pay.
All-employee share incentive plan (Sharesave Plan)	All employees including Executive Directors are encouraged to become shareholders through the operation of an all-employee share plan.	Tax favoured plan under which regular monthly savings may be made over a three or five year period and can be used to fund the exercise of an option, where the exercise price is discounted by up to 20%. Provides tax advantages to UK employees, with Executive Directors eligible to participate on a similar basis to other employees.	Maximum permitted savings based on HMRC limits from time to time.
Share ownership guidelines	To increase alignment between executives and shareholders.	Executive Directors are expected to build and maintain a minimum holding of shares. Executives must retain at least 50% of the shares acquired on vesting of share awards (net of tax) until the required holding is attained.	At least 200% of salary for the Chief Executive Officer and at least 150% of salary for the Chief Financial Officer or such higher level as the Committee may determine from time to time.

Note

1. Clawback and malus provisions apply to both the annual bonus and PSP. These provide for incentive recovery in the event of the discovery of a material misstatement of results, an error in the calculation of bonus outcome, significant failure of risk management, regulatory censure or in instances of individual gross misconduct discovered within five years of the end of the performance period. A further two years may be applied following such a discovery, in order to allow for the investigation of any such event. In order to effect any such clawback, the Committee may use a variety of methods, with-hold deferred bonus shares, future PSP awards or cash bonuses, or seek to recoup cash already paid.

A description of how the Company intends to implement the policy set out in this table for 2015 is set out in the annual report on remuneration.

Remuneration Policy report continued

Choice of performance measures for Executive Directors' awards

The use of a balanced scorecard for the annual bonus reflects the balance of financial and non-financial business drivers across the Company. The combination of performance measures ties the bonus plan to both the delivery of financial targets and strategic/personal objectives. This ensures there is an appropriate focus on the balance between financial and non-financial targets, with the scorecard composition being set by the Committee from year to year depending on the corporate plan.

The PSP is based on a mixture of financial measures and relative total shareholder return, in line with our key objectives of sustained growth in earnings leading to the creation of shareholder value over the long term. Total Shareholder Return provides a close alignment between the relative returns experienced by our shareholders and the rewards to executives. There is an underpin in place to address risk in the business, taking into account capital adequacy, liquidity, credit risk, operational risk and conduct & compliance risk.

In line with HMRC regulations for such schemes, the SAYE does not operate performance conditions.

How the Remuneration Committee operates the variable pay policy

The Committee operates the share plans in accordance with their respective rules, the Listing Rules and HMRC requirements where relevant. The Committee, consistent with market practice, retains discretion over a number of areas relating to the operation and administration of certain plans, including:

- Who participates in the plans
- When to make awards and payments
- How to determine the size of an award, a payment, or when and how much of an award should vest
- The testing of a performance condition over a shortened performance period
- How to deal with a change of control or restructuring of the Group
- Whether a participant is a good/bad leaver for incentive plan purposes, what proportion of an award vests at the original vesting date or whether and what proportion of an award may vest at the time of leaving
- How and whether an award may be adjusted in certain circumstances (e.g. for a rights issue, a corporate restructuring or for special dividends)
- What the weighting measures and targets should be for the annual bonus plan and PSP from year to year.

The Committee also retains the discretion within the policy to adjust existing targets and/or set different measures for the annual bonus and for the PSP if events happen that cause it to determine that the targets are no longer appropriate and amendment is required so they can achieve their original intended purpose and provided the new targets are not materially less difficult to satisfy.

Any use of the above discretions would, where relevant, be explained in the annual report on remuneration and may, as appropriate, be the subject of consultation with the Company's major shareholders.

Awards granted prior to the effective date

In approving this Directors' Remuneration Policy, authority is given to the Company to honour any commitments entered into with Directors that were entered into prior to the effective date of this policy. Details of any such payments will be set out in the annual report on remuneration as they arise.

Remuneration Policy for other employees

The Committee has regard to pay structures across the wider Group when setting the Remuneration Policy for Executive Directors and ensures that policies at and below the executive level form a coherent whole. There are no significant differences in the overall remuneration philosophy, although pay is generally more variable and linked more to the long term for those at more senior levels.

The Committee's primary reference point for the salary reviews for the Executive Directors is the average salary increase for the broader workforce.

A highly collegiate approach is followed in the assessment of annual bonus, with our corporate scorecard being used to assess bonus outcomes throughout the organisation, with measures weighted according to role, where relevant.

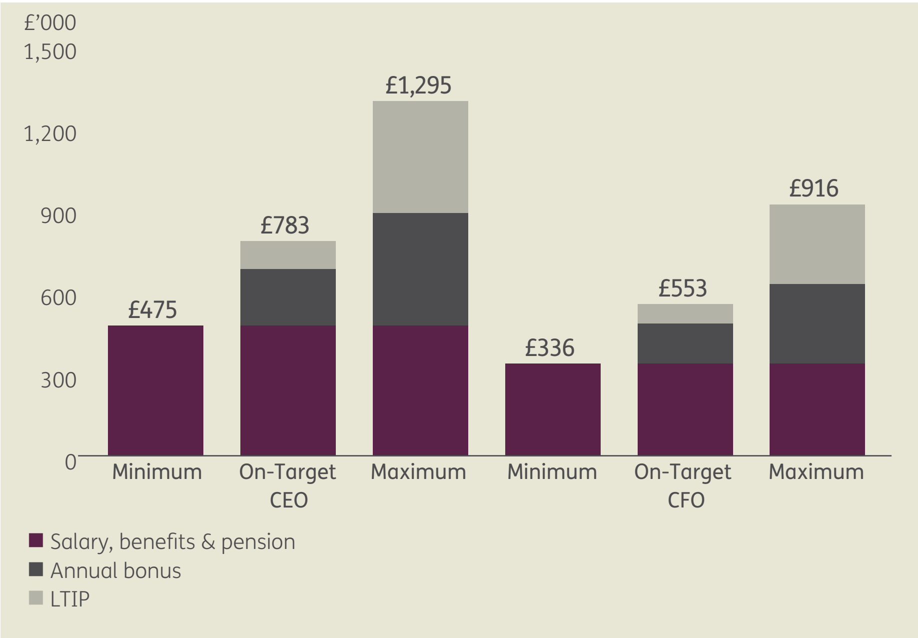
Overall, the Remuneration Policy for the Executive Directors is more heavily weighted towards performance-related pay than for other employees. In particular, performance-related long term incentives are not provided outside of the most senior executive population as they are reserved for those considered to have the greatest potential to influence overall levels of performance.

Although PSP is awarded only to the most senior managers in the Group, the Company is committed to widespread equity ownership. Accordingly, in 2014, our Sharesave Plan offer was launched for all employees. Executive Directors are eligible to participate in this plan on the same basis as other employees.

Illustrations of application of Remuneration Policy

The chart below illustrates how the composition of the Executive Directors' remuneration packages, as it is intended the policy will be implement in 2015, would vary under various performance scenarios.

Notes:
1. Minimum performance assumes no award is earned under the annual bonus plan and no vesting is achieved under the LTIP – thus only fixed pay (salary, benefits and pension are payable).
2. At on-target, half of the annual bonus is earned (i.e. 50% of salary) and 25% of salary is achieved under the LTIP (i.e. 25% of maximum).
3. At maximum full vesting is achieved under both plans (i.e. 100% of salary). Share price growth is ignored.
4. All-employee share plan participation is ignored.



Service contracts

The terms and provisions that relate to remuneration in the Executive Director service agreements are set out below:

Provision	Policy
Notice period	Twelve months on either side
Termination payments	A payment in lieu of notice may be made on termination to the value of their basic salary at the time of termination. Such payments may be made in instalments and in such circumstances can be reduced to the extent that the Executive Directors mitigate their loss. Rights to DSBP and PSP awards on termination are shown on page 57. The employment of each Executive Director is terminable with immediate effect without notice in certain circumstances, including gross misconduct, fraud or financial dishonesty, bankruptcy or material breach of obligations under their service agreements.
Remuneration	Salary, pension and core benefits are specified in the agreements. There is no contractual right to participate in the annual bonus plan or to receive long term incentive awards.
Post-termination restrictions	These include six month post termination restrictive covenants against competing with the Company; nine month restrictive covenants against dealing with clients or suppliers of the Company; nine month restrictive covenant against soliciting clients, suppliers and key employees.
Contract date	Andy Golding 19 May 2014, April Talintyre 19 May 2014
Unexpired term	Rolling contracts

Payments for loss of office

Annual bonus on termination

On termination, executives will be contractually entitled to salary over their notice period. Payments may be phased and subject to mitigation. There is no automatic/contractual right to bonus payments. For good leavers, the Remuneration Committee may elect to pay a pro-rata bonus for the period of employment at its discretion and based on full year performance.

PSP on termination

Share-based awards normally lapse on termination. In certain good leaver situations, awards would normally be time pro-rated taking into account the extent to which the performance conditions have been met if the executive is a good leaver. In the event that any departure is made from this default treatment of good leavers, the Committee's rationale would be set out in the annual report on remuneration.

The Company may also pay reasonable legal costs in respect of any compromise settlement.

In determining 'good leaver' status, best practice would be to stay within definitions of scheme rules i.e. death, ill health, injury, disability, retirement, redundancy, or his employing business being sold out of the Group. However, as is permitted under the rules, the Remuneration Committee will need to retain flexibility for the range of potential different circumstances, taking into account the individual's performance and the reasons for their departure. Where an executive is determined as a 'good leaver' by the Committee, this discretion and a rationale for the determination will be set out in the remuneration report.

Service contracts are available for inspection at the Company's registered office.

Approach to recruitment and promotions

The remuneration package for a new Director would be set in accordance with the terms of the Company's approved Remuneration Policy and subject to any prevailing limits imposed by the PRA Code. Currently, this would facilitate annual bonus of 100% of salary and PSP award of up to 200% of salary (lower if the regulatory framework prescribes this).

On recruitment, salary policy may (but need not necessarily) be set below the normal market rate, with phased increases as the executive gains experience. The rate of salary should be set so as to reflect the individual's experience and skills.

In addition on recruitment, the company may compensate for amounts foregone from a previous employer (using cash awards, the Company's share plans or awards under Listing Rule 9.4.2 as may be required) taking into account the quantum foregone; the extent to which performance conditions apply; form of award; and the time left to vesting.

For an internal appointment, any variable pay element awarded in respect of their prior role should be allowed to pay out broadly according to its terms. Any other ongoing remuneration obligations existing prior to appointment may continue, provided that they are put to shareholders for approval at the earliest opportunity.

For all appointments, the Committee may agree that the company will meet certain appropriate relocation costs.

For the appointment of a new Chairman or Non-Executive Director, the fee arrangement would be in accordance with the approved Remuneration Policy in force at that time.

External appointments

Executive Directors may accept directorships of other quoted and non-quoted companies with the consent of the Board who will consider in particular the time commitment required. It is also at the discretion of the Board as to whether the Executive Director will be able to retain any fees from such an appointment.

Chairman and Non-Executive Directors' remuneration

The Company has appointed a Non-Executive Chairman and eight Non-Executive Directors. Five of are Independent Non-Executive Directors. Two of the Non-Executive Directors, Dr David Morgan and Tim Hanford, (the JCF Directors) are Directors nominated by the major shareholder OSB Holdco Limited in accordance with the terms of the Relationship Agreement, further details of which are given on page 41.

Remuneration Policy report continued

The remuneration policy for the Chairman and Non-Executive Directors

The table summarises the key aspects of the remuneration policy for the Chairman and Non-Executive Directors.

Element	Purpose and link to strategy	Operation	Maximum opportunity
Fees	To attract and retain a high-calibre Chairman and Non-Executive Directors by offering a market competitive fee level.	The Chairman and Non-Executive Directors are entitled to an annual fee, with supplementary fees payable to the Chair of the Audit, Remuneration, Nomination and Risk Committees and for acting as the Senior Independent Director. Fees are reviewed annually. The Chairman and Non-Executive Directors are entitled to reimbursement of travel and other reasonable expenses incurred in the performance of their duties The level of these fees will be reviewed annually by the Board.	There is no prescribed maximum annual increase. The Committee is guided by the general increase in the Non-Executive market but on occasions may need to recognise, for example, change in responsibility and/or time commitments.

Letters of appointment

The Non-Executive Directors, (apart from the JCF Directors) are appointed by letters of appointment that set out their duties and responsibilities. The key terms are:

Provision	Policy
Period of appointment	Initial three year term
Notice periods	Three months on either side The appointments are also terminable with immediate effect and without compensation or payment in lieu of notice if the Chairman or Non-Executive Director (apart from the JCF Directors) is not re-elected to their position as a director of the Company by shareholders.
Payment in lieu of notice	The Company is entitled to make a payment in lieu of notice on termination.

Letters of appointment are available for inspection at the Company's registered office.

JCF Directors

Tim Hanford and Dr David Morgan are nominated by the major shareholder. Their appointments will terminate in accordance with the terms of the Relationship Agreement. Under the Relationship Agreement, the major shareholder will receive an annual fee of £60,000 from the Company in respect of each JCF Director that it appoints to the Board, in consideration for the provision of the Director's time and expertise. Where the Relationship Agreement allows, the fees for each of the JCF Directors may be increased in line with other Non-Executive Director fee increases. Neither Tim Hanford nor Dr David Morgan receives fees for the provision of their services.

Annual report on remuneration

Introduction

This section sets out details of the remuneration of the Executive and Non-Executive Directors (including the Chairman) received during the financial year ended 31 December 2014 and also describes the operation of the Remuneration Committee. The annual report on remuneration will, together with the annual statement of the Remuneration Committee Chairman on pages 52 to 53, be proposed for an advisory vote by shareholders at the forthcoming Annual General Meeting to be held on 2 June 2015. Where required, data has been audited by KPMG LLP and this is indicated where appropriate. In preparing this report consideration has been given to the GC100 and Investor Group Directors' Remuneration Reporting Guidance.

Remuneration Committee

Membership

Membership of the Remuneration Committee during the year and attendance by individual Committee members at meetings is shown below. The Remuneration Committee met nine times during the year.

Committee member	From	To	Number of meetings attended[1]
Mary McNamara (Committee Chairman)	19 May 2014	To date	6/6
Malcolm McCaig	01 February 2014	To date	9/9
Nathan Moss	19 May 2014	To date	6/6
Tim Hanford	01 February 2011	19 May 2014	3/3
David Mills	01 February 2011	02 May 2014	3/3

1. Attendance shown out of total number of meetings eligible to attend.

The Board considers each of the members of the Committee to be independent in accordance with the Code. The Chairman of the Board, Chief Executive and General Manager, HR also attend meetings of the Committee by invitation, but neither are present when matters relating to their own remuneration are discussed.

Role of the Remuneration Committee

The Remuneration Committee's responsibilities are set out in its terms of reference which are available on request to shareholders and on the Company's website. Its role includes:

- Setting the Remuneration Policy for all Executive Directors of the Company and the Chairman of the Board, the Company Secretary and all employees that are identified as Code Staff for the purposes of the Prudential Regulation Authority's Remuneration Code ('Code Staff' and 'the PRA Code' respectively)
- Within the terms of the Remuneration Policy and in consultation with the Chairman of the Board and/or Chief Executive, as appropriate, determine the total individual remuneration package of each Executive Director and the Chairman and other designated senior executives including bonuses, incentive payments and share option or other share awards
- Approve the design of, and determine targets for, any performance related pay schemes operated by the Company and approve total annual payments made under such schemes. The Committee will seek input from the Chief Risk Officer to ensure that awards reflect the Company's risk appetite and profile and takes into account current and potential future risks
- Ensure that contractual terms on termination, and any payments made, are fair to the individual, and the Company, that failure is not rewarded and that the duty to mitigate loss is fully recognised.

In carrying out its duties the Remuneration Committee takes into account any legal requirements, the PRA Code, UK Corporate Governance Code and UK Listing Rules. Determining the fees of the Non-Executive Directors is a matter for the Board as a whole.

Key matters considered by the Remuneration Committee

Key issues reviewed and discussed by the Remuneration Committee during the year included:

- Review and consideration of remuneration policy on and after admission, including review of proposed incentive schemes, performance metrics, clawback arrangements, bench marking data, Executive Director salaries and service agreements
- Share award to the Chairman
- Consideration of balanced business scorecard proposals, targets and bonus triggers
- SAYE Scheme award
- Review of Directors' remuneration report
- Review of the Committee's effectiveness.

Annual report on remuneration continued

Advisers to the Committee

Material advice or services were provided to the Committee during the year by the following advisers:

Adviser	Area of advice/services provided	Fee for 2014
New Bridge Street (part of Aon plc)	Remuneration consultants to the Committee. Provisions of advice on all aspects of executive remuneration including development of Remuneration Policy, guidance on performance metrics and benchmarking exercises. The majority of the fee for 2014 related to reviewing and preparing the Remuneration Policy.	£145,056
Ashurst LLP	Drafting Executive service contracts, rules for the DSBP, PSP and Sharesave scheme.	£70,000

New Bridge Street (NBS) was appointed by the Committee and neither NBS nor Aon plc have any other connection with the Group and therefore the Committee is satisfied that it provides objective and independent advice. New Bridge Street is a member of the Remuneration Consultants Group and abides by the voluntary code of conduct of that body, which is designed to ensure objective and independent advice is given to remuneration committees.

Ashurst LLP is the Company's legal adviser. It provided no further remuneration advice apart from that indicated above.

The Committee also receives advice and guidance on senior executive remuneration from the Chief Executive Officer, Chief Financial Officer and General Manager, Human Resources. The Group General Counsel and Company Secretary advises the Committee in respect of the UK Corporate Governance Code, share schemes and also acts as secretary to the Committee, ensuring that the Remuneration Committee fulfils its duties under its terms of reference and provides regular updates to the Remuneration Committee on relevant regulatory developments in the UK. No individual is present in discussions directly relating to their own pay.

Single total figures of remuneration – Executive Directors (audited information)

The table below sets out a single figure for the total remuneration received by each Executive Director for the year ended 31 December 2014 and the prior year:

Executive Directors	Year	Basic salary £000	Taxable benefits[1] £000	Pension £000	Annual bonus £000	Vested LTIP £000	Total
Andy Golding	2014	349	12	45	347	23	777
	2013	306	30	40	142	–	518
April Talintyre	2014	252	8	33	240	9	543
	2013	230	8	30	86	–	354

Notes:
1. Taxable benefits for 2014 include a company car allowance and private medical health insurance. Andy Golding's taxable benefit for 2013 included a relocation allowance.
2. 50% of Directors' annual bonuses in 2013 were deferred in cash until 2016. Andy Golding received £71,250 in April 2014 and will receive the other half (£71,250) in April 2016. April Talintyre received £43,000 in April 2014 and will receive the other half (£43,000) in April 2016.
3. 50% of the 2014 Annual Bonus figures that are detailed will be made in shares under the OneSavings Bank Deferred Share Bonus Plan 2014.
4. Prior to the IPO the Executive Directors participated in an existing management incentive plan (the MIP) under which they subscribed for ordinary shares and 'growth shares' in OSB Holdco Limited. The growth shares entitled them to share in the net proceeds realised by the OSB Holdco Limited from its investment in the Company above a hurdle rate of return. As part of the IPO, OSB Holdco Limited sold Ordinary Shares representing up to 30 per cent by value of these respective interests under the MIP as determined by reference to the value of the OSB Holdco's shareholding in the Company on Admission (including the proceeds of its sale of Ordinary Shares at such time) and net proceeds were paid to the Participants.

Executive Directors' salary (audited information)

	Salary as at 1 January 2014	Salary from 1 April 2014	Post IPO salary from 1 June 2014	Total salary paid in 2014
Andy Golding	308,250	320,000	375,000	349,145
April Talintyre	231,187	240,000	265,000	252,380

Executive Directors' pension (audited information)

The Executive Directors participate in a defined contribution pension scheme. They are entitled to a pension contribution equal to 1% of salary for every 0.5% contribution made by the Executive Director up to a maximum of 13%.

Contributions for each Director are shown in the table below.

Executive Director	Contributions paid in 2014 £'000
Andy Golding	45
April Talintyre	33

Executive Directors

Executive Bonus Scheme: 2014 performance against targets (audited)

In 2014 the Executive Directors were eligible to participate in the Executive Bonus Scheme under which cash bonuses were awarded according to the success in the delivery of corporate and individual objectives. Cash bonuses were capped at a maximum of 100% of basic salary at the year end. 50% of the bonus awarded was deferred into shares under the Deferred Share Bonus Plan and held for a three-year period. The deferred part of the award does not have any further performance conditions attached however it is subject to clawback. If the Executive Director leaves prior to vesting any entitlement to the deferred shares is forfeited unless for a good leaver reason such as redundancy, retirement or ill health.

A breakdown of the elements of the annual bonus, including the components in The Business Balanced Scorecard is set out below, including a summary of the headline metrics, the targets set and our performance against them.

			Performance achieved (% of bonus earned)		
Measure	Weighting	Measure	Andy Golding	April Talintyre	Commentary
Financial	35%	Various, including: Profitability; Growth; Capital; Return on Equity; Cost:Income Ratios.	33.75%	34%	All financial Key Performance Indicators were set at a stretch level at the start of 2014. During a year of significant change, performance versus all but one of these measures was significantly in excess of target, hence the bonus awarded for both individuals being close to the maximum available. For example: • Cost:income ratio – 2014 target <35% v actual 28%, • Return on equity – 2014 target >25% v actual 31%, • Underlying profit before tax – 2014 target £43m v actual £69.7m.
Non-financial	10%	Staff (Headcount & Attrition)	7.75%	7.75%	The company set a number of stretching targets for meeting headcount plans and minimising employee attrition. Whilst all targets were broadly achieved, not all targets were exceeded; hence the bonus earned not being at the maximum.
	15%	Customer (Satisfaction & Retention)	15%	15%	All customer related targets were exceeded, resulting in bonus earned in this area being at the maximum level.
	15%	Quality (Compliance, Credit Risk & Operational)	11.13%	9%	With the exception of one measure, all of the other stretching KPI's within this area were achieved or exceeded. April Talintyre's bonus earned was less than Andy Golding's, due to the individual weighting applied to the sole KPI that was not achieved.
	25%	Personal Performance (Subject to Year End Appraisal)	25%	25%	Both individuals achieved 'Outstanding' Year End Appraisal ratings, taking into account their overall performance versus individual objectives which were set at the beginning of 2014, and achieved in a year of considerable change.
Annual bonus (% of salary)	100%		92.63%	90.75%	

Notes:
The weightings are considered by the Remuneration Committee each year to ensure they reflect an appropriate balance of priorities for management. Where a change of emphasis is considered to be necessary, the weightings will be amended in future years.

Annual report on remuneration continued

Percentage change in the remuneration of the Chief Executive Officer

The table below sets out the percentage change in base salary, value of taxable benefits and bonus for the CEO compared with the average percentage change for employees. For these purposes UK employees who have been employed for over a year (and therefore eligible for a salary increase) have been used as a comparator group as they form the majority of the all employee population.

Change in Chief Executive Officer and employee pay from 2013 to 2014.

	Average percentage change 2013-2014		
	Salary	Taxable benefits	Annual bonus
Chief Executive Officer	14%	–60%	144%
UK Employees	7.16%	n/a	47%

Notes:
1. The CEO total Annual bonus opportunity in 2013 was capped at 50% of basic salary. In 2014 the total annual bonus opportunity was capped at 100% of basic salary.
2. An Executive Bonus Scheme was introduced in 2014 whereby Exco members could earn up to 80% of basic salary subject to performance criteria. In 2013 the maximum bonus that could be earned was 40% of basic salary.
3. The increase in average salary for UK employees includes all those employees eligible for an increase in April 2015 versus their respective salaries at April 2014. It therefore takes into account performance during the 2014 calendar year. It excludes those employees not eligible for an increase (namely those who have joined post October 2014).

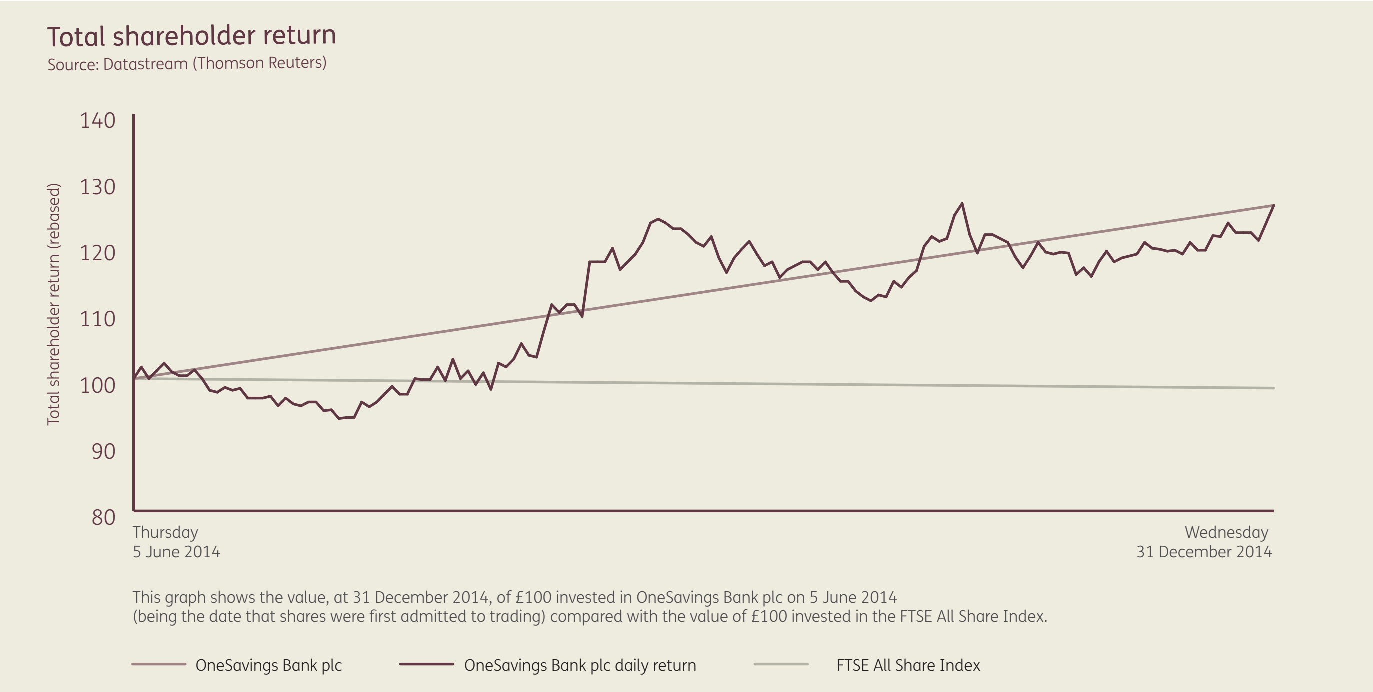
Comparison of Company performance and CEO remuneration

The following table summarises the CEO single figure for total remuneration and annual bonus pay-out as a percentage of maximum opportunity in 2014. As the Company only listed in 2014 there is no disclosure over a five year period as required by the regulations.

	2013	**2014**
Chief Executive Officer	Andy Golding	**Andy Golding**
Annual bonus (as a % of maximum opportunity)	92.5%	**92.63%**
CEO single figure of remuneration (£'000)	518	**777**

Total shareholder return

The graph below shows the Total Shareholder return performance of the Company over the period from Listing to 31 December 2014 to the performance of the FTSE All Share Index. This index is considered to be the most appropriate index against which to measure performance as the Company is a member of this index. As OneSavings Bank has only been listed for a short period during 2014 the entire historical performance to date as well as the statutory requirement to show movement in performance between listing and financial year ends has been shown.



Relative importance of the spend on pay

The chart below shows the Company's total employee remuneration (including the Directors) compared to operating profit before tax for the year under review and the prior year. The Company has not paid any dividends or made any share buybacks during the financial year. In order to provide context for these figures, underlying operating profit as a key financial metric used for remuneration purposes has been shown.

	2013	2014
Total employee costs	£13.4m	**£18.7m**
Distributions to shareholders	Nil	**Nil**
Underlying Profit Before Tax	£30m	**£69.7m**
Total Employee Costs v PBT	44.7%	**26.8%**
Average Headcount	341	**440**
Average PBT Per Employee	£87,976	**£158,409**

Notes:
1. Total assets were £4,936.4m in 2014 (£3,763.9m in 2013). Staff costs were £18.7m in 2014 (£13.4m in 2013). The increase in staff costs reflects the increase in staff numbers.

Implementation of Remuneration Policy for Executive Directors for 2015

Salary

Salary reviews are normally carried out in Q1 every year and take effect from 1 April in that year. It is the intention that the remuneration policy as set out in the policy report in respect of salary increases is applied. The Remuneration Committee has recently carried out a full year review of base salaries for the Executive Directors, which is the first salary review since our admission to the London Stock Exchange in June 2014. Our review took into account pay positioning and practice in other public quoted companies of a similar size to OneSavings Bank, both within the financial services sector and within the wider market. As a result of this review, the Committee determined that the base salaries should be increased to £410,000 for the Chief Executive and £290,000 for the Finance Director in order to align with market rates within comparable UK listed companies. As a result, the salaries for the Executive Directors during 2015 are:

Executive Director	Base salary from 1 January 2015 to 31 March 2015	Base salary from 1 April 2015
Andy Golding	£375,000	£410,000
April Talintyre	£265,000	£290,000

Benefits

These will remain as a car allowance, private medical insurance and life assurance for the Executive Directors.

Pension

The current pension arrangements described above will remain in place for the forthcoming financial year.

Annual bonus – Deferred Share Bonus Plan (DSBP)

The operation of the bonus plan for 2015 will be consistent with the framework detailed in the policy section of this report. The maximum opportunity for the year ending 31 December 2015 will be 100% of salary for all Executive Directors. Awards will be determined based on a 75:25 weighting between both financial results using a balanced scorecard approach, and strategic/personal performance.

Half of any bonus payment will be subject to 50% of payment made in shares under the DSBP, and clawback/malus provisions apply as detailed in the policy report.

75%	Balanced Business Scorecard	Max percentage weighting	+	25%	=	Annual Bonus Outcome
	Financial (and risk)	35%		Personal performance		(subject to over-riding Committee discretion to adjust downwards and clawback/malus)
	Customer	15%				
	Quality	15%				
	Staff	10%				

Proposed target levels have been set to be challenging relative to the 2015 business plan. Specific targets are deemed to be commercially sensitive. However, the Committee intends to disclose these retrospectively in next year's remuneration report to the extent that they do not remain commercially sensitive.

Annual report on remuneration continued

Performance Share Plan (PSP)
The first awards under the PSP will be made in March 2015. Awards for the Executive Directors will be 100% of salary.

The performance conditions applying to 2015 awards will be based on a combination of Earnings per Share (EPS) and total shareholder return (TSR); an equal weighting will apply to both, and they will be assessed independently. For the EPS element, growth targets are linked to the Company's three year growth plan, measuring growth from the base figure of 2014. For the TSR element, OneSavings Bank's relative performance is measured against the FTSE All Share index excluding Investment Trusts. The payout schedules for each element are set out below:

Performance level	EPS element (50% of total award)	TSR element (50% of total award)	% of that part of the award vesting
Below 'threshold'	Below 12% p.a.	Below median	0%
'Threshold'	12% p.a.	Median	25%
'Stretch'	18% or above	Upper quartile	100%
Pro-rata vesting in between the above points			

Once the provisional out-turn has been calculated, the Remuneration Committee will review the operation of the business against the Board's risk appetite framework, taking into account, capital, liquidity, credit, operational and conduct & compliance risk and may exercise its discretion to reduce the awards, potentially to zero, in the event of a breach of this risk appetite.

All employee share plans
It is planned to make an offer under the Company's SAYE scheme to all UK employees in 2015 (including to the Executive Directors) and at regular intervals thereafter.

Share ownership requirements
The required share ownership level for the Executive Directors for 2015 will be as set out in the policy report.

External Board appointments
Andy Golding is a Director/trustee of Building Societies Trust Limited but receives no remuneration for this position.

Single total figures of remuneration – Chairman and Non-Executive Directors (audited information)
The table below sets out a single figure for the total remuneration received by the Chairman and each Non-Executive Director the year ended 31 December 2014. As the Company listed in 2014 there is no prior year disclosure.

	Fees 2014 £000
Chairman	
Mike Fairey – Appointed 2 April 2014	193
Non-Executive Directors	
Graham Allatt – Appointed 6 May 2014	44
Rod Duke	68
Tim Hanford	53
Malcolm McCaig	61
Mary McNamara – Appointed 6 May 2014	47
Dr David Morgan	53
Nathan Moss – Appointed 14 May 2014	40
Stephan Wilcke	258
Past Directors	
Sir Callum McCarthy – Resigned 2 May 2014	17
David Mills – Resigned 2 May 2014	37
Total	

Notes
1. Mike Fairey's basic fee for acting as Chairman was £100k. He also received a £51k share subscription payment with an additional £42k gross up.
2. Stephan Wilcke was Executive Chairman from early 2012 to 1 April 2014. His emoluments in respect of his 2014 period of employment include salary of £106,626, £102,300 in bonus payments and a £13,861 pension payments.
3. Sir Callum McCarthy and David Mills also received £68k and £272k relating to IPO awards.
4. The figure disclosed for David Mills includes an additional payment of £16k for work in assisting with the recruitment of three new Non-Executive Directors over and above his normal duties as a Non-executive Director.

Non-Executive Directors cannot participate in any of the Company's share schemes and are not eligible to join a Company pension scheme.

Implementation of Non-Executive Director remuneration policy

Chairman and Non-Executive Director fees

The annual fees for serving as a Non-Executive Director were reviewed and agreed by the Board prior to listing. The fee levels that apply from listing to date are set out below.

Base Fees	2014 Fees
Chairman	£150,000
Non-Executive Director	£60,000
Additional fees	
Senior Independent Director	£10,000
Audit Committee Chair	£10,000
Remuneration Committee Chair	£10,000
Nomination Committee Chair	£10,000
Risk Committee Chair	£10,000

Payments to departing Directors

During the year, the Company has not made any payments to past Directors; neither has it made any payments to Directors for loss of office.

Statement of Directors' shareholdings and share interests (audited information)

Share ownership guidelines

The Remuneration Committee has approved share ownership guidelines which require the Chief Executive Officer to accumulate and maintain a holding in ordinary shares in the Company equivalent to no less than 200% of salary and the Chief Financial Officer 150% of salary. 50% of any vested share awards must be retained until the guideline is achieved.

Executive Directors' interests in shares of the Company

	Total number of shares at 31 December 2014	Interests in share incentive schemes awarded without performance conditions at 31 December 2014	Interests in share incentive schemes awarded subject to performance conditions as at 31 December 2014	Shareholding requirement (% of basic salary)	Current shareholding (% of basic salary)
Andy Golding	3,823,522	–	–	200%	2,187%
April Talintyre	1,529,415	6,716	–	150%	1,243%

Notes
1. As at and based on the share price of 214.5 pence on 30 December 2014.
2. There were no changes to directors' interests in the Company's shares during the period 31 December 2014 and 11 March 2015.

The Executive Directors are subject to lock up arrangements in respect of their ordinary shares held in the Company for a period of 360 days from the date of the underwriting agreement (5 June 2014).

Annual report on remuneration continued

Non-Executive Directors' shareholdings (audited information)

Non-Executive Director	Shareholding as at 31 December 2014
Graham Allatt	–
Rod Duke	94,537
Mike Fairey	30,000
Tim Hanford	–
Malcolm McCaig	111,805
Mary McNamara	–
Dr David Morgan	–
Nathan Moss	–
Stephan Wilcke	2,999,711

The following information was disclosed in the IPO Prospectus at the time of listing. The Chairman received an award of 30,000 ordinary shares for his services in preparing the Company for Listing. He is required to hold these shares while he remains as a Director of the Company, subject to the discretion of the Remuneration Committee. Stephan Wilcke is required to accumulate and maintain a holding of shares in the Company equivalent to no less than two times his Non-Executive Director fees. Rod Duke and Malcolm McCaig received an award of 106,481 and 159,722 ordinary shares respectively as nil price options (the 'IPO Awards') which vested immediately on listing. They were able to dispose of up to 30 per cent by value of the ordinary shares in which they were indirectly interested following the vesting of their IPO awards. All Non-Executive Directors are subject to lock up arrangements in respect of their ordinary shares held in the Company for a period of 180 days from the date of the underwriting agreement (5 June 2014). There are no other share ownership guidelines for Non-Executive Directors.

Directors' share awards (audited information)

Share awards made under the Sharesave Scheme granted to each of the serving Directors are set out in the table below. There were no grants under the DSBP or the PSP in 2014. No price was paid for any share award. There have been no changes to the terms and conditions of any share awards granted to Directors.

Directors	Scheme	Year	At beginning of year (number of shares)	Granted during the year (number of shares)	Released/ Exercised during the year (number of shares)	Lapsed/ waived during the year (number of shares)	At end of year (number of shares)	Exercise price (pence)	Date on which vests/becomes exercisable	Expiry of exercise period
April Talintyre	Sharesave	2014	–	6,716	–	–	6,716	134	18 July 2017	18 Jan 2018

Statement of voting on the remuneration report at the AGM

This will be the first year that the Directors' remuneration report will be put to shareholders for approval. The results of the vote will be disclosed in next year's Annual report on remuneration.

Approval

This report was approved by the Board of Directors, on the recommendation of the Remuneration Committee, on 16 March 2015 and signed on its behalf by:

Mary McNamara
Chairman of the Remuneration Committee
16 March 2015

Directors' report

The Directors present their Annual Report and the audited financial statements of the Group for the year ended 31 December 2014.

Share capital

Details of the Company's share capital are set out on page 99.

Employee share schemes

Details of the Company's employee share schemes are set out on page 86.

Results and dividends

The results for the year are set out in the statement of profit or loss on page 72. The Directors recommend the payment of a final dividend of 3.9 pence per share (2013: nil) on 5 June 2015 subject to approval at the Annual General Meeting on 2 June 2015, with a record date of 15 May 2015.

Directors

The Directors who served the Company during 2014 and up to the date of this report are listed on pages 36 to 37.

The following Board changes have occurred during the year:

Mike Fairey	Appointed 2 April 2014
Malcolm McCarthy	Retired 2 May 2014
David Mills	Retired 2 May 2014
Graham Allatt	Appointed 6 May 2014
Mary McNamara	Appointed 6 May 2014
Nathan Moss	Appointed 14 May 2014

Details of the current Directors, together with their biographies, can be found on pages 36 to 37.

Directors' interests

Directors' interests in the shares of the Company during the year are shown on page 65 in the Remuneration Report.

Directors' indemnities

The Company's Articles of Association provide, subject to the provisions of UK legislation, an indemnity for Directors and officers of the Company and the Group in respect of liabilities they may incur in the discharge of their duties or in the exercise of their powers, including any liabilities relating to the defence of any proceedings brought against them which relate to anything done or omitted, or alleged to have been done or omitted, by them as officers or employees of the Company and the Group.

Directors' and officers' liability insurance cover is in place in respect of all the Company's Directors.

Directors' powers

As set out in the Company's Articles of Association, the business of the Company is managed by the Board who may exercise all the powers of the Company.

Appointment and removal of Directors

The Board may appoint a Director, either to fill a vacancy or as an addition to the existing Board. This Director must retire at the next AGM of the Company and put themselves forward for reappointment by the shareholders. In addition to any power of removal conferred by the Companies Act, the Company may, by special resolution, remove any Director before the expiration of his period of office and may, subject to the Articles, by ordinary resolution appoint another person who is willing to act as a Director in his place.

Equal opportunities

OneSavings Bank is committed to applying its Equality and Diversity policy at all stages of recruitment and selection. Shortlisting, interviewing and selection will always be carried out without regard to gender, gender reassignment, sexual orientation, marital or civil partnership status, colour, race, nationality, ethnic or national origins, religion or belief, age, pregnancy or maternity leave or trade union membership. Any candidate with a disability will not be excluded unless it is clear that the candidate is unable to perform a duty that is intrinsic to the role, having taken into account reasonable adjustments. Reasonable adjustments to the recruitment process will be made to ensure that no applicant is disadvantaged because of his/her disability. Line managers conducting recruitment interviews will ensure that the questions that they ask job applicants are not in any way discriminatory or unnecessarily intrusive.

Employee engagement

Employees are kept informed of developments within the business and in respect of their employment through a variety of means, such as staff meetings, briefings and the intranet. Employee involvement is encouraged and views and suggestions are taken into account when planning new products and projects.

Greenhouse gas emissions

Emission type	CO_2e tonnes
Scope 1: Combustion	41.97
TOTAL Scope 1 emissions	41.97
Scope 2: Purchased energy	318.32
TOTAL Scope 2 emissions	318.32
Total emissions	**360.30**

Greenhouse Gas Emissions Intensity Ratio:

Total footprint (scope 1 and scope 2) – CO_2e	360.30
Turnover (£000)	118,911
Intensity ratio (tCO_2e/£1,000)	0.003

Notes:
- Our methodology has been based on the principles of the Greenhouse Gas Protocol.
- We have reported on all the measured emissions sources required under The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013, except where stated.
- This includes emissions under Scope 1 and 2, except where stated, but excludes any emissions from Scope 3.
- Conversion factors for electricity, gas and other emissions are those published by the Department for Environment, Food and Rural Affairs in 2014.
- Turnover has been taken from year end accounts 2014.

Statement of exclusions:
- Global diesel and petrol use (for vehicles) has been excluded from the report on the basis that it is not readily obtainable.
- Global F-gas emissions have been excluded from the report on the basis that it is not readily obtainable.
- The scope of reporting for electricity and gas emissions has been restricted to wholly owned properties. Tenanted buildings have been excluded due to lack of data.

Political donations

Neither the Company nor any of its subsidiaries made any political donations this year.

Major shareholders

As at 11 March 2015, there were 243,079,965 ordinary shares in issue. The Company has been notified to 11 March 2015 under the provision of the DTRs of the following significant interests in the voting rights of the Company:

	Percentage of current issued share capital
JC Flowers & Co	64.74%

Note:
All interests disclosed to the Company in accordance with DTR5 that have occurred, can be found on the News section of our corporate website: www.osb.co.uk.

Directors' report continued

Annual General Meeting

Accompanying this report is the Notice of the AGM which sets out the resolutions for the meeting, together with an explanation of them. This year's AGM will held on 2 June 2015 at The Lincoln Centre, 18 Lincoln's Inn Fields, London. The meeting will start at 2pm with registration from 1.30pm.

Audit

Each of the persons who is a Director at the date of approval of this report confirms that:

- So far as the Director is aware, there is no relevant audit information of which the Company's auditor is unaware
- The Director has taken all the steps that he/she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

KPMG LLP has indicated their willingness to continue holding office as auditor. A resolution to reappoint KPMG LLP as auditor will be put to shareholders at the forthcoming AGM.

Going concern statement

The Directors have undertaken a going concern assessment in accordance with 'Going Concern and Liquidity Risk Guidance for UK directors of UK Companies 2009', published by the Financial Reporting Council in October 2009.

As a result of this assessment, the Directors are satisfied that the Group and the Company have adequate resources to continue to operate as a going concern for the foreseeable future and have prepared the financial statements on that basis. In assessing whether the going concern basis is appropriate, the Directors have considered the information contained in the financial statements, the latest business plan, profit forecasts and the latest working capital forecasts.

These forecasts have been subject to sensitivity tests and having reviewed the ICAAP and ILAA and the Directors are satisfied that the Group and the Company have adequate resources to continue in operational existence for the foreseeable future.

Key information in respect of the Group's risk management framework, objectives and processes for mitigating risks including liquidity risk are set out in detail on pages 28 to 33.

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and accounts in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors are required to prepare the Group financial statements in accordance with IFRS as adopted by the European Union and Article 4 of the International Accounting Standards Regulation (IAS). The Directors have elected to prepare the parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law).

Under company law the Directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

In preparing the parent company financial statements, the Directors are required to:

- Select suitable accounting policies and then apply them consistently;
- Make judgements and accounting estimates that are reasonable and prudent
- State whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

In preparing the Group financial statements, IAS 1 requires that Directors:

- Properly select and apply accounting policies
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information
- Provide additional disclosures when compliance with the specific requirements in IFRS are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance
- Make an assessment of the Company's ability to continue as a going concern.

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

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report, Directors' Report, Directors' Remuneration Report and Corporate Governance Report that complies with that law and those regulations. The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the relevant financial reporting framework, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole
- the Strategic Report includes a fair review of the development and performance of the business and the position of the company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face
- the Annual Report and accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary to assess the Group's performance, business model and strategy.

Corporate governance statement

The Company's Corporate Governance Report, which includes a statement as to the Company's compliance with the UK Corporate Governance Code 2012 during the year under review, is set out on pages 36 to 68 and is, together with the information on share rights set out on page 99, incorporated into this corporate governance statement by reference.

Approved by the Board and signed on its behalf by:

Zoe Bucknell
General Counsel and Group Company Secretary
16 March 2015

Independent Auditor's Report to the Members of OneSavings Bank Plc only

Opinions and conclusions arising from our audit

1 Our opinion on the financial statements is unmodified
We have audited the financial statements of OneSavings Bank Plc for the year ended 31 December 2014 set out on pages 72 to 115.

In our opinion:
- the financial statements give a true and fair view of the state of the group's and of the company's affairs as at 31 December 2014 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union;
- the company financial statements have been properly prepared in accordance with UK Accounting Standards; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006; and, as regards the group financial statements, Article 4 of the IAS Regulation.

2 Our assessment of risks of material misstatement
The starting point for our audit was a consideration of the inherent risks to the Group's business model and how these have been mitigated. This included understanding the strength of the Group's capital and liquidity position, the diversification of assets, the flexibility and tenor of its balance sheet and the management of its cost base. We assessed and challenged the inherent risks with reference to:
- Independent economic forecasts and commentary;
- The views of our specialists in a number of areas including bank regulation, IT, tax and financial crime prevention;
- The views of the Prudential Regulatory Authority; and
- The significant changes taking place in banking regulation in the UK.

We also considered the Group's control environment and in particular whether its systems were processing transactions completely and faithfully, and included appropriate controls designed to prevent fraud. Our work included testing the key controls over the processing of transactions and the key inter-system and bank reconciliations. These assessments enabled us to form a judgement on going concern and also highlighted the key areas of financial statement risk on which our audit has focused. By looking at both broad risk themes across the Group and particular concerns within the business, we were able to calibrate our work to financial statements risk more precisely.

Having addressed the going concern assumption and whether the Group's database of transactions was a sufficient underlying basis for the accounts, we considered the significant risks of material misstatement lay in decisions over loan impairments and the recognition of interest income through the Group's effective interest rate calculations. As described on pages 46 to 49 these are also areas that have been focused on by the Group's Audit Committee. In forming our unmodified opinion on the financial statements, we undertook the following principal procedures on each of the areas as follows.

Loan impairment (£26.0m)
Refer to page 46 (Audit Committee Report), page 77 (accounting policy) and pages 90 to 92 (financial disclosures).

- The risk – The impairment provision relating to loans is one of the key judgemental areas that our audit is focused on due to the level of subjectivity inherent in estimating the impact of certain factors on the recoverability of loan balances.

The Group has grown its loan portfolio through diverse specialist loan products. Lower levels of lending in previous years provide the group with little historical experience to predict the likelihood of these loans falling into arrears. The increased lending in recent years has been at a time of historically low interest rates.

The Group performs an assessment of these loans for impairment, with the key assumptions being the probability of an account falling into arrears and subsequently defaulting, the market valuations of collateral provided and the estimated time and cost to sell any property repossessed by the Group. These assumptions differ across the Group's loan portfolios of residential lending (comprising first charge, second charge and shared ownership lending), Buy-To-Let and SME lending, and personal loans, reflecting the diverse nature of lending performed by the Group and different characteristics of each book. Due to the limited historic information and sensitivity of these assumptions there is a risk that actual experience will differ from the Group's current expectations.

The Group implements a number of forbearance procedures on selected loans in arrears, such as restructuring of a loan or capitalisation of arrears balances. There is the risk that these measures, and the subsequent improvement in arrears on the forborne loans, are not appropriately taken into consideration when calculating the required provisions, resulting in a lower impairment provision.

- Our response – Our audit procedures included, among others, evaluating and testing the key controls over the impairment provisioning process, including controls over mortgages both collectively and specifically provided for, such as credit committee review of impairment.

In relation to loans specifically provided for, we tested the completeness of the loans identified by the Group as high risk through a consideration of all loans for risk factors such as magnitude, arrears and previous loan restructures. For the cases specifically provided for, we re-performed the calculation and assessed the key assumptions underlying these calculations.

Independent Auditor's Report to the Members of OneSavings Bank Plc only
continued

Our testing of the loans collectively provided for included re-performance of the model calculations and agreement of the data inputs in the model to the mortgage data system in order to assess the accuracy of performance of the collective impairment model. The assumptions inherent in the model were critically assessed against our understanding of the Group, its recent performance and industry developments. In addition, taking into account the specific type of lending carried out by the Group, we benchmarked the Group's assumptions and provision coverage rates against other similar institutions to assess both the level of the impairment provision in comparison to industry norms and the continuing appropriateness of the assumptions used.

We evaluated the arrears monitoring process, including monitoring of credit trends in the portfolio, to assess whether emerging trends are reflected in the provision level. Other procedures performed included an assessment of forbearance activity to check that data arising from these concessions is accurately reflected in the impairment provision calculation.

Effective interest rates on organic and acquired loans (£169.2m)
Refer to page 46 (Audit Committee Report) and page 82 (accounting policy).

- The risk – An important part of the Group's ongoing business plan continues to be the expansion of its 'front book' of loans, through a combination of organic origination and loan book acquisition, to offset the legacy lower margin back book. Accounting standards require that all cash flows relating to loans are spread over the expected life of the loan on an effective interest rate basis, requiring complex and subjective calculation.

The effective interest rate calculation, which uses relevant interest rates, fees and costs, incorporates assumptions around loan expected lives (driven by estimations of loan repayment profiles) and, in the case of acquired credit impaired mortgages, additional variables such as the purchase price and estimated recoverable values.

Due to the relatively low levels of historical organic lending in comparison to the significant recent growth, the Group has limited information available from which to assess trends in prepayment, redemption and product transfers, resulting in increased subjectivity to these assumptions, as detailed patterns of customer behaviour have not been clearly established.

- Our response – Our audit procedures in relation to loans originated by the Group included the testing of key controls in relation to the accuracy of data inputs from the mortgage systems into the models and the consistency of methodology and application across each of the loan portfolios owned by the Group. We assessed the reasonableness of the models' key assumptions, including interest rates, product structures and expected lives by performing stress tests, benchmarking and considering historic experience. We also assessed the mathematical accuracy of the models through re-performance of the model calculations.

Our testing of acquired loan books included the procedures detailed above, and further procedures including an assessment of acquisition fair values and total amounts recoverable. We also considered whether any 'catch up' adjustments were required on portfolios where actual cash flow experience has differed from that originally predicted.

For the acquired loan books, we considered the Group's control environment in respect of its oversight and governance of the mortgage service providers and, in addition, we visited the servicers for the mortgage books where these were not administered by the Group to consider the adequacy of the control environment at these entities and to assess the accuracy and consistency of the information provided by the servicer companies to the Group.

3 Our application of materiality and an overview of the scope of our audit
The materiality for the Group financial statements as a whole was set at £3,400,000, determined with reference to a benchmark of forecast Group profit before tax, normalised to exclude this year's Initial Public Offering ('IPO') expense as disclosed in note 9, of £68,000,000, of which it represents 5.0%.

We report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £170,000, in addition to other identified misstatements that warranted reporting on qualitative grounds.

Audits for Group reporting purposes were performed at all three of the Group's reporting components. These audits covered 100% of Group revenue, profit before tax and total assets. The Group audit team instructed component auditors as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The Group audit team set component materiality at £2,500,000 for all components, having regard to the size and risk profile of the Group across the components. The audit of one of the three components was performed by component auditors with the rest being performed by the Group audit team.

Group instructions were provided to the component auditors, and telephone conference meetings were also held. At these meetings, the findings reported to the Group audit team were discussed in more detail to ensure understanding.

4 Our opinion on other matters prescribed by the Companies Act 2006 is unmodified

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006;
- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the information given in the Corporate Governance Report set out on page 38 with respect to internal control and risk management systems in relation to financial reporting processes and about share capital structures is consistent with the financial statements.

5 We have nothing to report in respect of the matters on which we are required to report by exception

Under ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the annual report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our audit and the directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy; or
- the Audit Committee Report does not appropriately address matters communicated by us to the audit committee.

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- the company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the directors' statement, set out on page 68, in relation to going concern; and
- the part of the Corporate Governance Report on page 38 relating to the company's compliance with the ten provisions of the UK Corporate Governance Code specified for our review.

We have nothing to report in respect of the above responsibilities.

Scope and responsibilities

As explained more fully in the Directors' Responsibilities Statement set out on page 68, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate. This report is made solely to the company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at www.kpmg.com/uk/auditscopeukco2014a, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

Richard Gabbertas (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
1, The Embankment,
Neville Street,
Leeds,
LS1 4DW
16 March 2015

Statement of Profit or Loss

For the year ended 31 December 2014

	Notes	**Group 2014 £'000**	Group 2013 £'000
Interest receivable and similar income	2	**209,882**	150,607
Interest payable and similar charges	3	**(84,681)**	(79,841)
Net interest income		**125,201**	70,766
Fair value gains/(losses) on financial instruments	4	**(4,323)**	(840)
Gains/(losses) on sales of financial instruments	5	**2,258**	(24)
Fees and commissions receivable		**875**	728
Fees and commissions payable		**(507)**	(1,696)
External servicing fees		**(4,593)**	(3,503)
Total income		**118,911**	65,431
Administrative expenses	6	**(32,390)**	(23,986)
Depreciation and amortisation	19,20	**(896)**	(547)
FSCS and other provisions	31	**(2,767)**	(2,152)
Operating profit		**82,858**	38,746
Impairment losses	16,17	**(11,685)**	(7,329)
Profit before exceptional IPO expenses		**71,173**	31,417
Exceptional IPO expenses	9	**(7,428)**	–
Profit before taxation		**63,745**	31,417
Taxation	10	**(12,208)**	(4,646)
Profit for the year		**51,537**	26,771
Earnings per share, pence per share			
Basic	11	**21.7**	13.4
Diluted	11	**21.7**	13.4

The above results are derived wholly from continuing operations.

The notes on pages 77 to 115 form part of these accounts.

The financial statements on pages 72 to 115 were approved by the Board of Directors on 16 March 2015.

Statement of Other Comprehensive Income

For the year ended 31 December 2014

	Group 2014 £'000	Group 2013 £'000
Items which may be reclassified to profit or loss:		
Fair value changes on available-for-sale securities		
Arising in the year	**1,013**	(1,131)
Transferred to profit or loss	**166**	(705)
Revaluation of foreign operations	**(696)**	372
Tax on items in other comprehensive income	**(238)**	395
Other comprehensive income for the year	**245**	(1,069)
Profit for the year	**51,537**	26,771
Total comprehensive income for the year	**51,782**	25,702

The notes on pages 77 to 115 form part of these accounts.

Statement of Financial Position

As at 31 December 2014

	Notes	Group 2014 £'000	Bank 2014 £'000	Group 2013 £'000	Bank 2013 £'000
Assets					
Cash in hand		**288**	**288**	267	267
Loans and advances to credit institutions	13	**767,318**	**727,462**	269,101	247,648
Investment securities	14	**158,597**	**158,597**	361,045	361,045
Loans and advances to customers	15	**3,919,397**	**3,071,094**	3,041,248	2,322,268
Derivative assets	33	**937**	**937**	757	757
Fair value hedges – assets		**68,738**	**68,738**	67,863	67,863
Deferred taxation asset	21	**3,563**	**574**	10,901	7,260
Intangible assets	19	**2,305**	**2,305**	1,117	1,117
Property, plant and equipment	20	**3,104**	**2,443**	4,955	1,812
Investments in subsidiaries and intercompany loans	18	**–**	**834,506**	–	713,105
Other assets	22	**12,280**	**6,348**	6,632	6,326
Total assets		**4,936,527**	**4,873,292**	3,763,886	3,729,468
Liabilities					
Amounts owed to retail depositors	23	**4,331,639**	**4,331,639**	3,251,576	3,251,576
Amounts owed to credit institutions	24	**23,009**	**23,009**	1,438	1,438
Amounts owed to other customers	25	**4,353**	**4,353**	2,351	2,351
Debt securities in issue	26	**238,390**	**–**	273,759	–
Derivative liabilities	33	**25,447**	**25,447**	22,566	22,566
Fair value hedges – liabilities		**3,126**	**3,126**	–	–
Current taxation liability		**2,945**	**2,993**	69	–
Deemed loan liability	18	**–**	**204,111**	–	254,875
Intercompany loans	18	**–**	**727**	–	–
Other liabilities	27	**13,609**	**9,128**	12,826	10,486
FSCS and other provisions	31	**1,598**	**1,598**	1,281	1,281
Subordinated liabilities	28	**27,573**	**27,573**	27,579	27,579
Perpetual subordinated bonds	29	**15,234**	**15,234**	15,263	15,263
		4,686,923	**4,648,938**	3,608,708	3,587,415
Equity					
Share capital	30	**2,431**	**2,431**	1,265	1,265
Share premium	30	**157,901**	**157,901**	119,885	119,885
Retained earnings		**74,998**	**51,868**	21,273	14,290
Other reserves	30	**14,274**	**12,154**	12,755	6,613
		249,604	**224,354**	155,178	142,053
Total equity and liabilities		**4,936,527**	**4,873,292**	3,763,886	3,729,468

The notes on pages 77 to 115 form part of these accounts.

The financial statements on pages 72 to 115 were approved by the Board of Directors on 16 March 2015.

Andy Golding
Chief Executive
16 March 2015

April Talintyre
Finance Director
16 March 2015

Statement of Changes in Equity

For the year ended 31 December 2014

Group	Share capital £'000	Share premium £'000	Capital contribution £'000	Transfer reserve £'000	Foreign exchange reserve £'000	Available-for-sale reserve £'000	Share-based payment reserve £'000	Retained earnings £'000	Equity bonds[1] £'000	Total £'000
Balance at 1 January 2014	**1,265**	**119,885**	**3,326**	**(12,818)**	**403**	**(156)**	**–**	**21,273**	**22,000**	**155,178**
Profit for the year	–	–	–	–	–	–	–	51,537	–	51,537
Coupon paid on equity bonds[2]	–	–	–	–	–	–	–	(1,138)	–	(1,138)
Other comprehensive income	–	–	–	–	(696)	941	–	–	–	245
Capital reorganisation (note 30)	922	(922)	(2,626)	–	–	–	–	3,326	–	700
Share issue	244	41,307	–	–	–	–	–	–	–	41,551
Share issue related costs	–	(2,369)	–	–	–	–	–	–	–	(2,369)
Share based payments	–	–	3,768	–	–	–	132	–	–	3,900
Balance at 31 December 2014	**2,431**	**157,901**	**4,468**	**(12,818)**	**(293)**	**785**	**132**	**74,998**	**22,000**	**249,604**

Bank	Share capital £'000	Share premium £'000	Capital contribution £'000	Transfer reserve £'000	Foreign exchange reserve £'000	Available-for-sale reserve £'000	Share-based payment reserve £'000	Retained earnings £'000	Equity bonds[1] £'000	Total £'000
Balance at 1 January 2014	**1,265**	**119,885**	**–**	**(15,231)**	**–**	**(156)**	**–**	**14,290**	**22,000**	**142,053**
Profit for the year	–	–	–	–	–	–	–	38,716	–	38,716
Coupon paid on equity bonds[2]	–	–	–	–	–	–	–	(1,138)	–	(1,138)
Other comprehensive income	–	–	–	–	–	941	–	–	–	941
Capital reorganisation (note 30)	922	(922)	700	–	–	–	–	–	–	700
Share issue	244	41,307	–	–	–	–	–	–	–	41,551
Share issue related costs	–	(2,369)	–	–	–	–	–	–	–	(2,369)
Share based payments	–	–	3,768	–	–	–	132	–	–	3,900
Balance at 31 December 2014	**2,431**	**157,901**	**4,468**	**(15,231)**	**–**	**785**	**132**	**51,868**	**22,000**	**224,354**

1 Equity bonds comprise £22m of 6.591% perpetual subordinated bonds. See note 30 for more detail.
2 Coupon paid on equity bonds is shown net of tax.

Group 2013	Share capital £'000	Share premium £'000	Capital contribution £'000	Transfer reserve £'000	Foreign exchange reserve £'000	Available-for-sale reserve £'000	Retained earnings £'000	Equity bonds[1] £'000	Total £'000
Balance at 1st January 2013	1,001	105,149	3,326	(12,818)	31	1,285	(4,048)	22,000	115,926
Profit for the year	–	–	–	–	–	–	26,771	–	26,771
Coupon paid on equity bonds[2]	–	–	–	–	–	–	(1,450)	–	(1,450)
Other comprehensive income	–	–	–	–	372	(1,441)	–	–	(1,069)
Capital injections	264	14,736	–	–	–	–	–	–	15,000
Balance at 31 December 2013	1,265	119,885	3,326	(12,818)	403	(156)	21,273	22,000	155,178

Bank	Share capital £'000	Share premium £'000	Capital contribution £'000	Transfer reserve £'000	Foreign exchange reserve £'000	Available-for-sale reserve £'000	Retained earnings £'000	Equity bonds[1] £'000	Total £'000
Balance at 1 January 2013	1,001	105,149	–	(15,231)	–	1,285	(1,555)	22,000	112,649
Profit for the year	–	–	–	–	–	–	17,295	–	17,295
Coupon paid on equity bonds[2]	–	–	–	–	–	–	(1,450)	–	(1,450)
Other comprehensive income	–	–	–	–	–	(1,441)	–	–	(1,441)
Capital injections	264	14,736	–	–	–	–	–	–	15,000
Balance at 31 December 2013	1,265	119,885	–	(15,231)	–	(156)	14,290	22,000	142,053

1 Equity bonds comprise £22m of 6.591% perpetual subordinated bonds. See note 30 for more detail.
2 Coupon paid on equity bonds is shown before tax.

The reserves are further disclosed in note 30.

Statement of Cash Flows

For the year ended 31 December 2014

	Group 2014 £'000	Bank 2014 £'000	Group 2013 £'000	Bank 2013 £'000
Cash flows from operating activities				
Profit before tax	**63,745**	**48,657**	31,417	23,298
Adjustments for non-cash items:				
Depreciation and amortisation	**896**	**713**	547	440
Interest on subordinated liabilities	**1,261**	**1,261**	1,256	1,256
Interest on perpetual subordinated bonds	**1,144**	**1,144**	1,255	1,255
Impairment charge on loans net of write offs	**(1,496)**	**(669)**	(3,439)	(4,744)
(Gain)/loss on sale of financial instruments	**(2,258)**	**(2,258)**	24	24
FSCS and other provisions	**2,767**	**2,767**	2,152	2,152
Fair value losses on financial instruments	**4,323**	**4,323**	840	840
Share based payments	**3,785**	**3,785**	–	–
Changes in operating assets and liabilities				
Decrease in loans and advances to credit institutions	**–**	**–**	87,024	87,024
(Increase) in loans to customers	**(876,653)**	**(748,157)**	(841,760)	(820,671)
Increase in retail deposits	**1,080,063**	**1,080,063**	506,930	506,930
(Increase)/decrease in intercompany balances	**–**	**(171,438)**	–	245,453
(Increase)/decrease in other assets	**(2,849)**	**29**	(3,964)	(4,903)
(Increase)/decrease in derivatives and hedged items	**629**	**629**	(27,817)	(27,817)
(Increase)/decrease in bank and other deposits	**23,573**	**23,573**	(21,164)	(21,164)
Net increase in other liabilities	**3,772**	**2,760**	3,586	1,181
Exchange differences on working capital	**(695)**	**–**	452	–
Cash generated from/(used in) operating activities	**302,007**	**247,182**	(262,661)	(9,446)
Interest paid on bonds and subordinated debt	**(2,442)**	**(2,442)**	(2,437)	(2,437)
FSCS and other provisions paid	**(2,450)**	**(2,450)**	(3,187)	(3,187)
Tax paid	**(1,517)**	**(913)**	(489)	–
Net cash from operating activities	**295,598**	**241,377**	(268,774)	(15,070)
Cash flows from investing activities				
Net sales of investment securities	**205,885**	**205,885**	47,434	47,434
Purchases of equipment and intangible assets	**(2,980)**	**(2,529)**	(1,559)	(768)
Cash generated from investing activities	**202,905**	**203,356**	45,875	46,666
Cash flows from financing activities				
Coupon paid on equity bonds	**(1,450)**	**(1,450)**	(1,450)	(1,450)
Proceeds from share issues and capital contributions	**42,251**	**42,251**	15,000	15,000
Share issue (IPO) costs paid	**(5,699)**	**(5,699)**	–	–
Net issue/(repayment) of debt	**(35,367)**	**–**	273,759	–
Cash (used in)/generated from financing activities	**(265)**	**35,102**	287,309	13,550
Net increase in cash and cash equivalents	**498,238**	**479,835**	64,410	45,146
Cash and cash equivalents at 1 January				
Cash in hand	**267**	**267**	282	282
Loans and advances to credit institutions repayable on demand	**269,101**	**247,648**	204,676	202,487
	269,368	**247,915**	204,958	202,769
Cash and cash equivalents at 31 December				
Cash in hand	**288**	**288**	267	267
Loans and advances to credit institutions repayable on demand	**767,318**	**727,462**	269,101	247,648
	767,606	**727,750**	269,368	247,915
Movement in cash and cash equivalents	**498,238**	**479,835**	64,410	45,146

Notes to the financial statements

For the year ended 31 December 2014

1. Accounting Policies

The principal accounting policies applied in the preparation of the accounts for the Group and the Bank are set out below.

a) Basis of preparation
The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU); and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC).

The financial statements have been prepared on historical cost basis, as modified by the revaluation of available for sale financial assets, derivative contracts and financial assets held at fair value through profit or loss.

As permitted by section 408 of the Companies Act 2006, no statement of profit or loss is presented for the Bank.

b) Going concern
The Board undertakes regular rigorous assessments of whether the Bank is a going concern in the light of current economic conditions and all available information about future risks and uncertainties.

Projections for OneSavings Bank plc have been prepared, covering its future performance, capital and liquidity, for a period in excess of 12 months from the date of approval of these financial statements including stress scenarios. These projections show that the Group has sufficient capital and liquidity to continue to meet its regulatory capital requirements as set out by the Prudential Regulatory Authority.

The Board has therefore concluded that the Group has sufficient resources to continue in operational existence for the foreseeable future and as a result it is appropriate to prepare these financial statements on a going concern basis.

c) Basis of consolidation
The Group accounts include the results of the Bank and its subsidiary undertakings. Subsidiaries are fully consolidated from the date on which control is transferred to the Group and are de-consolidated from the date that control ceases. Upon consolidation inter-company transactions, balances and unrealised gains on transactions are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Bank's financial statements investments in subsidiary undertakings are stated at cost less provision for any impairment.

d) Foreign currency translation
The consolidated financial statements are presented in pounds sterling which is the presentation currency of the Group. The financial statements of each of the Bank's subsidiaries are measured using the currency of the primary economic environment in which the subsidiary operates (the 'functional currency'). Foreign currency transactions are translated into the functional currencies using the exchange rates prevailing at the date of the transactions. Monetary items denominated in foreign currencies are re-translated at the rate prevailing at the period end. Foreign exchange gains and losses resulting from the re-translation and settlement of these items are recognised in profit or loss.

The assets and liabilities of foreign operations with functional currencies other than sterling are translated into the presentation currency at the exchange rate on the reporting date. The income and expenses of foreign operations are translated at the rates on the dates of transactions. Exchange differences on foreign operations are recognised in other comprehensive income and accumulated in the foreign exchange reserve within equity. When a foreign operation is wholly or partly disposed of with loss of control, the relevant accumulated exchange differences are reclassified to profit or loss as part of the gain or loss on disposal. In a partial disposal without loss of control, the proportionate share of cumulative exchange differences is reattributed to non-controlling interest.

e) Segmental reporting
IFRS 8 requires operating segments to be identified on the basis of internal reports and components of the Group regularly reviewed by the chief operating decision maker to allocate resources to segments and to assess their performance. For this purpose, the chief operating decision maker of the Group is the Board of Directors.

The Group lends solely within the UK and the Channel Islands and as such no geographical analysis is required.

The Group segments its lending by product, focusing on the customer need and reason for a loan. It operates under three segments; Buy-to-Let/SME, Residential Mortgages, and Personal Loans.

f) Interest income and expense
Interest income and interest expense for all interest-bearing financial instruments measured at amortised cost are recognised in profit or loss using the effective interest rate (EIR) method. The EIR is the rate which exactly discounts the expected future cash flows, over the expected life of the financial instrument, to the net carrying value of the financial asset or liability.

In calculating the EIR the Group estimates the cash flows considering all contractual terms but not future credit losses. Potential early repayment charges, origination fees received and paid on loans to customers, together with premium/discount paid on/received on acquired loan books and acquisition costs on loan books are included within loans and advances to customers and are amortised over the expected life of those assets using the EIR method.

Interest income on available for sale investments is included in interest receivable and similar income. Interest on derivatives is included in interest receivable and similar income or interest expense and similar charges following the underlying instrument it is hedging.

Notes to the financial statements continued

For the year ended 31 December 2014

1. Accounting Policies continued

g) Fees and commissions

Fees and commissions which are an integral part of the EIR of a financial instrument are recognised as an adjustment to the EIR and recorded in interest income. Other fees and commissions are recognised on the accruals basis as services are provided or on the performance of a significant act, net of VAT and similar taxes.

h) Taxation

Income tax comprises current and deferred tax. It is recognised in profit or loss, other comprehensive income or directly in equity, consistently with the recognition of items it relates to.

Current tax is the expected tax charge or credit on the taxable income or loss in the period and any adjustments in respect of previous years.

Deferred tax is the tax expected to be payable or recoverable in respect of temporary differences between the carrying amounts of assets or liabilities for accounting purposes and carrying amounts for tax purposes.

Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available to utilise the asset. The recognition of deferred tax is mainly dependent on the projections of future taxable profits and future reversals of temporary differences. The current Board's projections of future taxable income assume that the Group will utilise its deferred tax asset within the next 5 years.

i) Dividends

Dividends are recognised in equity in the period in which they are paid or, if earlier, approved by shareholders.

j) Cash and cash equivalents

Cash and cash equivalents comprise cash, non-restricted balances with central banks and highly liquid financial assets with original maturities of less than three months from the date of acquisition subject to an insignificant risk of changes in their fair value.

k) Intangible assets

Purchased software and costs directly associated with the development of computer software are capitalised as intangible assets where the software is a unique and identifiable asset controlled by the Group and will generate future economic benefits.

Costs to establish technological feasibility or to maintain existing levels of performance are recognised as an expense.

Software is amortised on a straight-line basis in profit or loss over its estimated useful life, which is generally five years. Intangible assets are reviewed for impairment on an annual basis.

l) Property, plant and equipment

Property, plant and equipment comprise freehold land and buildings, major alterations to office premises, computer equipment, motor vehicles and fixtures measured at cost less accumulated depreciation. These assets are reviewed for impairment annually and if they are considered to be impaired are written down immediately to their recoverable amounts.

Gains and losses on disposals calculated as the difference between the net disposal proceeds with the carrying amount of the asset are included in profit or loss.

Items of property, plant and equipment are depreciated on a straight-line basis over their estimated useful economic lives as follows:

Buildings	50 years
Equipment, fixtures and vehicles	5 years

Leased assets are depreciated over the shorter of the lease term and their useful lives. Land is not depreciated.

The cost of repairs and renewals is charged to profit or loss in the period in which the expenditure is incurred.

m) Financial instruments

The Group initially recognises loans and advances, deposits, debt securities issued and subordinated liabilities when the Group becomes a party to the contractual provisions of the instrument. The Group classifies its financial instruments in accordance with IAS 39 and IAS 32 into the following categories:

(i) Loans and receivables: which are predominantly mortgage loans, advances to customers and money market advances with fixed or determinable payments that are not quoted in an active market and that the Group does not intend to sell in the near term. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the EIR method, less impairment losses. Where exposures are hedged by derivatives, designated and qualifying as fair value hedges, the fair value adjustment (for the hedged risk) to the carrying value of the loans and advances so hedged is reported in Fair value hedges – assets.

1. Accounting Policies continued

(ii) Financial assets at fair value through profit or loss: are instruments:
- which upon initial recognition are designated at fair value through profit or loss to eliminate or significantly reduce a measurement recognition inconsistency or;
- which are acquired principally for the purpose of selling in the near term or forming part of the portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking.

Financial assets in this category are initially recognised and subsequently measured at fair value in the statement of financial position, with transaction costs recognised in profit or loss. All changes in fair value are recognised as part of net income in profit or loss. The fair values are based on quoted market prices (where there is an active market) or other valuation techniques (where there is no active market or the securities are unlisted). Other valuation techniques include the use of recent arm's length transactions, discounted cash flow analysis and other commonly used methods. During the current and prior year no financial assets were classified at fair value through profit or loss except for derivatives with positive fair values.

(iii) Available-for-sale financial assets: comprise securities held for liquidity purposes (certificates of deposit, treasury bills and money market instruments in the nature of loans and advances to credit institutions). These assets are non-derivatives that are designated as available-for-sale and not categorised in any other financial asset categories. These are held at fair value with movements being taken to other comprehensive income and accumulate in the AFS reserve within equity, except for impairment losses which are taken to profit or loss. When the instrument is sold, the gain or loss accumulated in equity is reclassified to profit or loss.

(iv) Held-to-maturity investments: are non-derivative financial assets with fixed or determinable payments and fixed maturity where the Group intends to hold to maturity. These assets are measured at amortised cost using the EIR method less any impairment. Following a sale of more than an insignificant part of its assets held to maturity in 2013, the Group is prohibited from using this category in the current year.

(v) Financial liabilities: comprise deposits, issued debt securities and subordinated liabilities used as sources of funding. They include the Sterling Perpetual Subordinated Bond where the terms allow no discretion over the payment of interest. The Group has no financial liabilities held for trading or designated at fair value through profit or loss except for derivatives with negative fair values.

Financial liabilities are initially measured at fair value less direct transaction costs, and subsequently held at amortised cost using the EIR method.

(vi) Classification as liability or equity: financial instruments that include no contractual obligation to deliver cash or another financial asset on potentially unfavourable conditions are classified as equity.

Equity financial instruments comprise own shares and the 6.591% Perpetual Subordinated Bond which was issued with terms that include discretion over the payment of interest.

(vii) Derecognition of financial assets and liabilities: Financial assets are derecognised when the contractual rights to receive cash flows have expired and where substantially all the risks and rewards of ownership have been transferred.

Financial liabilities are derecognised only when the obligation is discharged, cancelled or has expired.

(viii) Sale and repurchase agreements: Financial assets sold subject to repurchase agreements are retained in the financial statements when required under the de-recognition criteria of IAS 39. The financial assets that are retained in the financial statements are reflected as loans or investment securities and the counterparty liability is included in amounts owed to depositors, credit institutions or other customers. Financial assets purchased under agreements to resell at a pre-determined price are accounted for as loans and receivables. The difference between the sale and repurchase price is treated as interest and accrued over the lives of agreements using the EIR method.

n) Derivative financial instruments and hedge accounting

The Group uses derivative financial instruments (interest rate swaps) for the purpose of reducing fair value interest rate risk to hedge its exposure to the interest rate risk arising from financing and investment activities. In accordance with its treasury policy, the Group does not hold or issue derivative financial instruments for trading.

Derivative financial instruments are recognised at their fair value with changes in their fair value going through profit or loss. Fair values are calculated by discounting cash flows at the prevailing interest rates.

All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative.

Certain derivatives embedded in financial instruments are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value. These embedded derivatives are separately measured at fair value with changes in fair value recognised in profit or loss.

The Group designates certain derivatives as a hedge of fair value of a portfolio of recognised assets or liabilities (macro fair value hedge). Hedge accounting is used for derivatives designated in this way provided the criteria specified in IAS 39 are met.

Notes to the financial statements continued
For the year ended 31 December 2014

1. Accounting Policies continued

Where there is an effective hedge relationship for fair value hedges, the changes in fair value of the hedged item arising from the hedged risk are taken to profit or loss. The fair value changes of both the hedged item and the derivative substantially offset each other to reduce profit volatility. To qualify for hedge accounting at inception, the hedge relationship must be clearly documented and the derivative must be expected to be highly effective in offsetting the hedged risk. In addition, effectiveness must be tested throughout the life of the hedge relationship.

The Group discontinues hedge accounting when testing demonstrates that a derivative is not or has ceased to be highly effective as a hedge, the derivative ceases through expiry or sale or the underlying hedged item matures, is sold or is repaid.

If a derivative no longer meets the criteria for hedge accounting the cumulative fair value hedging adjustment is amortised over a period up to the maturity of the previously designated hedge relationship. If the underlying item is sold or repaid the unamortised fair value adjustment is immediately reflected in profit or loss.

o) Impairment of financial assets
The Group regularly assesses whether there is evidence that a financial asset or a portfolio of financial assets not carried at fair value through profit or loss is impaired. A financial asset or portfolio of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of the asset and prior to the reporting date ('a loss event'), and that loss event or events has/or have had an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a Group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment. An individual provision is also made where an account is not in arrears but the Group has exercised forbearance in the conduct of the account. Any provision is based on a management assessment of the propensity for the account to realise a loss had forbearance not been shown taking account of the amount recoverable on mortgage indemnity cover and additional security.

For financial assets carried at amortised cost, the amount of impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original EIR.

Impairment losses on available-for-sale assets are recognised by transferring the cumulative loss that has been recognised directly in equity to the statement of profit or loss. The cumulative loss that is removed from equity and recognised in the statement of profit or loss is measured as the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss on that asset previously recognised in the statement of profit or loss.

If, in a subsequent period, the fair value of the debt security classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the statement of profit or loss, the impairment loss is reversed through the statement of profit or loss.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure and any costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, financial assets are Grouped on the basis of similar risk characteristics, taking into account asset type, industry, geographical location, collateral type, past-due status and other relevant factors. These characteristics are relevant to the estimation of future cash flows for Groups of such assets by being indicative of the counterparty's ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows in a Group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Group and historical loss experience for assets with credit risk characteristics similar to those in the Group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist. In addition, the Group uses its experienced judgement to estimate the amount of an impairment loss. This incorporates amounts calculated to overcome model deficiencies and systemic risks where appropriate and supported by historic loss experience data. The use of such judgements and reasonable estimates is considered by management to be an essential part of the process and does not impact reliability.

Impairment losses and any subsequent reversals are recognised in profit or loss. Following impairment, interest income is recognised using the original EIR which was used to discount the future cash flows for the purpose of measuring the impairment loss.

When a loan is uncollectable, it is written off against the related provision. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are taken through profit or loss.

1. Accounting Policies continued

The Bank's objective in restructuring a loan will primarily be to maximise the potential recovery of its outstanding debt. A loan restructuring (forbearance) is the modification or elimination of a loan prior to or at its maturity date by means other than those prescribed under the contractual terms of the loan agreement. This may involve extending the payment arrangements and the agreement of new loan conditions. When the terms of the loan have been re-negotiated, the loan is no longer considered past due. The Bank continually reviews re-negotiated loans to ensure that all criteria are met and future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original EIR.

p) Debt valuation adjustment
The debt valuation adjustment (DVA) is included in the fair value of derivative financial instruments. The DVA is based on the expected loss a counterparty faces due to the risk of the Group's default. The methodology is based on a standard calculation, taking into account:
- the one-year probability of default;
- the expected exposure at default;
- the expected loss given default; and
- the average maturity of the swaps.

q) Provisions and contingent liabilities
A provision is recognised when there is a present obligation as a result of a past event, it is probable that the obligation will be settled and the amount can be estimated reliably.

Contingent liabilities are possible obligations arising from past events, whose existence will be confirmed only by uncertain future events, or present obligations arising from past events which are either not probable or the amount of the obligation cannot be reliably measured. Contingent liabilities are not recognised but disclosed unless their probability is remote.

r) Employee benefits – defined contribution scheme
Obligations for contributions to defined contribution pension arrangements are recognised as an expense in profit or loss as incurred.

s) Share-based payments
Share-based payments to employees made under the Group's share-based incentive schemes are measured at the fair value of awarded shares or options at the grant date and charged on a straight-line basis to the profit and loss account over the vesting period in which the employees become unconditionally entitled to the awards. The grant date fair value of share-based payment awards granted to employees is recognised as an employee expense, with a corresponding increase in equity.

The fair value of the awards granted is measured using an option valuation model, taking into account the terms and conditions upon which the awards were granted. The amount recognised as an expense is adjusted to reflect the actual number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date. For share-based payment awards with non-vesting conditions, the grant date fair value of the share-based payment is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes.

t) Exceptional items
Exceptional items are material income or expense items which are non-recurring in nature. Exceptional items are reported separately in the statement of profit or loss to highlight the core performance of the Group and make it more relevant for comparison with other periods.

u) IPO expenses
Qualifying costs attributable to the primary issuance were debited directly to equity. They include incremental costs that are directly attributable to issuing the primary shares such as advisory and underwriting fees. Costs associated with both the primary issuance and secondary sale of shares were allocated between profit or loss and equity based on the number of primary and secondary shares sold during the issue. Other non-qualifying costs were taken to profit and loss.

v) Securitisation
Special purpose entities (SPEs) used to raise funds through securitisation transactions are assessed on a case-by-case basis under criteria of IFRS 10 and if these entities are governed and controlled by the Group they are consolidated as if they were wholly owned subsidiaries. Loans transferred to SPEs under securitisation agreements are not derecognised by the Company if they fail derecognition criteria.

Whilst the securitisation entity has been consolidated as a 100% subsidiary, the mortgage loans included within the securitisation structure are ring-fenced, with the cash flows being used to repay its liabilities in line with the priority of payments set out in the securitisation prospectus.

w) Judgements in applying accounting policies and critical accounting estimates
In preparing these financial statements, the Group has made judgements, estimates and assumptions which affect the reported amounts within the current and next financial year. Actual results may differ from these estimates.

Estimates and judgements are regularly reviewed based on past experience, expectations of future events and other factors. The key areas where estimates and judgements are made are as follows:

Notes to the financial statements continued

For the year ended 31 December 2014

1. Accounting Policies continued

(i) Loan book impairments: Specific provision assessments for individually significant loans or portfolios of loans involve significant judgment in relation to estimating future cash flows, including the cost of obtaining and selling collateral, the likely sale proceeds and any rental income prior to sale. The most critical estimate is of the level of house prices where a variance of 10% equates to a change of £4.6m (2013: £4.2m) in the provision.

All assets without a specific provision are assessed collectively. Collective provisions are calculated using twelve month delinquency roll rates and one year probability of defaults on different segments of the loan book. These rates along with forced sale discounts and the level of house prices are applied to calculate expected losses. Judgement is exercised in deciding how to apply historic experience to current market conditions. The most critical estimate is of the level of house prices where a variance of 10% applied to the calculation of the loss given default equates to a change of £2.4m (2013: £1.9m) in the provision. The impact of house price variances on the probability of default is difficult to quantify, but could be material.

(ii) Loan book acquisition accounting and income recognition: Acquired loan books are initially recognised at cost. Significant judgement is exercised in calculating their effective interest rate (EIR) using cash flow models which include assumptions on the likely macroeconomic environment, including HPI, unemployment levels and interest rates, as well as loan level and portfolio attributes and history used to derive prepayment rates, the probability and timing of defaults and the amount of incurred losses.

(iii) Effective interest rate: A number of assumptions are made when calculating the effective interest rate for newly originated loan assets. These include their expected lives, likely redemption profiles and the anticipated level of any early redemption charges. Net fee income is a significant element of the effective interest rate of the Buy-to-Let products and is recognised in profit and loss over the expected life of the loans. Judgment is used in assessing the expected life of products with an initial discounted or fixed period which then revert to the standard variable rate. The impact of a six month longer expected life on 2014 new origination would be to recognise an additional £1m of interest income in 2014 as the impact of spreading fee income over a longer period is more than offset by the impact of a higher revert rate for the additional period.

x) Adoption of new standards

During the year the Group adopted the following new standards and amendments which became effective from 1 January 2014:

- IFRS 10, Consolidated Financial Statements. This standard partly replaced IAS 27, Separate Financial Statements and SIC 12, Consolidation – Special Purpose Entities. It defines the principle of control and establishes control as the basis for determining which entities are consolidated. It also sets out the accounting requirements for the preparation of consolidated financial statements. Adoption of the IFRS 10 did not change accounting treatment of the Group's subsidiaries. Disclosures were updated accordingly
- IFRS 11, Joint Arrangements. This new standard replaced IAS 31, Interests in Joint Ventures and SIC 13, Jointly Controlled Entities – Non-Monetary Contributions by Venturers. The new standard removed the choice to apply the proportionate consolidation method, requiring all joint arrangements to be accounted for under the equity method. Adoption of the standard had no impact on the financial statements
- IFRS 12, Disclosure of Interests in Other Entities. This standard applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. IFRS 12 was assessed for the Rochester securitisation vehicle and did not result in significant changes to disclosures
- Amendments to IAS 27, Separate Financial Statements and IAS 28, Investments in Associates and Joint Ventures triggered by publication of IFRS 10-12. Adoption of the amendments has not had a significant impact on the financial statements
- Amendments to IAS 32 Financial Instruments: Presentation, Offsetting Financial Assets and Financial Liabilities. Adoption of the amendments has not had a significant impact on the financial statements.

IFRIC 21 Levies, effective from 1 January 2014, was adopted by the Group early, as permitted, in respect of FSCS levy in 2013. In the 2013 Annual Report, the Group restated its financial statements and comparative information in accordance with the interpretation. Further restatement was not required in 2014.

The new standards and amendments below have not been yet endorsed by the EU and therefore have not been applied in preparing these financial statements:

- IFRS 15, Revenue from Contracts with Customers, effective from 1 January 2017, replaces IAS 11 Construction contracts, IAS 18 Revenue and several related interpretations. It introduces a single framework for revenue recognition based on new concepts and principles. The new standard is not expected to have a significant impact on the financial statements
- IFRS 9, Financial Instruments, effective from 1 January 2018, replaces IAS 39 Financial Instruments: Recognition and Measurement and sets out significantly different classification, recognition, measurement of financial instruments, expected credit losses and hedge accounting. It is expected to have a significant impact on operations particularly in the risk and finance functions of the Group. The Group is assessing the process changes required to comply with IFRS 9 and the associated impact on its financial statements
- IFRS Annual Improvements to IFRSs, 2010 to 2012 and 2011 to 2013 cycles, both effective 1 July 2014, consisting of minor amendments to existing standards. The annual improvement cycles are not expected to have a significant impact on the financial statements.

2. Interest receivable and similar income

	Group 2014 £'000	Group 2013 £'000
On BTL/SME mortgages	**88,001**	42,729
On residential mortgages	**105,754**	100,135
On personal loans	**21,576**	14,488
On reverse repo transactions	**460**	39
On investment securities	**1,684**	3,386
On other liquid assets	**1,661**	1,942
Net expense on derivative financial instruments	**(9,254)**	(12,112)
	209,882	150,607

Included within interest receivable is £1,161k (2013: £1,888k) in respect of interest accrued on accounts with a specific provision.

3. Interest payable and similar charges

	Group 2014 £'000	Group 2013 £'000
On retail deposits	**78,672**	77,987
On Perpetual Subordinated Bonds	**1,144**	1,255
On subordinated liabilities	**1,261**	1,256
On wholesale borrowings	**6,407**	1,550
Net income on derivative financial instruments	**(2,803)**	(2,207)
	84,681	79,841

4. Fair value gains (losses) on financial instruments

	Group 2014 £'000	Group 2013 £'000
Ineffective portion of hedges	**(1,340)**	673
Amortisation of cancelled swaps	**(3,198)**	(2,755)
Net gains/(losses) on unmatched swaps	**154**	1,135
Debt valuation adjustment	**61**	107
	(4,323)	(840)

Amortisation of cancelled swaps represents amortisation of the hedged adjustment on cancelled swaps which were effective hedges at the point of cancellation.

Unmatched swaps are derivatives that do not form part of a hedging relationship.

The debt valuation adjustment (DVA) is calculated on the Group's derivative liabilities and represents exposure of their holders to the risk of the Group's default.

5. Gains/(losses) on sales of financial instruments

The Bank routinely buys and sells liquidity assets in order to confirm the ease with which cash can be realised and the robustness of the valuations assigned to such assets. During the year, transactions in liquid assets resulted in a net gain of £2,258k (2013: loss of £24k), primarily due to the sale of the RMBS portfolio.

Notes to the financial statements continued

For the year ended 31 December 2014

6. Administrative expenses

	Group 2014 £'000	Group 2013 £'000
Staff costs	**18,701**	13,421
Facilities costs	**2,157**	1,296
Marketing costs	**1,316**	661
Support costs	**3,201**	2,441
Professional fees	**3,136**	2,386
Other costs[1]	**3,879**	3,781
	32,390	23,986

1 Other costs mainly consist of irrecoverable VAT expense.

Included in professional fees are amounts paid to the auditors of the Group, further analysed below:

	Group 2014 £'000	Group 2013 £'000
Audit of the Bank and Group accounts	**220**	180
Audit of the Group's subsidiary undertakings pursuant to legislation	**115**	60
Tax advisory services	**17**	34
Tax compliance services	**27**	27
Audit related assurance services	**53**	36
All other non-audit services	**98**	46
	530	383

Other non-audit services includes advice on regulatory changes including CoRep and the Group's Target Operating Model.

As disclosed in note 9, a further £855k was paid to the auditors in connection with the stock exchange listing.

Staff numbers and costs

Staff costs comprise the following categories

	Group 2014 £'000	Group 2013 £'000
Salaries, incentive pay and other benefits	**16,374**	11,644
Share-based payments	**17**	–
Social security costs	**1,439**	1,132
Other pension costs	**871**	645
	18,701	13,421

The average number of persons employed by the Group (including Executive Directors) during the period was 419 FTE (2013: 332 FTE).

7. Directors' emoluments and transactions

Executive Directors' emoluments – 2014

	Salary & fees £'000	Incentive pay[1] £'000	Other benefits £'000	Contribution to personal pension policy £'000	Total £'000
A Golding	**349**	**347**	**12**	**45**	**753**
A Talintyre	**252**	**240**	**8**	**33**	**533**
Total executive emoluments	**601**	**587**	**20**	**78**	**1,286**

1 50% of the incentive pay is in the form of shares deferred for three years under the Deferred Share Bonus Plan. The deferred part does not have any further performance conditions attached, however it is subject to clawback and is forfeited if the Executive Director leaves prior to vesting unless a good leaver reason applies such as redundancy, retirement or ill health.

7. Directors' emoluments and transactions continued

Executive Directors' emoluments – 2013

	Salary & fees £'000	Incentive pay[2] £'000	Other benefits £'000	Contribution to personal pension policy £'000	Year ended 31-Dec-13 Total £'000
A Golding	306	142	30	40	518
A Talintyre	230	86	8	30	354
Total executive emoluments	536	228	38	70	872

2 Incentive pay comprises cash bonuses. A proportion of these are deferred until 2016 and are subject to claw back in the event that financial targets are not met or if there is a material financial downturn or failure of risk management before the end of the deferral period.

Non-Executive Directors' emoluments

	Group 2014 Fees £'000	**Group 2014 IPO Awards[3] £'000**	Group 2013 Fees £'000
G Allatt	**44**	**–**	–
R Duke	**68**	**181**	50
M Fairey	**193**	**–**	–
T Hanford	**53**	**–**	40
M McCaig	**61**	**272**	50
Sir C McCarthy	**17**	**272**	40
M McNamara	**47**	**–**	–
D Mills	**37**	**272**	50
Dr D Morgan	**53**	**–**	40
N Moss	**40**	**–**	–
S Wilcke	**258**	**–**	364
P Williams	**–**	**–**	40
	871	**997**	674
Total Directors' emoluments	**2,157**	**997**	1,546

3 Certain Non-Executive Directors received IPO awards in the form of nil price options which vested in full on admission.

S Wilcke stepped down as Executive Chairman of the Group on 1 April 2014 in advance of the listing on the London Stock Exchange and M Fairey was appointed as an Independent Non-Executive Chairman. S Wilcke remained on the Board as a Non-Executive Director.

S Wilcke's remuneration in respect of his 2014 period of employment includes salary of £107k, bonus payments of £102k, £14k in pension contributions and £35k non-executive fees. His remuneration in 2013 comprised of £225k salary, £110k performance incentive pay and £29k pension contributions.

M Fairey received a fee of £100k and a payment of £51k to purchase 30k shares in the Bank at IPO. The Bank also covered the cost of income tax and national insurance of £42k.

During 2013 A Golding, A Talintyre and S Wilcke subscribed for Growth Shares in OSB Holdco Ltd ('Holdco'), one of the Bank's shareholders, under a long term incentive plan ('LTIP') at nominal value. The purpose of the scheme was to reward executive management for execution of the Bank's strategy and growth in shareholder value over a multi-year period, and was linked to the exit value attained by Holdco on exit.

The difference between the unrestricted market value and nominal value of the Growth Shares, grossed up for income tax and national insurance covered by the Bank, was £23k for A Golding, £9k for A Talintyre and £18k for S Wilcke. These shares were subject to a vesting schedule but vested in full at IPO in June 2014.

The figures above include £nil (2013: £nil) compensation for loss of office during the period.

The Annual Report on Remuneration explains the Board's policy on Directors' Remuneration and describes the process through which remuneration is determined.

At 31 December 2014 outstanding loans granted in the ordinary course of business to Directors and their connected persons amounted to £nil (2013: £nil).

See Note 8 Share-based payments and the Annual Report on Remuneration for further details on Directors' emoluments.

Notes to the financial statements continued

For the year ended 31 December 2014

8. Share-based payments

During the year, the Group established the following share-based schemes:

OSB Sharesave Scheme

The Save As You Earn (SAYE) or Sharesave Scheme is open to all UK based employees and allows them to save a fixed amount of between £5 and £250 per month over either three or five years in order to use these savings at the end of the qualifying period to buy the Bank's shares at a fixed price established when the scheme was announced. The Group launched its first Sharesave scheme in June 2014 setting the exercise price for both three and five-year plans at 134 pence per share, a 20% discount on the share price on that date.

IPO Share Award

Certain Directors, senior managers and other employees of the Bank received one off share awards in the form of nil price options over shares in the Bank on its admission to the London Stock Exchange. A proportion of these awards vested on admission with the remainder vesting over either a 12, 24 or 48 month period. The cost of IPO Share Awards based on their fair value at grant date of 170 pence per share (the IPO offer price) is recognised over the respective vesting period (adjusted for expected attrition) with awards that vested on admission being immediately expensed in full. The expense is reported within exceptional IPO expenses in the statement of profit or loss and is offset fully by an additional capital contribution as the awards were granted by OSB Holdco Ltd, the Bank's major shareholder.

Deferred Share Bonus Plan

The Deferred Share Bonus Plan (DSBP) applies to Executive Directors and certain senior managers and requires 50% of their performance bonuses to be deferred in shares for three years. There are no further performance conditions attached but the share awards are subject to clawback provisions. The DSBP is a share awards and as such is expensed over the relevant vesting period. The first DSBP will relate to 2014 bonuses and is expected to be granted in March 2015 and is therefore not included in these financial statements.

Performance Share Plan

Executive Directors and certain senior managers are also eligible for a Performance Share Plan (PSP) based on performance conditions linked to earnings per share and total shareholder return over a three year vesting period. The first award is expected to be granted in March 2015 and is therefore not included in these financial statements.

Further detail of share-based schemes is available in the Annual Report on Remuneration on page 64.

The share-based expense for the year includes the grant date fair value of share awards vested on IPO and a charge in respect of the remaining IPO awards with future vesting provisions as well as a charge in respect of the Sharesave scheme. The IPO related charge is reported within note 9 Exceptional IPO expenses and the Sharesave scheme charge is included in employee expenses within note 6 Administrative expenses.

Movements in the number of IPO share awards and the employee Sharesave scheme and their weighted average exercise prices are presented below:

	IPO share award		Sharesave	
	Number	Weighted average exercise price £	Number	Weighted average exercise price £
At 1 January 2014	–	–	–	–
Granted	3,726,844	–	538,567	1.34
Exercised	(1,030,206)	–	–	–
Forfeited	(23,130)	–	(10,746)	1.34
At 31 December 2014	2,673,508	–	527,821	1.34
Exercisable at At 31 December 2014	119,791	–	–	–

The weighted average market price at exercise for share options exercised in the year was 170 pence.

The range of exercise prices and weighted average remaining contractual life of outstanding awards are as follows:

	2014		2013	
Exercise price	Number	Weighted average remaining contractual life	Number	Weighted average remaining contractual life
IPO share award				
Nil	2,673,508	1.9	–	–
Sharesave				
134 pence	527,821	3.3	–	–
	3,201,329	2.2	–	–

8. Share-based payments continued

For the share-based awards granted during the year, the weighted average grant date fair value of those options was 153 pence. The valuation of share options is based on the following assumptions:

The grant date fair value of the IPO share awards was the issue price of £1.70 as they are in the form of nil price options which carry rights to dividends during the vesting period. The charge in respect of awards with future vesting provisions assumed a weighted average attrition of 2.6%per annum. This is lower than the overall expected staff attrition rate as nil attrition was assumed for certain senior managers and other senior staff receiving larger awards.

The grant date fair value of options under the Sharesave Scheme was determined using a Black-Scholes model. This determined the fair value of options over 1 ordinary share in the 3 and 5 year Sharesave Scheme as 31 pence and 34 pence respectively, using the following assumptions:

Volatility: an assumption of 20% was used for both schemes based on the three and five year average 30 day volatility of the FTSE 350 Diversified Financials. This benchmark volatility was selected as the Bank's shares have only traded for a short time since admission in June 2014 and within the Bank's peer group there is no directly comparable listed company.

Dividend Yield: an assumption of 3% was used based on the limited analyst consensus at the time of grant.

Grant date share price: £1.596.

9. Exceptional IPO expenses

Exceptional IPO expenses consist of expenses incurred in connection with the stock exchange listing (IPO) and share-based awards granted on admission. These non-recurring expenses were presented separately to provide better comparability of the current reporting period with previous years.

Exceptional IPO expenses are summarised in the table below:

	Total £'000	Charged to profit or loss £'000	Charged to reserves £'000
IPO related costs	6,029	3,660	2,369
Share awards vested on IPO	2,272	2,272	–
IPO share awards with future vesting provisions	1,496	1,496	–
	9,797	7,428	2,369

IPO related expenses include £855k paid to the Group auditors.

Share awards represent the grant date fair value of nil price options over OSB shares granted to certain Directors, senior managers and other employees of the Bank at admission. These options were granted by OSB Holdco Ltd, the Bank's major shareholder and as such the expense is offset fully by an additional capital contribution.

Note 1 u) explains the basis of the split of IPO costs between profit or loss and reserves.

10. Taxation

	Note	**Group 2014 £'000**	Group 2013 £'000
Corporation tax		**(4,755)**	(69)
Total current taxation		**(4,755)**	(69)
Deferred taxation	21	**(7,453)**	(4,577)
Total taxation		**(12,208)**	(4,646)

Notes to the financial statements continued

For the year ended 31 December 2014

10. Taxation continued

The taxation on the Group's profit before taxation differs from the theoretical amount that would arise using the weighted average taxation rate applicable to profits of the Group as follows:

	Group 2014 £'000	Group 2013 £'000
Profit before taxation	**63,745**	31,417
Profit multiplied by the weighted average rate of corporation taxation in the UK during 2014 of 21.5% (2013: 23.25%)	**(13,705)**	(7,304)
Taxation effects of:		
Expenses not deductible for taxation purposes	**(641)**	(147)
Adjustments in respect of earlier years	**2,235**	(1,330)
Coupon on PSBs classified as equity[1]	**–**	337
Capital allowances	**43**	29
Recognition of deferred taxation – Interbay Group	**–**	4,185
Re-measurement of deferred taxation – change in taxation rate	**(96)**	(416)
Other	**(44)**	–
Total taxation (charge)/credit	**(12,208)**	(4,646)

1 Coupons on equity PSBs are now reported net of taxation in the Statement of Changes in Equity.

In 2013 the Group recognised a deferred tax asset in respect of Interbay losses brought forward after reassessment of its future profitability and recoverability of the associated deferred tax.

11. Earnings per share

Earnings per share (EPS) are based on the profit for the period and the number of ordinary shares. Basic EPS are calculated by dividing profit attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the year. Diluted earnings per share take into account share options, awards and preference shares which can be converted to ordinary shares.

For the purpose of calculating earnings per share, profit attributable to ordinary shareholders is arrived at by adjusting profit for the year for the after-tax amounts of a coupon on equity bonds:

	Group 2014 £'000	Group 2013 £'000
Profit for the year	**51,537**	26,771
Adjustments:		
Coupon on perpetual subordinated bonds classified as equity	**(1,450)**	(1,450)
Tax on coupon[1]	**312**	–
Profit attributable to ordinary shareholders	**50,399**	25,321

The Group reorganised its share capital during the year due to the IPO, as disclosed in note 30. In accordance with IAS 33, earnings per share for all periods have been prepared on the basis of the new structure after the reorganisation, as summarised in the table below:

Weighted average number of shares, millions	Group 2014	Group 2013
Basic	**232.6**	188.9
Diluted	**232.7**	188.9

Earnings per share, pence per share	Group 2014	Group 2013[2]
Basic	**21.7**	13.4
Diluted	**21.7**	13.4

1 The tax deduction for the equity perpetual subordinated bonds coupon was taken through the profit and loss in 2013.
2 Previously reported as 14.2p per share before deduction of coupons on perpetual subordinated bonds classified as equity.

12. Dividends

The Directors propose a final dividend of 3.9 pence per share (2013: nil) payable on 5 June 2015 with a record date of 15 May 2015. This dividend is not reflected in these financial statements as it is subject to approval by shareholders at the Annual General Meeting on 2 June 2015.

13. Loans and advances to credit institutions

	Group 2014 £'000	Bank 2014 £'000	Group 2013 £'000	Bank 2013 £'000
Loans and advances to credit institutions have remaining maturities as follows:				
Repayable on demand	**767,318**	**727,462**	102,185	80,732
Less than three months	**–**	**–**	166,916	166,916
One to five years	**–**	**–**	–	–
	767,318	**727,462**	269,101	247,648

Of the above balance £nil (2013: £166.9m) are short-term investments in securities purchased under agreements to resell (reverse repos). These securities have been included within cash equivalents in the statement of cash flows as they satisfy relevant recognition criteria.

14. Investment securities

	Group and Bank 2014 £'000	Group and Bank 2013 £'000
Government investment securities	**158,181**	339,171
Other investment securities:		
Listed	**–**	21,442
Unlisted	**416**	432
	158,597	361,045
Investment securities have remaining maturities as follows:		
Less than three months	**58,381**	144,935
Three months to one year	**23,240**	122,602
One to five years	**57,747**	72,066
More than five years	**19,229**	21,442
	158,597	361,045

Investment securities include £20.0m (2013: £nil) of assets sold under repurchase agreements (repos). In accordance with IAS 39, these securities have been retained in the Group's assets.

At the reporting date, treasury assets with a carrying value of £102.0m (2013: £101.6m) were pledged with the Bank of England under the FLS scheme.

The Directors of the Bank consider that the primary purpose of holding investment securities is prudential. These securities are held as liquid assets with the intention of use on a continuing basis in the Bank's activities and are classified as financial assets available-for-sale, loans and receivables or held-to-maturity as appropriate.

Movements during the year of investment securities classified as available-for-sale are analysed as follows:

	Group and Bank 2014 £'000	Group and Bank 2013 £'000
At 1 January	**339,603**	320,158
Additions	**1,171,747**	846,170
Disposals and maturities	**(1,353,932)**	(830,327)
Reclassifications	**–**	5,438
Changes in fair value	**1,179**	(1,836)
At 31 December	**158,597**	339,603

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14. Investment securities continued

Movements during the year of investment securities classified as held-to-maturity are analysed as follows:

	Group and Bank 2014 £'000	Group and Bank 2013 £'000
At 1 January	–	68,240
Additions	–	167,000
Disposals and maturities	–	(229,802)
Reclassifications	–	(5,438)
At 31 December	–	–

During 2013, the Group sold more than an insignificant part of securities classified as held-to-maturity. Under IAS 39, this triggered reclassification of the remaining securities to assets available-for-sale.

Movements during the period of investment securities classified as loans and receivables are analysed as follows:

	Group and Bank 2014 £'000	Group and Bank 2013 £'000
At 1 January	**21,442**	21,941
Disposals and maturities	**(21,442)**	(499)
At 31 December	–	21,442

15. Loans and advances to customers

	Group 2014 £'000	Bank 2014 £'000	Group 2013 £'000	Bank 2013 £'000
BTL/SME mortgages	**2,049,475**	**1,736,100**	1,076,474	800,566
Residential mortgages	**1,760,753**	**1,225,825**	1,761,564	1,318,492
Personal loans	**109,169**	**109,169**	203,210	203,210
	3,919,397	**3,071,094**	3,041,248	2,322,268

Maturity analysis

Loans and advances to customers are repayable from the reporting date as follows:

	Group 2014 £'000	Bank 2014 £'000	Group 2013 £'000	Bank 2013 £'000
Less than three months	**36,916**	**35,271**	48,854	44,100
Three months to one year	**14,538**	**11,268**	36,434	28,642
One to five years	**346,453**	**271,445**	361,562	300,745
More than five years	**3,547,527**	**2,774,234**	2,621,931	1,970,574
	3,945,434	**3,092,218**	3,068,781	2,344,061
Less: provision for impairment losses on loans and advances (see note 16)	**(26,037)**	**(21,124)**	(27,533)	(21,793)
	3,919,397	**3,071,094**	3,041,248	2,322,268

The above analysis may not reflect actual experience of repayments, since many mortgage loans are repaid early.

During the year the Group purchased mortgage books from other financial institutions with a gross value of £26m for a total of £20m (2013: gross value £182m, purchase price £133m). The Group purchased a personal loan book in 2013 for £258m.

At 31 December 2014, mortgages with a carrying value of £328.0m (2013: £369.2m) were pledged under the Group's securitisation programme.

16. Provision for impairment losses on loans and advances

Movement in provision for impairment losses on loans and advances to customers is as follows:

2014:

Individual	BTL/SME £'000	Residential mortgages £'000	Personal loans £'000	Total £'000
Group				
At 1 January 2014	22,245	2,217	–	24,462
Write offs in year	(11,652)	(1,529)	–	(13,181)
Charge/(credit) for the year net of recoveries	4,720	160	–	4,880
At 31 December 2014	15,313	848	–	16,161
Bank				
At 1 January 2014	18,160	731	–	18,891
Write offs in year	(7,795)	(493)	–	(8,288)
Charge/(credit) for the year net of recoveries	843	161	–	1,004
At 31 December 2014	11,208	399	–	11,607

Collective	BTL/SME £'000	Residential mortgages £'000	Personal loans £'000	Total £'000
Group				
At 1 January 2014	115	858	2,098	3,071
Write offs in year	–	–	–	–
Charge/(credit) for the year net of recoveries	1	933	5,871	6,805
At 31 December 2014	116	1,791	7,969	9,876
Bank				
At 1 January 2014	24	780	2,098	2,902
Write offs in year	–	–	–	–
Charge/(credit) for the year net of recoveries	24	720	5,871	6,615
At 31 December 2014	48	1,500	7,969	9,517

Total	BTL/SME £'000	Residential mortgages £'000	Personal loans £'000	Total £'000
Group				
At 1 January 2014	22,360	3,075	2,098	27,533
Write offs in year	(11,652)	(1,529)	–	(13,181)
Charge/(credit) for the year net of recoveries	4,721	1,093	5,871	11,685
At 31 December 2014	15,429	2,639	7,969	26,037
Bank				
At 1 January 2014	18,184	1,511	2,098	21,793
Write offs in year	(7,795)	(493)	–	(8,288)
Charge/(credit) for the year net of recoveries	867	881	5,871	7,619
At 31 December 2014	11,256	1,899	7,969	21,124

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For the year ended 31 December 2014

16. Provision for impairment losses on loans and advances continued

2013:

Individual	BTL/SME £'000	Residential mortgages £'000	Personal loans £'000	Total £'000
Group				
At 1 January 2013	27,249	1,179	–	28,428
Write offs in year	(10,765)	(3)	–	(10,768)
Charge/(credit) for the year net of recoveries	5,761	1,041	–	6,802
At 31 December 2013	22,245	2,217	–	24,462
Bank				
At 1 January 2013	23,781	524	–	24,305
Write offs in year	(9,611)	(3)	–	(9,614)
Charge/(credit) for the year net of recoveries	3,990	210	–	4,200
At 31 December 2013	18,160	731	–	18,891

Collective	BTL/SME £'000	Residential mortgages £'000	Personal loans £'000	Total £'000
Group				
At 1 January 2013	1,188	1,356	–	2,544
Write offs in year	–	–	–	–
Charge/(credit) for the year net of recoveries	(1,073)	(498)	2,098	527
At 31 December 2013	115	858	2,098	3,071
Bank				
At 1 January 2013	972	1,260	–	2,232
Write offs in year	–	–	–	–
Charge/(credit) for the year net of recoveries	(948)	(480)	2,098	670
At 31 December 2013	24	780	2,098	2,902

Total	BTL/SME £'000	Residential mortgages £'000	Personal loans £'000	Total £'000
Group				
At 1 January 2013	28,437	2,535	–	30,972
Write offs in year	(10,765)	(3)	–	(10,768)
Charge/(credit) for the year net of recoveries	4,688	543	2,098	7,329
At 31 December 2013	22,360	3,075	2,098	27,533
Bank				
At 1 January 2013	24,753	1,784	–	26,537
Write offs in year	(9,611)	(3)	–	(9,614)
Charge/(credit) for the year net of recoveries	3,042	(270)	2,098	4,870
At 31 December 2013	18,184	1,511	2,098	21,793

In previous years the Group provided, but did not write off loans after the security assets were sold, if it was still pursuing further recovery. In 2014 the Group changed its approach and such loans were written off.

Any future recoveries after a loan has been written off are taken to profit or loss against write offs.

17. Impairment losses

	Group 2014 £'000	Group 2013 £'000
Impairment losses on loans and advances to customers (see note 16)	**11,685**	7,329
	11,685	7,329

18. Investments in subsidiaries, intercompany loans and transactions with related parties

The Bank has the following subsidiary undertakings:

2014	Class of shares	Activity	Country of registration	Ownership	Inter company interest £000	Balance due to (by) the Bank £000
EasiOption BPO Services Private Ltd	Ordinary	Back office processing	India	100%	–	–
Easioption Ltd	Ordinary	Holding company	England	100%	–	–
Easiprocess Private Ltd	Ordinary	Back office processing	India	100%	–	(295)
Guernsey Home Loans Ltd	Ordinary	Mortgage provider	England	100%	1,027	29,462
Guernsey Home Loans Ltd	Ordinary	Mortgage provider	Guernsey	100%	3,141	95,295
Heritable Development Finance Ltd[1]	Ordinary	Mortgage originator and servicer	England	85%	–	1,534
Interbay Group Holdings Ltd[2]	Ordinary	Mortgage provider	England	99%	5,420	308,422
Jersey Home Loans Ltd	Ordinary	Mortgage provider	England	100%	320	8,178
Jersey Home Loans Ltd	Ordinary	Mortgage provider	Jersey	100%	12,490	383,405
Prestige Finance Ltd	Ordinary	Mortgage originator and servicer	England	100%	–	(431)
Reliance Property Loans Ltd	Ordinary	Mortgage provider	England	100%	146	4,733
Rochester Financing No.1 Plc[3]	Ordinary	Securitisation entity	England	0%	–	(204,111)
Swingcastle Limited	Ordinary	Dormant entity	England	100%	–	–

2013	Class of shares	Activity	Country of registration	Ownership	Inter company interest £000	Balance due to (by) the Bank £000
EasiOption BPO Services Private Ltd	Ordinary	Back office processing	India	100%	–	–
Easioption Ltd	Ordinary	Holding company	England	100%	–	–
Easiprocess Private Ltd	Ordinary	Back office processing	India	100%	–	(575)
Guernsey Home Loans Ltd	Ordinary	Mortgage provider	England	100%	1,292	34,920
Guernsey Home Loans Ltd	Ordinary	Mortgage provider	Guernsey	100%	3,427	109,324
Heritable Development Finance Ltd[1]	Ordinary	Mortgage originator and servicer	England	85%	–	–
Interbay Group Holdings Ltd[2]	Ordinary	Mortgage provider	England	99%	–	120,047
Jersey Home Loans Ltd	Ordinary	Mortgage provider	England	100%	416	7,072
Jersey Home Loans Ltd	Ordinary	Mortgage provider	Jersey	100%	14,838	434,897
Prestige Finance Ltd	Ordinary	Mortgage originator and servicer	England	100%	2,273	1,785
Reliance Property Loans Ltd	Ordinary	Mortgage provider	England	100%	163	4,882
Rochester Financing No.1 Plc[3]	Ordinary	Securitisation entity	England	0%	(1,309)	(254,875)
Swingcastle Limited	Ordinary	Dormant entity	England	100%	–	–

1 Heritable Development Finance Ltd was set up in December 2013 with Heritable Capital Ltd as a business development partnership. The entity is majority owned and controlled by the Bank.
2 Interbay Group Holdings Ltd (OSB IGH Ltd) is the Interbay Group holding company.
3 Rochester Financing No. 1 Plc (Rochester) is a securitisation entity established by the Bank in October 2013 to raise diversified funds. Although not legally owned by the Group, it is fully controlled and consequently consolidated as a 100% subsidiary.

All of the above investments are reviewed annually for impairment. All of the subsidiaries are actively trading (with the exception of Swingcastle) or are fully funded by the Bank. Based on management's assessment of the future cash flows of each entity, no impairment has been recognised.

In addition to the above subsidiaries, the Bank has transactions with Kent Reliance Provident Society (KRPS), one of its founding shareholders. The Bank provides KRPS with various services including IT, finance and other support functions. During the year the Bank covered operating expenses of KRPS amounting to £0.2m.

The capital reorganisation described in note 30 reduced KRPS's share in the ordinary share capital of the Group to under 1%. As part of this reorganisation KRPS received an additional allocation of ordinary shares from OSB Holdco Ltd, the other founding shareholder, as consideration for the Bank's buy-out of the agency agreement to run a number of branches for the Bank in 2013. This transaction settled the Bank's liability of £0.7m and is recorded as a capital contribution in the statement of equity.

All related party transactions were made on terms equivalent to those that prevail in arm's length transactions. During the period there were no related party transactions between the key management personnel and the Bank other than as described below.

Transactions with Key Management Personnel

The Board considers the key management personnel to comprise Executive and Non-Executive Directors. Details of remuneration paid and outstanding loans with key management personnel and connected persons are set out in note 7.

During the year, the Group provided A Golding a mortgage of £802k, issued on standard terms and on an arm's length basis. The mortgage was fully repaid by 31 December 2014.

Key management personnel and connected persons held deposits with the Group of £86k (2013: £86k).

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18. Related parties and investments in Group undertakings continued

Investments in subsidiaries are classified as financial assets. The net movement during the year is as follows:

	2014 £'000		
	Shares in subsidiary undertakings	**Loans to subsidiary undertakings**	**Total**
At 1 January	**3,476**	**454,754**	**458,230**
Additions	**–**	**171,438**	**171,438**
At 31 December	**3,476**	**626,192**	**629,668**

	2013 £'000		
	Shares in subsidiary undertakings	Loans to subsidiary undertakings	Total
At 1 January	3,476	700,207	703,683
Additions	–	9,422	9,422
Securitisation[1]	–	(254,875)	(254,875)
At 31 December	3,476	454,754	458,230

1. Balance payable to Rochester Financing No.1 Plc as a result of the securitisation transaction.

19. Intangible assets

	Group and Bank 2014 £'000	Group and Bank 2013 £'000
Cost		
At 1 January	**3,727**	3,272
Additions	**1,614**	455
At 31 December	**5,341**	3,727
Amortisation		
At 1 January	**2,610**	2,362
Charged in year	**426**	248
At 31 December	**3,036**	2,610
Net book value		
At 31 December	**2,305**	1,117

Intangible assets consist of computer software. There were no capitalised costs related to the internal development of software during the period.

20. Property, plant and equipment

2014

Group	Freehold land and buildings £'000	Equipment, fixtures and vehicles £'000	Total £'000
Cost			
At 1 January 2014	1,419	9,451	10,870
Reclassification to other assets	–	(2,747)	(2,747)
Cost and depreciation grossed up	–	1,428	1,428
Additions	21	1,345	1,366
Translation difference	–	43	43
At 31 December 2014	1,440	9,520	10,960
Depreciation			
At 1 January 2014	241	5,674	5,915
Cost and depreciation grossed up	–	1,428	1,428
Charged in year	23	447	470
Translation difference	–	43	43
At 31 December 2014	264	7,592	7,856
Net book value			
At 31 December 2014	1,176	1,928	3,104

Bank	Freehold land and buildings £'000	Equipment, fixtures and vehicles £'000	Total £'000
Cost			
At 1 January 2014	1,419	5,042	6,461
Additions	21	893	914
At 31 December 2014	1,440	5,935	7,375
Depreciation			
At 1 January 2014	241	4,408	4,649
Charged in year	23	260	283
At 31 December 2014	264	4,668	4,932
Net book value			
At 31 December 2014	1,176	1,267	2,443

2013

Group	Freehold land and buildings £'000	Equipment, fixtures and vehicles £'000	Total £'000
Cost			
At 1 January 2013	1,419	8,540	9,959
Additions	–	1,150	1,150
Disposals	–	(63)	(63)
Translation difference	–	(176)	(176)
At 31 December 2013	1,419	9,451	10,870
Depreciation			
At 1 January 2013	219	5,509	5,728
Charged in year	22	277	299
Disposals	–	(17)	(17)
Translation difference	–	(95)	(95)
At 31 December 2013	241	5,674	5,915
Net book value			
At 31 December 2013	1,178	3,777	4,955

Notes to the financial statements continued

For the year ended 31 December 2014

20. Property, plant and equipment continued

Bank	Freehold land and buildings £'000	Equipment, fixtures and vehicles £'000	Total £'000
Cost			
At 1 January 2013	1,419	4,729	6,148
Additions	–	313	313
At 31 December 2013	1,419	5,042	6,461
Depreciation			
At 1 January 2013	219	4,238	4,457
Charged in year	22	170	192
At 31 December 2013	241	4,408	4,649
Net book value			
At 31 December 2013	1,178	634	1,812

Following a review of property, plant and equipment, certain items have been reclassified to other categories within the statement of financial position.

Fixed assets across the subsidiaries which were fully depreciated have been recognised on a gross basis in 2014.

21. Deferred taxation

Deferred taxation asset	Group 2014 £'000	Bank 2014 £'000	Group 2013 £'000	Bank 2013 £'000
At 1 January	**10,901**	**7,260**	15,472	13,257
Profit or loss (charge)/credit	**(7,453)**	**(6,801)**	(4,577)	(6,003)
Tax taken directly to equity	**115**	**115**	–	–
Reclassification from liabilities	**–**	**–**	6	6
At 31 December	**3,563**	**574**	10,901	7,260
Analysed as:				
Losses carried forward	**2,875**	**–**	10,805	7,181
Accelerated depreciation	**141**	**27**	96	79
Share-based payments	**598**	**598**	–	–
Other	**(51)**	**(51)**		
	3,563	**574**	10,901	7,260
Deferred taxation liability				
At 1 January	**–**	**–**	389	389
Tax taken directly to equity	**–**	**–**	(395)	(395)
Reclassification to assets	**–**	**–**	6	6
At 31 December	**–**	**–**	–	–

The UK Government announced that the main rate of corporation tax would reduce from 23% to 21% for the year beginning 1 April 2014 and a further 1% reduction to 20% for the year beginning 1 April 2015. This results in a weighted average rate of 21.5% for 2014 (2013: 23.25%). The reductions to 21% and 20% that were announced in the 2012 Autumn Statement and 2013 Budget respectively became substantively enacted through the 2013 Finance Act on 17 July 2013.

The deferred tax asset as at 31 December 2014 has been calculated using the rates substantively enacted for the expected periods of utilisation.

22. Other assets

	Group 2014 £'000	Bank 2014 £'000	Group 2013 £'000	Bank 2013 £'000
Prepayments	**3,205**	**3,160**	4,237	4,105
VAT receivable	**–**	**–**	13	13
Other assets	**9,075**	**3,188**	2,382	2,208
	12,280	**6,348**	6,632	6,326

23. Amounts owed to retail depositors

	Group and Bank 2014 £'000	Group and Bank 2013 £'000
Amounts owed to retail depositors	**4,331,639**	3,251,576

Repayable in the ordinary course of business as follows:

	Group and Bank 2014	Group and Bank 2013
On demand	**1,432,528**	1,252,674
Less than three months	**208,435**	187,850
Three months to one year	**1,651,258**	827,742
One to five years	**1,039,418**	983,310
	4,331,639	3,251,576

24. Amounts owed to credit institutions

Repayable in the ordinary course of business as follows:

	Group and Bank 2014 £'000	Group and Bank 2013 £'000
Less than three months	**23,009**	1,438
	23,009	1,438

Amounts owed to credit institutions include an obligation of £20.0m to repurchase investment securities sold in a repo transaction, as disclosed in note 13.

25. Amounts owed to other customers

Repayable in the ordinary course of business as follows:

	Group and Bank 2014 £'000	Group and Bank 2013 £'000
Less than three months	**4,353**	851
Three months to one year	**–**	1,000
One to five years	**–**	500
	4,353	2,351

26. Debt securities in issue

	Group 2014 £'000	Bank 2014 £'000	Group 2013 £'000	Bank 2013 £'000
One to five years	**238,390**	**–**	273,759	–
	238,390	**–**	273,759	–

Debt securities in issue comprise AAA and AA+ rated notes issued by Rochester Financing No. 1 Plc (Rochester) and sold to third-party investors in 2013. Rochester is a mortgage securitisation entity established by the Bank in 2013. The Bank retained the remaining notes and residual certificates issued by Rochester and as such did not transfer substantially the risk and rewards of ownership of the securitised mortgages. These mortgages therefore remain on the Bank's balance sheet and the Group consolidates Rochester.

The notes sold originally had a nominal value of £273m, paid down to £238m as at 31 December 2014, and a final maturity date of July 2046, however the interest payable on the notes steps up from January 2018, with the holder of the majority of the residual certificates (currently the Bank) having the right to redeem the outstanding notes from this date. The Bank has an incentive to call at the step up date and the debt securities have accordingly been classified as having an expected maturity at that date in the table above. The actual repayment profile of the notes cannot be determined as quarterly repayments depend on, amongst other factors, the schedule of principal receipts on the securitised mortgages.

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27. Other liabilities

	Group 2014 £'000	Bank 2014 £'000	Group 2013 £'000	Bank 2013 £'000
Falling due within one year				
Tax deducted at source from interest paid	**1,111**	**1,111**	1,822	1,822
Accruals and deferred income	**5,694**	**5,341**	7,869	7,608
Other creditors	**6,804**	**2,676**	3,135	1,056
	13,609	**9,128**	12,826	10,486

28. Subordinated liabilities

	Group and Bank 2014 £'000	Group and Bank 2013 £'000
Linked to LIBOR (London Interbank Offered Rate):		
Floating rate Subordinated Liabilities 2015	**3,001**	3,002
Floating rate Subordinated Liabilities 2016	**3,003**	3,003
Floating rate Subordinated Liabilities 2017	**5,655**	5,656
Floating rate Subordinated Loans 2022	**708**	706
Linked to the average standard mortgage rate of the five largest building societies:		
Floating rate Subordinated Liabilities 2017	**5,047**	5,049
Fixed rate:		
6.45% Subordinated Liabilities 2024	**10,159**	10,163
	27,573	27,579

Subordinated liabilities are repayable at the dates stated or earlier at the option of the Group with the prior consent of the Prudential Regulation Authority. All subordinated liabilities are denominated in Sterling.

The rights of repayment of the holders of these issues are subordinated to the claims of all depositors and all creditors.

29. Perpetual subordinated bonds

	Group and Bank 2014 £'000	Group and Bank 2013 £'000
Sterling perpetual subordinated bonds	**15,234**	15,263

The bonds were issued with no discretion over the payment of interest and are therefore classified as financial liabilities. The coupon rate was 7.875% until the call date on 27 August 2014 after which it was reset to 5.9884% based on the 5 year gilt yield on 14 July 2014.

30. Share capital

2014

Group and Bank	Number of shares: Ordinary A shares	Ordinary B shares	Ordinary E shares	Convertible Preference shares	New ordinary shares
As at 1 January	26,000	21,662	1,000	1,067,140	–
Capital reorganisation	(26,000)	(21,662)	(1,000)	(1,067,140)	218,638,200
IPO share issue	–	–	–	–	24,441,765
As at 31 December	–	–	–	–	243,079,965

Group and Band	£000's: Value	Premium	Total
Ordinary shares	**2,431**	**157,901**	**160,332**

2013

Group and Bank 2013	Number of Shares: Ordinary A shares	Ordinary B shares	Ordinary E shares	Convertible Preference shares
As at 1 January	26,000	20,897	1,000	804,154
Capital injections	–	765	–	262,986
As at 31 December	26,000	21,662	1,000	1,067,140

Group and Bank 2013	£000's: Value	Premium	Total
Ordinary A shares	26	25,974	26,000
Ordinary B shares	22	93,241	93,263
Ordinary E shares	150	–	150
Convertible Preference shares	1,067	670	1,737
As at 31 December	1,265	119,885	121,150

During the year the Group reorganised its share capital in order to prepare for the public listing. The reorganisation involved an issue of interim shares, conversion, bonus issue and change of denomination. Ordinary B, E and preference shares regardless of nominal value were exchanged for the new £0.01 ordinary shares on a one-for-200 basis. Ordinary A shares were exchanged for 0.7m new shares, a proportion of about one A share for 26 new shares.

In addition, OSB Holdco Ltd bought out B Shares issued by OSB IGH Limited in connection with the Interbay acquisition and E shares issued by the Bank in connection with the Prestige acquisition. The shares were cancelled and their value enhancement of £3.3m, previously kept in the capital contribution reserve, was reclassified to retained earnings.

During the IPO the Group issued and sold to the public 24.4m shares at £1.70 per share.

The capital reorganisation reduced KRPS's share in the ordinary share capital of the Group to under 1%. As part of the reorganisation KRPS received an additional allocation of ordinary shares from OSB Holdco Ltd as consideration for the Bank's buy-out of the agency agreement to run a number of branches for the Bank in 2013. This transaction settled the Bank's liability of £0.7m and is recorded as a capital contribution in the statement of equity.

Perpetual subordinated bonds

In addition to the PSBs in note 29, the Bank has issued £22m 6.591% PSBs which are classified as equity, as full discretion can be exercised by the Directors over the payment of the coupon. The classification of these PSBs means that any coupon payments on them are treated within retained earnings rather than through profit or loss.

Transfer reserve

The transfer reserve of £12.8m (Bank: £15.2m) represents the difference between the true value of net assets transferred to the Group from Kent Reliance Building Society in 2011 and the value of shares issued to the A ordinary shareholders.

AFS reserve

The AFS reserve of £0.8m (2013: £(0.2)m) represents the cumulative net change in the fair value of investment securities measured at fair value through other comprehensive income net of deferred tax.

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31. FSCS and other provisions

The Financial Services Compensation Scheme (FSCS) has provided compensation to consumers following the collapse of a number of deposit takers. The compensation paid out to consumers is currently funded through loans from the Bank of England and HM Treasury which at 31 December 2014 stood at approximately £16bn.

In order to repay the loans and cover its costs, the FSCS charges levies on firms authorised by the Prudential Regulation Authority and the Financial Conduct Authority. Total levies for Scheme Year 2014/15 amounted to £276m. In January 2014, the FSCS announced an indicative levy of £287m for firms in 2015/16. The Group contributes to the FSCS based on its share of UK deposits.

The ultimate FSCS levy to the industry as a result of the insolvencies cannot currently be estimated reliably as it is dependent on various uncertain factors including the potential recoveries of assets by the FSCS and changes in the level of protected deposits and the population of FSCS members at the time.

Group and Bank	**FSCS 2014 £'000**	**Other provisions 2014 £'000**	**Total 2014 £'000**	FSCS 2013 £'000	Other provisions 2013 £'000	Total 2013 £'000
As at 1 January	**1,151**	**130**	**1,281**	2,166	150	2,316
Paid during the year	**(2,435)**	**(15)**	**(2,450)**	(3,163)	(24)	(3,187)
Charge/(credit)	**2,768**	**(1)**	**2,767**	2,148	4	2,152
At 31 December	**1,484**	**114**	**1,598**	1,151	130	1,281

32. Financial commitments and guarantees

a) As at 31 December 2014, the Group's contracted or anticipated capital commitments not provided for amounted to £3,373k (2013: Nil).

b) Operating lease commitments are summarised in the table below:

	Group 2014 £'000	**Bank 2014 £'000**	Group 2013 £'000	Bank 2013 £'000
Land and buildings: due within				
One year	**494**	**269**	507	286
Two to five years	**1,148**	**517**	967	707
More than five years	**14**	**14**	66	60
	1,656	**800**	1,540	1,053

c) Undrawn mortgage loan facilities

	Group 2014 £'000	**Bank 2014 £'000**	Group 2013 £'000	Bank 2013 £'000
As at 31 December	**262,452**	**233,128**	156,920	133,986

Undrawn loan facilities are approved loan applications which have not yet been exercised. They are payable on demand and are usually drawn down or expire within three months.

d) The Group did not have any issued financial guarantees as at 31 December 2014 (2013: nil).

33. Risk management and financial instruments

Overview
Financial instruments form the vast majority of the Group's and Bank's assets and liabilities. The Group manages risk on a consolidated basis, and risk disclosures are provided on this basis.

Types of financial instrument
Financial instruments are a broad category which includes financial assets, financial liabilities and equity instruments. The main financial assets of the Group are loans to customers and liquid assets which in turn consist of cash in the Bank of England Reserve account, call accounts with other credit institutions and UK and EU sovereign debt. These are funded by a combination of financial liabilities and equity instruments. Financial liability funding comes predominantly from retail deposits, supported by debt securities, subordinated debt, wholesale and other funding. Equity instruments include own shares and perpetual bonds meeting the equity classification criteria. The Group's main activity is mortgage and personal lending; it raises funds or invests in particular types of financial assets primarily in order to satisfy banking industry regulations and manage the risks arising from its operations. The Group does not trade in financial instruments for speculative purposes.

The Group uses derivative instruments to manage various aspects of market risk. Derivative financial instruments ('derivatives') are financial instruments whose value changes in response to changes in underlying variables such as interest rates, commodity or security prices, or indices. Typically the contract value of derivatives is much smaller than that of the instruments they relate to which makes them a convenient tool for benefiting in value changes without the need to buy or sell the whole underlying product. The most common derivatives comprise futures, forwards and swaps.

Derivatives are used by the Group solely to reduce the risk of loss arising from changes in market factors. Derivatives are not used for speculative purposes.

Types of derivatives and uses
The derivative instruments used by the Group in managing its risk exposures are interest rate swaps and basis rate swaps. Interest rate swaps convert fixed interest rates to floating or vice versa. Basis rate swaps perform a similar function by converting cash flows from one interest rate basis to another. As with other derivatives, the underlying product is not sold and payments are based on notional principal amounts.

The Group uses interest swaps to convert its instruments, such as mortgages, deposits and liquid assets, from fixed and in some cases inflation- or base rate-linked rates to LIBOR-linked variable rates. This ensures it can always service outgoing interest payments on its liabilities with incoming interest on its assets, regardless of changes in the market rates.

The following table describes the significant activities undertaken by the Group and the risks associated with such activities.

Activity	Risk
Fixed rate savings products and fixed rate funding	Decrease in interest rates
Fixed rate mortgage lending and fixed rate asset investments	Increase in interest rates

Financial risks
The principal risks to which the Group is exposed are credit, liquidity, market and operational risks. Each of these is considered below.

Credit risk
Credit risk is the risk that unexpected losses may arise as a result of the Group's borrowers or market counterparties failing to meet their obligations to repay.

The Group has adopted the Standardised Approach for assessment of credit risk capital requirements. This approach considers risk weightings as defined under Basel II principles.

The classes of financial instruments to which the Group is most exposed are loans and advances to customers, loans and advances to credit institutions, cash in the Bank of England Reserve account, call accounts with other credit institutions and UK and EU sovereign debt. The maximum exposure to credit risk is generally represented by the carrying amount of each financial asset plus any off-balance sheet credit commitments.

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33. Risk management and financial instruments continued

Credit risk – loans and advances to customers

Credit risk associated with mortgage lending is largely driven by the housing market and level of unemployment. A recession and/or high interest rates could cause pressure within the market, resulting in rising levels of arrears and repossessions.

All loan applications are assessed with reference to the Group's Lending Policy. Changes to the policy are approved by the Board, with mandates set for the approval of loan applications.

The Credit Committee and the ALCO regularly monitor lending activity, taking appropriate actions to re-price products and adjust lending criteria in order to control risk and manage exposure. Where necessary and appropriate, changes to the Lending Policy are recommended to the Risk Committee and the Board.

The following table shows an analysis of the lending portfolio by borrower type at the reporting date:

	Group 2014		Bank 2014	
	£'000	%	£'000	%
BTL/SME mortgages	**2,064,905**	**52%**	**1,586,175**	**51%**
Residential mortgages	**1,763,391**	**45%**	**1,388,905**	**45%**
Personal loans	**117,138**	**3%**	**117,138**	**4%**
Gross loans	**3,945,434**	**100%**	**3,092,218**	**100%**

	Group 2013		Bank 2013	
	£'000	%	£'000	%
BTL/SME mortgages	1,098,834	36%	806,334	34%
Residential mortgages	1,764,639	58%	1,332,419	57%
Personal loans	205,308	6%	205,308	9%
Gross loans	3,068,781	100%	2,344,061	100%

Property values are updated to reflect changes in the house price index. A breakdown of the table above by indexed loan to value is as follows:

Loan to value analysis by band:

Group	2014			
Band	BTL/SME £'000	Residential £'000	Total £'000	%
0–50%	**221,167**	**763,978**	**985,145**	**26%**
50%–60%	**307,073**	**295,894**	**602,967**	**16%**
60%–70%	**567,012**	**285,088**	**852,100**	**22%**
70%–80%	**657,466**	**232,326**	**889,792**	**23%**
80%–90%	**265,551**	**160,068**	**425,619**	**11%**
90%–100%	**16,366**	**16,807**	**33,173**	**1%**
>100%	**30,270**	**9,230**	**39,500**	**1%**
Gross mortgages	**2,064,905**	**1,763,391**	**3,828,296**	**100%**
Personal loans			**117,138**	
Gross loans			**3,945,434**	

Bank	2014			
Band	BTL/SME £'000	Residential £'000	Total £'000	%
0–50%	**140,900**	**661,147**	**802,047**	**27%**
50%–60%	**247,686**	**239,044**	**486,730**	**16%**
60%–70%	**436,483**	**226,802**	**663,285**	**22%**
70%–80%	**485,643**	**161,688**	**647,331**	**22%**
80%–90%	**241,702**	**88,345**	**330,047**	**11%**
90%–100%	**13,002**	**8,162**	**21,164**	**1%**
>100%	**20,759**	**3,717**	**24,476**	**1%**
Gross mortgages	**1,586,175**	**1,388,905**	**2,975,080**	**100%**
Personal loans			**117,138**	
Gross loans			**3,092,218**	

33. Risk management and financial instruments continued

Group

Band	2013[1] BTL/SME £'000	Residential £'000	Total £'000	%
0–50%	151,148	1,011,391	1,162,539	41%
50%–60%	150,881	168,400	319,280	11%
60%–70%	259,211	242,630	501,842	18%
70%–80%	345,459	176,377	521,836	18%
80%–90%	179,049	112,499	291,548	10%
90%–100%	13,303	10,371	23,673	1%
>100%	39,157	3,598	42,755	1%
Gross mortgages	1,138,207	1,725,266	2,863,473	100%
Personal loans			205,308	
Gross loans			3,068,781	

Bank

Band	2013 BTL/SME £'000	Residential £'000	Total £'000	%
0–50%	82,199	803,387	885,585	41%
50%–60%	97,301	199,558	296,858	14%
60%–70%	184,294	166,660	350,954	16%
70%–80%	255,368	119,612	374,980	17%
80%–90%	147,792	36,715	184,507	9%
90%–100%	10,619	2,951	13,569	1%
>100%	30,491	1,809	32,299	2%
Gross mortgages	808,063	1,330,690	2,138,753	100%
Personal loans			205,308	
Gross loans			2,344,061	

1 The 2013 LTV table has been updated to reflect HPI movements up to December 2013 to provide a consistent basis for comparison to the 2014 LTV table.

Analysis of mortgage portfolio by arrears and collateral held

The tables below provide further information on collateral in the mortgage portfolio by payment due status. Capped collateral only recognises collateral to the value of each individual mortgage and does not recognise over-collateralisation. The full collateral position is captured in the loan-to-value analysis above.

	Group 2014		Bank 2014	
	Loan balance £'000	Capped collateral £'000	Loan balance £'000	Capped collateral £'000
Not impaired:				
Not past due	3,397,241	3,392,717	2,597,347	2,594,898
Past due up to 3 months	344,579	343,199	313,191	312,197
Past due 3 to 6 months	30,528	30,306	25,191	25,177
Past due 6 to 12 months	9,553	9,514	5,309	5,304
Past due over 12 months	4,981	4,938	2,476	2,475
Possessions	1,431	1,368	764	763
	3,788,332	3,782,042	2,944,278	2,940,814
Impaired:				
Not past due	12,316	11,789	11,925	11,397
Past due up to 3 months	1,514	1,346	–	–
Past due 3 to 6 months	–	–	–	–
Past due 6 to 12 months	2,680	1,954	2,680	1,954
Past due over 12 months	11,786	8,217	11,788	8,217
Possessions	11,687	10,041	4,409	4,268
Gross mortgages	39,983	33,347	30,802	25,836
Personal loans	117,138		117,138	
Gross loans	3,945,434		3,092,218	

Notes to the financial statements continued

For the year ended 31 December 2014

33. Risk management and financial instruments continued

	Group 31 December 2013		Bank 31 December 2013	
	Loan balance £'000	Capped collateral £'000	Loan balance £'000	Capped collateral £'000
Not impaired:				
Not past due	2,485,653	2,484,326	1,828,268	1,826,971
Past due up to 3 months	256,369	256,088	222,181	221,900
Past due 3 to 6 months	24,572	23,945	19,113	18,860
Past due 6 to 12 months	18,550	18,380	14,013	13,843
Past due over 12 months	7,670	7,616	6,963	6,908
Possessions	2,366	2,365	1,273	1,273
	2,795,180	2,792,720	2,091,811	2,089,755
Impaired[1]:				
Not past due	20,930	18,432	18,838	16,339
Past due up to 3 months	2,010	2,010	–	–
Past due 3 to 6 months	629	617	35	35
Past due 6 to 12 months	2,815	1,805	2,297	1,290
Past due over 12 months	20,159	15,300	17,008	14,516
Possessions	21,750	19,064	8,764	7,521
Gross mortgages	68,293	57,228	46,942	39,701
Personal loans	205,308		205,308	
Gross loans	3,068,781		2,344,061	

1 Impaired is defined as loans with a specific provision against them at the reporting date.

Below is a summary of capped collateral:

	Group 2014		**Bank 2014**	
	Loan balance £'000	**Capped collateral £'000**	**Loan balance £'000**	**Capped collateral £'000**
Not past due and not impaired	**3,397,241**	**3,392,717**	**2,597,347**	**2,594,898**
Past due but not impaired	**391,072**	**389,325**	**346,931**	**345,916**
Impaired	**39,983**	**33,347**	**30,802**	**25,836**
Gross mortgages	**3,828,296**	**3,815,389**	**2,975,080**	**2,966,650**
Personal loans	**117,138**		**117,138**	
Gross loans	**3,945,434**		**3,092,218**	

	Group 31 December 2013		Bank 31 December 2013	
	Loan balance £'000	Capped collateral £'000	Loan balance £'000	Capped collateral £'000
Not past due and not impaired	2,485,653	2,484,326	1,828,268	1,826,971
Past due but not impaired	309,527	308,394	263,543	262,784
Impaired	68,293	57,228	46,942	39,701
Gross mortgages	2,863,473	2,849,948	2,138,753	2,129,456
Personal loans	205,308		205,308	
Gross loans	3,068,781		2,344,061	

33. Risk management and financial instruments continued

Analysis of personal loans by arrears

The arrears analysis of unsecured personal loans is provided in the table below:

Group and Bank	2014 £'000	2013 £'000
Not impaired:		
Not past due	**107,161**	194,522
Past due up to 3 months	**1,588**	4,649
Past due 3 to 6 months	**1,197**	2,940
Past due 6 to 12 months	**3,085**	3,074
Past due over 12 months	**4,107**	123
	117,138	205,308

Geographical analysis by region

An analysis of loans by region is provided below:

	Group 2014		Bank 2014	
Region	£'000	%	£'000	%
East Anglia	**110,686**	**3%**	**98,819**	**3%**
East Midlands	**145,158**	**4%**	**121,975**	**4%**
Greater London	**1,387,227**	**39%**	**1,254,682**	**42%**
Guernsey	**133,496**	**3%**	**–**	**–**
Jersey	**398,804**	**10%**	**–**	**–**
North East	**53,645**	**1%**	**48,075**	**2%**
North West	**193,087**	**5%**	**170,410**	**6%**
Northern Ireland	**12,041**	**0%**	**11,604**	**0%**
Scotland	**52,336**	**1%**	**51,311**	**2%**
South East	**740,862**	**19%**	**686,010**	**23%**
South West	**236,463**	**6%**	**218,545**	**7%**
Wales	**85,260**	**2%**	**75,116**	**3%**
West Midlands	**185,675**	**5%**	**168,307**	**6%**
Yorks & Humberside	**93,556**	**2%**	**70,226**	**2%**
Gross mortgages	**3,828,296**	**100%**	**2,975,080**	**100%**
Personal loans	**117,138**		**117,138**	
Gross loans	**3,945,434**		**3,092,218**	

	Group 2013		Bank 2013	
Region	£'000	%	£'000	%
East Anglia	72,349	3%	67,311	3%
East Midlands	110,231	4%	103,102	5%
Greater London	777,121	27%	733,347	34%
Guernsey	147,790	5%	–	–
Jersey	452,059	16%	–	–
North	8,101	0%	8,101	0%
North East	39,825	1%	38,429	2%
North West	151,001	5%	139,701	7%
Northern Ireland	12,946	1%	12,481	1%
Scotland	52,150	2%	50,886	2%
South East	578,873	20%	562,288	26%
South West	177,713	6%	168,369	8%
Wales	70,009	2%	63,697	3%
West Midlands	132,758	5%	124,057	6%
Yorks & Humberside	80,547	3%	66,984	3%
Gross mortgages	2,863,473	100%	2,138,753	100%
Personal loans	205,308		205,308	
Gross loans	3,068,781		2,344,061	

Notes to the financial statements continued

For the year ended 31 December 2014

33. Risk management and financial instruments continued

Credit risk – investment securities and loans and advances to credit institutions

The Group holds treasury instruments in order to meet liquidity requirements and for general business purposes. The credit risk arising from these investments is closely monitored and managed by the Group's Treasury department. In managing these assets, Group treasury operates within guidelines laid down in the Treasury Policy approved by the Board and performance is monitored and reported to ALCO monthly, including through the use of an internally developed rating model based on counterparty credit default swap spreads.

The Group has limited exposure to emerging markets (Indian operations) and non-investment-grade debt. The ALCO is responsible for approving Treasury counterparties.

During the year, the average balance of cash in hand, loans and advances to credit institutions and investment securities on a monthly basis was £753,921k (2013: £633,877k).

	Group				
2014:	**AAA £'000**	**AA £'000**	**A £'000**	**Less than A rating £'000**	**Total £'000**
Call accounts	**568,756**	**34,279**	**110,205**	**54,078**	**767,318**
Floating rate notes	**34,348**	**–**	**–**	**–**	**34,348**
Treasury bills	**123,833**	**–**	**–**	**–**	**123,833**
Other securities	**–**	**–**	**–**	**416**	**416**
Total	**726,937**	**34,279**	**110,205**	**54,494**	**925,915**
Percentages	**79%**	**4%**	**12%**	**5%**	**100%**

	Bank				
2014:	**AAA £'000**	**AA £'000**	**A £'000**	**Less than A rating £'000**	**Total £'000**
Call accounts	**568,756**	**–**	**110,205**	**48,501**	**727,462**
Floating rate notes	**34,348**	**–**	**–**	**–**	**34,348**
Treasury bills	**123,833**	**–**	**–**	**–**	**123,833**
Other securities	**–**	**–**	**–**	**416**	**416**
Total	**726,937**	**–**	**110,205**	**48,917**	**886,059**
Percentages	**82%**	**–**	**12%**	**6%**	**100%**

	Group 31 December 2013				
	AAA £'000	AA £'000	A £'000	Less than A rating £'000	Total £'000
Call accounts	–	28,282	73,903	–	102,185
Floating rate notes	4,986	–	–	–	4,986
Gilts	–	36,660	–	–	36,660
Reverse repos	–	166,916	–	–	166,916
RMBS	15,420	–	6,022	–	21,442
Treasury bills	96,663	200,862	–	–	297,525
Other securities	–	–	–	432	432
Total	117,069	432,720	79,925	432	630,146
Percentages	18.5%	68.7%	12.7%	0.1%	100.0%

	Bank 31 December 2013				
	AAA £'000	AA £'000	A £'000	Less than A rating £'000	Total £'000
Call accounts	–	9,862	70,870	–	80,732
Floating rate notes	4,986	–	–	–	4,986
Gilts	–	36,660	–	–	36,660
Reverse repos	–	166,916	–	–	166,916
RMBS	15,420	–	6,022	–	21,442
Treasury bills	96,663	200,862	–	–	297,525
Other securities	–	–	–	432	432
Total	117,069	414,300	76,892	432	608,693
Percentages	19%	68%	13%	0%	100%

33. Risk management and financial instruments continued

Industry sector/asset class

2014:	Group £'000	Group %	Bank £'000	Bank %
Banks	**198,966**	**21%**	**159,110**	**18%**
Central governments	**624,972**	**68%**	**624,972**	**70%**
Supranationals	**101,977**	**11%**	**101,977**	**12%**
Total	**925,915**	**100%**	**886,059**	**100%**

2013:	Group 31 December 2013 £'000	Group 31 December 2013 %	Bank 31 December 2013 £'000	Bank 31 December 2013 %
Banks	286,695	46%	265,242	43%
Central governments	241,802	38%	241,802	40%
Supranationals	101,649	16%	101,649	17%
Total	630,146	100%	608,693	100%

Geographical exposure

2014:	Group £'000	Group %	Bank £'000	Bank %
United Kingdom	**789,119**	**85%**	**784,082**	**88%**
Rest of Europe	**101,977**	**11%**	**101,977**	**12%**
Australia	**31,954**	**3%**	**–**	**–**
India	**2,865**	**0%**	**–**	**–**
Total	**925,915**	**100%**	**886,059**	**100%**

2013:	Group 31 December 2013 £'000	Group 31 December 2013 %	Bank 31 December 2013 £'000	Bank 31 December 2013 %
United Kingdom	497,411	79%	507,044	83%
Rest of Europe	101,649	16%	101,649	17%
Australia	28,886	5%	–	–
India	2,200	0%	–	–
Total	630,146	100%	608,693	100%

The Group monitors exposure concentrations against a variety of criteria, including asset class, sector and geography. To avoid refinancing risks associated with any one counterparty, sector or geographical region, the Board has set appropriate limits. These are contained in the Treasury Policy.

Liquidity risk

Liquidity risk is the risk of having insufficient liquid assets to fulfil obligations as they become due or the cost of raising liquid funds becoming too expensive.

The Group's approach to managing liquidity risk is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding in order to retain full public confidence in the solvency of the Group and to enable the Group to meet its financial obligations. This is achieved through maintaining a prudent level of liquid assets and control of the growth of the business. The Group established a Reserve account with the Bank of England and gained access to its Contingent Liquidity Facilities in 2014.

Liquidity management is the responsibility of the ALCO, with day-to-day management delegated to Treasury as detailed in the Treasury Policy. The ALCO is responsible for setting limits over the level and maturity profile of wholesale funding and for monitoring the composition of the Group financial position.

For each material class of financial liability a contractual maturity analysis is provided in notes 23 to 29.

An Asset Encumbrance Policy has also been approved with encumbrance levels monitored monthly at ALCO.

The Group also monitors a range of numeric triggers, defined in the Contingency Funding Plan (CFP) and Recovery and Resolution Plan (RRP), which are designed to capture liquidity stresses in advance in order to allow sufficient time for management action to take effect.

These are monitored daily by the Risk team, with breaches immediately reported to the Chief Risk Officer, Deputy Chief Risk Officer, CEO, CFO and Head of Treasury.

Notes to the financial statements continued

For the year ended 31 December 2014

33. Risk management and financial instruments continued

The following table provides an analysis of the Group's gross contractual cash flows payable under financial liabilities:

Group 2014	**Up to 3 months £'000**	**3–12 months £'000**	**1–5 years £'000**	**More than 5 years £'000**	**Total £'000**
Amounts owed to retail depositors	**1,432,813**	**209,016**	**1,664,447**	**1,083,448**	**4,389,724**
Amounts owed to credit institutions and other customers	**27,079**	**–**	**–**	**–**	**27,079**
Debt securities in issue[1]	**–**	**–**	**238,390**	**–**	**238,390**
Derivative financial instruments	**785**	**4,491**	**12,234**	**8,088**	**25,598**
Other liabilities	**13,609**	**–**	**–**	**–**	**13,609**
Subordinated liabilities	**297**	**3,878**	**25,759**	**752**	**30,686**
Perpetual subordinated bonds	**295**	**890**	**4,728**	**15,000**	**20,913**
Total liabilities	**1,474,878**	**218,275**	**1,945,558**	**1,107,288**	**4,745,999**

1 Debt securities in issue do not include future interest due as this cannot be determined as principal repayments depend on, amongst other factors, the schedule of principal receipts on the securitised mortgages. See note 26 for more details.

Bank 2014	**Up to 3 months £'000**	**3–12 months £'000**	**1–5 years £'000**	**More than 5 years £'000**	**Total £'000**
Amounts owed to retail depositors	**1,432,813**	**209,016**	**1,664,447**	**1,083,448**	**4,389,724**
Amounts owed to credit institutions and other customers	**27,079**	**–**	**–**	**–**	**27,079**
Derivative financial instruments	**785**	**4,491**	**12,234**	**8,088**	**25,598**
Other liabilities	**9,128**	**–**	**–**	**–**	**9,128**
Subordinated liabilities	**297**	**3,878**	**25,759**	**752**	**30,686**
Perpetual subordinated bonds	**295**	**890**	**4,728**	**15,000**	**20,913**
Total liabilities	**1,470,397**	**218,275**	**1,707,168**	**1,107,288**	**4,503,128**

Group As at 31 December 2013	Up to 3 months £'000	3–12 months £'000	1–5 years £'000	More than 5 years £'000	Total £'000
Amounts owed to retail depositors	1,403,941	836,320	1,037,535	–	3,277,796
Amounts owed to credit institutions and other customers	1,991	1,004	518	–	3,513
Debt securities in issue	–	–	273,759	–	273,759
Derivative financial instruments	(796)	138	15,227	7,996	22,565
Other liabilities	12,826	–	–	–	12,826
Subordinated liabilities	65	909	11,323	19,299	31,596
Perpetual subordinated bonds	595	1,184	4,736	15,000	21,515
Total liabilities	1,418,622	839,555	1,343,098	42,295	3,643,570

Bank As at 31 December 2013	Up to 3 months £'000	3–12 months £'000	1–5 years £'000	More than 5 years £'000	Total £'000
Amounts owed to retail depositors	1,403,941	836,320	1,037,535	–	3,277,796
Amounts owed to credit institutions and other customers	1,991	1,004	518	–	3,513
Derivative financial instruments	(796)	138	15,227	7,996	22,565
Other liabilities	10,486	–	–	–	10,486
Subordinated liabilities	65	909	11,323	19,299	31,596
Perpetual subordinated bonds	595	1,184	4,736	15,000	21,515
Total liabilities	1,416,282	839,555	1,069,339	42,295	3,367,471

It has been assumed that Perpetual Subordinated Bonds will not mature at the first call date.

Market risk

Market risk is the risk of an adverse change in Group income or the Group's net worth arising from movement in interest rates, exchange rates or other market prices. Market risk exists, to some extent, in all the Group's businesses. The Group recognises that the effective management of market risk is essential to the maintenance of stable earnings and preservation of shareholder value.

33. Risk management and financial instruments continued

Interest rate risk

The primary market risk faced by the Group is interest rate risk. Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. It is most prevalent in mortgage lending where fixed rate mortgages are not funded by fixed rate deposits of the same duration, or where the fixed rate risk is not hedged by a fully matching interest rate derivative.

The Group is exposed to movements in interest rates reflecting the mismatch between the dates on which interest receivable on assets and interest payable on liabilities are next reset to market rates or, if earlier, the dates on which the instruments mature. The Group measures Interest Rate risk using fourteen different interest rate curve shift scenarios designed to emulate a full range of market movements. These fourteen scenarios are defined by ALCO and are based on three 'shapes' of curve movement (shift, twist, and flex) with movements in rates scaled to approximate the potential move over one year at 99.9% two-tailed confidence interval with interest rates floored to zero. In addition, the regulatory scenario of an un-floored parallel shift of 200bps in both directions is applied.

Exposure is mitigated on a continuous basis through the use of derivatives within limits set by the ALCO and the Board (currently 3% of Common Equity Tier 1 Capital). After taking into account the derivatives entered into by the Group, a parallel interest rate increase of 2% would result in a gain of £2.4m (2013: £1.5m gain) in the statement of profit or loss.

There is no material difference between the interest rate risk profile for the Group and that for the Bank.

Structured entities

The only structured entity within the Group, Rochester Financing No.1 Plc ('Rochester'), holds legal title to a pool of mortgages which are used as a security for issued debt. The transfer of mortgages fails derecognition criteria because the Bank retained the remaining notes and residual certificates issued and as such did not transfer substantially the risks and rewards of ownership of the securitised mortgages. Therefore, the Group is exposed to the credit, interest rate and other risks on the securitised mortgages to the same extent as on the other mortgages. It mitigates these risks on a Group basis as discussed throughout this note.

Cash flows generated from the mortgages securitised within Rochester Financing No.1 Plc are ring-fenced, i.e. can only be used to pay interest and principal of the issued debt securities in a waterfall order according to the seniority of bonds. The securitisation vehicle is self-funded and the Group is not contractually or constructively obliged to provide it further liquidity or financial support. The maximum loss exposure at any point in time is the amount of cash and cash equivalents held in Rochester.

Fair value adjustments for hedged risk

This represents the fair value adjustments to the carrying value of financial assets and liabilities as a result of portfolio hedging.

Fair values of financial assets and financial liabilities

The following tables give a comparison of book and fair values of the Group's financial assets and liabilities at the reporting date.

Group 2014	Carrying amount £'000	Principal amount £'000	Fair value Level 1 £'000	Fair value Level 2 £'000	Fair value Level 3 £'000	Fair value Total £'000
Financial instruments measured at fair value						
Financial assets						
Investment securities	158,597	155,871	158,181	416	–	158,597
Derivative assets	937	553,173	–	937	–	937
	159,534	709,044	158,181	1,353	–	159,534
Financial liabilities						
Derivative liabilities	(25,447)	(1,825,928)	–	(25,447)	–	(25,447)
Financial instruments not measured at fair value						
Financial assets						
Cash in hand	288	288	–	288	–	288
Loans and advances to credit institutions	767,318	766,257	–	767,318	–	767,318
Loans and advances to customers	3,919,397	3,945,435	–	–	4,297,190	4,297,190
	4,687,003	4,711,980	–	767,606	4,297,190	5,064,796
Financial liabilities						
Amounts owed to retail depositors	(4,331,639)	(4,291,221)	–	(4,377,204)	–	(4,377,204)
Amounts owed to credit institutions	(23,009)	(22,997)	–	(23,009)	–	(23,009)
Amounts owed to other customers	(4,353)	(4,060)	–	(4,353)	–	(4,353)
Debt securities in issue	(238,390)	(237,722)	–	–	(238,390)	(238,390)
Subordinated liabilities	(27,573)	(27,353)	–	(28,703)	–	(28,703)
Perpetual subordinated bonds	(15,234)	(15,000)	–	(18,500)	–	(18,500)
	(4,640,198)	(4,598,353)	–	(4,451,769)	(238,390)	(4,690,159)

Notes to the financial statements continued

For the year ended 31 December 2014

33. Risk management and financial instruments continued

Bank 2014	**Carrying amount £'000**	**Principal amount £'000**	**Fair value Level 1 £'000**	**Fair value Level 2 £'000**	**Fair value Level 3 £'000**	**Fair value Total £'000**
Financial instruments measured at fair value						
Financial assets						
Investment securities	**158,597**	**155,871**	**158,181**	**416**	**–**	**158,597**
Derivative assets	**937**	**553,173**	**–**	**937**	**–**	**937**
	159,534	**709,044**	**158,181**	**1,353**	**–**	**159,534**
Financial liabilities						
Derivative liabilities	**(25,447)**	**(1,825,928)**	**–**	**(25,447)**	**–**	**(25,447)**
Financial instruments not measured at fair value						
Financial assets						
Cash in hand	**288**	**288**	**–**	**288**	**–**	**288**
Loans and advances to credit institutions	**727,462**	**726,401**	**–**	**727,462**	**–**	**727,462**
Loans and advances to customers	**3,071,094**	**3,256,562**	**–**		**3,367,119**	**3,367,119**
Investments in Group undertakings	**834,506**	**834,506**	**–**	**834,506**	**–**	**834,506**
	4,633,350	**4,817,757**	**–**	**1,562,256**	**3,367,119**	**4,929,375**
Financial liabilities						
Amounts owed to retail depositors	**(4,331,639)**	**(4,291,221)**	**–**	**(4,377,204)**	**–**	**(4,377,204)**
Amounts owed to credit institutions	**(23,009)**	**(22,997)**	**–**	**(23,009)**	**–**	**(23,009)**
Amounts owed to other customers	**(4,353)**	**(4,060)**	**–**	**(4,353)**	**–**	**(4,353)**
Debt securities in issue	**–**	**–**	**–**	**–**	**–**	**–**
Subordinated liabilities	**(27,573)**	**(27,353)**	**–**	**(28,703)**	**–**	**(28,703)**
Perpetual subordinated bonds	**(15,234)**	**(15,000)**	**–**	**(18,500)**	**–**	**(18,500)**
	(4,401,808)	**(4,360,631)**	**–**	**(4,451,769)**	**–**	**(4,451,769)**

Group 2013	Carrying amount £'000	Principal amount £'000	Fair value Level 1 £'000	Fair value Level 2 £'000	Fair value Level 3 £'000	Fair value Total £'000
Financial instruments measured at fair value						
Financial assets						
Investment securities	361,045	359,547	357,473	432	–	357,905
Derivative assets	757	523,450	–	757	–	757
	361,802	882,997	357,473	1,189	–	358,662
Financial liabilities						
Derivative liabilities	(22,566)	(1,073,800)	–	(22,566)	–	(22,566)
Financial instruments not measured at fair value						
Financial assets						
Cash in hand	267	267	–	267	–	267
Loans and advances to credit institutions	269,101	269,003	–	269,101	–	269,101
Loans and advances to customers	3,041,248	3,231,050	–	–	3,439,255	3,439,255
	3,310,616	3,500,320	–	269,368	3,439,255	3,708,623
Financial liabilities						
Amounts owed to retail depositors	(3,251,576)	(3,213,635)	–	(3,296,988)	–	(3,296,988)
Amounts owed to credit institutions	(1,438)	(1,417)	–	(1,438)	–	(1,438)
Amounts owed to other customers	(2,351)	(2,324)	–	(2,369)	–	(2,369)
Debt securities in issue	(273,759)	(273,000)	–	–	(273,759)	(273,759)
Subordinated liabilities	(27,579)	(27,353)	–	(28,918)	–	(28,918)
Perpetual subordinated bonds	(15,263)	(15,000)	–	(15,710)	–	(15,710)
	(3,571,966)	(3,532,729)	–	(3,345,423)	(273,759)	(3,619,182)

33. Risk management and financial instruments continued

Bank 2013	Carrying amount £'000	Principal amount £'000	Fair value Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Financial instruments measured at fair value						
Financial assets						
Investment securities	361,045	359,547	357,473	432	–	357,905
Derivative assets	757	523,450	–	757	–	757
	361,802	882,997	357,473	1,189	–	358,662
Financial liabilities						
Derivative liabilities	(22,566)	(1,073,800)	–	(22,566)	–	(22,566)
Financial instruments not measured at fair value						
Financial assets						
Cash in hand	267	267	–	267	–	267
Loans and advances to credit institutions	247,648	247,550	–	247,648	–	247,648
Loans and advances to customers	2,322,268	2,506,331	–		2,626,182	2,626,182
Investments in Group undertakings	713,105	713,105	–	713,105	–	713,105
	3,283,288	3,467,253	–	961,020	2,626,182	3,587,202
Financial liabilities						
Amounts owed to retail depositors	(3,251,576)	(3,213,635)	–	(3,296,988)	–	(3,296,988)
Amounts owed to credit institutions	(1,438)	(1,417)	–	(1,438)	–	(1,438)
Amounts owed to other customers	(2,351)	(2,324)	–	(2,369)	–	(2,369)
Debt securities in issue	–	–	–	–	–	–
Subordinated liabilities	(27,579)	(27,353)	–	(28,918)	–	(28,918)
Perpetual subordinated bonds	(15,263)	(15,000)	–	(15,710)	–	(15,710)
	(3,298,207)	(3,259,729)	–	(3,345,423)	–	(3,345,423)

Fair values are determined using the following fair value hierarchy that reflects the significance and observability of the inputs used in making the measurements:

Level 1
These are valuation techniques that are based entirely on quoted market prices in an actively traded market and are the most reliable.

Level 2
These are valuation techniques for which all significant inputs are taken from observable market data. These include valuation models used to calculate the present value of expected future cash flows and may be employed either when no active market exists or when there are quoted prices available for similar instruments in active markets.

Where discounting techniques are used in respect of derivatives, the management have chosen to use LIBOR. The fair value of the Group's derivative financial instruments incorporates an assessment of credit risk. In calculating the valuation of the credit risk adjustments (CVA) and debt valuation adjustments (DVA) consideration is given to the respective credit ratings and whether the derivative is collateralised or not.

In considering which similar instruments to use, management take into account the sensitivity of the instrument to changes in market rates and the credit quality of the instrument.

Basis risk derivatives are valued using discounted cash flow models and observable market data and will be sensitive to benchmark interest rate curves.

Level 3
These are valuation techniques for which any one or more significant input is not based on observable market data.

Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist, Black-Scholes and other valuation models. Assumptions and market observable inputs used in valuation techniques include risk-free and benchmark interest rates, foreign currency exchange rates, equity index prices and expected price volatilities. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date that would have been determined by market participants acting at arm's length.

Observable prices are those that have been seen either from counterparties or from market pricing sources including Bloomberg. The use of these depends upon the liquidity of the relevant market.

Notes to the financial statements continued

For the year ended 31 December 2014

33. Risk management and financial instruments continued

As disclosed in the tables above, financial instruments with fair value measured at level 3 include loans and advances to customers and debt securities in issue. Neither loans to customers nor debt securities in issue are measured at fair value in the statement of financial position.

Loans to customers belong to this level because their valuation uses unobservable inputs on collectability rates and redemption profiles. Their fair value is calculated using modelled receipts of interest and principal which are discounted at market rates.

Debt securities in issue are classified as level 3 because their principal is repaid using the cash flows from the underlying securitised mortgages, which in turn use the same unobservable inputs on collectability rates and redemption profiles. The fair value of issued debt securities was assumed to be equal their book value.

34. Pension scheme

Defined contribution scheme:
The amount charged to profit or loss in respect of contributions to the Group's defined contribution and stakeholder pension arrangements is the contribution payable in the period. The total pension cost in the year amounted to £871k (2013: £645k).

Defined benefit scheme:
KRBS operated a defined benefit pension scheme (the 'Scheme') funded by the payment of contributions to a separately administered fund for nine retired members. The Society's Board decided to close the Scheme with effect from 31 December 2001 and introduced a new defined contribution scheme to cover service of Scheme members from 1 January 2002.

The Scheme Trustees, having taken actuarial advice, decided to wind up the Scheme rather than continue to operate it on a 'paid up' basis. The winding up is largely complete. As at 31 December 2014 the liability to remaining members is £2k (31 December 2013: £2k) matched by Scheme assets.

35. Capital management

The Group is governed by its Capital Management Policy. The objectives of the Bank's Capital Management Policy are to efficiently manage the capital base to optimise shareholder returns whilst maintaining capital adequacy and satisfying key stakeholders such as customers and regulators.

The Bank's prime objectives in relation to the management of capital are to comply with the requirements set out by the Prudential Regulation Authority (PRA), the Bank's primary prudential supervisor, to provide a sufficient capital base to cover business risks and support future business development.

Capital management is based on the three 'pillars' of Basel II: Under Pillar 1, the Bank calculates its minimum capital requirements based on 8% of risk weighted assets. The Prudential Regulation Authority then applies a multiplier to this amount to cover risks under Pillar 2 of Basel II and generate an Individual Capital Guidance (ICG). As instructed by the PRA, the Bank manages and reports its capital on a solo consolidated basis and hence the Bank's capital position is not disclosed separately.

The Group's Pillar 1 capital information is presented in this note. To comply with Pillar 2, the Group completes an annual self assessment of risks known as the 'Internal Capital Adequacy Assessment Process' (ICAAP) reviewed by the PRA. Pillar 3 requires firms to publish a set of disclosures which allow market participants to assess information on that firm's capital, risk exposures and risk assessment process. The Group's Pillar 3 disclosures can be found on the Group's website.

On 1 January 2014, a new set of rules, Basel III came into force through the Capital Requirements Directive and Regulation (CRD IV). Basel III complements and enhances Basel I and II with additional safety measures. Basel III changed definitions of regulatory capital, introduced new capital buffers and liquidity ratios, and modified the way regulatory capital is calculated. In the table below the current year is presented under the new rules but the last year is not restated for CRD IV and therefore is not directly comparable.

The ultimate responsibility for capital adequacy rests with the Board of Directors. The Bank's ALCO, which consists of the Chief Executive Officer, Chief Financial Officer and other senior executives, is responsible for the management of the capital process including approving policy, overseeing internal controls and setting internal limits over capital ratios.

The Bank actively manages its capital position and reports this on a regular basis to senior management via the ALCO and other governance committees. Capital requirements are included within budgets, reforecast and strategic plans with initiatives being executed against this plan.

35. Capital management continued

During the period the Group complied with the capital requirements set out by the PRA.

	2014 £'000	2013 £'000
Common equity tier 1 capital		
Called up share capital	**2,431**	198
Share premium/Capital contribution	**162,369**	121,157
Retained earnings	**60,886**	23,361
Transfer reserve	**(12,818)**	(12,818)
Other reserves	**785**	(156)
Deductions from common equity tier 1 capital		
Intangible assets	**(2,305)**	(1,117)
Deferred tax asset	**(3,563)**	–
Investments in subsidiaries	**–**	–
Common equity tier 1 capital	**207,785**	130,625
Additional Tier 1 capital		
Convertible preference shares	**–**	1,067
Share premium on preference shares	**–**	670
Total Tier 1 Capital	**207,785**	132,362
Tier 2 capital		
Subordinated debt	**54,219**	57,127
Collective Provisions	**9,876**	3,072
Deductions from tier 2 capital	**(2,000)**	–
Total Tier 2 Capital	**62,095**	60,199
Other regulatory adjustments	**–**	–
Total regulatory capital	**269,880**	192,561

The Bank has solo consolidation waivers for most of its subsidiaries. The impact of this has been included in the above table.

36. Operating segments

The Group operates under three segments:

1. Buy-to-Let/SME; secured lending on property for investment and commercial purposes;
2. Residential Mortgages; lending to customers who live in their own homes, secured either via first or second charges against the residential home; and
3. Personal Loans; unsecured lending, which currently comprises solely the acquisition of the former Northern Rock performing consumer finance portfolio of c.70,000 customers from UK Asset Resolution in 2013.

The financial position and results of operations of the above segments are summarised below:

2014	BTL/SME £'000	Residential mortgages £'000	Personal loans £'000	Central £'000	Total £'000
Balances at the reporting date					
Gross loans and advances to customers	**2,064,905**	**1,763,391**	**117,138**	**–**	**3,945,434**
Provision for impairment losses on loans and advances	**(15,429)**	**(2,639)**	**(7,969)**	**–**	**(26,037)**
Loans and advances to customers	**2,049,476**	**1,760,752**	**109,169**	**–**	**3,919,397**
Capital expenditure	**1,558**	**1,339**	**83**	**–**	**2,980**
Profit or loss for the year					
Net interest income	**50,310**	**57,146**	**17,745**	**–**	**125,201**
Other income/(expense)	**(960)**	**(6,118)**	**(1,470)**	**2,258**	**(6,290)**
Total income	**49,350**	**51,028**	**16,275**	**2,258**	**118,911**
Impairment losses	**(4,721)**	**(1,093)**	**(5,871)**	**–**	**(11,685)**
Contribution to profit	**44,629**	**49,935**	**10,404**	**2,258**	**107,226**
Operating expenses					**(40,714)**
FSCS and other provisions					**(2,767)**
Profit before taxation					**63,745**
Taxation					**(12,208)**
Profit for the year					**51,537**

Notes to the financial statements continued

For the year ended 31 December 2014

36. Operating segments

Group 2013	BTL/SME £'000	Residential mortgages £'000	Personal loans £'000	Central £'000	Total £'000
Balances at the reporting date					
Gross loans and advances to customers	1,098,834	1,764,639	205,308	–	3,068,781
Provision for impairment losses on loans and advances	(22,360)	(3,075)	(2,098)	–	(27,533)
Loans and advances to customers	1,076,474	1,761,564	203,210	–	3,041,248
Capital expenditure	452	1,081	72	–	1,605
Profit or loss for the year					
Net interest income	17,199	42,334	11,233	–	70,766
Other income/(expense)	(531)	(3,999)	(805)	–	(5,335)
Total income	16,668	38,335	10,428	–	65,431
Impairment losses	(4,688)	(543)	(2,098)	–	(7,329)
Contribution to profit	11,980	37,792	8,330	–	58,102
Operating expenses					(24,557)
Regulatory provisions					(2,128)
Profit before taxation					31,417
Taxation					(4,646)
Profit for the year					26,771

37. Country by country reporting

Country by Country Reporting (CBCR) was introduced through Article 89 of the Capital Requirements Directive IV (CRD IV), aimed at the banking and capital markets industry.

All institutions within the scope of CRD IV should publish annually, on a consolidated basis, by country where they have an establishment:
a) their name, nature of activities and geographic location
b) number of employees
c) their turnover
d) pre-tax profit or loss
e) corporation tax paid
f) any public subsidies received.

Institutions will be required to publicly disclose the information from 1 January 2015 and from 1 July 2014 they must disclose (a)-(c) above.

The ongoing reporting deadline is 31 December each year, starting from 31 December 2015, and disclosures should relate to the most recently ended accounting period.

37. Country by country reporting continued

The name, nature of activities and geographic location of the Group's companies is presented below:

Company Name	Nature of Activity	Location
Cavenham Financial Services Limited	Mortgage servicer	UK
Easioption Ltd	Holding company	UK
Guernsey Home Loans Ltd	Mortgage provider	UK
Heritable Development Finance Limited	Mortgage originator and servicer	UK
Interbay Group Holdings Limited	Mortgage provider	UK
Interbay Holdings Ltd	Holding company	UK
Interbay Financial I Limited	Raising and managing funding for the Interbay Group	UK
Interbay Financial II Limited	Raising and managing funding for the Interbay Group	UK
5D Finance Limited	Provider of financial controller services to the Interbay Group	UK
5D Lending Ltd	Holding of commercial mortgage loans	UK
Interbay Funding, Ltd	Mortgage provider	UK
Interbay ML, Ltd	Holding of commercial mortgage loans	UK
Jersey Home Loans Limited	Mortgage provider	UK
Prestige Finance Limited	Mortgage originator and servicer	UK
Reliance Property Loans Limited	Mortgage provider	UK
Rochester Financing No.1 Plc	Securitisation entity	UK
Swingcastle Limited	Dormant entity	UK
Guernsey Home Loans Ltd (Guernsey)	Mortgage provider	UK[1]
Jersey Home Loans Ltd (Jersey)	Mortgage provider	UK[1]
EasiOption BPO Services Private Ltd	Back office processing for the Group	India[2]
Easiprocess Private Ltd	Back office processing for the Group	India[2]

1 Guernsey Home Loans Ltd (Guernsey) and Jersey Home Loans Ltd (Jersey) are incorporated in Guernsey and Jersey respectively but are considered to be located in the UK as they have no employees, are tax resident and centrally managed and controlled in the UK.
2 The Indian subsidiaries provide back office processing and earn a management fee from OneSavings Bank plc for providing those services. They are both incorporated and tax resident in India.

Other disclosures required by the CBCR directive are provided below

	UK	India	Consolidation[2]	Total
Average number of employees on an FTE basis	258	161	–	419
Turnover[1]	118,678	2,175	(1,942)	118,911
Profit/(loss) before tax	63,511	452	(218)	63,745
Corporation tax paid[3]	1,427	90	–	1,517
Public subsidies received	–	–	–	–

1 Turnover represents total income before impairment losses, regulatory provisions and operating costs, but after net interest, net commissions and fees, gains and losses on financial instruments and external servicing fees.
2 Relates to a management fee from Indian subsidiaries to OneSavings Bank plc for providing back office processing.
3 During the year the Group utilised £42m of tax losses brought forward which reduced the amount of corporation tax paid.

Glossary

AGM	Annual General Meeting
ALCO	Asset and Liability Committee
APB	Auditing Practices Board
BoE	Bank of England
CAPEX	Capital Expenditure
CCO	Chief Credit Officer
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CFP	Contingency Funding Plan
CML	Council of Mortgage Lenders
CPI	Consumer Price Inflation
CRD IV	Capital Requirement Directive and Regulation
CRO	Chief Risk Officer
DSBP	Deferred Share Bonus Plan
DTR	Disclosure and Transparency Rules
EBA	European Banking Authority
EIR	Effective Interest Rate
EPS	Earnings Per Share
EU	European Union
FCA	Financial Conduct Authority
FD	Finance Director
FLS	Funding for Lending Scheme
FRC	Financial Reporting Council
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act
FTE	Full Time Equivalent Employees
FTSE	Financial Times Stock Exchange
GDP	Gross Domestic Product
GOSH	Great Ormond Street Hospital
GRC	Global Rate Change
HDF	Heritable Development Finance
HMRC	Her Majesty Revenue and Customs
HPI	House Price Inflation
HR	Human Resources
IAS	International Accounting Standards
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
ILAA	Individual Liquidity Adequacy Assessment
IPO	Initial Public Offering
ISA	Individual Savings Account
JCF	J.C.Flowers
KRBS	Kent Reliance Building Society
KRPS	Kent Reliance Provident Society
LIBOR	London Inter Bank Offered Rate
LTIP	Long Term Incentive Plan
LTV	Loan to Value
MI	Management Information
MMR	Mortgage Market Review
MPC	Monetary Policy Committee
NISA	New Individual Savings Account
NPS	Net Promoter Score
OFT	Office of Fair Trading
ONS	Office of National Statistics
PRA	Prudential Regulatory Authority
PRS	Private Rented Sector
PSB	Perpetual Subordinated Bonds
PSP	Performance Share Plan
RMBS	Residential Mortgage Backed Securities
RoE	Return on Equity
RWA	Risk Weighted Assets
SAYE	Save As You Earn
SID	Senior Independent Director
SLRP	Supervisory Liquidity Review Process
SME	Small Medium Enterprises
SPE	Special Purpose Entity
SREP	Supervisory Review and Evaluation Process

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